

**PROTECTION OF FRANCHISEES IN THE UNITED STATES AND EUROPE:
LESSONS FOR SLOVAKIA**

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ABSTRACT

This thesis evaluates the current legal framework of the franchise, specifically the legal issues regarding the protection of the franchisee. The franchise is considered to be a widely recognized yet new and modern way of doing business. Under Slovak law, the franchise is treated as the innominate contract and there is no particular regulation nor case law, so the questions may arise, especially the ones concerning the protection of the weaker party, the franchisee. The thesis focuses on the question of whether the regulation of the business format franchise in Slovakia's new draft amendment to the Civil Code would lead to the development of a stronger franchise environment shielding the franchisee.

This question will be answered with the focus on the laws and case law of the United States, France, and Germany. The choice of these jurisdictions was made based on the fact that the United States is the most developed and tested regulatory system for franchising in the world. Also, French and German regulations will be analyzed as these are civil law countries like Slovakia and they have been the main benchmark for Slovakia. By evaluating the advantages and disadvantages of these legal systems, we can more easily find the loopholes and weaknesses in the current Slovak franchise regulations and provide it with possible improvements and solutions regarding the protection of franchisees as weaker parties.

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INTRODUCTION

What is franchising and why is it so widely accepted? Franchising, a successful business model, has become a part of many countries' legal systems all over the world. The main reason why it is so widespread is that it brings benefits to the economy and particularly to both the franchisor and the franchisee.¹ The franchisee can enter the market with the franchisor's proven formula of doing business with less risk, established clientele, and franchisor's reputation.² The franchisor expands his business more quickly through the franchisees while still controlling what they do and how they operate the franchise. Franchising can strengthen the brand's recognition and its reach.³

A properly tested and structured franchise system can generate substantial advantages for both parties. However, it has its downsides as well. Before entering the contract, the franchisee needs to be provided with sufficient information to evaluate this business opportunity and make sure that it will be the right fit for him. This point is crucial for the initial formation of the franchise relationship. However, it is common that the franchisor provides the franchisee only with information about the positive aspects of his business make the potential franchisee interested in his franchise.⁴ The situation like this is caused by the power and information imbalance of the franchisor and the franchisee. The franchisor has more knowledge, information, resources, and therefore a power that puts him in a more advantageous position which creates a room for possible business 'maneuvers' in his favor. Therefore, the regulatory intervention to address issues like this is much needed. The American and European legal systems offer solutions to protect the weaker party of this relationship – the franchisee. These policies and their effects will be discussed further in this thesis.

Slovak law does not possess any specific legal framework for franchising. The current legislation does not treat the franchise contract as a separate type of contract and therefore the parties to the contract are free to set its structure and content as long as it is specific enough, meaning that the subject of the obligation is sufficiently certain and the contract observes the general mandatory principles of law.⁵ There are no other formal requirements for a franchise contract under current legislation. Therefore, the protection of the franchisee as a weaker party is at stake even more. The power imbalance and information imbalance disfavor the franchisee and make him more vulnerable. The franchisee has less knowledge and experience and when not being careful enough can be easily deceived by the franchisor.

¹ Andrew Terry and Des Giugni, *Business and the Law* (Cengage Learning Australia Pty Limited, 2009) 404.

² International Franchise Association (IFA), 'Is a franchise a good way to start your own business?' (2020) <<https://www.franchise.org/faqs/resources/is-a-franchise-a-good-way-to-start-your-own-business>> accessed 30 May 2020.

³ *Ibid.*

⁴ Elizabeth Spencer, *The Regulation of Franchising in the New Global Economy* (Edward Elgar Publishing, 2010), 65.

⁵ Act no. 513/1991 Coll. Commercial Code (Commercial Code), § 269 (2).

The importance of franchising in Slovakia has been growing over the years. I believe this is soon to be reflected in the new draft amendment to the Civil Code which will regulate the franchise contract as a nominate contract of the first time.⁶ The strengths and loopholes of the current regulation, the necessity of the new regulation and the evaluation of the new draft with the focus on the franchisee will be addressed in this thesis.

Jurisdictions Covered

The jurisdictions in this thesis were selected based on how developed and well-tested their regulatory systems are with the focus on the case law, secondary literature, and their rich experience in franchising. The main attention will be therefore given to the United States (“the US”), the birthplace of the franchise with most developed regulatory system and case law, followed by the European benchmark civil law systems of France and Germany. The critical analysis of the existing Slovak law on business format franchise will be made in the final chapter of this thesis. By evaluating the advantages and disadvantages of the abovementioned legal systems, the weaknesses in the Slovak system will be recognized more easily with the possibility of providing feasible solutions and improvements regarding the regulation of franchise and protection of the franchisees under the Slovak law.

Methodology and a Word on Legal Scholarship

The main aim of this thesis is to better understand franchise as a business model and learn about the various legal methods employed by American, French and German laws to protect franchisees, normally the weaker parties in business format franchise systems. Based on the so-gained knowledge, the defects of Slovak regulatory system will be critically assessed in order to propose a range of solutions aimed at improving not only the current legal environment but also the recently put forward franchise act proposal.

It ought to be added as well that the subject matter of franchise in Slovakia is neglected and that is the main reason why the literature is extremely scarce. Consequently, this comparatively oriented thesis will also contribute to filling of this scholarly vacuum in this country. An analysis will be made based on the existing materials from Slovakia, but also from the other jurisdictions mentioned. The evaluation of these sources will be made based on their possible applicability and adaptability to the Slovak business and legal environment and the potential benefits Slovakia could gain from more comprehensive regulation of franchise.

⁶ Draft amendment to the Act no. 40/1964 Coll. Civil Code (Civil Code).

Roadmap to the Thesis

In order to achieve the above aims and goals, the thesis is divided into four chapters. The first chapter deals with franchising and the nature of the franchise relationship between the franchisor and the franchisee. The cornerstone of this relationship is a franchise contract which reflects the power and information asymmetries already inherent in the franchisor-franchisee relationship. Those imbalances indicate the necessity of a regulatory intervention to protect the weaker party – the franchisee. The legal measures taken by the US to address these inefficiencies are addressed and examined in the second chapter of this thesis. This chapter focuses on the brief history of franchising in the US, covers the franchise practice and disclosure requirements on both federal and state levels, and also deals with relationship laws adopted by states which go beyond mere disclosure.

The next chapter focuses on the European approach to the franchise regulation, specifically French and German approach, as these franchise markets have grown significantly over the years and offer a good model for Slovakia as civil law countries. This chapter also covers the development and history of franchise on the European continent, franchise regulations and definition of the franchise in both of these countries, pre-contractual disclosure and case law.

The final chapter evaluates the franchise legislation in Slovakia and its development. Most importantly, it deals with the new amendment to the Civil Code which transforms franchise contracts into a nominate type of contract for the first time in Slovak history. This chapter will include the analysis of the newly proposed provisions which will regulate franchise contracts and it will evaluate the concept of pre-contractual liability which contains the element of the disclosure obligation.

Lastly, the franchise policies, regulations and the case law of these three jurisdictions with the focus on their use of the protection mechanisms to shield the weaker party will be analyzed to propose various policy recommendations that might be applicable in the Slovak socio-economic and legal environment.

CHAPTER I: FRANCHISE BUSINESS AND ITS REGULATION

1.1 The nature of the franchise relationship

The development of franchising involved products and distribution of these products. Product franchising involved a franchisee, who was focusing on one manufacturer's product, and obtaining the manufacturer's identity to some extent.⁷ The mid-1950s in the US saw the birth of the business format franchise as a new form of franchising.⁸ The business format franchise is an arrangement where the franchisor provides franchisees with a comprehensive operating system.⁹ This format is efficient for both, the franchisor and the franchisee. The franchisor can easily access a broader market through franchisee's activities while the franchisee profits from the franchisor's reputation, name recognition, and expertise which is connected to the larger business enterprise.¹⁰ Most of the modern franchise systems are business-format franchises¹¹ and therefore when I am referring to term franchise in this thesis, I am referring to the business-format franchise (unless otherwise stated).

According to the International Franchise Association, franchising is defined as:

"[A] method of distributing products or services. At least two levels of people are involved in a franchise system: (1) the franchisor, who establishes the brand's trademark or trade name and a business system; and (2) the franchisee, who pays a royalty and often an initial fee for the right to do business under the franchisor's name and system. Technically, the contract binding the two parties is the 'franchise', but that term is often used to mean the actual business that the franchisee operates."¹²

Franchising is considered to be a national and international strategy for growing a business and expanding it to new markets.¹³ Franchising involves an agreement with many elements similar to other contracts (for example sales, service contract and/or licensing contract). Even though there are many similarities with other contracts, the franchise agreement is a distinct type of contract because of its distinguishing attributes, in particular, the uniformity obligations for the franchisee and the controlling position of the franchisor.¹⁴ The control of the franchisor is almost a hundred percent.¹⁵ Yet, many entrepreneurs choose franchising over other, more independent alternatives, because of the franchisor's proven successful formula of doing business.¹⁶

⁷ David Gurnick and Steve Vieux 'Case History of the American Business Franchise' (1999) 24 Okla City U L Rev 48.

⁸ The definition and the connotation of the term "franchise" differ. Yet, normally the contemporary sources today consider the US to be the birth of the business format franchise.

⁹ Spencer, *The Regulation* (n. 4), 49.

¹⁰ Gurnick and Vieux (n. 7), 40.

¹¹ Spencer, *The Regulation* (n. 4), 49.

¹² IFA, 'What is Franchise?' <<https://www.franchise.org/faqs/basics/what-is-a-franchise>> accessed 24 March 2020.

¹³ See generally Stephen Giles, Michael Redfern and Andrew Terry, *Franchising: Law and Practice* (Butterworths, 1998).

¹⁴ Howard Yale Lederman 'Franchising and the Franchise Law – An Introduction' (2013) 92 MICH. BAR J., 34.

¹⁵ *Husain v McDonald's Corp*, 205 Cal App 4th 860, 869; 140 Cal Rptr 3d 370 (2012).

¹⁶ Lederman (n. 14).

Franchising exists in more than 160 countries all over the world and is used in more than 70 different business sectors.¹⁷ The reason why franchising works and why it is so popular is because it is beneficial to both – franchisor and franchisee.¹⁸ The franchisor who developed a unique and successful formula of doing business allows the franchisee to use this system in a controlled way in the operation of the franchisee's independently-owned business.¹⁹ If properly executed, the franchising can generate substantial advantages for both parties involved in this contract. While companies choose this way of doing business because it can help them overcome financing and monitoring challenges and leverage business skills and incentives; individuals choose it to lower the risk and get bigger rewards than being an independent entrepreneur.²⁰ Franchising provides an opportunity to enter the market with a tested and proven business with an established reputation which can significantly reduce the business risks the start-ups usually face.²¹

Although there are many examples of how successful and beneficial this relationship can be, franchising includes certain disadvantages for both parties. From the franchisor's point of view, his reputation is at stake, therefore the franchisor has to consistently ensure that the franchisee keeps the minimum operational standards to maintain the uniformity and consistency throughout the franchise system of the franchisor. Contrary to this, such excessive control by franchisor may burden franchisee, impair his independence, profitability, and growth potential. In extreme cases, franchise may even cause the franchisee go out of business, for example, by contracting for the right of encroachment. Because of the possible franchisor's abuses, a proper balance needs to be found between the franchisor's system and experience and franchisee's entrepreneurial spirit.²²

1.2 The asymmetries in a franchise contract

The franchise agreement is a cornerstone of the franchise relationship. Traditional contract theory highlights the freedom of parties to enter a contract, emphasizing the social values of individualism and self-determination.²³ However, it has been suggested that this traditional theory is not appropriate for franchising and should be modified in order to accommodate the needs of this phenomenon. As

¹⁷ Mario L. Herman 'International Franchising' (2020) International Franchise Law Lawyer <<https://www.internationalfranchiselaw.com/franchise-law-overview/about-franchising/international-franchising>> accessed 24 March 2020.

¹⁸ Terry and Giugni (n. 1).

¹⁹ Yun Zhang, 'The Information Imbalance in the Franchising Relationship: Best Practice Model for Prior Disclosure and an Evaluation of China's Regulatory Regime' (DPhil thesis, University of New South Wales 2011).

²⁰ Dalberg Global Development Advisors, 'Franchising in Frontier Markets' (2009) <https://www.shopsplusproject.org/sites/default/files/resources/Franchising_in_Frontier_Markets.pdf> accessed 24 March 2020.

²¹ Manitoba Law Reform Commission 'Franchise Law' (2008) Report n. 116, 9 <http://www.manitobalawreform.ca/pubs/pdf/116-full_report.pdf> accessed 24 March 2020.

²² Jolene Lim, 'Matching franchisor-franchisee roles and competencies' (Griffith University, 2004) <<https://pdfs.semanticscholar.org/846c/0aadf15a62141d35eaa229508834cb335b62.pdf>> accessed 22 March 2020.

²³ Elizabeth Spencer 'Consequences of the interaction of standard form and relational contracting in franchising' (2009) 29 Franchise LJ 31-39, 57.

stated by Lee Rau: “The concern that motivates these suggestions arises from the very synergy that has made franchising so successful. The concern is that a franchisee’s investment of time and money in the promotion of the franchisor’s trade name and trademarks, from which the synergy flows and upon which a franchise system’s success largely depends, can be forfeited by a franchisor’s arbitrary action.”²⁴

Even though franchise contracts share many similarities with other types of contracts as mentioned before, it is clear that many scholars support the approach that franchising is seen as a *sui generis* contract.²⁵ Franchise contracts have been described as relational contracts with incompleteness as their main features. Those contracts are flexible and rely on the cooperation and trust of the parties to gain mutual benefit, and profit.²⁶ As said by Paul Steinberg and Gerald Lescatre: “Unlike a traditional contract, franchise contracts establish a relationship where the stronger party can unilaterally alter the fundamental nature of the obligations of the weaker party. [...]”²⁷ The relational nature of franchise contracts implies that many aspects and features of this relationship are not specified in the contract, thus this necessary incompleteness prompts an examination of the norms and practices to identify the complete content of the franchisor and franchisee’s mutual exchange.²⁸ However, this may lead to uncertainty during the relationship between the franchisor and franchisee.

As already stated, the franchise agreement is considered to be the core of the franchise relationship. The usual franchisee is an inexperienced entrepreneur who wants to start a small business but at the same time he wants to limit the risks associated with it. On the other side, there is an experienced franchisor with a sophisticated business entity who provides the franchisee with a proven business formula and the advantages of a common trademark.²⁹ Due to the relational nature of the franchise contract, the flexibility and independence between the parties is usually tempered by the franchisor’s ability to control the franchisee and his operations, which may lead to franchisor overreach or even abuse of power. The power and information imbalance between the franchisor and franchisee and the necessity of franchisee’s protection will be further discussed in the following subsections. However, it is important to note that franchisees may also abuse their rights, especially in the countries of lower rule of law index.

²⁴ Lee Rau, ‘Implied Obligations in Franchising: Beyond Terminations’ (1992) 47(3) *Business Lawyer*, 1053 <<https://www.jstor.org/stable/pdf/40687320.pdf?refreqid=excelsior%3A803f74397e0d69832d8b45ba500b9bb9>> accessed 20 March 2020.

²⁵ Paul Steinberg and Gerald Lescatre, ‘Beguiling Heresy: Regulating the Franchise Relationship’ (2004) 109 *Penn State Law Review* 56 and Tibor Tajti, ‘Franchise and Contract Asymmetry: A Common Trans-Atlantic Agenda?’ (2016) 37 *Loy. L.A. Int’l & Comp. L. Rev.* 257, 272. In Germany, which has not sector-specific laws as of yet, the predominant opinion is that franchise is a mixed type of contract. See Peter-Christian Müller-Graff, ‘Franchising: A Case of Long-Term Contracts’ (1988) 144(1) *Journal of Institutional and Theoretical Economics* 1, 134 <<https://www.jstor.org/stable/pdf/40751056.pdf?refreqid=excelsior%3A17f03b725a3e578404f2489e720c8145>> accessed 20 March 2020.

²⁶ Gillian K. Hadfield, ‘Problematic Relations: Franchising and the Law of Incomplete Contracts’ (1990) 42(4) *Stanford Law Review* 927 <<https://www.jstor.org/stable/pdf/1228908.pdf?refreqid=excelsior%3Adbdd6297cf3268864edb0c3730757c7e>> accessed 24 March 2020.

²⁷ Steinberg and Lescatre (n. 25).

²⁸ Hadfield (n. 26).

²⁹ *Ibid.*

In these countries, starting a franchise business is considered risky and threatening to franchisor's know-how, trademarks, and intellectual property rights.³⁰

1.2.1 Power imbalance

The franchise contracts reflect the asymmetries already inherent in the relationship between franchisor and franchisee. Despite this relationship being cooperative and reliant, it is also characterized by the following problems, both of great significance: a power and an information asymmetry.³¹ Their presence may lead to further risks and challenges for the weaker party, but also for the legislators who are trying to improve the regulatory environment. However, these imbalances are inherent in the franchise contract due to the need for its uniformity.³²

In the franchise contracts, the balance of power is usually weighted heavily in favor of the franchisor.³³ This is inevitable because the franchisor has its reputation at risk. That is why the control powers over the franchisee's operations are vested in the hands of the franchisor in order to maintain uniformity and quality standards and to protect the franchisor's name. To ensure this, the franchisor imposes obligations and limitations on the franchisee through the franchise agreement. The element of control³⁴ is also part of some countries' definition of franchising (for example in the United States' FTC Rule, see Chapter two of this paper).

The imbalance of power and very little room to negotiate lead us to the conclusion that franchise contracts satisfy the elements of the standard form contract.³⁵ The standard form contract is usually entered into between parties with unequal bargaining power (the weaker party has little voice in setting the terms of the contract). In franchising relationship, the franchisee is the weaker party, while the franchisor has the main bargaining position to maintain the uniformity of the franchise, to control the brand and system administration, and to regulate other possible negative externalities. Inequality of economic resources, knowledge, size of the parties, franchisee's individualism and naivety, disparities in legal representation are also other contributing factors to the imbalance.³⁶ To add, the franchise

³⁰ Melissa Ann Sicat, 'Developing a more robust Filipina franchising industry: what the Philippines can learn from the U.S. and Europe' (Central European University, 2019) 8-9.

³¹ Spencer, 'Consequences' (n. 23) 31-32.

³² *Ibid.*

³³ Robert Lusch, 'Source of Power: Their Impact on Intrachannel Conflict' (1976) 13 *Journal of Marketing Research* 4, 382-390. <<https://www.jstor.org/stable/pdf/3151021.pdf?refreqid=excelsior%3A413af29369047a457bf57d25f7339758>> accessed 21 March 2020.

³⁴ The issues which are considered to be significant control: for example choice of location, advertising and sales methods, and business hours.. See Franchise Rule 16 C.F.R. Part 436: Compliance Guide, May 2008 <<https://www.ftc.gov/system/files/documents/plain-language/bus70-franchise-rule-compliance-guide.pdf>> accessed 21 March 2020.

³⁵ Friedrich Kessler, 'The Contracts of Adhesion – Some Thoughts about Freedom of Contract Role of Compulsion in Economic Transactions' (1943) 43 *Columbia Law Review* 629 <https://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?article=11639&context=journal_articles> accessed 21 March 2020.

³⁶ Spencer, 'Consequences' (n. 23) 32.

contract is normally also adhesionary³⁷ contract offered to franchisee on ‘take-it-or-leave-it’ basis where the franchisee generally has no possibility to negotiate its provisions.³⁸

1.2.2 *Information imbalance*

Simply said: when one party to a contract or transaction has more or better information than the other party, this is considered an information asymmetry. In addition to the power imbalance, the information asymmetry is a characteristic feature in the business format franchise relationship. The prospective franchisee does not always possess all information when making a decision whether to buy or not to buy the franchise and therefore, it might be difficult for him to form an unbiased opinion about the nature of the franchise business he wants to acquire. Franchisees can suffer substantial losses when they are not provided with full and complete information regarding the franchisor-franchisee relationship, details of the contract, or franchisor’s prior business experience.³⁹ This can create some uncertainty for the franchisee’s future business operations.⁴⁰ Also, even if the franchisee is provided with the information, he still may suffer because of the stronger position of the franchisor and the power asymmetry.

While the franchisees are often not familiar with the franchise business concept in detail, the franchisor is in a monopoly position with respect to what information will be provided to franchisee.⁴¹ Generally, the franchisor invests a lot of time and money into franchise development and from his point of view it may seem reasonable that he is the one who has control over the information provided to the future franchisees. Also, due to the nature of the franchise agreement, all terms and conditions are drafted by the franchisor with the minimum bargaining power of the franchisee.⁴² Such information imbalance in favor of franchisor is based on the power imbalance between the franchisor and franchisee which was discussed in the previous paragraphs. The franchisee’s lack of information is mainly caused by the franchisor’s control of the information about the franchise system.⁴³

For franchisees, every piece of information is crucial before they commit themselves to a franchise business opportunity legally and financially. Information related to the costs, benefits, and risks are of great significance for the protection of a franchisee. However, it is common that the franchisor wants to project only the positive image of his business to attract potential franchisees. As said by Steinberg and Lescatre “the franchise industry has been relatively successful in keeping from the public and

³⁷ Distinction between standard form and adhesion contracts is not clear, many writers and legal sources use the terms interchangeably. See Spencer, ‘Consequences’ (n. 23) 37.

³⁸ James Jordan and Judith Gitterman ‘Franchise agreements: contracts of adhesion?’ (1996) 16(1) Franchise LJ 14.

³⁹ Peter Lagarias and Robert Boulter, ‘Modern Reality of the Controlling Franchisor: The Case for More, Not Less, Franchisee Protections’ (2010) 29 Franchise LJ 140.

⁴⁰ Zhang (n. 19) 40.

⁴¹ *Ibid.*

⁴² Spencer, *The Regulation* (n. 4) 79.

⁴³ Zhang (n. 19) 42.

legislators the true nature of what goes on in franchising... ”⁴⁴ This indicates the strong tendency toward information imbalance in favor of franchisor, thus a regulatory intervention to address these inefficiencies is much needed. One of the solutions is disclosure.⁴⁵ Its use and use of the other legal measures will be discussed in the next chapters.⁴⁶

⁴⁴ Steinberg and Lescatre (n. 25).

⁴⁵ Spencer, *The Regulation* (n. 4).

⁴⁶ See chapter 2 (subchapter 2.2) and chapter 3 (subchapters 3.2.2 and 3.3.2) of this thesis.

CHAPTER II: FRANCHISING IN THE UNITED STATES

The business format franchise as a distribution method of goods and services represents a crucial part of the American economy. Its roots can be traced back to the need for homogeneity and uniformity of products and services distributed across the US territory.⁴⁷ The growth and development of the franchise business has paralleled the economic growth in the US and increased the level of creativity and innovation.⁴⁸ Hence, the US is not only the birthplace of modern franchising, but it possesses the world's largest franchise industries.⁴⁹

The term franchise itself has its origin in the common law concept of the franchise as a “special grant of rights from the sovereign.”⁵⁰ In order to better understand the development of franchise in the US and its protection of the franchisee, we need to take a look at the historical landmarks which lead us to the current regulation of the business-format franchise.

2.1 Brief History of Franchise in the United States

To understand the development of the franchise, it is essential to look at the definition and origin of this word. As stated in the American Heritage Dictionary of the English language,⁵¹ the word franchise originally comes from the French word “*franche*” meaning “free or exempt” and as a first definition it is stated that it is “a privilege or right granted by law.”⁵² During the medieval times, it was granted by the king, church, or local government to the grantee for the right to maintain civil order, collect taxes, promote building roads and organize markets.⁵³ The payment by the grantee (royalty) was usually required in an exchange for this right/privilege.⁵⁴ This term is still being used nowadays.⁵⁵

In a more traditional approach, the franchise was property⁵⁶ which emerged from a contractual relationship between the sovereign (which had to be a party in a contract) and the holder of the property right,⁵⁷ therefore this term could not apply to private agreements.⁵⁸ However, this started to slightly

⁴⁷ Gurnick and Vieux (n. 7) 37.

⁴⁸ Gurnick and Vieux (n. 7).

⁴⁹ Franchise Direct ‘Top 100 Franchises 2020’ (2020) <<https://www.franchisedirect.com/top100globalfranchises/rankings>> accessed 18 March 2020.

⁵⁰ Gurnick and Vieux (n. 7) 37.

⁵¹ American Heritage Dictionary of the English Language, ‘Franchise’ (2020) <<https://ahdictionary.com/word/search.html?q=franchise>> accessed 16 March 2020.

⁵² *Ibid.*

⁵³ Roger Blair and Francine Lafontaine ‘The Economics of Franchising’ (2005) University of Illinois at Urbana-Champaign’s Academy for Entrepreneurial Leadership Historical Research Reference in Entrepreneurship <<https://ssrn.com/abstract=1496115>> accessed 16 March 2020. See also Roger Blair and Francine Lafontaine ‘The Evolution of Franchising and Franchise Contracts: Evidence from the United States’ (2009) 3(2) Entrepreneurial Business LJ, 382-383.

⁵⁴ Gurnick and Vieux (n. 7) 38.

⁵⁵ Blair and Lafontaine ‘The Economics’ (n. 53). See also Blair and Lafontaine, ‘The Evolution’ (n. 53).

⁵⁶ *West River Bridge Co. v. Dix*, 47 U.S. (6 How.) 507, 541 (1848) as cited in Gurnick and Vieux (n. 7) 37.

⁵⁷ See *Larson v. South Dakota*, 278 U.S. 429, 432 (1929) as cited in Gurnick and Vieux (n. 7) 37.

⁵⁸ *Ibid.*

change in the 19th century and at the beginning of the 20th century. According to some authors, the concept of the franchise started in the 1850s with Isaac Singer's distribution of sewing machines.⁵⁹ Isaac Singer, a founder of Singer Sewing Company, is considered to be the "father of modern-day franchising."⁶⁰ His franchise agreements were created in order for him to distribute the sewing machines over a large geographic area. He contracted mostly with the local salesmen to whom he gave a right to sell his sewing machines in a specified region. In exchange for that they had to pay a licensing fee to Singer.⁶¹

The real shift regarding the private nature of the franchise contracts started happening in the 1930s⁶² and later evolved in the mid-1950s due to the economic and infrastructural growth and higher mobility of the Americans in the US.⁶³ While in the 1950s individuals and businesses had agreements which were called franchise agreements, some courts were still reluctant to apply this term to private contracts stating that the contract cannot be considered a franchise when it lacks "the indispensable element of the franchise for it is not conferred by any sovereignty or state."⁶⁴

In the modern world, franchising is usually being described as "the most significant marketing phenomenon of the century"⁶⁵ or as "an updated version of the American dream."⁶⁶ As it can be seen, the term franchise and its understanding has evolved over the centuries.⁶⁷ The meaning of the business-format franchise may be currently defined as a relationship between franchisor and franchisee who exchange their economic interests among each other for the benefit of both. This arrangement vests specific rights to them.

2.2 Franchise regulations in the United States

In the US, the regulation of franchise is at both the federal and state levels. However, it was not always like that. The growth of franchising gained momentum mostly in the 1950s⁶⁸ and 1960s which led to important regulatory progress in the franchise industry later on.⁶⁹ Many lawsuits were brought against the franchisors claiming that the relationship between franchisor and franchisee can be "characterized

⁵⁹ James Amos Jr., *Complete idiot's guide to franchising* (Alpha, 2005).

⁶⁰ Honey Gandhi 'Franchising in the United States' (2014) 20(1) Law and Business Review of the Americas 3.

⁶¹ Amos (n. 59).

⁶² *See Bendix Home Appliances v. Radio Accessories Co.*, 129 F.2d 177, 197 (9th Cir. 1942); as cited in Gurnick and Vieux (n. 7) 37.

⁶³ Gandhi (n. 60).

⁶⁴ *NLRB v. Bill Daniels, Inc.*, 202 F.2d 579, 582 (6th Cir. 1953).

⁶⁵ Norman Axelrad 'Franchising: Changing Legal Skirmish Lines or Armageddon' (1971) 26 Bus. Law 695-719.

⁶⁶ *Ibid.*

⁶⁷ Blair and Lafontaine, 'The Evolution' (n. 53).

⁶⁸ Many restaurants started to formally develop franchises in 1950s, for example KFC in 1952, McDonald's in 1955, Pizza Hut in 1958. *See* David Cole et al, 'Encyclopedia of modern everyday inventions' (ABC-CLIO, 2003) as cited in Gandhi (n. 60).

⁶⁹ William Killion 'The Modern Myth of the Vulnerable Franchisee: The Case for a More Balanced View of the Franchisor-Franchisee Relationship' (2008) 28 Franchise L. J. 23, 26-27.

by such pervasive power of [franchisor's] control.”⁷⁰ Many articles from that time were trying to highlight the problems of inexperienced franchisees and the existence of the “exploitative” practices in franchising.⁷¹ Even though the legislators on a federal level were reluctant to enact disclosure requirements or best business practices for franchising, states were not inactive in regard to this matter. This led to California’s 1971 enactment of the Franchise Investment Law – one of the first franchise disclosure laws in the country.⁷² In 1979, the Federal Trade Commission (“FTC”) followed and adopted the Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures – 16 C.F.R. § 436 (“FTC Rule”) to protect the franchisees and the industry itself through disclosure.⁷³

As was already mentioned, in the US there are regulations on both, the federal and the state levels which cover two areas of franchise practice:

- a) the disclosure requirements at the federal level and the registration, notice, and supplementary disclosure requirements at the state level,⁷⁴ and
- b) the relationship laws adopted by states which go beyond a mere disclosure and regulate other aspects of the relationship between the franchisor and franchisee.⁷⁵

In this section, both of these areas will be covered with the main focus on the protection of the franchisee.

2.2.1 The disclosure requirements

The franchisor has to comply with disclosure requirements on the federal level and the registration, notice, and additional requirements at the state level for the offer and sale of the franchise to the prospective franchisee. According to the federal FTC Rule, the franchisor was required to provide franchisee during their first face-to-face meeting or at least ten days before the signing date of the franchise contract with a Uniform Offering Circular (“UFOC”) which consisted of 23 informational items.⁷⁶ Later in 2007, this rule was modified to bring it into much closer alignment with state franchise disclosure laws. Even though it closely tracks the UFOC Guidelines, in some cases the new disclosure document called the Franchise Disclosure Document (“FDD”) demands more extensive disclosures,⁷⁷

⁷⁰ *Ibid.* 26.

⁷¹ For example, in Wall Street Journal’s article ‘Investigations, Dealer Revolt, Market Saturation Plague Fast Food Firms, Others’ was stated the following: “...*The franchise holder today is often no businessman at all but perhaps a plumber or electrician who has been told he needs no experience to profit handsomely and that the enfranchiser will teach him all he needs to know.* ...” See Killion (n. 67) 26.

⁷² California Franchise Investment Law, CAL. CORP. CODE § 31000 (1971).

⁷³ Gandhi (n. 60) 7.

⁷⁴ *Ibid.*

⁷⁵ Tibor Tajti, *Systemic and topical mapping of the relationship of the Draft common frame of reference and arbitration* (Vilnius, Kazimieras Simonavičius University, 2013) 73.

⁷⁶ These informational items include for example the franchisor’s litigation history, any exclusive territory accompanying the franchise, assistance of franchisor, franchise purchasing and startup costs, and franchisor’s financial performance representations. See 16 C.F.R. §436 (1979). See also Lederman (n. 14).

⁷⁷ For example, it requires more extensive disclosures on lawsuits the franchisor has filed against franchisees; a warning when there is no exclusive territory; and an explanation of what the term “renewal” means for each franchise system. See FTC,

but in other cases it loosens the requirements.⁷⁸ However, for the FTC Rule and other states' franchise laws to apply, the agreement between the franchisor and franchisee and their business relationship must fall under the definition of a "franchise"⁷⁹ with the following elements:

- trademark: the franchisor gives the franchisee a right to operate a business which is identified by or associated with the franchisor's trademark and to use this trademark in conducting the business operations related to the franchise;
- control: the franchisor exercises or has the right to exercise a substantial level of control or assist the franchisee in his business operations;
- consideration: the franchisee promises to pay the franchisor \$500 or more in exchange for the right to operate the franchise.⁸⁰

All franchisors who offer their franchises in the US have to comply with the amended FTC Rule. However, under federal law it is not obligatory to register your franchise or file the FDD.⁸¹

As for the additional ex-ante protections of franchisees,⁸² many states have extra disclosure, registration, and/or notice requirements. Those states may have stricter rules than the ones in the amended FTC Rule which result in franchisor making additional disclosures and complying with other formalities beyond the amended FTC Rules requirements.⁸³ The states with registration⁸⁴ requirement typically demand a pre-offer merit⁸⁵ review where examiners are given a power to analyze the application and they may require changes to the FDD. Failure to abide by these laws may result in fines and penalties for the franchisors.⁸⁶ The registration states also demand an approval process of a registration application in the FDD format.⁸⁷ The application is examined for the accuracy and completeness by the state's examiners who then advise the franchisor of their approval of the application or inform him of further amendments that need to be made to the application.⁸⁸ In most of the registration states, the franchisor cannot sell nor offer his franchise to franchisee until the registration has been approved by the state or the franchisor

'FTC Issues Updated Franchise Rule' (2007) <<https://www.ftc.gov/news-events/press-releases/2007/01/ftc-issues-updated-franchise-rule>> accessed 16 March 2020.

⁷⁸ For example, it does not require disclosure of so-called "risk factors," franchise broker information, or extensive information about every component of any computer system that a franchisee must purchase. *See ibid.*

⁷⁹ 16 C.F.R. § 436. *See* Gandhi (n. 60) 9 and Lederman (n. 14) 36-37.

⁸⁰ 16 C.F.R. § 436.1 (h). *See also* Gandhi (n. 60) 9.

⁸¹ 16 C.F.R. § 436. *See also* North American Securities Administrators Association (NASAA) '2008 Franchise Registration and Disclosure Guidelines' (2007) <<https://www.nasaa.org/wp-content/uploads/2011/08/6-2008UFOC.pdf>> accessed 16 March 2020.

⁸² Tajti, *Systemic* (n. 75) 72.

⁸³ 16 C.F.R. § 436.10. *See also* Gandhi (n. 60) 9.

⁸⁴ States that require registration of FDD: CA, HI, IL, IN, MD, MI, MN, NY, ND, RI, VA, WA, WI. *See* Franchise Law Solutions 'The Franchise Registration States' (2020) <<https://www.franchiselawsolutions.com/blog/the-franchise-registration-states/>> accessed 18 March 2020.

⁸⁵ *See* Nany Lanard, 'Which States Are Franchise Registration States?' (2017)

<<https://www.lanardandassociates.com/blog/2017/09/franchise-registration-and-notification-states/>> accessed 30 May 2020.

⁸⁶ This does not apply in the states which require only a notice to be filed with them. *See also ibid.*

⁸⁷ NASAA (n. 81). *See also* Gandhi (n. 60) 10.

⁸⁸ Gandhi (n. 60) 10.

was granted an exemption.⁸⁹ On the contrary, the notice states⁹⁰ have simpler rules. There is usually no need to file the FDD and the application is not reviewed by special examiners.⁹¹ However, in the US, the majority of the states require neither filing nor registration prior to sale of franchises.⁹²

2.2.2 *The relationship laws*

The relationship laws go beyond mere disclosure and regulate other aspects of the franchisor-franchisee relationship. They were created to mostly combat two issues: to correct the apparent inequality in the franchisor-franchisee relationship and to protect franchisees against perceived abuse by franchisors.⁹³ They typically deal with unjust termination of the contract,⁹⁴ restrictions on free association among franchisees,⁹⁵ renewal of the contract, assignment, and transfer of a franchise, and encroachment by the franchisor.⁹⁶ To note, these abuses are forbidden by mandatory franchise relationship laws, irrespective of the express agreement provisions.⁹⁷

However, the franchisor advocates find these laws undesirable. This opposition is based on an assumption that before signing the contract the franchisees are provided with all relevant information, thus they make a well-informed decision when signing a contract.⁹⁸ In particular, franchisees are assumed to have read the franchise disclosure documents which were made accessible to them in detail, made the comparisons of the various contracts, and disclosure documents from other franchisors and discussed all documents with a specialized franchise attorney. According to the franchisor advocates, since the franchisees have a possibility to consider all of the relevant information, there is no need for special legislative protection.⁹⁹ Though, this approach is questionable due to the fact that novice franchisees lack prior business experience. This may present cognitive obstacles when acquiring information about the potential franchise business.¹⁰⁰ Such obstacles may lead franchisees to ignore disclosure documents, avoid conducting a comparison between various franchise contracts, and refrain from consulting with specialized attorneys during the pre-contractual stage.¹⁰¹ Given this reality, franchise laws need to be created for the inexperienced franchisees to protect them from possible

⁸⁹ *Ibid.*

⁹⁰ CT, FL, KY, ME, NE, NC, SC, SD, TX, UT.

⁹¹ Gandhi (n. 60) 10.

⁹² For example, AK, DE, DC. *See* Tajti, *Systemic* (n. 75).

⁹³ Robert Emerson and Uri Benoliel, 'Are Franchisees Well-Informed: Revisiting the Debate over Franchise Relationship Laws' (2012) 76 Alb L Rev 196-197.

⁹⁴ ARK. CODE ANN. § 4-72-209 (2012); CAL. BUS. & PROF. CODE §§ 20020-21 (West 2012) *See also* Emerson and Benoliel (n. 90) 197.

⁹⁵ ARK. CODE ANN. § 4-72-206(2); CAL. CORP. CODE §§ 31220, 31302.5 (West 2012), *See also ibid.*

⁹⁶ Gandhi (n. 60) 12.

⁹⁷ Robert Emerson, 'Franchise Encroachment' (2010) 47 Am. Bus. LJ 191, 257.

⁹⁸ Emerson and Benoliel (n. 93) 193.

⁹⁹ *Ibid* 197.

¹⁰⁰ Hadfield (n. 26).

¹⁰¹ *See generally* Robert Lord and Karen Maher 'Alternative Information Processing Models and Their Implications for Theory, Research and Practice' (1990) 15 ACAD. MGMT. REV. 9, 14.

opportunism by franchisors. Under current Slovak legislation there are no specific franchisor-franchisee relationship laws that would offer this kind of protection to the franchisee.

2.3 Criticism of the United States System

As a result of the federal and state regulatory schemes that have developed over the last 50 years, selling franchises has become a complex and expensive operation. Many franchisors, franchisees, government officials and other franchise consultants would most probably agree that based on the history of abuses and fraudulent behavior by franchisors, and their broad discretion in many areas of the franchise relationship, there is more than enough evidence that regulation in franchising is needed.¹⁰² In relation to this, the following questions arise:

Does the US regulatory system achieve its stated goals? Is it effective?

Even though there are no special statistics about the levels of compliance with federal and state disclosures, according to Rupert Barkoff this level is considered to be quite high.¹⁰³ The information given to prospective franchisees by franchisors is valuable and helps them decide whether (not) to buy a certain franchise. However, the prescribed format of the FDD does not give the potential franchisee the whole picture of the franchise and it is only the beginning of the due diligence process.¹⁰⁴

In the US, there are three groups of criticism concentrating on the following insufficiencies related to the franchise system. The first group focuses on the fact that under the FTC Rule there is no private right of action allowing to bring a suit based on the violation of this rule.¹⁰⁵ This issue was analyzed in *Freedman v. Meldy's Inc.*,¹⁰⁶ and later reinforced in *Mon-Shore Management, Inc. v. Family Media*.¹⁰⁷ Those decisions shield franchisors from private actions by any of their franchisees under the FTC Rule.¹⁰⁸ Therefore, in the states where registration is not mandatory, the franchisees can rely only on the common law fraud claims. However, fraud is difficult to prove because of the high number of elements that must all be proven in order for a plaintiff to prevail on his claim.¹⁰⁹ The second group criticizes the

¹⁰² Rupert Barkoff 'Franchise Sales Regulation Reform: Taking the Noose Off the Golden Goose' (2009) 3(2) Entrepreneurial Business LJ 233.

¹⁰³ *Ibid* 245.

¹⁰⁴ Michael Seid and Dave Thomas, *Franchising for Dummies* (For Dummies, 2d ed., 2006), 90-91.

¹⁰⁵ Stephanie Russ and Max Schott 'Basics track: registration and disclosure' (2019) International Franchise Association <https://www.franchise.org/sites/default/files/2019-05/BasicsTrack_RegistrationandDisclosure.pdf> accessed 16 March 2020.

¹⁰⁶ *Freedman v. Meldy's, Inc.*, 587 F. Supp. 658 (E.D. Pa. 1984).

¹⁰⁷ *Mon-Shore Management, Inc. v. Family Media, Inc.*, 584 F. Supp. 186 (S.D.N.Y. 1984).

¹⁰⁸ Stuart Sutherland 'The Risks and Exposures Associated with Franchise Noncompliance' (1987) 42(2) The Business Lawyer 377. <<https://www.jstor.org/stable/pdf/40687128.pdf?refreqid=excelsior%3Afcc2fc168bf5aec2777d5f35e20b7801>> accessed 21 March 2020.

¹⁰⁹ See Barkoff (n. 102) 236. Also, the New Jersey Superior Court held that a violation of the FTC Rule is a per se violation of the New Jersey Consumer Fraud Act, N.J. Rev. Stat. Ann. § 56:8-1 (West 1964 & Supp. 1986), which does contain a private right of action. *Morgan v. Air Brook Limousine*, 2 Bus. Franchise Guide (CCH) 1 8560 (N.J. Super. Ct. Law Div. Jan. 31, 1986). See Sutherland (n. 105).

limited resources of the FTC to carry out its role properly. When it comes to the franchise sales regulation enforcement, the triage and sorting of certain situations has been the FTC's essential approach. According to this strategy, the FTC is trying to find the situations where the fraud is obvious and causes a widespread injury to the public. Contrary to this, the individual franchisee who has been injured is left on his own to fight this issue.¹¹⁰ The last group focuses on the fact that in order to fully regulate the franchise regime in the US, disclosure is too narrow an approach. According to this group's supporters, franchise relationship laws are equally important as rules which govern the disclosure. Also, no expansion of the Franchise Disclosure Rule during the last 2007 amendment is considered a downside by the advocates of this theory who are also critical to the state relationship laws. They view them as being too little, and oriented to abuses that may have been the key source of attention in the 1970s, but do not adequately deal with the problems of today.¹¹¹

Is this regulation efficient?

According to Barkoff and many other scholars and lawyers, the franchise system in the US is not efficient enough.¹¹² Here is the list of some of the apparent inefficiencies of the system:

a) The dual-level of regulation

Franchising is regulated on both, the federal and state level which may seem duplicative. As mentioned before, the absence of the private right of action under the FTC rule is one of this federal law's weaknesses. The registration states' laws cured this issue to some extent by providing mistreated franchisees with the right to sue franchisors for misrepresentations made during the sale process or failure to register altogether. Also, the FTC Disclosure rule does not regulate ongoing franchise relationships.¹¹³

b) The variations in state laws

The state laws do not offer the same protection. While there are many similarities, each state has its own idiosyncrasies and notable differences exist, such as different definitions for the term franchise,¹¹⁴ different statutes of limitation,¹¹⁵ and different exemptions. The differences are also reflected in administrative rules or internal informal procedures which also lead to the lack of uniformity between the states which can make the sale process more difficult.

¹¹⁰ Barkoff (n. 102) 246.

¹¹¹ *Ibid.* See also Rupert Barkoff and Andrew Selden, *Fundamentals of Franchising* (2d ed. 2004).

¹¹² Barkoff (n. 102) 247.

¹¹³ *Ibid.*

¹¹⁴ Trademark, control and payment of the fee are usually the main criteria for an agreement to be distinguished as a franchise agreement. However, in NY only the fee element and either the trademark or control are necessary. See N.Y. GEN. BUS. § 681.3.

¹¹⁵ CAL. CORP. CODE § 31303 (generally 4 years for making fraudulent representations); § 31304 (2 years for failure to register). The Washington Registration Law has no specified statute of limitation; the general statute of limitation is two years. See WASH. REV. CODE § 4.16.080 (three years after the date of discovery for fraud); § 4.16.040 (six years for contract claims); § 4.16.130 (two years for claims where a statute of limitation is not specified). See Barkoff (n. 102) 247.

c) *The review process*

The main issue at stake here according to Barkoff ¹¹⁶ is whether the state review of disclosure statements adds any value to the disclosure process itself. As stated by him, there are no statistics available whether fraud in states which review the disclosures is more common than in the states that do not. However, the lack of statistics may be interpreted either way.

Another issue arises here which is linked to the fact whether the multiple reviews by different states are necessary. Do such reviews improve the quality of disclosures? According to Barkoff, multiple reviews only create more problems. Normally, the franchisors have to use different disclosure documents for different states which adds only a burden to them in regard to spending more time and money on these additional disclosures.¹¹⁷ Based on the struggles of the franchisors and their lobbying to bring about a policy change, the state regulators tried to deal with this problem by designing the “Coordinated Review Program”, whereby franchisor could submit his application in two or more jurisdictions simultaneously and then work with a franchise examiner from only one jurisdiction. This program wanted to establish uniform review standards to expedite the registration process and save franchisors’ money and time.¹¹⁸ Unfortunately, it received mixed reviews and its use was suspended indefinitely due to the challenges created by 2007 amendments to the FTC Rule.¹¹⁹

¹¹⁶ Barkoff (n. 102) 247.

¹¹⁷ *Ibid.*

¹¹⁸ Coordinated View ‘Home section’ (2007) <<http://www.coordinatedreview.org>> accessed 23 March 2020.

¹¹⁹ Adam Siegelheim ‘Coordinated Review Program Indefinitely Suspended’ (2007) New Jersey Law Blog <<https://www.njlawblog.com/2007/10/articles/franchise/coordinated-review-program-indefinitely-suspended/>> accessed 23 March 2020.

CHAPTER III: FRANCHISING IN EUROPE

3.1 Brief History of Franchise in Europe

Even though franchising is mentioned in historical materials dating back to the mercantile codes of the Middle Ages, it really became a common and popular form of business in Europe in the 1970s when the British Franchise Association was established, followed by the French and German Franchise Federations and the European Franchise Federation.¹²⁰ While the original roots of franchising might be lost in time, there is no argument where the modern concept of franchising comes from. The business-format franchise came to Europe from the birthplace of the franchise, the US.¹²¹

The European Franchise Federation promoted the development of franchise across Europe and encouraged countries to adopt the franchise-specific regulation. The greater presence of franchising is demonstrated by the waves of the franchise-specific regulation that occurred in the 1990s and the following years.¹²² Franchising has continued to grow in Europe and its potential has been recognized by the EU as well.¹²³ However, in the latest study concluded for the European Parliament¹²⁴ it is stated that the regulation for franchising in the EU and its member states is currently dysfunctional.¹²⁵ Why is that? The private law-based model which is characteristic for Continental Europe “presumes the existence of franchise-specific rules enshrined in civil (or commercial) codes”¹²⁶ or other statutes. This may be the reason why so many civil law countries do not have the specific rules which could be applicable to the franchise contracts. Such a desire of civil law countries to codify everything may actually become an obstacle to coming up with a detailed regulation of such a complex issue as a franchise. The various franchise regulations in the EU member states and the lack of their uniformity may be the cause of why “franchising has failed to fulfill its potential in the EU.”¹²⁷

However, it cannot be denied that some European countries regulate certain aspects and features of franchising, even though those might not be uniform across Europe as already mentioned. In this chapter, the focus will be on French and German franchise regulations, mostly in regard to the protection of franchisee.

¹²⁰ Mark Abell, ‘The Regulation of Franchising in the European Union’ (DPhil thesis, Queen Mary, Univ. of London 2011) 38.

¹²⁰ Dalberg (n. 20).

¹²¹ Tajti, ‘Franchise’ (n. 25) 259.

¹²² Abell, ‘The Regulation’ (n. 120) 39.

¹²³ Mark Abell, ‘Legal Perspective of the Regulatory Framework and Challenges for Franchising in the EU: study’ (2018) <[https://www.europarl.europa.eu/RegData/etudes/STUD/2016/587317/IPOL_STU\(2016\)587317_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/STUD/2016/587317/IPOL_STU(2016)587317_EN.pdf)> accessed 28 March 2020.

¹²⁴ *Ibid.*

¹²⁵ *Ibid.*

¹²⁶ Tajti, *Systemic* (n. 75).

¹²⁷ Abell, ‘Legal Perspective’ (n. 123).

3.2 Franchise regulations in France

Over the years, France has become one of the largest and most developed markets for franchising in Europe.¹²⁸ According to the French Franchise Federation's study,¹²⁹ in 2018 there were more than 2 000 franchise networks in France. France is considered to be the first country in Europe to adopt a law that relates to franchising. The *Loi Doubin*, a pre-contractual disclosure law, was enacted mostly due to the fact that in the 1980s many franchisees in France went into liquidation because of misleading promises of the franchisors. This law lacks the regulation of other aspects of the franchise relationship because such regulation could (according to the 1984 French experts) negatively affect the “dynamic character of franchising.”¹³⁰

3.2.1 Regulation and definition of the franchise

Even though franchising is widely used as a business form (particularly in the distribution sector), no legal definition can be found in French law. According to the various commentators and the case law,¹³¹ the franchise can be defined as an agreement between two independent companies or persons, where the franchisor provides the franchisee with its distinctive signs (i.e. trademark), know-how and commercial and technical assistance. In addition to paying fees, the franchisee is also committed to using the know-how and distinctive signs in a uniform manner.¹³²

When it comes to the definition of “franchise”, there is no statutory definition in France. It used to be described in a 29 November 1973 administrative order which is no longer in force.¹³³ The European Code of Ethics for Franchising which was adopted by the French Franchise Association defines franchising as “a system of marketing goods and/or services and/or technology, which is based upon a close and ongoing collaboration between legally and financially separate and independent undertakings, the Franchisor and its individual Franchisees, whereby the Franchisor grants its individual Franchisee the right, and imposes the obligation, to conduct business in accordance with the Franchisor's concept.”¹³⁴ This definition is recognized by French courts.¹³⁵

¹²⁸ Spencer, *The Regulation of Franchising* (n. 4), 159.

¹²⁹ Jean Samper, ‘Franchising in France explained to foreign franchisors’ (2019) <<https://franchisebusinessclub.com/article/franchising-in-france-explained-to-foreign-franchisors>> accessed 29 March 2020. See generally French Franchise Federation <<https://www.franchise-fff.com>> accessed 28 March 2020.

¹³⁰ Odavia Bueno Diaz, *Franchising in European Contract Law: A comparison between the main obligations of the contracting parties in the Principles of European Law on Commercial Agency, Franchise and Distribution Contracts (PEL CAFDC), French and Spanish law* (Walter de Gruyter, 2009) 33-34.

¹³¹ Decision of the Paris Court of Appeal, Morvan Intercontinent, Bull. Transp., 1978, 277. See also Charles Jourdan case of 1 December 1988, OJ L 35,7, 7 January 1989.

¹³² Getting the Deal Through (GTDT), ‘Franchise in 32 jurisdictions worldwide’ (2011), 48 <https://www.plesner.com/~media/plesnerdocuments/artikler/2015_05_01_franchise.ashx> accessed 24 March 2020.

¹³³ Franchise Land ‘Definition of Franchising’ <<http://www.franchise-land.com/en/become-a-franchisor/the-bible/definition-of-franchising.html>> accessed 29 March 2020.

¹³⁴ European Franchise Federation (EFF), ‘Franchising: definition & description’ <<http://www.eff-franchise.com/101/franchising-definition-description.html>> accessed 21 March 2020.

¹³⁵ GTDT (n. 132) 48.

In France, general contractual features of franchise agreements are governed by the Civil Code, while the commercial aspects are governed by the Commercial Code.¹³⁶

3.2.2 *Pre-contractual disclosure*

As mentioned before, even though franchising is a well-established distribution system in France, there is no specific legislation which governs it because legislating on franchising would risk ‘weakening its dynamic and evolving features.’¹³⁷ However, French legislators dealt with franchising to some extent in relation to pre-contractual disclosure. Article L330-3 of the Commercial Code – also known as *Loi Doubin* – provides pre-contractual disclosure obligations¹³⁸ and is relevant to all contracts (so not just franchise contract) by which one person grants to another one a trade name, a trademark or sign, and requires an exclusivity or quasi-exclusivity undertaking for the exercise of such other person’s activity.¹³⁹ In order to protect the franchisee, this law requires disclosure, so the franchisee can make an informed decision with “full knowledge of relevant facts.”¹⁴⁰

The precontractual information must be disclosed in a disclosure document that must contain truthful information allowing the potential franchisee to freely enter into franchise agreement on a fully informed basis.¹⁴¹ This document must be delivered at least 20 days prior to the signature of the franchise contract or, if applicable, before the payment of any sum of money that is required;¹⁴² and according to the sections L330-3 and R330-1 of the Commercial Code it must contain:

- information on franchisor: company name, location, description of his activities, capital, registration number, bank accounts, the identity of the entrepreneur or of the managers, date of the company’s formation, principal stages of its evolution over the past five years, annual financial statements of the two last financial years or the annual reports for the past two years, if the company’s securities are publicly traded;
- information on licensed trademark: registration, registration number, date of acquisition of the trademark or date and duration of the license of the trademark (if applicable);
- information on the state and prospects of the market;
- information on the network: list of the member companies with indication of the operating mode, list of the companies (located in France) with which the franchisor concluded the same

¹³⁶ *Ibid.* 49.

¹³⁷ Raphaël Mellerio, ‘The Franchise Law Review: France’ (2018) <<https://thelawreviews.co.uk/chapter/1159206/france>> accessed 21 March 2020.

¹³⁸ *Ibid.*

¹³⁹ GTDT (n. 132) 49.

¹⁴⁰ Law No. 89-1008, concerning the development of commercial and artisanal enterprises and the improvement of their economic, legal and social environment, article 1. *See also* Philip Ziedman, ‘With the best intentions: Observations on the international regulation of franchising’ (2014) 19(2) *Stanford Journal of Law* 253.

¹⁴¹ Claire Poirson, ‘Franchising in France’ (2019) *Lexology*. <<https://www.lexology.com/library/detail.aspx?g=c98726bc-8053-4d59-ac3a-81230434e31b>> accessed 20 March 2020.

¹⁴² UNIDROIT ‘France – Legislation and Regulations Relevant to Franchising’ (2018) <<https://www.unidroit.org/guide-franchise-2nd-national-info/131-instruments/franchising/guide/guide-2edition/national-information-2nd-franchise/country/299-france-legislation-and-regulations-relevant-to-franchising>> accessed 20 March 2020.

contract and the date of conclusion or renewal, or both, of these agreements, the indication of the number of companies which have left the network during the previous year and of the reason why they left the network, the indication of the presence within the business area of the franchisee of any commercial premises where the products or services concerned are sold;

- information on the contract: the terms and conditions of renewal, cancellation, and assignment of the contract, and the scope of the exclusive rights.¹⁴³

The reform of French contract law from 2016 has brought some changes to pre-contractual obligations. According to the new article 1112-1 of the Civil Code “[a] party who knows information that is of decisive importance for the consent of the other, must inform him of it where the latter is legitimately unaware of this information or relies on the contracting party. Information is of decisive importance if it has a direct and necessary relationship with the content of the contract or the status of the parties.”¹⁴⁴ In other words, this applies to the franchisors who must act dutifully and in cooperation with the prospective franchisee. Franchisors are therefore advised to be as transparent as possible when providing information to the franchisees. This provision also adds additional protection to the franchisee.

Also, the new article 1171 of the Civil Code states that “in a preformulated standard agreement, any clause which creates a significant imbalance between the rights and obligations of the parties to an agreement is deemed null and void. The determination of the significant imbalance does not relate to the main object of the agreement or the adequacy of the price to the performance.”¹⁴⁵ As franchise contract is typically seen as standard form contract (as discussed in chapter one of this thesis) mainly because of the limited scope of negotiation on the contract terms, it remains to be seen in the future whether courts will use this provision to set aside or restrict the application of, for example, exclusion of liability and exclusivity.¹⁴⁶

When there is a violation of disclosure requirements, the franchisee may bring an action before the commercial courts to be granted damages. Other remedies available to the franchisees are rescission or termination of the contract due to the breach by the franchisor (for example, if the franchisor’s consent was not valid or if the franchisor committed a material breach).¹⁴⁷

¹⁴³ GTDT (n. 132) 49.

¹⁴⁴ Article 1112-1 of French Civil Code 2016 <<https://www.trans-lex.org/601101/ /french-civil-code-2016/>> accessed 23 March 2020

¹⁴⁵ Mellerio (n. 137).

¹⁴⁶ *Ibid.*

¹⁴⁷ Poirson (n. 141).

3.2.3 Case law

As already mentioned in the previous subchapter, not providing the mandatory disclosure document may lead to the cancellation of the contract or the franchisor's liability.¹⁴⁸ Franchisor's failure to provide the franchisee with proper and mandatory disclosure may be considered as fraudulent. This can eventually lead to the cancellation of the franchise contract.¹⁴⁹ In such cases, French courts make an analysis if the information provided by the franchisor is sincere. Then, they verify if some part of it was intentionally hidden from the franchisee to convince him to sign the contract, and/or if this piece of information which was missing would have led franchisee not to enter into franchise agreement at all. According to the case law, if the presentation of the franchisor is very broad and general, inaccurate, or incorrect, it may be considered a willful misrepresentation and can lead to contract cancellation.¹⁵⁰

However, the contract cancellation does not necessarily have to be caused by the franchisor's abuse of power or lack of provided information. The case of *Raymond Dayan v. McDonald's Corporation*¹⁵¹ illustrates that occasionally it is a franchisee that may abuse his position. As the case – admittedly from the early days of franchise expansion to France – showed, terminating the franchise contract may not be easy even if the franchisee is repeatedly and egregiously not complying with the contract's provisions on quality standards.¹⁵²

Referring to the previous paragraph, if the missing information from the disclosure document cannot justify the cancellation of the franchise contract, the franchisor may be held liable and ordered to reimburse the franchisee. The franchisee may demonstrate that if he had known this missing information, it might have led him to sign the contract on different terms, and that lack of such information had caused him damage. As an example, the Paris Court of Appeal considered that the franchisee's damage consisted of the absence of having the opportunity "not to contract" or "to limit its financial obligations."¹⁵³ Nonetheless, it is still important to note that the franchisee has to prove the existence of a direct connection between the franchisor's failure to provide the information and his damages.¹⁵⁴

¹⁴⁸ ICLG 'France: Franchise 2020' (2020) <<https://iclg.com/practice-areas/franchise-laws-and-regulations/france>> accessed 27 May 2020.

¹⁴⁹ *Ibid.*

¹⁵⁰ *Ibid.* See also the Cour de Cassation, decision of 6 May 2003, 01-00515 in which court annulled contract because it was considered to have been concluded on the basis of an inexistent trademark.

¹⁵¹ *Dayan et al v. McDonald's Corp.*, 125 ILL. App.3d 972 (1984).

¹⁵² *Ibid.*

¹⁵³ *Ibid.* See also Paris Court of Appeal, September 20th, 2000, confirmed by the Cour de Cassation, Commerciale, February 4th, 2004.

¹⁵⁴ *Ibid.*

3.3 Franchise regulations in Germany

3.3.1 Regulation and definition of the franchise

According to the latest franchise statistics from Germany, in 2019 there were 960 franchise systems in total with aggregate sales of 129 billion Euros.¹⁵⁵ The total revenues figure increased by 5.1% compared to the previous year.¹⁵⁶ Franchising business in Germany has grown significantly over the last years and it goes without doubt that there is still room for further development.¹⁵⁷ Even though the franchise business is really popular in Germany, there is no codified franchise law, nor any specific legal provisions which govern a franchise contract. When deciding a franchise dispute, the court resorts to the general provisions of the contract law (the German Civil Code), consumer law, commercial law (the German Commercial Code) and forms the analogies to other types of contracts.¹⁵⁸ Similarly to France, there is no statutory definition of “franchise” in Germany as well and the courts partly recognize the definition enshrined into the European Code of Ethics for Franchise.¹⁵⁹

3.3.2 Pre-contractual disclosure

Under German law, there is no special regulation nor statute which deals with pre-contractual disclosure. When dealing with this issue, only general provisions regarding the opening of contractual negotiations between the franchisor and franchisee apply (the principle of *culpa in contrahendo*).¹⁶⁰ Prior to the signing of the franchise agreement, the franchisor must make sure that all relevant information has been presented to the potential franchisee. The content and the scope of those duties depend on case by case basis, taking into consideration the experience and knowledge of the franchisee.

In case of violation of this duty or in case the franchisor deceives the franchisee, the franchisee has the right to claim damages as one of the private law remedies. This includes the right to reimbursement of the entry fee and all expenses incurred in connection with the franchised business.¹⁶¹ Also, the franchisee might be entitled to a right to rescind the franchise agreement. The franchisor can be ordered to consent to the cancellation of the franchise contract.¹⁶² However, the franchisee must prove that he would not have signed the contract if he had been properly informed of a particular piece of information.¹⁶³

¹⁵⁵ The German Franchise Association (GFA), ‘Global opportunities in the German market’ (2019) <<https://en.franchiseverband.com/#>> accessed 24 March 2020.

¹⁵⁶ *Ibid.*

¹⁵⁷ Karin Weinzierl, ‘Is your franchise fit for Germany?’ (2010)

<<https://www.franchisedirect.com/information/internationalfranchising/isyourfranchisefitforgermany/202/969/>> accessed 24 March 2020.

¹⁵⁸ Buse Heberer Fromm, ‘Franchising in Germany’ (2019) Lexology. *See also* Getting the Deal Through (n. 128) 55.

¹⁵⁹ *Ibid.* *See also* GTDT (n. 132) 55.

¹⁶⁰ *Ibid.* *See also* ICLG ‘Germany: Franchise 2020’ (2020) <<https://iclg.com/practice-areas/franchise-laws-and-regulations/germany>> accessed 24 March 2020.

¹⁶¹ Fromm (n. 158).

¹⁶² GTDT (n. 132) 56.

¹⁶³ Fromm (n. 158).

According to the case law, it is the franchisee's obligation to gather a sufficient amount of information about the general market conditions and the impact of those conditions on the prospective franchise business. Though, there is one exception to this rule which applies if there are certain circumstances the franchisor was aware of and which are recognizably of importance to the other party's decision as to whether or not to enter the franchise business.¹⁶⁴ Therefore, the scope of disclosure requirements is dependent on the franchisee's need and the possibility to obtain information. Consequently, the franchisor must provide franchisee with information about the way the franchise system works and its success rate.¹⁶⁵ Contrary to the legal environment in France, there is no specific compliance procedure in Germany. However, the franchisors are advised to expressly disclose all relevant information in writing.¹⁶⁶

3.3.3 Case law

As may be seen from the previous paragraphs, the franchisees are given certain kinds of protection based on private law remedies when they are not provided with the relevant and necessary information or when they are deceived by the franchisor's behavior. The protection which resembles the California Franchise Investment Act can be derived from the case of German courts.

It is common for any agreement to contain a system of dispute resolution. Franchisors and franchisees are entitled to submit their disputes to arbitration which offers flexibility and privacy to both parties and also finality of an award. The choice of arbitration tribunal and the choice of applicable law is at the free discretion of the parties. However, the foreign award must be declared enforceable by a domestic court, in this case German court. An award is executed in accordance with the New York Convention¹⁶⁷ and state courts should be very careful when refusing the execution of arbitral awards. The two following cases regarding the Subway fast-food restaurant franchise illustrate the situation when the execution of foreign United States' award was refused because the franchise agreement provided for arbitration in New York while the franchisee was German (located in Dresden and Bremen).¹⁶⁸

The facts of these two cases were similar. The franchisor (based in the Netherlands) concluded the franchise agreements with German franchisees. The parent company of the franchisor was based in New York, so the place of arbitration according to the contract. The applicable law was the law of

¹⁶⁴ *Ibid.* See also GTDT (n. 132) 56.

¹⁶⁵ German case law and Franchise Association give us some leads on disclosure requirements: description of franchise concept, initial and ongoing support by the franchisor, date of beginning of the franchise system; required capital for the franchisee's business; accurate information on the profitability of the franchisee's business; and pending lawsuits with an impact on the potential franchisee's business. See also GFA, 'The German Franchise Association' (2020) <<https://en.franchiseverband.com/association/>> accessed 24 March 2020.

¹⁶⁶ Fromm (n. 158). See also GTDT (n. 132) 56.

¹⁶⁷ UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 10 June 1958).

¹⁶⁸ Fromm (n. 158).

Lichtenstein. Both franchisees had financial difficulties. The franchisor obtained the US arbitral awards in both cases, ordering the franchisees to pay the outstanding fees. German courts rejected the execution of these awards based on the article 5(1)(a) of the New York Convention.¹⁶⁹

Applicable law of Lichtenstein referred to Austrian Civil Code and its following provision: “A contractual provision contained in general conditions of business or form contracts which does not determine one of the main mutual performances is in any event void if, considering all the circumstances of the case, it is grossly unfavorable to one of the parties.” In accordance with this provision, the courts found that the franchisees were unreasonably disadvantaged by the place of arbitration.¹⁷⁰ The reasoning of both courts¹⁷¹ shared the same view that there were no grounds, other than the convenience of the parent company, for the franchisee to fly to New York. The franchisee was grossly burdened unilaterally because there was no similar burden on the franchisor. Also, in these cases “the franchisor exploited its overwhelming structural and financial power in order to impose an extremely unfavorable court jurisdiction agreement on its contractual partner.”¹⁷² The courts recognized the power imbalance and the need for the franchisee’s protection.

3.4 Conclusion

When we compare French and German franchise regulations to the ones in the US, we can clearly see that mostly general contract rules apply in these European systems. Also, their regulations cannot be considered to be as developed as the American ones. The franchise policies are still evolving on the European continent, especially because of the impact and lobbying powers of the franchise associations which do not necessarily favor detailed franchise regulation; especially if the protection of franchisees is at stake.¹⁷³ Their significant influence on important franchise policies helps the franchise practitioners to find their way in the franchise business and get more familiar with the franchise world. Also, these efforts may shield franchisees from possible abuses and opportunism of the franchisors and enhance the stability of the franchise system. Even though some gaps can be found in French and German franchise policies, and certain improvements would be welcomed, the mixture of these systems can serve as a good starting model for Slovak franchise regulations.

¹⁶⁹ The UN Convention (n. 167).

¹⁷⁰ Karsten Metzlaß and Karl Rauser ‘Franchising and Execution of Arbitration Awards’ (2009) <<https://www.internationallawoffice.com/Newsletters/Franchising/Germany/Nrr-Stiefenhofer-Lutz/Franchising-and-Execution-of-Arbitration-Awards>> accessed 23 March 2020.

¹⁷¹ Dresden Higher Regional Court, judgment of 7 December 2007, 11 Sch 8/07; Bremen Higher Regional Court, judgment of 30 October 2008, 2 Sch 2/08.

¹⁷² Metzlaß and Rauser (n. 170).

¹⁷³ IFA ‘Franchise Advocacy?’ <<https://www.franchise.org/advocacy>> accessed 30 May 2020.

CHAPTER IV: FRANCHISING IN SLOVAKIA

Franchising is considered to be an expanding economic and legal concept in Slovakia. The more frequent use of franchising can be seen in the growth of smaller retail structures where this concept is often used. The key advantages of franchising, such as gaining the market share by the franchisor in combination with the franchisee's knowledge of the local environment are the main factors that have been causing further expansion and growth of this concept in Slovakia.¹⁷⁴ To keep up with the modern legal practice, we can see the further development of this concept and the need for more detailed regulation.

4.1 Brief history of Franchise in Slovakia

Economic and political changes in 1989 increased the interest of the entrepreneurs in franchising in Czechoslovakia. However, the initial expansion of franchising was slightly hampered at first due to a lack of knowledge about franchising and mistrust of the entrepreneurs.¹⁷⁵ Also, the Czechoslovak market was yet not developed enough, there was a lack of legal awareness and imperfect legislation in general. The beginning of franchising development in Czechoslovakia dates back to 1991 when the first foreign franchise systems began to enter the Czechoslovak market.¹⁷⁶ The very first franchise that entered the market was Yves Rocher in Prague.¹⁷⁷ In Slovakia, it was McDonald's which is now considered to be a leader in fast-food chains on the Slovak market.¹⁷⁸

Nowadays, there are more than 140 franchise concepts in Slovakia of which only 32 are domestic original Slovak franchises.¹⁷⁹ The ratio of domestic and foreign franchise concepts is not really favorable for Slovakia, mainly because of the fact that in developed countries the number of domestic concepts usually prevails.¹⁸⁰ Slovak franchise market is not as developed as it could be, however, the market conditions for franchising in Slovakia are promising and there is a potential for growth.¹⁸¹

¹⁷⁴ Lubos Frolkovic and Pavol Biksadsky, 'Franchising in Slovakia' (2005) 3 Int'l J Franchising L 3.

¹⁷⁵ Vojtech Chloupek, 'Czech Republic' (2018) 5 The Franchise Law Review <<https://thelawreviews.co.uk/chapter/1159204/czech-republic>> accessed 25 May 2020.

¹⁷⁶ Chamber of Commerce of the Czech Republic, 'Informačná brožúra o franchisingu' (2009) <http://www.socr.cz/file/519/34_info_brozura_o_franchisingu.pdf> accessed 24 March 2020.

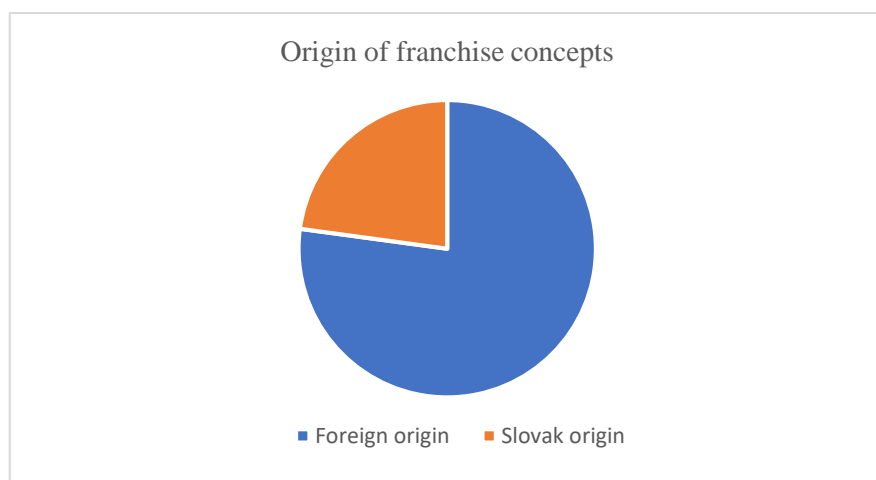
¹⁷⁷ Franchising.sk 'Nové miesta pre obchody si dôkladne vyberáme' (2019) <<https://franchising.sk/clanek/2405/nove-miest-a-pre-obchody-si-dokladne-vyberame/>> accessed 24 March 2020.

¹⁷⁸ Franchising.sk, 'McDonald's' (2019) <<https://franchising.sk/franchisa/114/mcdonald-s/>> accessed 24 March 2020.

¹⁷⁹ Slovak Franchise Association (SFA), 'Koncepty' (2020) <<https://sfa.sk/sk/franchisingove-koncepty>> accessed 25 March 2020.

¹⁸⁰ US Commercial Service 'Franchising industry: A Reference for US Exporters' *United States of America Department of Commerce*, 93.

¹⁸¹ *Ibid.*



4.2 Current franchise regulations in Slovakia

In general, Slovakia has a dual system of law applicable to contracts, based on the Civil Code no. 40/1964 Coll. (“Civil Code”)¹⁸² and Commercial Code no. 513/1991 Coll. (“Commercial Code”).¹⁸³ The Civil Code is the main regulator of private law and contract law in Slovakia, hence the Commercial Code refers to the Civil Code on many general issues. Because of this dual-track regulation, it is possible for one contract to be governed by both codes (for example sales contract).¹⁸⁴ Generally, the Commercial Code is applied when the parties to the contract are entrepreneurs and the content of the contract is related to the business issues. Therefore, the franchise contracts are subject to the Commercial Code, with a subsidiary application of the Civil Code.¹⁸⁵

Since 1992, when Commercial Code came into force, the Slovak entrepreneurs have encountered a number of unknown terms while doing business. One of these terms is the concept of franchising. Even though franchising is a widely known form of doing business, as noted before, there has not been a particular regulation of franchising in Slovak legislation.¹⁸⁶

The question which arises in connection to franchising in Slovakia is whether franchising meets all characteristic features of doing business under the Commercial Code. According to article 2(1) of the Commercial Code: “The term business shall mean systematic activities, which are independently conducted for the purpose of making a profit by an entrepreneur in his own name and at his own responsibility.”¹⁸⁷ However, many would say that the concept of independence is absent in franchising, or more precisely, limited to some extent. That is the reason why many Slovak and Czech authors

¹⁸² Act no. 40/1964 Coll. Civil Code (Civil Code).

¹⁸³ Commercial Code (n. 5).

¹⁸⁴ Frolkovic and Biksadsky (n. 174).

¹⁸⁵ *Ibid.*

¹⁸⁶ Alexandra Vicová, ‘Franchising’ (2010) <<https://www.epi.sk/odborny-clanok/Franchising.htm>> accessed 25 May 2020.

¹⁸⁷ Commercial Code (n. 5), § 2(1).

consider the franchise agreement to be a “sui generis” type of contract.¹⁸⁸ As Jana Burešová said: “Doing business via franchising is a special form of doing business and it is not possible to agree without further that the franchisee can decide at his own discretion about the time and place of doing business or even organization of his work [...]. Though, the franchisee decides on the manner of doing business only at the moment of concluding the franchise contract, and subsequently he has to comply with the ‘franchise package’ of the franchisor.”¹⁸⁹

The crucial provision for franchising in Slovakia is article 269(2) of the Commercial Code which states that the parties may enter into the contract which is not regulated as a certain type of contract under this Commercial Code. Hence, since the franchise contract is not regulated in Slovakia, it is considered to be a “nameless” (innominate) contract. Parties to the contract are in principle free to set the structure and content of such a contract.¹⁹⁰ However, the content of the contract provisions cannot be in conflict with mandatory provisions of the law. Also, the written form is recommended because it strengthens the position of the contracting party in proving its claim in the event of a dispute, in particular with regard to proving that the subject matter of the obligation is sufficiently certain.¹⁹¹ If the parties do not sufficiently identify the subject matter of their obligations, the contract will be deemed null and void.¹⁹² This may be the case, for example, when the subject matter is not identified in terms of its quality and/or quantity or when the ambiguities concerning the content of the contract cannot be removed by interpretation or using the dispositive provisions of law.¹⁹³ As a matter of fact, there are no other formal requirements for a franchise contract to be found in Slovak legislation.

While no particular requirements for the content of the franchise agreement exist under the Slovak law, the enjoyment of the rights for either party under a franchise contract must still be in accordance with certain general principles of Slovak commercial and civil law.¹⁹⁴ When drafting a franchise agreement, good morals and fair dealing in business must be taken into consideration because of the importance of those concepts under Slovak contract law. Their breach may lead to the invalidity of specific contract provisions that violate the good morals or the non-enforceability of a contractual claim that violates fair business practices.¹⁹⁵

¹⁸⁸ Tímea Kováčsová, ‘Franchisingová zmluva (§ 269(2) Obchodného zákonníka)’ (2015) <<https://www.epi.sk/vzor-zmluvy-a-pravneho-podania/Franchisingova-zmluva-269-ods-2-Obchodneho-zakonnika.htm>> accessed 25 May 2020.

¹⁸⁹ Jana Burešová, ‘Závislosť vo franchisingu’ (2002) 7 Obchodní právo, 3.

¹⁹⁰ Frolkovic and Biksadsky (n. 174).

¹⁹¹ *Ibid.* See also Andrea Cehláriková, et al. ‘Komentár zákona č. 513/1991 Zb.’ <<https://www.epi.sk/komentovane-ustanovenie/Komentar-k-p-269-zakona-513-1991-Zb.htm>> accessed 31 May 2020.

¹⁹² Commercial Code (n. 5), § 269 (2).

¹⁹³ Patakyova M., et al., *Commercial Code. Commentary.* (C .H. Beck SK, 2016), § 37. See also RELEVANS, ‘Porovnanie požiadaviek na určitost’ predmetu tzv. hlavnej zmluvy pri obchodnoprávnej a občianskoprávnej zmluve o budúcej zmluve’ (2020) <<https://www.epravo.sk/top/clanky/porovnanie-poziadaviek-na-urcitost-predmetu-tzv-hlavnej-zmluvy-pri-obchodnopravnej-a-obcianskopravnej-zmluve-o-buducej-zmluve-4752.html>> accessed 31 May 2020.

¹⁹⁴ Dennis Campbell, *International Franchising* (Kluwer Law International, 2006).

¹⁹⁵ Frolkovic and Biksadsky (n. 174), 4.

Since the franchise agreement in Slovakia is the innominate contract, its form is not regulated. The written form is required only when explicitly demanded by the law or at least by one party during their negotiations.¹⁹⁶ Therefore, parties may enter into a written or oral franchise agreement. However, based on the nature of franchising and the absence of legal regulation it is recommended to conclude the franchise contract in writing.¹⁹⁷

Similarly, as in France and Germany, there is no statutory definition of a franchise in Slovakia. Typically, the definition provided in the European Code of Ethics for Franchising is being used.¹⁹⁸ The Slovak Franchise Association was established in 1994 and it is the only official center for franchising in Slovakia. Its main purpose is to support the development and growth of franchising through its existing members and create the best conditions for franchisors and franchisees.¹⁹⁹ The membership is voluntary. Adopted Code of Ethics should be used as a key guideline for drafting a franchise contract. Even though this code concerns only the members of the association, the importance of this document in Slovakia is growing as a main foundation for the standards to be applied in franchise agreements.²⁰⁰

4.3 The New Amendment to the Slovak Civil Code

In 2020, it has been 56 years since the adoption of the Civil Code. The socio-economic transformations after 1989, especially the transition to the market economy, required changes in the legal system. The year 1989 brought a new impulse to possible recodification of the Civil Code which resulted in an extensive amendment of the Civil Code in 1991 and adoption of the Commercial Code.²⁰¹ Followed by other numerous amendments and unsuccessful preparations of the new wording of the Civil Code, the need for recodification was growing. The mentioned dual regulation of private law considerably obscures the legal regulation and impairs its predictability.²⁰² The plan to remove deficiencies of the Civil Code through very extensive regulation within the Commercial Code turned out to be an absolutely improper legislative strategy.²⁰³ The issue of unification of the law of obligations in Slovakia has been perceived as urgent and desirable for quite some time.²⁰⁴

¹⁹⁶ Commercial Code (n. 5), § 271(2).

¹⁹⁷ If franchise agreement stipulates transfer of rights to industrial property, it must be concluded in writing anyway (§ 508(2) Commercial Code). See also Campbell (n. 191).

¹⁹⁸ EFF (n. 132).

¹⁹⁹ SFA, 'O nás' (2020) <<https://sfa.sk/sk/o-nas>> accessed 25 May 2020.

²⁰⁰ Frolkovic and Biksadsky (n. 174), 6.

²⁰¹ Petr Lavický and Jan Hurdik, *Private Law Reform* (Brno, 1st edition, 2014), 257.

²⁰² Najpravo.sk, 'Vieme, prečo sa nebude prijímať nový Občiansky zákonník' (2018) <<https://www.najpravo.sk/clanky/vieme-preco-sa-nebude-prijimat-novy-obciansky-zakonnik.html>> accessed 25 May 2020.

²⁰³ Jan Lazar, *Otázky kodifikácie súkromného práva*. (Iura Edition, 2006), 9-10.

²⁰⁴ Najpravo.sk (n. 200).

In 2012, the recodification of the Civil Code was reinstated into the government's legislative task frame plan.²⁰⁵ In accordance with the concept of the Legislative Intent,²⁰⁶ the monist model of the law comprising also commercial obligations was considered as more suitable.²⁰⁷

However, the current draft amendment to the Civil Code is only the first partial implementation of the new Civil Code. Based on the careful evaluation of historical traditions, domestic and foreign experience in this matter, mostly the Czech experience, the government is now formally proposing "only" an amendment to the current Civil Code, not an entirely new Civil Code.²⁰⁸ The Commercial Code will be still maintained, but with the modified material scope and new regulation of some types of contracts which are very common in practice, but their legal regulation is currently lacking. Such contracts are a leasing contract, an electronic services contract, and a franchise contract.²⁰⁹

4.3.1 Franchise contract as a nominate contract

Under Slovak legislation, the legal relationship between the franchisor and the franchisee has never been regulated as a nominate type of contract. The proposed legislation takes into consideration of the previous business practice and it also respects the knowledge of relevant franchise associations (for example International Franchise Association). All proposed franchise provisions are of a mandatory nature.²¹⁰

According to the new draft amendment by a franchise contract, one person (the franchisor) undertakes to grant to another person (the franchisee) a set of rights and information which belong to the franchisor to carry out business activities or due to their nature are intended to serve this purpose. The franchisee undertakes to pay the franchisor a franchise fee. The written form is prescribed for franchise agreements.²¹¹

The franchise agreement will contain provisions on the rights and obligations of both the franchisor and the franchisee. The franchisor is required to provide the franchisee with instructions for the exercise of the rights franchised and to provide assistance related to the franchise.²¹² The franchisor has the right to control the use of the franchise by the franchisee to the extent necessary to protect the franchisor's rights related to the subject of the franchise.²¹³

²⁰⁵ Lavický and Hurdik (n. 198) 258.

²⁰⁶ Legislative Intent of the Civil Code published in Annex to the journal *Justičná revue* vol. 8-9/2002.

²⁰⁷ *Ibid.* 14.

²⁰⁸ *Ibid.*

²⁰⁹ Explanatory report to the amendment to the Civil Code, 4.

²¹⁰ *Ibid.*, 99.

²¹¹ Draft (n. 6), § 334.

²¹² *Ibid.* § 335.

²¹³ *Ibid.* § 336.

The newly proposed provisions also regulate the obligations of the franchisee in relation to the use of the franchise. The franchisee is required to use it in good faith and follow the franchisor's instructions related to the quality of the goods and/or services. These provisions are mandatory in the sense that they cannot be excluded from the contract, but the parties can determine the required level of quality of goods and/or services.²¹⁴

Termination of the franchise contract does not have any special regulations. The general rules set forth in the Commercial Code apply.²¹⁵ Franchise agreements are usually terminated by their mutual consent or by one of the parties giving notice of termination.²¹⁶

4.3.2 *Pre-contractual disclosure*

The new draft amendment to the Civil Code and its provision of § 58 formally brought into the Slovak law the concept of pre-contractual liability (*culpa in contrahendo*), which contains an element of the disclosure obligation.²¹⁷ Given the fact that there is currently no such provision in the Slovak legislation, the Slovak courts have gradually developed and adopted the general application of this concept based on the provisions of § 415 and § 420 (general liability for damage) of the current Civil Code, namely on the basis of already rich Czech case law in this direction.²¹⁸ That is why it is not surprising that the inspiration to incorporate this provision to the Civil Code was taken mostly from the new Czech Civil Code (§ 1728).²¹⁹ This provision sets out the following general rules:

- parties are entitled to hold talks freely and they are not liable when the contract is not concluded,
- if a party dishonestly starts or continues to negotiate the conclusion of a contract, it shall be liable for any damage caused to the other party.²²⁰

As we can see, these rules are general and broad and we will see in the near future how courts will deal with its application.²²¹ Other than this, there are no special provisions that deal with the formal requirements for pre-contractual disclosure information concerning specifically the franchise contracts. As we can see from both the current Slovak legislation and proposed changes to the Civil Code, Slovak law does not require the existence of a special franchise disclosure document before entering into the franchise agreement.²²²

²¹⁴ *Ibid.* § 339.

²¹⁵ *Ibid.* § 342.

²¹⁶ Chloupek (n. 175).

²¹⁷ Draft (n. 6), § 58.

²¹⁸ Petra Baňáková, 'Predzmluvná zodpovednosť - Culpa in contrahendo' (2019).

<<https://www.epravo.sk/top/clanky/predzmluvna-zodpovednost-culpa-in-contrahendo-4423.html>> accessed 30 May 2020.

²¹⁹ Explanatory report (n. 209), 11.

²²⁰ Draft (n. 6), § 58.

²²¹ Chloupek (n. 175).

²²² Robert Nešpůrek, Ivan Rámeš, and Tereza Ditrychová, 'Domestic and international franchising, master franchising, and regulation of franchise agreements in Czech Republic: overview' (2018) <[https://uk.practicallaw.thomsonreuters.com/9-632-3990?transitionType=Default&contextData=\(sc.Default\)&firstPage=true&bhcp=1](https://uk.practicallaw.thomsonreuters.com/9-632-3990?transitionType=Default&contextData=(sc.Default)&firstPage=true&bhcp=1)> accessed 29 May 2020.

It is common in practice that franchisor voluntarily provides the future franchisee with the pre-contractual information which is essential for the franchisee to make a deliberate choice whether or not to sign the franchise contract, and therefore enter into the franchisor's franchise network.²²³ Even though the European Code of Ethics and its principles of good faith and fair business are reflected in the current Slovak legislation, the franchisee is recommended to conduct his own due diligence for his own protection.²²⁴ This is strongly advised also because the franchisee, as a weaker party to the franchise contract, is neither covered nor benefits from consumer protection laws. According to the European Court of Justice's judgment in *Francesco Benincasa v. Dentalkit Srl*,²²⁵ contracts that are commercial or relate to professional activity are not protected by these laws. However, it is important to note that franchise in Europe is not exclusively B2B (business-to-business franchises), and some member states may provide more extensive protection to the franchisee, thus apply consumer law protections. For example, Germany can apply consumer protection laws in cases when transaction is not linked to business or professional activity and franchisee is considered to be a "founder."²²⁶ Something similar applies in France if the franchisee is viewed as a "non-professional."²²⁷

²²³ *Ibid.*

²²⁴ *Ibid.*

²²⁵ Case C-269/95 *Francesco Benincasa v. Dentalkit Srl*. [1997] ECR I-03767.

²²⁶ Perez Alati Grondona Benites Arntsen and Martinez De Hoz 'Consumer Protection' (Lexology, 2020) <<https://www.lexology.com/library/detail.aspx?g=273d1195-278d-4cdf-b2ec-6cd8524a4d35&filterId=dcc5bb9c-bf76-4779-8939-9af8014cde20>> accessed 29 May 2020.

²²⁷ *Ibid.*

CONCLUSION AND RECOMMENDATIONS

In conclusion, it can be summarized that each jurisdiction has its own set of rules that regulate the franchise. Some similarities can be found in connection to the requirement of pre-contractual disclosure to protect the potential franchisee from franchisor's opportunism. However, each of these systems has its own idiosyncrasies that make them slightly different from each other.

As we can see from the United States' model, there is no doubt that regulation in franchising is needed. If there is no regulation, the possibility of power abuse and overreach by the franchisor is much higher. While the regulation on both the federal and state levels can provide wide-ranging protections to the franchisees, it may also seem as duplicative. Also, the protection of the state laws is not the same and each state has its own nuances which do not contribute to the uniformity.

When assessing whether the US model would be appropriate for Slovakia, we have to take into consideration the fact that the United States has a lot of experience in the area of franchise and it treats the franchise regulation more in-depth than the civil law countries where comprehensive regulation is lacking in many of them. Franchising has been present in Slovakia only since the 1990s and it is considered to be the "*new kid on the block*"²²⁸ trying to find its place not only in Slovak but also in many other European legal systems. A desire of the civil law countries to have everything codified may actually be what is tying our hands when it comes to franchise regulation.

As previously stated, the United States is the first country to regulate the franchise. Its regulation of franchising is primarily established to prevent the abuses of the franchisor. The main feature is to protect the franchisee *ex ante* through the pre-sale disclosure as stated in the FTC Rule. As for the additional ex-ante protections of the franchisees,²²⁹ many states have extra disclosure, registration, and/or notice requirements. Those requirements may be stricter than the ones in the FTC Rule and they can result in franchisor making additional disclosures and complying with other formalities.²³⁰ I believe that the uniform set of rules for the pre-sale disclosure would be much efficient because it would cause fewer problems for the franchisors who have to comply with different disclosure requirements in different states. This burden of red tape causes franchisors additional financial and administrative burdens. Given the fact that Slovakia is not a federation, it can take the "best of both worlds" in finding the proper balance to protect the franchisee while at the same time not to heavily burden the franchisor with various state laws' requirements. However, since the franchisee is the weaker party, I would recommend

²²⁸ Patrick Mayock, 'Big Brands Playing the Growth Game in Europe' (2014) HOTEL NEWS NOW <<http://www.hotelnewsnow.com/Articles/24552/Big-brands-playing-the-growth-game-in-Europe>> accessed 23 March 2020. See also Tajti, 'Franchise' (n. 25) 259.

²²⁹ Tajti, *Systemic* (n. 75) 72.

²³⁰ 16 C.F.R. § 436.10. See also Gandhi (n. 60) 9.

Slovakia put more emphasis on the protection of inexperienced franchisees from possible opportunism and power abuse by the franchisors.

The United States' multi-level disclosure requirements clearly demonstrate that legislators focus on assisting the franchisees considering the franchisor's power and information advantage he has over them. The usual franchisee is typically inexperienced with limited resources and knowledge about the business while the franchisor has the main bargaining positions and drafts the franchise agreement with proper legal assistance. Inequality of economic resources, knowledge, size of the parties, the information they possess and disparities in legal representation are contributing factors to the franchise asymmetry which is recognized in the US. Based on this, the registration and disclosure states play an active role in assisting the franchisor and the franchisee. The state examiners review the franchisor's application and may require changes to the FDD. Not abiding by these laws may result in fines for the franchisors which can be also seen as another level of protection towards the franchisees.

In comparison, under current Slovak legislation the pre-disclosure requirement is absent. The legislators tried to cure this issue by adopting the general concept of pre-contractual liability in the new draft amendment to the Civil Code. Though, there are no special requirements concerning specifically the franchise contracts. Also, pre-contractual disclosure was not made mandatory for the franchisors which may be seen as a downside of the proposed legislation. The United States with its model of the most detailed pre-contractual disclosure in the world clearly supports the view that mandatory disclosure can increase the protection of the potential franchisees.²³¹ Based on the United States' regulations, more comprehensive franchise legislation would be more suitable in Slovakia as well. Appropriate disclosure requirements could reduce some risks of pre-contractual misrepresentation and ensure more adequate protection for the franchisees.

Also, it would be advisable for Slovakia to follow the relationship laws which regulate other important aspects of the franchisor-franchisee relationship, such as unjust termination of the contract, renewal of the contract, transfer of franchise and encroachment by the franchisor, irrespective of the expressed provisions in the contract to provide the franchisee with further protection.

When we look at the European continent, notwithstanding the lack of franchise-specific regulations, it is worth looking at the French and German approaches towards franchising. As both France and Germany are civil law countries, it is easier to find some similarities between their franchise strategies and the Slovak one. All three countries share the franchise definition of the European Code of Ethics

²³¹ Mark Abell, *The Law and Regulation of Franchising in the EU* (Cheltenham, UK and Northampton, MA, USA: Edward Elgar Publishing, 2013), 233.

for Franchising which is partly recognized by their courts as well. Even though franchise business is really popular in Europe and the number of franchise systems has been rising annually, it can be concluded that in comparison to the US, the franchise regulation and case law in these countries is still not as developed as it is on the American continent.

Also, because of the lack of franchise-specific regulation, the parties concluding the franchise contract in the civil law system countries usually resort to the general provisions of the contract law, consumer law and commercial law to form some kind of analogy to other types of contract.²³² This is the situation under current Slovak regulations as well. However, the absence of franchise-specific regulation may be considered as one of the downsides of these systems because while in some circumstances these general provisions may be suitable to deal with the problematic situation, it might not be in franchise-specific matters.

In conclusion, as a matter of franchise regulations, the current Slovak approach, and the recently proposed draft to regulate the franchise contract are not sufficient enough. The more in-depth regulation of franchise contract would be desired with the focus on the franchise asymmetry which should be included in proposed franchise regulation. The stronger position of the franchisor is inherent in franchise agreement but it should be tolerated only to the extent necessary to protect his know-how, reputation, and other related rights. Also, the pre-contractual disclosure based on the American model would be welcomed in Slovakia, based on the fact that proper disclosure could ensure a higher level of protection for the franchisees and would make franchisor more accountable for possible misrepresentations made during the sale process. To add another level of protection for the franchisee, more detailed regulation of the franchisor-franchisee relationship should be passed based on the model of the US relationship laws. These provisions would not necessarily have to be part of a separate legal instrument. In my opinion, the proposed structure in the new draft amendment would be sufficient if necessary adjustments to make provisions more thorough to reflect the specific nature of franchise-related issues would be made. In regard to franchise associations, their impact is visible in European countries and can clearly strengthen the franchisee's position. That is the main reason why I would suggest, in addition to the previous recommendations, to make the membership in the Slovak Franchise Association mandatory.

Only time will show what affects will the newly proposed provisions have on franchising in Slovakia. Slovakia's market conditions for franchising are promising and there is a potential for growth. However, Slovakia has to keep up with the countries which have mastered the franchise regulation (or at least came as close as possible to it) in order to attract the foreign investors, offer a higher level of protection to the franchisees, and therefore create new jobs and boost its economy.

²³² Fromm (n. 158).

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