Revisiting the franchise contract

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Abstract

Commercial distribution corresponds, in the economic process, to the activity of intermediation between supply and demand, through which the producer, using intermediaries, manages to deliver products and services to consumers, while at the same time seeks to know and satisfy the demands of the latter. Within the industrial revolution, mechanization combined with new production techniques, allowed production directed towards self-consumption to be replaced by surplus production, on a large scale, which created the need to dispose of goods. With the advent of industrial capitalism, the industrial enterprise started to assume the central role of the economic system, with trade being relegated to a secondary role. The producers, in view of the surpluses resulting from mass production, began to feel the need to resort to intermediaries who would assume the distribution of the products in several markets, namely, in distant markets. Distribution gradually begins to become independent from the production, presenting itself as an auxiliary activity for the industry. In this sense, commercial distribution is no longer centred on the physical distribution of products, but takes on a series of activities aimed at adjusting supply to demand, which includes attracting customers, providing after-sales services, financing and risk-taking, consultancy, promotion and advertising, among others. These activities are articulated in more or less complex processes. Thus, distribution begins to represent the main means to increase the company's profits, becoming the object of study and deepening. However, given the insufficiency of the occasional purchase and sale contracts to cover the web of intricate obligations required in the distribution of goods to the various operators of a distribution chain, leading to an undesirable increase in distribution costs, there was a need to create more sophisticated contractual schemes. In contracts, such as franchising, it is possible to witness the productive integration of the distributor into the producer network, accompanied, in different degrees of intensity, by the attribution and recognition of intellectual property rights. This contract was associated, both in the United States, a country where it first appeared, and in Europe, to periods of economic recession, in which excess supply in face of demand will compel producers to conquer new markets. This objective, owing to the difficulties of the producer to assume the distribution of the products, given the lack of capital, characteristic of post-recessive times, will be achieved through the delivery of the distributive function to the distributor, thus seeking, in accordance with the principle of division of labour, achieve greater efficiency. The crisis currently experienced worldwide following the Pandemic COVD 19 and the role that this contract can play in the economic recovery, makes it imperative to revisit this contract in order to approach its modalities, advantages and the legal framework.

Keywords: *franchising, distribution, franchise, contract.*

JEL Classification: K22, K23, K33

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1. Introduction

The franchising is associated both in the United States, where the system first appeared, and in Europe, with periods of economic recession, when excess supply over demand will force producers to conquer new markets. This objective, given the lack of capital, characteristic of post-recessive periods, for the producer to take on the distribution of the products, will be achieved by delivering the distribution function to the distributor, thus seeking, in accordance with the principle of the division of labour, to achieve greater efficiency[2].

[2] Aldo Frignani, *Il franchising di fronte all´ordinamento italiano: spunti per un´indagine comparatistica*, "Factoring, leasing, franchising, venture capital, leveraged buy-out, hardship clause, countertrade, cash and carry, merchandising, know–how, securization," G. Giappichelli Editore, Torino, 1996, p. 206, Esperanza Gallego Sanchez, *La franquicia*, Trivium, Madrid, 1991, pp. 19 ff. The first manifestation of this phenomenon will appear in the middle of the 19th century, the first known contract being that of the *Singer Sewing Machine Company* which some authors, such as Gallego Sanchez, *La franquicia*, cit. p. 22, date from 1892 and others around 1850 and 1870, such as Miguel Gorjão–Henriques da Cunha, *Da Restrição da Concorrência na Comunidade Europeia à Franquia da Distribuição*, Almedina, Coimbra, 1998, pp. 227, 543 and Isabel Alexandre, *O contrato de franquia, O Direito*, Lisboa, a.123 n.2-3 (Abr.-Set 1991), p. 324, dictated by the impossibility for East Coast industrialists to expand their activities to the West and South of the country, through direct action and with their own capital. At the beginning of the 20th century this formula was exploited by the automobile sector, General Motors, Ford, Western Auto and the oil sector in the dissemination of petrol pumps. It is not by chance that these two sectors stand out raising the attention of US *antitrust* legislation. The pharmaceutical market, Rexall Drugstores, soft drink producers such as Coca Cola, Pepsi, and, in 1940, in the catering sector, Kentucky Fried Chicken, also adopted these contracts to expand. It will be, however, in the 1950s, in the post-World War II period, that *franchising* will reach its peak, as a result of the willingness of demobilized soldiers with some equity to invest and the expansion plans of small and medium-sized enterprises, strangled by a lack of liquidity. It will therefore extend to various production and service areas, including *McDonald's, Baskin-Robbins, Holiday Inn, Roto-Rooter, Dunkin Donuts, McDonald's, Burger King, H&R Block, Lee Myles, Midas, 7-Eleven, Dunhill Personnel, Wendy's, Pearle Vision Center, Dairy Queen, Sheraton, Arthur Murray Dance Studios, Duraclean carpet cleaning services, Howard Johnson Motor Lodge.* Cfr. Aldo Frignani, *Il franchising di fronte*, cit, p. 206, *idem*, *Nuove riflessioni in tema di franchising, cit., p.* 268, Gallego Sanchez, *La franquicia*, cit., p. 20. In this sense, Roberto Pardolesi, *I Contratti di distribuzione*, Jovene, Napoli, 1979, p. 185, n. 262, identifies the *product and service franchise*, considering that it may arise between producer and retailer, concerning the point of sale, a department or a type of product; between producer and wholesaler (alcoholic beverages); between wholesaler and retailer, with the possibility of horizontal agreements; *franchise* with a trademark licence which includes the trademark license to producers and associations and the trademark license and, finally, the *chain style franchise* which is based on a complete commercial formula and is the protagonist of the expansion witnessed in the 1970s. At that time, the *franchising*, with the exception of *Bata*, a Czechoslovak footwear company and the French *Lainiere de Roubaix*, as Isabel Alexandre notes, *O contrato de franquia*, cit. p. 325, note 13, it was practically unknown in Europe. It will be American companies such as *Avis, Hertz, Coca Cola*, which will initially implement the franchising in Europe. In the 1980s, the saturation of markets in the 1970s will lead several European companies, including *Monoprix, Prisunix, Prenatal, Pronuptia and Benetton*, to make this system commonplace among European companies. On the development of *franchising*, cfr. Aldo Frignani, *Nuove riflessioni in tema di franchising*, cit., pp. 269 ff. *idem*, *Il franchising di fronte*, cit., pp. 206 e ss, Gallego Sanchez, *La franquicia*, cit., pp. 19 ff., Fabio Bortolotti, *Il contratto di franchising. La nuova legge sull´affiliazione commerciale. Le norme antitrust europee*, Cedam, 2004, pp. 2 e ss. Between us, Pinto Monteiro, *Contratos de*

The concept of a franchise agreement implemented in Europe does not correspond to the simple transposition of the American example, assuming the contours dictated by the profile of the parties, the demands of the markets and consumer preferences[3].

However, on both continents, modern *franchising* presents itself as a strategy of commercial expansion, a technique of dominating foreign markets, through the creation and control of distribution channels, making risk management possible.

As demonstrated by the various arrangements that this contract has adopted in Europe and the United States, it cannot be reduced to a mere distribution technique, since it also translates into a way for the franchisor to exploit an idea or formula that has enabled the trademark to guarantee its commercial success, and for the franchisee, with investment savings and legal independence, to be able to enjoy the commercial success and *know-how of* others[4].

Distribuição Comercial, Almedina, Coimbra, 2002, pp. 12 ff, Miguel Gorjão–Henriques, *Da restrição da concorrência na comunidade Europeia: a franquia de distribuição*, cit. pp. 225 ff, Maria de Fátima Ribeiro, *O contrato de franquia*, cit., pp. 12 ff, Miguel Pestana de Vasconcelos, *O contrato de franquia*, cit., pp. 11 ff, Isabel Alexandre, *O contrato de franquia*, cit., pp. 323 ff.

[3] In this sense, Aldo Frignani, *Nuove riflessioni in tema di franchising*, cit., p. 271, points to two psychological differences which distinguish the European franchising from the American franchising: the American franchisee values in the franchise the possibility of being an independent worker, with easy profit, whereas the European franchisee focuses on reducing risk; this aversion to risk also explains why the European franchisee prefers, unlike the American franchisee, to pay higher *royalties* during the contract rather than a high entry, from which literature extracts the European franchisee's desire to receive the assistance of the franchisor during the term of the contract. As Leloup *La franchise, Droit et pratique,* 4.ª ed, Delmas, Paris, 2004, p. 10, *franchising* becomes a financial product, and there are franchisors who buy it back from the most successful franchisees in order to reinvest it in new franchises; franchisees who speculate on the stock exchange in the value of the shares of the franchising company; financial companies invest in the quality of the main franchisee. In addition to these psychological differences, functional differences lie in the fact that in the United States the franchise contract is an alternative to large-scale distribution, while in Europe it is the major distribution chains that begin to use *franchising to* expand and enter hard-to-conquer markets. Cfr. Aldo Frignani, *Il franshising di fronte*, cit., p. 208, followed Gallego Sanchez, *La franquicia*, cit., p. 21. From a legal point of view, the *franchise agreement* will adapt to the specific characteristics of the various European legal systems, while the American *franchising* has a more general and broad dogmatic construction, even including the commercial concession, as opposed to the systematization and conceptualization of European *civil law* literature. In this sense, Aldo Frignani, *Il franchising di fronte*, cit., p. 207, *idem*, *Il contratto di franchising. La nuova legge sull´affiliazione commerciale*, G. Giappichelli Editore, Torino, 2004, p. 3, *idem*, *Nuove riflessioni in tema di franchising*, cit., p. 273, Santini, *Commercio e servizi*, cit., p. 180, n.º 182, Pardolesi, *I contratti di distribuzione*, cit., p. 184, note 362, which states that, since American *franchising* corresponds to the global commercial agreement by which the franchisor grants the franchisee the trademark licence and the use of the trademark , communicating to the franchisee the *know-how*, binding him to the obligation of secrecy, providing him with details and guidance on how to manage the point of sale, it covers practically all distribution contracts. Similarly, Leloup, *La franchise en Amérique du Nord*, Cahiers de Droit de l´Entreprise, Supplément Distribution, 1979, n. º 2, pp. 8 ff.

[4] In this sense, Santini, *Commercio e Servizi*, cit., p. 178, defined *franchising* as a *"marketing of ideas"*. Among us, Maria de Fátima Ribeiro, *O contrato de franquia*, cit., p. 18, emphasizes that the franchisor was initially not guided by the need to sell products, but rather wanted to take advantage

The object of this study is the distribution franchising, a method which is characterized by the franchisee selling the products of the franchisor's trademark in his establishment under his distinctive signs.

In this traditional form of franchise contract, which some literature corresponds to the American *product franchise*[5], the establishment of the franchisee is simply a channel through which the products of the franchisor's trademark reach the consumer. Within this category, it is possible to distinguish between the distribution franchise, which exists between producer and retailer when the former produces the goods, making them distributed by the franchise network, a very popular model in the textile sector, and the distribution franchise, quite common in the food sector, performed by the wholesaler and retailer, where the franchisor acquires a set of products which are then distributed, through the franchise contract, by a set of resellers. Furthermore, a distinction is often made between wholesale and retail franchising, in the former variant consumers of the franchisee's products or services are wholesalers, while in the latter the franchisee's business is targeted at consumers[6].

In the service franchising, the franchisee, instead of selling goods, offers services under the insignia, trade name or trademark of the franchisor and following his instructions. It is very popular in restaurants, hotels, dry-cleaning, hairdressing and car rental[7]. The latter is one of the most widespread, given the relatively low cost of investment required to the franchisee.

In the production or industrial franchise, it is the franchisee himself who

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of his trademark reputation. Maria de Fátima Ribeiro, *cited above*, pp. 18-19, 153-154, identifies the commercial formula as 'the licence of the trademark image', which considers to be composed of the franchisor's know-how and non-secret technical knowledge. In our opinion, it is more appropriate to the franchise contract, the extent of the *commercial* expression, which includes the trademark, the trademark image, patents, insignia and know-how. In this sense, Pinto Monteiro, *Contrato de agência, concessão e de franquia (franchising)*, cit., p. 321, *idem, Contratos de distribuição*, cit., p. 120, Zuddas, *Somministrazione, Concessione di vendita, Franchising*, Giappichelli Editore, Torino, 2003, pp. 278-279, refers to the existence of an image license in a sense that seems quite close to the commercial image, which defines as the ability to offer consumers a line of products or services as their own, but identified with the main company. In this paper, we follow closely, Frignani, *Il contratto di franchising*, cit., pp. 116 and 143, when we consider the commercial image as an added value resulting from coordinated franchising and franchising work in the application of the methods on which the network is built, including the use of know-how. The commercial image of the network is, for the author, the main element of value of the network and the main source of its expansion.

[5] Cfr. Gallego Sanchez, *La franquicia*, cit., p. 41, Menezes Cordeiro, *Do contrato de franquia*, cit. p. 69, nota 16. Carlos Olavo, *O contrato de franchising*, Novas perspectivas do Direito Comercial, Almedina, 1988, pp. 163-164.

[6] Cfr. Gallego Sanchez, *La franquicia*, cit., p. 41.

[7] This is the case with *Mcdonald´s, Pizza Hut, KFC, Burger King, 5 à sec, Press to, Novotel, Holiday Inn, Avis, Sixt, Hertz, Wallstreet, Mod´s hair, Century 21, Laforêt immobilier, Pronuptia, Benetton*, LeLoup, *La franchise*, cit., pp. 28-29, distinguishes in the service franchising those which require a high investment, such as the hotel, restaurant and car rental business, from those which require a lower investment, such as the services provided in the area of hairdressing, repair and laundry services and medical, teaching and affective counselling services, examples of which are the matrimonial agencies. The decrease in initial investment corresponds to an increase in the degree of specialization, with a greater reliance on know-how and technical assistance.

manufactures, according to the instructions of the franchisor, the products he sells under his trademark[8].

This is the Community classification, upheld by the Court of Justice of the European Communities in 1986 in the *Pronunptia* case, which has since been upheld by literature and enshrined in Commission Regulation No. 4087/88[9].

[8] It is therefore accompanied by the trademark license and, as a rule, the know-how and patent license, so that the franchisee can produce the goods to which the contract relates. Examples are Coca Cola, Pepsi–Cola, Yoplait. Leloup, *La franchise*, cit., p. 32, suggests the term production and marketing *franchise*, given that the franchisee undertakes these two activities. Some authors prefer the term production franchise, since industrial franchise is one of the subdivisions of this method, together with craft and agricultural franchise. Cfr. Leloup, *La franchise*, cit., p. 31. As Gallego Sanchez, *La franquicia*, cit., p. 42, the use of this method may, among other things, enable the franchisor to invest in technology and research instead of production units or simply avoid transport costs by setting up production units in strategic locations. In this sense, Maria de Fátima Ribeiro, *O contrato de franquia*, cit., p. 213, states that it is a modality widely used in international trade where transport costs are, as a rule, uncompetitive.

[9] Cfr. Canaris, *Handelsrecht*, cit., p. 380, Baldi, Venezia, *Il contratto di agenzia*, cit., pp. 151 ff, Zuddas, *Somminstrazione*, cit., p. 293 ff., Paulo Cendon, *I contratti nuovi*, cit., pp. 414 ff., Leloup, *La franchise*, cit., pp. 27 and ff, Gallego Sanchez, *La franquicia*, cit., pp.41 ff., Ricardo Alonso Soto, *Los contratos de distribucion mercantil*, cit., pp. 204 ff, Marisa Amoroso, *Gli aspetti di marketing*, cit., pp. 8-14. Among us, Pinto Monteiro, *Contratos de distribuição comercial*, cit., pp. 123-214, Menezes Cordeiro, *Manual de Direito comercial*, Vol. I, cit., p. 517. Maria de Fátima Ribeiro, *O contrato de franquia*, cit., pp. 212 ff, Isabel Alexandre, *O contrato de franquia*, cit., pp. 351 ff., Carlos Olavo, *O contrato de franchising*, Novas perspectivas do Direito Comercial, cit., p. 163, Gorjão-Henriques, *Da restrição da concorrência*, cit., pp. 279 ff., Pestana Vasconcelos, *O contrato de franquia*, cit., p. 22. This classification is not without its critics, first of all because, strictly speaking, in all these modalities we find the franchise of services. Franchising differs from other production and distribution contracts by the characteristics of the production and sale of products or provision of services, which, in a franchise network, must be uniform. See Maria de Fátima Ribeiro, *O contrato de franquia*, cit., p. 216. Zanelli, *Il contratto di franchising*, Tratatto di Diritto Privato, diretto da Pietro Rescigno, Vol. 11, Obligazioni e Contratti, Tomo III, UTET, Torino, 1984, pp. 49 ff., only recognizes the need to extend to all the activities of the franchised company the coverage of all the distinctive signs inherent to the organization and company of the franchisee, creating an aggregate network of dealers that both in internal relations and in relations with the public identify the grantor with the dealer. Based on this reasoning, Zanelli identifies the franchise in the strict sense with the *concessione aggregativa* to which he opposes the *concessione distributiva*, *which* includes the sales concession and the manufacturing license, corresponding to the production and distribution franchise, to which the said author does not recognize autonomy, reducing them to the know-how and concession license with a view to disseminating the products through independent centers. The franchise as an *concessione aggregativa* corresponds to the contract by which the franchisor grants the other party the exercise of an activity of production and provision of services, subject to conditions and under the control of the franchisor, with the use of its distinctive signs and other intellectual property rights, such as patents, trademarks, accompanied by the transfer of *know-how and* technical assistance, receiving as consideration the payment of a sum, as a rule made up of a fixed portion (entry fee) and a portion proportional to turnover (royalties). The criticism which may be levelled at this systemization lies in the fact that the products must also be placed on the market with the coverage of all the distinguishing signs of the franchisor, so as to ensure the added value of the establishment of a franchised network, the identification of the members of the network with the franchisor. The "*codice genetico paradigmatico"* that Zanelli, *Il franchising*, cit., p. 889, identifies in the franchise services has to be present in the other modalities. On the other hand, it is increasingly difficult to compartmentalize the sale of goods and the provision of services. This difficulty will be reflected in the classification

2. The franchise contract most common clauses

Before taking a position on the concept of a franchise contract, a task which, given the complexity of the contract and the diversity of its forms, is not easy, we must briefly analyse the most frequent clauses in this contract, since it began to be legally atypical, but socially typical in Europe, based on the already very extensive literature on this contract and on the franchise contracts present in the decisions of the Commission and the Court of Justice[10].

proposed by European Union case law, since the European franchise contract, given its complexity, often includes elements of the franchise of production, distribution and provision of services. One example is catering chains where a service business is involved, but where consumers buy goods, the finished product, such us hamburgers or ice cream. However, Zanelli's doctrinal position has the merit of individualizing the aggregating element of the franchise, that is, the marketing of services. In this regard, Maria de Fátima Ribeiro, *O contrato de franquia*, cit., pp. 218-219. Within the non-Community classifications, it is possible to add the *package franchise, as* opposed to the *product franchise,* a classification adopted by the *Federal Trade Commission*. In the former, the franchisor authorizes the franchisee to develop his business in accordance with his business image, identified with his trademark, manufacturing products or providing services on which the trademark is affixed, while in the latter, it is only a question of granting simple licenses to sell branded products, on an exclusive basis or with other products. The US *franchise package* will correspond to the production and service franchise contracts adopted in most European countries, with the *product franchise* corresponding to the distribution *franchise*. Carlos Olavo, *O contrato de franchising*, Novas perspectivas do Direito Comercial, Almedina, 1988, pp. 163-164. This classification is worthy of criticism, firstly, because, in both cases, the franchisee adopts the business image of the franchisor and because it excludes situations in which the franchisee distributes products which, although supplied by the franchisor, are not manufactured by the franchisor, nor those in which all the products are not supplied by the franchisor. In that regard, Isabel Alexandre, *O contrato de franquia*, cit., p. 350 and Gorjão - Henriques, *Da restrição da concorrência*, cit., p. 274. The German literature, Martinek, Semler, *Handbuch des Vertriebsrecht*, C H Beck, München, 1996, pp. 366-367, qualifies *product franchising* as first generation franchising and *package franchising* with the second generation. The distinction between *business format franchise* and *product distribution franchise* is more relevant in Europe. In the first modality, a contractual relationship is involved, through which the franchisor assumes the obligation to accompany the economic activity of the franchisee in training, assistance and *know-how*, while the franchisee, at his own risk and with the investments at his charge, uses the commercial name and brand of the franchisor, according to his instructions. The *product distribution franchise* corresponds to the granting of authorization by manufacturers of prestigious brands for the sale of their products, normally on an exclusive basis, being provided by the franchisees a complete service, before and after the sale. This method differs from the exclusive distribution system contemplated in Regulation n.º 1983/83, given the greater intervention and control exercised by the franchisor. Gorjão - Henriques, *Da restrição da concorrência*, cit., p. 274. Menezes Cordeiro, *Do contrato de franquia*, cit. p. 69, note 16, identifies the *product franchise* with the *traditional franchise,* making the *business format franchise* the *package franchise,* respectively.

[10] Cfr. in Italian literature, Zuddas, *Somministrazione*, cit., p. 332, Frignani, *Il franchising do fronte all´ordinamento* cit., pp. 210-211, Pinto Monteiro, *Contratos de distribuição*, cit., p. 62, Menezes Cordeiro, *Do contrato de franquia*, cit., p. 76-77, Maria de Fátima Ribeiro, *O contrato de franquia*, cit., p. 140, Pestana Vasconcelos, *O contrato de franquia*, cit, p. 18, Isabel Alexandre, *O contrato de franquia*, cit., p. 372, Gorjão Henriques, Gorjão-Henriques, *Da Restrição da Concorrência na Comunidade Europeia à Franquia da Distribuição*, cit., p. 250. In European Union competition law, Regulation 4087/88 and the Pronuptia Agreement of 28 January 1986, Case 161/84, ECR I-85, stand out. 1986, page 0035, and the Commission decisions of 17 October 1986 concerning

Usually, the franchisor assumes the following obligations: transmission of the right to use the trademark and other distinctive signs, transmission of know-how; territorial exclusivity; provision of technical assistance; obligation to take back stocks, obligation to provide accounting and financial assistance services. The franchisee undertakes the obligation to set up a sales or production outlet, bearing the respective investments; the obligation to use the distinguishing signs and the know-how of the franchisor in the course of business; stock obligation, secrecy obligation, exclusive supply obligation, non-competition obligation, location clause; obligation to pay entry fee and/or royalties; obligation to bear the franchisor's control[11].

In the franchise contract, the franchisee is always granted the right to use the trademark which the franchisor owns, usually accompanied by other distinctive signs such as the trademark and logos. It is unquestionable that the trademark is the distinctive sign that attracts or retains customers, as it is through the trademark that customers identify the product or service in question.

The trademark must, however, already be successfully implemented on the market in general terms, although it does not, of course, need to be implemented on the market where it is to be exploited. Franchise may be exactly the means chosen by the producer to bring the trademark to market. If this happens, it will result in an increase in the consideration to be paid by the franchisee, corresponding to the greater value of the trademark image[12].

The obligation to licence the use of a trademark which has already been implemented on the market is justified by the exploitation of the trademark image which accompanies the franchise agreement, which is not limited to the trademark, but includes all the other distinctive signs of the trade which, although they are not

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Yves Roche, published in the OJ L 8/49 of 10/01/1987; of 17 December 1986 on Pronuptia, published in the OJ No L 13/29, of 15/01/1987 on Computerland, published in the OJ No L222/12, of 10/08/1987, of 14 November 1988 on *Service Master, published in the OJ No L* 332/38, of 3/12/1988; and of 2 December 1988 on Charle Jordan, published in the OJ No L 35/31, of 7/02/1989.On the most frequent clauses, including those most relevant to European Union competition law, cfr. Maria de Fátima Ribeiro, *O contrato de franquia*, cit., pp. 143-144, 157 ff, Pestana Vasconcelos, *O contrato de franquia*, cit, pp. 126 ff, Isabel Alexandre, *O contrato de franquia*, cit., pp. 337 ff., Frignani, *Contributo ad una ricerca sui profili dogmatici del franchising (con particolare riferimento all'Italia)*, "Factoring, Leasing, franchising, Venture capital", cit., pp. 244-245, Joanna Goyder, *EU distribution law*, Hart Publishing, Oxford and Portland, Oregon, 2011, pp. 176 ff.. Even before Regulation 4087/88, the contract remained atypical, cfr. Pestana Vasconcelos, *O contrato de franquia*, cit, p. 18, Gorjão Henriques, *Da Restrição da Concorrência na Comunidade Europeia à Franquia da Distribuição*, cit., pp. 434-435, despite recognising a process of legal typification of the contract. Isabel Alexandre, *O contrato de franquia*, cit., p. 372, however, consideres it typical.

[11] Cfr. Frignani, *Il franchsing di fronte all`ordinamento*, cit., pp. 210-211, Zuddas, *Somministrazione*, cit., p. 314 ff., Paulo Cendon/Bussati, *I contratti nuovi*, cit., pp. 419 ff., Gallego Sanchez, *La franquicia*, cit., pp. 44 ff., Maria de Fátima Ribeiro, *O contrato de franquia*, cit., p. 144, Pestana Vasconcelos, *O contrato de franquia*, cit., pp. 25 ff..

[12] In this sense, Maria de Fátima Ribeiro, *O contrato de franquia*, cit., p. 159.

independently covered by the agreement, are related to it[13].

From a restrictive point of view, the trademark licence is not an essential element of the distribution franchise, but is excluded by an exclusive supply clause which expressly prohibits the franchisee from affixing the trademark to products which are not supplied to him by the franchisor or by suppliers indicated by him, it being understood that the products are, as a rule, already supplied with a trademark. The trademark licence, in this restrictive sense, will be present only in the production franchise, under which the franchisee attaches the trademark to the products he manufactures and markets under the contract[14].

As we have already observed, the franchise contract is guided by the promotion and maintenance of the commercial image of the franchisor, with special focus on the trademark image, which should be common to the whole network.

However, the assignment of the use of the mark is insufficient if it is not accompanied by the transmission of the method of exploitation adopted by the franchisor on the basis of which the trademark achieved notoriety[15].

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[13] This element associated with the reputation of the franchisee forms part of the attractive capital of the franchise, giving rise to the franchisor´s duty to protect the trademark and other distinctive signs, avoiding acts which might adversely affect them and acting against acts of third parties or members of the network which might denigrate them. This obligation justifies the duty of the franchisor to control and monitor the activities of members of the network in order to prevent damage to the franchise, the depreciation of which is reflected not only in the franchisor but also in the franchisees. Therefore, the Commission in the *Guidelines on Vertical Restraints*, point 45 als. d) and e), considers it necessary to cover in the exemption recognized in Regulation No 330/2010 for the protection of licensed intellectual property rights the obligation of the franchisee to inform the franchisor of infringements of those rights, to initiate legal proceedings against infringers or to assist the franchisor in any legal proceedings against infringers.

[14] *See* Carlos Olavo, *O contrato de franchising*, Novas perspectivas do Direito Comercial, cit., p. 166, Oliveira Ascensão, *Direito Comercial*, Vol. II, Direito Industrial, Lisboa, 1994, p. 317, Isabel Alexandre, *O contrato de franquia*, cit., p. 355, Maria de Fátima Ribeiro, *O contrato de franquia*, cit., pp. 164-165, Pestana Vasconcelos, *O contrato de franquia*, p. 40, Gorjão-Henriques, *Da restrição da concorrência*, cit., p. 246, nota 593. In the same sense, Leloup, *La franchise*, cit., p. 32. It is the trademark license, in its broadest design, as a temporary use of the trademark, including all authorizations, which is regarded by American case-law as the cornerstone of the *franchising* system, as decided in *Siegel v. Chicken Delight Inc Chicken Delight Inc*, 448 F. 2d 43 and in *Susser v. Carvel Corporation*, 332 F. 2d 505. It is also in this broader perspective that Frignani, *Nuove reflessioni in tema di franchsing*, cit, 283, considers trademark licencing to be an essential element, although years earlier, *idem*, *Il franchising di fronte*, cit, p. 219, note 46, disagreed with that position in US case-law. It is on the basis of this broader concept that it can be argued that the trademark license will be present in all forms of franchising, cfr. Leloup, *La franchise*, cit., pp. 38-39, 325.The protection of trademark *goodwill* resulting from the trademark license is one of the arguments used by franchisors, under competition law, to legitimize *tying agreements, i.e.* contracts in which one party sells another a certain product (*tying product),* but on condition that the buyer acquires another product (*tied product),* creating what is called a *positive tie* or not acquiring the product from another supplier, which is called a *negative tie*, which accompany franchising contracts.

[15] According to Virassimy, *Les contrats de dependence*, cit, p. 83-84, following Saint Alary, *Le contrat de franchise*, cit., p. 83, the operating method that the franchisor will transmit to the franchisee must correspond to an already proven method, in order to guarantee the franchisee a

In that regard, the transfer of know-how, which was at the origin of the trademark reputation, is essential. The exploitation of the mark, without the *know-how* which made it well-known to the public, would make it difficult to have a common image on the network and would also make it possible to verify conduct likely to harm the network, with a direct impact both on the commercial results of the franchisees and on the value of the successful franchisor's formula[16].

In the franchise contract, the franchisor will give the knowledge necessary for the franchisee to autonomously repeat his successful experience in order to achieve the same results in his own market. It is the know-how transmitted by the franchisor that will allow the franchisee to try to repeat his commercial success[17].

The franchise contract, without the transfer of know-how, would be reduced to a simple license to use or exploit a distinctive sign.

The transfer of know-how verified in the context of the franchise contract has been classified by literature as a genuine know-how license, whereby the franchisor transmits to the franchisee an industrial secret, in the sense already sustained, allowing the latter to exploit it for a limited period in return for the payment of a price by the licensee[18].

The franchise contract is not, however, limited to a licence of know-how, since it comprises other essential elements: the license to use the trade mark (and

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minimum normal success, observing the franchisor's instructions, thus justifying the payment of the *entry fee* and *royalties.* In that regard, for the purposes of assessing the success of the commercial formula, the three-two rules were advocated, that is to say, the franchisor should have had three pilot establishments in operation for at least two years in order to ensure that there was no question of a false franchise. Cfr. Gorjão-Henriques, *Da restrição*, cit., p. 324.

[16] Cfr. Virassimy, *Les contrats de dependence*, cit, p. 83-84, following Saint Alary, *Le contrat de franchise*, cit., p. 83, it demands that the know-how transmitted must be reliable, as it is faithful repetition that allows to obtain a minimum quality standard in all points of the network. The most rigorous classification of know-how is by Massageur Fuentes, *Los secretos industriales y comerciales y su trasmissión: régimen juridico*, Estudios sobre marcas, Navarro Chinchilla/Vasquez Garcia (coord), Comares, Granada, 1995, p. 188, which identifies *know-how* with business secrets that it defines as secret knowledge referring indistinctly to the industrial or commercial field, including the organizational aspects of the company. This category includes commercial and industrial secrets. The secrecy of *know-how* is not, however, an absolute value, but must be measured in relative terms. This flexibility is justified by the fact that there is knowledge which is not secret in certain technological assets, but which can be a real novelty for others, who gain a competitive advantage by acquiring it.

[17] Bessis, *Le contrat de Franchise*, LGDJ, Paris, 1990, p. 34. Maria de Fátima Ribeiro, *O contrato de franquia*, cit., p. 170, points out that, while it is true that the franchisor must transmit the know-how necessary for the repetition of the success of the establishment, it is no longer required to transmit the know-how necessary for the repetition of the success of the business. Franchisor must be allowed not to give its franchisees the capacity to enter into a franchise contract or create their own network.

[18] Commission Regulation (CE) n.º 772/2004 of 7 April 2004 on the application of Article 81, n.º 3 of the Treaty to categories of technology transfer agreements recognizes the condition of intangible property that is necessary for it to be licensed. The know-how licence is a contract whereby one of the parties (licensor), owner of a business secret, authorises another (licensee) to exploit it for a certain time or not, in return for a certain price. Cfr. Massaguer Fuentes, *Los secretos industriales y comerciales y su transmissión: régimen jurídico.* "Estúdios sobre sobre marcas", Navarro, Vasquez (coord), Granada, 1995, p. 209.

possibly other distinctive signs) and the provision of technical assistance.

The franchise contract concerns instrumental know-how in relation to the network's trademark image. However, in the know-how license the licensee does not become part of a commercial chain created by the licensor, nor is he subject to instructions, control or teaching by the licensor. The know-how licence in the franchise contract has to be framed in a mixed contract, in which it is accompanied by the license or assignment of other rights over intangible property (patents, trademarks, models and designs, copyright) or the provision of services.

Technical assistance from the franchisor is an essential feature of the franchise agreement, not only for the duration of the contract, but also before the start of business, in particular by carrying out market and profitability studies, as well as selecting the location of the point of sale.

The franchise's first duty is to carry out the activity covered by the franchise agreement, using the distinguishing signs of the franchisor and exploiting the know-how transmitted by him, in accordance with his instructions.

That obligation is essential if the main objectives of the franchisor are to be achieved with that contract: the expansion of the business and of the trademark image, it being understood that, in view of the fact that a network system is at issue, its failure not only damages the franchisee, but also the other elements of the network[19].

The franchisee must pay a counterpart, which is divided into two categories: the *initial fee* (*initial fee*, *droit d´éntreé*) and the periodic instalments (*royalties*), in some cases payable on a cumulative basis and in other alternatives. The periodic instalments normally correspond to a percentage of turnovers in the period to which they relate, even if a minimum value is set[20].

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[19] As Maria de Fátima Ribeiro, *O contrato de franquia*, cit., p. 183, this obligation is often absent from European Union Law, although in Regulation n.º 4087/88 it was implicit in the obligation to apply the commercial methods designed by the franchisor and to use the industrial property rights that are the object of the licence, observing the rules of the franchisor regarding the equipment and presentation of the premises and/or means of transport, provided for in Article 3.º, al. f) e g) of the nº 2. Otherwise the behavior of the franchisee that devalues the brand image and the network will be ground for termination of the contract.

[20] As we have already observed, in the United States an *initial fee* tends to be charged higher, while in Europe there is a tendency to pay higher *royalties*, explained by the franchisee's attitude towards the risk, the franchisor's assistance and the degree of autonomy. Cfr. Mauro Bussati, Paulo Cendon, *I contratti nuovi*, cit., p. 423, Gallego Sanchez, *La franquicia*, cit, p. 22, Fauceglia, *Il franchising*, cit., 189, Frignani, *Nuove riflessioni in tema di franchising, "*Factoring, leasing, franchising, venture capital, leveraged buy-out, hardship clause, countertrade, cash and carry, merchandising, know–how, securization," cit., p. 271, *idem*, Franchising, "Dizionario del Diritto privato", a cura de Natalino Irti, Carnevali, Diritto commerciale e industriale, Giuffré Editore, Milano, 1980, p. 524. The *royalties* may, in some cases, correspond to a fixed amount, as noted by Leloup, *Le franchise*, cit., p. 148. Remuneration has been regarded as an essential element of the franchise contract under European Union law, and to a large extent under European and American case law. However, some authors, De Nova, *I contratti nuovi*, UTET, 1990, p. 152, admit that the contracts do not provide for any kind of remuneration. The Benetton contracts, in which no remuneration was fixed, have given rise to a number of case-law decisions in one direction and another in Europe and the United States, as La Placa, *Contributo alla ricerca dei confini giuridici del*

The initial service has normally been understood as consideration for the trademark license and/or the right to use other distinguishing marks, transmission of know-how and technical assistance initially provided, which constitute the successful formula which is the subject of the franchise contract[21].

This contract, aware of the need to protect the commercial image of the franchisor, on which, as we have seen, the network is based, is also characterized by the strong and intense interference of the franchisor in the activity of the franchisee, who must comply with the indications given to him and to accept the control and supervision by the franchisor, in areas ranging from the internal organization, which includes the financial, administrative and accounting areas, to production and sales methods, *marketing*, *merchandising* and after-sales assistance[22].

Control and supervision can be exercised upstream, by standardizing the franchisee's behaviour in guides of conduct, centralizing decisions in the franchisor, and downstream, with inspections and audits.

The exercise of control over the activities of franchisees is not only a right, but a power-duty, since it is intended to ensure the uniformity and homogeneity of the network, while safeguarding the attractive capital of the business image on which the contract is based. The lack of control and the inertia of the franchisor in the face of conduct which in any way jeopardize the network not only harm the franchisor, but also the other franchisees, constituting a breach of contract by the franchisor.

The franchise contract is normally accompanied by a location clause, whereby the establishment can only be transferred with the franchisor's consent. The criteria for choosing the location include the know-how, as the business image of the franchisor is inseparable from the location and type of establishment where

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contratto di franchising, Giur. It. 1991, I, 2, pp. 197 ff. Italy has always been more receptive to the qualification of the contract as a franchise regardless of this provision, despite the contrary opinion of the literature, as stated by La Placa, *Contributo alla ricerca dei confini giuridici del contratto di franchising*, p. 198. Italian case-law accepted the existence of indirect retribution, the determination of which is left to the discretion of the parties. This idea was accepted by literature which often refers to the existence of hidden payments, masked by an increase in the prices of products or services sold by the franchisor to the franchisee. In this regard, Frignani, *Franchising*, cit., p. 317, idem, *Un 'nome' al contratto tra Benetton e rivenditori*, nota a Trib. Lecce 9 febbraio 1990, Giur. It., 1991, I, 2, p. 733, La Placa, *Contributi alla ricerca dei confini giuridici del contratto di franchising*, cit., p. 199.

[21] See, in this sense, Pestana Vasconcelos, *O contrato de franquia*, cit., p. 34, Maria de Fátima Ribeiro, *O contrato de franquia*, cit., p.187, Gorjão–Henriques, *Da restrição da concorrência*, cit., p. 297. Le Tourneau, *Les contrats de franchise*, cit., p. 269. This author, *Les contrats de franchise*, cit., p. 270, argues that this initial instalment should be paid at each renewal, which he calls *redevence de renouvellement*. Leloup, *La franchise*, cit., p.145-147 rejects the designation *droit d'entréé*, preferring the expression *rémunérations initiales* to designate the initial costs incurred by the franchisor in designing the franchise network. *Zanelli, Il franchising, NovissDI, App III, 1982*, p. 888, identifies in the payment of the *entry fee* a form of self-financing by the franchisor, maintaining that, in some contracts, the rules of *investment contracts* apply, considering the franchise as *security*.

[22] Gallego Sanchez, *La franquicia*, cit., pp. 57 ff.

the goods or services are sold[23].

It is also usual in the franchise agreement to prohibit the sale of products to resellers not belonging to the network, in order to prevent the sale of products without observing the instructions and know-how of the producer from jeopardizing the reputation of the trademark and the commercial image of the network.

The same applies to the franchisee's dependence on local advertising of the franchisor's approval; an understandable restriction to prevent poorly designed advertising from undermining the network's trademark image. The obligation to communicate improvements to the know-how and the obligation of secrecy, both of which are natural obligations in the know-how license contract, the terms of which are also present in the franchise contract, are also natural obligations in the franchise contract[24].

The *intuitu personae* nature of that contract, as well as the general rules on the assignment of the contractual position, justify the prohibition on the assignment of the franchisee's contractual position without the franchisor's consent[25].

In the franchise contract it is also common to agree on territorial exclusivity, even if this clause is not an essential element of the contract[26].

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[23] Leloup, *La franchise*, cit., p. 206, considering that the contract is concluded *ratione loci*. Maria de Fátima Ribeiro, *O contrato de franquia*, cit., p. 195, excludes that clause from production franchise contracts, in which the craft and industrial establishment are usually beyond the reach of the public.

[24] Maria de Fátima Ribeiro, *O contrato de franquia*, cit., p. 196, admits that in the absence of an express stipulation the type and form of advertising must be subject to the agreement of the franchisee, a solution that does not extend to local advertising. In the *Guidelines on Vertical Restraints*, 2000, the Commission admitted in the point 44, als. c) and d) that these obligations are covered by the exemption of Regulation n.º 2790/1999, but restricted this obligation to know-how that has not become publicly owned. This understanding is maintained in the point 45, c) and d) of the *Guidelines on Vertical Restraints*.

[25] This clause was already covered by Regulation n.º 4087/88, Art. 3, n.º 2, al. j), and was considered to have been accepted in Regulation n.º 2790/1999, as is clear from the *Guidelines on Vertical Restraints*, 2000, point 44, al. g), which remains the case under the recent Regulation n.º 330/2010, as is clear from point 45, al. g) of the *Guidelines on Vertical Restraints*.

[26] Frignani, *Contributo ad una ricerca*, cit., p. 244 considers it to be a phenomenon present in all contracts, but moderates the position in *Il contratto di franschising*, cit., p. 79, stating that it is a forecast present in most contracts. In view of the wording of Article 2 of Regulation n.º 4087/88, it was held that territorial exclusivity was a condition for the applicability of the exemption provided for therein, to which case law and Italian literature responded negatively, as is clear from Frignani, *Il contratto di franchising sulla necessità della forma scritta e sulla esclusiva come "naturale negotti"*, cit., pp. 343 ff. In Italian case-law, the *naturale negotii of* this clause was discussed, as stated by Frignani, *Il contratto di franchising*, cit., p. 83 e Zuddas, *Somministrazione, concessione di vendita, franchising*, cit., pp. 319 and seq., this having been denied either from the point of view of negotiating practice or in view of the cause of the contract. Since exclusivity is not a natural element of the contract, its enforceability against the franchisor is subject to a written reduction. There are, however, situations in which recourse may be had to the cancellation of the contract on the ground of error or malice or to the disapproval of the franchisor's conduct in the light of good faith, in particular, as Frignani, *Il contratto di franchising*, cit., p. 82, refers, when the estimated invoicing values suggested by the franchisor are based on the assumption that the franchisor is the sole distributor of the products in the territory and, subsequently, other resellers begin to sell the products covered by the contract in that territory. Zuddas, *Somministrazione, concessione di*

Exclusivity can be defined in favour of the franchisor, the franchisee or both, with the distribution franchise being a fertile field for the different combinations. The most common method is reciprocal, whereby the franchisee is obliged not to supply other franchisees and the franchisee undertakes not to sell goods which compete with those of the franchisee within a given geographical area[27].

vendita, franchising, cit., p. 321, accepts that the insertion of a new franchisee in the territory of the franchisee may be considered abuse of economic dependence, if the result is an imbalance in rights and obligations arising from the reduction in profit for the older franchisee. As regards to the enforceability of the clause against the third party, given the lack of external effectiveness of the obligations and provided that the *franchisor* does not approve it, it may be admitted in cases where there is clear unfair competition from the third party by the way it has acquired the products, e.g. where a franchise network based on a selective distribution system is involved, the third party acquires from a franchisee in breach of the clause which prevented him from selling the products to the third. Cfr. Frignani, *Il contratto di franchising*, cit., p. 97, Zuddas, *Somministrazione, concessione di vendita, franchising*, cit., p. 322. The franchisor's approval excludes unlawful conduct on the part of a third party, the contractual liability of the franchisor being presented as a means for the franchisor to enforce the exclusivity recognised in the contract. Cfr. Zuddas, *Somministrazione, concessione di vendita, franchising*, cit., p. 321. Italian literature and case law have further reservations about calling for unfair competition in order to sanction the benefit which the third party at no cost will obtain from the commercial image built up under the franchise contract, by the franchisee and the franchisor, which in the case of imitation of the techniques and presentation could lead to parasitic competition. Cfr. Frignani, *Il contratto di franchising*, cit., p. 91.

[27] That method may be simple or open, if the *franchisor* does not undertake to prevent other franchisees from being present in the franchisor's territorial area and if the franchisor is able to purchase from other suppliers products which are not competing, even if a percentage of the franchisor's products is safeguarded, *in* a variant which Frignani, *Contributo*, cit., p. 244, *idem*, *Il franchising di fronte*, cit., p. 225, regards the franchisee as an improper franchise. As Gallego Sanchez, *La franquicia*, cit., p. 54, comments, an area for competition is ensured here both in the quality of services and in the price, which may benefit the franchisor and consumers. It is also possible to find that method in a strengthened or closed version, that is to say, where the franchisor not only undertakes not to use other franchisees in that territorial area, but also undertakes to prevent other franchisees, in the course of their business, from invading the boundaries of the area assigned to them, by agreeing to those obligations of de facto negative provision not to market products to consumers outside the area assigned to them, with the breach of that obligation constituting grounds for termination of the contract. In European Union competition law, this clause was subject to the conditions imposed by Regulation n.º 4087/88 in Article 4.º, a) the franchisee should be free to obtain the products covered by the franchise from other franchisees and where those products were also distributed through another network of distributors approved by the franchisor, the franchisee should be able to obtain the products from those distributors. Under Article 3, al. b) of the Regulation, exclusive supply was permitted only where, owing to the nature of the products covered by the franchise, objective quality specifications could not be applied. In *Guidelines on the application of Article 81(3) of the Treaty (2004/C 101/08),* JO C 101 of 24.04.2007, p. 97, point 31, it is accepted that restrictions which are objectively necessary for the proper functioning of the agreement, such as obligations aimed at protecting the uniformity and reputation of the franchise system, are also not covered by Article 101.º, n.º 3. Accordingly Guidelines on Vertical Restraints, 2010, point 190, al b) exclude from article 101º, nº 1 of the TFUE a non-compete obligation in respect of goods or services purchased by the franchisee where such an obligation is necessary to maintain the common identity and reputation of the franchised network. Tying, also usually associated with this obligation, is recognised as an efficiency gain provided that tying contributes to ensuring a certain uniformity and standardization in terms of

This clause has received a benevolent treatment by the literature, which recognizes its character as a counterpart to the limitations imposed on the franchisee, performing, in particular at an early stage of the contract, the economic function of recovery by the franchisee of the investment made[28].

This contract is usually accompanied by a non-competition clause and may remain in force beyond the end of the contract. Its main purpose is to prevent the franchisee from using the know-how transmitted in competing activities and wasting resources on businesses of the same nature. Despite the doubts raised from a competition point of view, this clause is a consequence of the fiduciary and collaborative relationship inherent in the contract[29]. It also complements the

quality. Even the imposition of fixed and minimum resale prices, which is considered a hardcore restriction, and not only maximum resale prices, may be necessary to organize in a franchise or similar distribution system using a uniform distribution format. Cfr *Guidelines on Vertical Restraints*, points 222 and 225. Accordingly, the *Guidelines on Vertical Restraints*, point 190, al. b) exclude from Article 101.º, n.º 1 of TFUE a non-compete obligation in respect of goods or services purchased by the franchisee where such an obligation is necessary to maintain the common identity and reputation of the franchised network. The obligation not to compete during the contract and after the expiry of the contract also deserves more lenient treatment in the context of the franchise because it involves the transfer of know-how , in accordance with Article 5.º, n.º 3 and the *Guidelines on Vertical Restraints*, point 148, clauses prohibiting the acquisition of a financial holding in the capital of a competing undertaking to such an extent that this would give the undertaking the power to influence the economic behavior of that undertaking (point45, al b)). This close exclusivity benefits both those franchisors that create a homogeneous and organized network, reducing costs, and those franchisees who are less subject to fluctuations in clientele, see the profitability of their establishments increase, while benefiting from the group policy developed by the franchisor. This lack of competition may, however, harm consumers. Gallego Sanchez, *La franquicia*, cit., p. 55, also refers in the distribution franchise to the agreement of absolute exclusivity, in which the franchisee, in addition to the obligation not to invade the territorial area of other franchisees, also undertakes to prevent its customers from reselling the products outside the territorial area defined in the contract. That clause is most applicable internationally, where the franchisor is a wholesaler who supplies to retailers in a given territorial area, but the effects it produces, from a competition point of view, are worrying, since it exposes the network, leading it to control and restrict the commercial activity of the exclusive franchisee's customers. In the light of both Article 4, b) of Regulation 2790/1990 and Article 4.º al. b) of Regulation 330/2010, this limitation of the commercial activity of the franchisee's customers is a factor in the exclusion from the exemption. Exclusivity in favour of each of the parties may take any of the above forms.

[28] Frignani, *Il contratto di franchising*, cit., p. 80, stressing that the greater the investment, the greater the sphere of protection, in the wake of what was already advocated in the Pronuptia judgment by the TJCE. Gallego Sanchez, *La franquicia*, cit., pp. 27 e 54 -55.

[29] On the requirements of time, space and object and existence imposed by art. 2596.º of the Codice Civile concerning the conventional limits of competition and an "*interesse apprezziabile*" based on art. 1379. do *Codice Civile*, cfr. Frignani, *Nuove riflessioni in tema*, cit., p. 291, followed by Baldi, *Il diritto della distribuzione commerciale*, cit., pp. 132-133, nota 24, Baldi, Venezia, *Il contratto di agenzia*, cit., pp.191-192. Roberto Pardolesi, *I contratti di distribuzione*, cit., p. 348, Santini, *Commercio e Servizi*, cit., p. 174, rely on art. 2125.º concerning the non-competition pact to support the existence of an autonomous consideration during the term of the clause after the contract expires. Some literature has put forward the link between this clause and the possibility of establishing a customer indemnity. Cfr. De Liddo, *Le vicende del rapporto di Franchising*, I Contratti, 1994, p. 473. In Spanish literature, Dominguez Garcia, *Aproximación al regimen juridico*, cit., pp. 427-428, Ulmer , *Der vertragshändler*, cit., p. 241. In the same sense, but only from an *iure condendo*, De Nova, *Nuovi contratti*, cit., p. 226, note 20 and Frignani, *Il franchising*,

obligation of secrecy which accompanies the transfer of know-how[30].

UTET, 1990, p. 119, after having rejected the application of the employment contract scheme. Under French law, it is also subject to the limits of space, time and subject matter, and proportionality is required in the interests of the franchisor and the network. In European Union competition law, this clause first had its validity conditional on the protection of the franchisor's intellectual property rights or in order to maintain the common identity and reputation of the franchise network and provided it did not exceed one year. Regulation 2790/99, Article 5.º, b) also limits the duration of this non-compete obligation to a period of one year after the expiry of the agreement, but requires that the non-compete clause relates to goods or services which compete with the goods or services covered by the contract, is limited to the premises and land from which the buyer has operated during the contract period and is indispensable to protect know-how transferred by the supplier to the buyer. It is safeguarded the possibility of imposing an unlimited restriction in time on the use and dissemination of know-how which is not yet in the public domain. Regulation 330/2010 maintains the same solution in Article 5.º/3, d). The non-compete obligation during the contract also deserves more lenient treatment within the franchise because the transfer of know-how is involved, as is clear from the *Guidelines on Vertical Restraints*, point 148, by stating that the transfer of substantial know-how normally justifies a non-compete obligation for the entire duration of the franchise contract. However, where such an obligation is necessary for the common identity and reputation of the franchised network, it does not fall under n.º 1 of article 101.º of the TFUE, as follows from point 190, al. b) of the *Guidelines on Vertical Restraints*, 2010. Leloup, *La Franchisage*, cit., pp. 344 and seq., considers the non-compete obligation to be the best method of ensuring that a former member of the network does not exploit the franchise system, that being the consideration borne by the franchisee for the competitive advantage inherent in the franchise contract. To the contrary, Maria de Fátima Ribeiro, *O contrato de franquia*, cit., pp. 291 and seq., rejects this obligation as the most appropriate means of protecting secrecy and know-how, considering the obligation not to use know-how to be sufficient to ensure such protection and maintaining that the prohibition of entry into the franchise network for a certain period after termination of the contract is more proportionate to the restriction of the freedom of work of the franchisee. The author concludes, *ob cit.*, p. 295, by applying the GCC regime established by Decree-Law 446/85 of 25 October 1985, proposing that the conduct of the franchisee, at the stage following the termination of the contract, should be scrutinised by the unfair competition regime.

[30] This obligation of non-competition is also connected with the obligation of the franchisor to accept back the *stocks*, which, not being provided for in most contracts, has raised many problems inherent in the termination of the contract and therefore deserves attention from literature and case law. This is aggravated by the fact that the analogous application of the agency's legal regime, given the absence of acquisition of the products by the agent, does not contain any provision which might prove applicable. The fact that the franchisee has acquired the products, in particular where a minimum quantity or minimum *stock* clause is laid down, the termination of the contract, together with the cessation of use of the trade mark and other distinctive signs and, in most cases, the post-contractual obligation not to compete, makes it practically impossible for the distributor to dispose of those goods. In that regard, the contractual provision for the take-over of *stocks* or an authorization for post-contractual sale of the goods in question for a certain period of time is presented as a solution. However, as Gallego Sanchez, *La franquicia*, cit., p. 49, points out, the latter solution may be ineffective in view of the absence of distinctive signs of the franchisor and the possible indication of another distributor for the same territorial area. Italian literature considers that, in this scenario, the franchisee should be allowed to sell the products after the end of the contract. In that regard, Baldi,Venezia *Il contratto di agenzia*, cit., p. 193., Frignani, *Il contratto di franchising*, cit., pp. 190-191.Roberto Pardolesi, *I contratti di distribuzione*, cit., pp. 336 and seq., considers that the possible negative effects on the network arising from the sale of goods by the franchisee are not sufficient to counterbalance the exposure of the distributor to whom the products acquired, without the possibility of being resold, no longer have any value. In line with German case-law, the author maintains that, in cases where *stock* is imposed on the franchisee by means of a minimum stockholding clause, good faith, as set out in Article 1375.º of the *Codice Civile*,

In the franchise contract it is also possible to find clauses concerning the accounting and financial assistance of the franchisee, although it is lawful for the franchisee to proceed with the accounting, administrative and financial management of his company, provided that it does not compromise the franchisor's commercial image and complies with the obligation to make accessible to the franchisor's inspection all the documentation relating to those areas, inherent in the obligation to support the franchisor's control of his activity[31].

Under this contract, minimum sales quotas are often determined, with the franchisee assuming the risk of the agreed result. The franchisee will not be liable for the failure to achieve the agreed outcome if it is attributable to the refuse of franchisor or the sellers indicated by him to sell the products requested by the franchisee[32].

This clause emanates from the general obligation of the franchisee to promote and boost sales and the provision of contractual services[33].

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requires that, at the end of the contract, the goods be repurchased by the franchisee at the price charged by the latter, adding that, in the event of a fall in price, good faith only protects the franchisee from the damage inherent in the stock which cannot be marketed and no longer from market fluctuations. Nor does it cover products which the franchisee has acquired. Leloup, *La franchise*, cit., p. 343, argues, quite rightly, that the existence of a non-compete pact necessarily entails for the franchisor the duty to repurchase the *stock, the* conditions for which must be defined in the contract. Among us, Pinto Monteiro, *Contratos de distribuição comercial,* cit., p. 169, refers that this is a particularly delicate problem, given the acquisition by the concessionaire of the property over the goods. The Honorable Professor recommends that the interested parties regulate this point beforehand, in particular through an appropriate clause inserted in the contract. This is because, in the absence of such a clause, the concessionaire or the franchisor should not be obliged to take back the goods in stock, given the absence of a legal and/or contractual basis. Pinto Monteiro, *Contratos de distribuição comercial*, cit., p. 170. When the termination of the contract is due to the fault of the grantor/franchisee, it is maintained by the author that the compensation of the grantor/franchisee may include the obligation to take back the goods in stock or such losses may be imputed to the compensation to which he is entitled. He adds that, given the lack of agreement between the parties, the answer to this problem may still be in the integration of the negotiating declaration, in accordance with the provisions of art. 239.º of the CC, if good faith requires that the negotiating declaration should be integrated in accordance with the will that the parties would have had if they had provided for the omitted point, namely if it were to be concluded that the products were acquired under a resolutive condition, i.e. the termination of the distribution contract would have the effect of determining the termination of that purchase, with the consequence that each party would have to return what it received. These remedies will be extended to franchise where justified. Pestana de Vasconcelos, *Do contrato de franquia*, cit., pp. 108-109, sustains, in the franchise contract, the existence of a post-contractual duty resulting from the general good faith clause enshrined in the article 762.º, n.º 2 of the CC, which Menezes Cordeiro, *Da Boa Fé no Direito Civil*, Vol I, Almedina, Coimbra, 1984, pp. 629-630, justifies with reasons of materiality and trust.

[31] Maria de Fátima Ribeiro, *O contrato de franquia*, cit., pp. 203-204.

[32] This concerns a minimum *royalty* guarantee clause to which a penalty clause may be attached if an amount to which the franchisor is entitled is set if the quota is not met.

[33] Baldi, Venezia *Il contratto di agenzia*, cit., p. 189. In European Union competition law, the provision of this clause did not, under Article 3.º, al. f) of Regulation n.º 4087/88, prevent the application of the exemption as it is considered necessary to maintain the common identity and good reputation of the network. Maria de Fátima Ribeiro, *O contrato de franquia*, cit., p. 209, considers that this is a further example of the benevolence of European Union competition law

More challenging is the clause for setting the selling price of goods and services, which is often included in franchise contracts.

This clause, through the stabilisation of the final price, aims to pursue a wider purpose, the existence of a *non-price competition* that encourages network members to compete in the services that accompany the product, including delivery, credit, repair, advertising, promotions[34]. Price fixing allows the franchisor to influence the level of services by encouraging network members to invest in non-price criteria such as services, promotions, consolidating the franchisor's reputation with consumers. The safekeeping of the fixed price coupled with an exclusivity clause protects the network from *free-riders*. The members of the network, in this case the franchisees, assured that the price charged is common to all members of the network and aware that they are not in *price competition* with competitors, are more willing to invest in additional services and thus persuade consumers to look for their products, bringing added value to the network and efficiency to distribution. On the other hand, price fixing allows the franchisee a profit margin to invest in higher quality customer services[35].

This clause, in the framework of the franchise contract, is an instrument to

with regard to franchising, since in the commercial concession in the motor vehicle sector, where this clause consisted of an obligation to produce results, it was not exempted under Article 4.º, n.º 3, *contrary to* Regulation 123/85, which accepted only the obligation of the dealer "to seek to sell" a minimum quantity of products. Later, in Regulation 1475/1995, Article 4º, n.º 3 remained the same and only provided for the intervention of a third expert if the parties could not agree on the minimum quantity of contract products to be sold annually. Also in the motor vehicle sector, Regulation 1400/2002 of 31 July 2002 on the application of Article 81.º, n.º 3 of the Treaty to categories of vertical agreements and concerted practices in the motor vehicle sector, JO L 203, de 1.08.2002, p. 30, in the art. 6.º, al. b) states that the setting or attainment of sales targets is one of the matters which may be referred to an independent expert or arbitrator, to whom disputes concerning the fulfilment of their contractual obligations under vertical agreements must be submitted in order to benefit from the exemption. The Regulation has not interfered with the content of this clause, appearing to be satisfied that it may be subject to independent expert review. Commission Regulation (EU) N.º 461/2010 of 27 May 2010 on the application of Article 101.º, n.º 3 TFEU to categories of vertical agreements and concerted practices in the motor vehicle sector does not deal with this issue. Commission Regulation (EC) N.º 330/2010 of 20 April 2010 on the application of Article 101.º, n.º 3 of the Treaty to categories of vertical agreements and concerted practices, which replaced Commission Regulation (EC) N.º 2790/1999, as it is understood in the wake of COM(2009) 388 that in this sector there are no significant shortcomings in competition which distinguish it from other sectors of the economy and which may require the application of different and stricter rules than those enshrined in Regulation (EU) N.º 330/2010.

[34] This thesis was defended by an author associated with the Chicago School of Economics, Telser, *Why Should Manufacturers Want Fair Trade?* J.L. & Econ, Vol. 3, 1960, p.86. Bork, *A Reply to Professors Gould and Yamey,* Yale L.J., Vol. 76, 1967, pp..733-34, points to efficiency in distribution as the preponderant reason for applying these vertical restraints, denying them anti-competitive effects. Later, reasons will be mentioned such as quality certification by the retailers in the network, Marvel, McCafferty, *Resale Price Maintenance and Quality Certification,* RAND J. ECON. Vol. 15, 1984, p. 346. Roberto Pardolesi, *I contratti di distribuzione*, cit., pp. 54-55, considers that the purpose of this pricing system is to ensure that the trader accepts vertical integration.

[35] Cfr. in the opposite direction, Comanor, *Vertical price-fixing, vertical market restrictions and the new antrust policy*, Harv. L. Rev, Vol. 98, 1985, pp. 983 and seq.

safeguard the homogeneity of the network, encourage franchisees to differentiate the product by the quality of the services that accompany it and thereby eliminate *free-riding,* increasing the efficiency of distribution.

Despite the economic advantages described above, this clause has nevertheless been considered a restrictive practice under Article 101 TFEU and has been incorporated in successive regulations into the *black list, i.e. the* group of clauses for which the general presumption of positive effects underlying vertical restraints, identified in Article 101(3) TFEU, is denied. The Commission considers that this practice leads to market sharing, crystallization of distribution networks, preventing all or part of the distributors from reducing their sales prices for that particular trademark and diminishing competition between manufacturers and/or retailers, in particular when manufacturers use the same distributors to distribute their products and the resale price maintenance system is applied by all or a large number of manufacturers, and to horizontal anti-competitive effects[36].

3. Advantages of the franchise contract

The franchisor, through this contract, exploits the success of its commercial formula, receiving an *initial fee* and periodic payments (*royalties)* for the transmission of the license to use the trademark and other distinctive signs and of all the industrial and commercial know-how, as well as technical assistance[37]. The franchisor also manages, by means of the contract, to transfer the risk of the activity to the franchisee, who, at the beginning, in addition to assuming the investments to launch the activity, also takes over the commercial indetermination

[36] Cfr. V Korah, D Sullivan, *Distribution agreemens under the EC Competition Rules,* Hart Publishing, Oxford and Portland, Oregon, 2002, pp. 173 and seq. as V Korah,D Sullivan, *Distribution agreemens under the EC Competition Rules,* cit., p. 191, the imposition of a maximum price and the recommendation of fixed or minimum prices are not covered by that prohibition, pointing out that the recommended price in the franchise may be treated as a fixed price, while ensuring that the relevant advertising does not work with the franchisees as a form of pressure, which could make it difficult to exempt franchise contracts which, by reason of market power, infringe Article 101.º TFUE. The Commission's position on this clause and the impossibility of an individual exemption is debatable. Cfr. *Guidelines on Vertical Restraints,* point 224. However, at point 225 it is recognised that this practice may be necessary to organise, in a franchise or similar distribution system using a uniform distribution format, a coordinated low price campaign in the short term (2 to 6 weeks in most cases), benefiting consumers, which was not the case in the *Guidelines on Vertical Restraints,* 2000.

[37] Cfr. Pinto Monteiro, *Contratos de distribuição comercial,* cit., p. 121, by using the term *formula that* we also adopt for bringing together the image and commercial method to which the license to use distinctive signs and the transmission of other intellectual property rights are associated. The conclusion of franchise contracts also has an amplifying effect on the profitability of the franchisor's commercial formula, since the increase in brand awareness, service quality and market penetration associated with the contract will attract new franchisees and new contracts. Cfr. Leloup, *La franchise,* cit., pp. 117-118.

inherent to it[38].

In the specific case of distribution franchising, the franchisor controls and directs, through independent companies, the distribution of his goods, without the costs and risks inherent in setting up and maintaining subsidiaries, preserving the quality of the services and standardising the conditions of sale, with financial compensation[39].

The risks for the franchisor are generally confined to incorrect behaviour by the franchisee or the other members of the network, the negative effects of which are felt by the franchisor, but also by all the other members of the network, given the strong interconnection between all its members. This inconvenience can be avoided with a careful choice of franchisees, with intense supervision of the franchisees' activity, accompanied by a system of incentives, often implemented through vertical restrictions[40].

The advantages clearly outweigh the disadvantages of the contract for the franchisor.

The franchisee also reaps multiple benefits from this contract. He will be able to develop a commercial activity based on a formula already tested, thus reducing the business risks. Under this contract, the franchisee sells goods and services that are already known to the public or that are highly likely to be implanted with them, supported by the trademark and other distinctive signs of the

[38] The franchisee will have to make available the premises suitable for the exercise of the activity which is the object of the contract, as well as assume all the expenses with the assembly and decoration of this establishment, industrial or commercial, always according to the strict instructions of the franchisor. This investment will only be profitable during the contract, given that with the termination of the contract, the franchisee will hardly be able to use that structure. The franchisee shall be responsible for creating the *stock* and working capital necessary for the normal exercise of the business in question. See Maria de Fátima Ribeiro, *O contrato de franquia*, cit., pp. 20 e 21 and Philippe Le Tourneau, *Les contrats de franchisage*, cit., p. 126. Other financial advantages may also be pointed out, such as the margin that the franchisor charges the franchisee, the reduction of costs, as well as advantages in personnel management and simplification of the administrative structure, as highlighted by Salvador Miquel Peris, Francisca Parra Guerrero, Christian Lhermie, Mª Jose Miquel Romero, *Distribución comercial*, cit, pp. 125-126.

[39] The franchise contract allows the parties to appear before third parties with the image of a single product or service from a single activity. Cfr. Galgano, *L`imprenditore, Impresa, contratti di impresa, titulo di credito, falimento*, Bologna, 1982, p. 251. As Menezes Cordeiro, *Do contrato de franquia*, p. 74, states, this contract allows "*the* creation *of worldwide networks to offer goods and services, duly promoted and advertised, with all the guarantees of safety and quality, on the basis of small independent units",* as an alternative to the more costly creation of a network of subsidiaries. Cfr. Gallego Sanchez, *La franquicia*, cit., p.26. The fact that the contract is concluded between legally independent entities, as Pedro Romano Martinez, *Contratos Comerciais*, Principia, Cascais, 2001, p. 23, gives the franchisor the possibility of being an entrepreneur instead of an employee. Gallego Sanchez, *La franquicia*, cit., p. 28, points out that it is a radical change from the category of subordinated worker to that of franchisee, where he assumes the risks of the activity.

[40] As Mendelsohn, *The Guide to Franchising*, 6.ª ed, Cassel, New York, 1999, pp. 28-29, notes, the franchisor, notwithstanding of the non-compete obligation usually prescribed in the contract, may be training a future competitor. Another disadvantage is the need for intensive and close supervision in order to avoid conduct by the franchisee which could harm the franchisor and the network.

prestigious company to the public and economic agents, which not only facilitates the profitability of the business, but also the granting of credit to the franchisee by financial institutions[41].

The franchisee will also benefit from the knowledge, experience and technical assistance provided by the franchisor, thus overcoming the lack of experience inherent in launching a new activity[42]. Access to the franchisor's experience and knowledge puts the franchisee at a clear competitive advantage over its non-farmed competitors[43].

The franchisee also has a clear reduction in business risk compared with the risk of a trader who is not part of a franchise network[44].

The legal autonomy of the franchisee contrasts, however, with the economic subordination resulting from the fact that the company is integrated into a network system and is therefore subject to the financial control and supervision of the franchisor.

The franchisor, in some cases, tends to abuse the franchisee's lack of experience and, on the basis of the prerogatives of the contract, to demand excessive financial compensation, to impose mandatory supplies and/or prices which are too high, to exert excessive control over the business, which nullifies any power of the franchisee to run his business, under threat of termination or non-renewal of the contract[45].

From the consumer's point of view, franchising, as we have seen, will allow a remarkable increase in the quality of the goods and services provided, by stimulating competition for quality, as an alternative to price competitiveness, although a reduction in prices will also be possible as a result of the franchisee's

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[41] Salvador Miquel Peris, Francisca Parra Guerrero, Christian Lhermie, Mª Jose Miquel Romeroi, *Distribución comercial*, cit, p. 127. In German literature, this contract is seen as an effective means of developing small and medium-sized enterprises as an alternative to the creation of oligopolies. In this sense, Gross, Skaupy, *Franchising in der Praxis*, cit., p. 18 and seq. See Gallego Sanchez, *La franquicia*, cit., p. 27. As Maria de Fátima Ribeiro, *O contrato de franquia*, cit., p. 23, points out, the franchisee does not bear the costs and risks inherent in the selection of products, but enjoys the pre-selection of products chosen by the franchisor. On the other hand, the supply policy is also the responsibility of the franchisor. Cfr. Gallego Sanchez, *La franquicia*, cit., p. 27.

[42] Gallego Sanchez, *La franquicia*, cit., 27.

[43] The franchisee also benefits from a tried and tested commercial and advertising policy that clearly brings him a competitive advantage.

[44] Gallego Sanchez, *La franquicia*, cit, p. 27, Mendelsohn, *The guide to franchise*, cit., p.33, Michael Martinek, *Moderne Vertragstypen*, Band II-Franchising, Know–how–Verträge, Management und Consultingverträge, Verlag CH Beck, München, 1992, p. 17.

[45] Cfr. Gallego Sanchez, cit., p. 28. The disadvantages for the franchisee are also those mentioned by Mendelsohn, *The guide to franchise*, cit., p. 35, namely, the limitations imposed on the franchisee in the transfer of the establishment, which without the clientele, logos and all the elements that identify the establishment with a network, calling into question the respective arrangement, is limited to the rights over the property, not even being able to talk about the rigour of a transfer. This difficulty can be overcome if the transfer is in favour of a network element or if the contract expressly provides for the franchisor's consent to the transfer, which is complicated in view of the requirement in the selection of franchisees. Another disadvantage is the dependence on the franchisor and the vulnerability to vicissitudes which may affect the image of the brand, as well as to errors in commercial policy.

cost reduction resulting from the assistance provided by the franchisor and, in the case of distribution franchising, economies of scale. The expansion of products and services through the opening of new outlets, in addition to increasing the variety of choice, allows consumers even in more remote areas to have access to products and services with the same characteristics as those marketed in central locations[46].

The benefits of franchising to the market in general are several, first of all because by allowing the expansion of a successful activity, through small and medium-sized independent companies, it obviates the creation of oligopolies, with advantages in competition[47].

These advantages for consumers and the market are pointed out as a justification for the benevolent attitude that the contract has deserved from EU competition law[48].

In view of these considerations, we need to try to find a satisfactory notion of the franchise contract.

4. Franchise contract notion

The construction of a legal concept of the franchise contract is made particularly difficult by the various configurations assumed by the contract. There are, therefore, a panoply of definitions, arising from literature and case law, without ignoring the efforts to regulate the contract, in terms of competition, by European Union Competition Law and by some associations connected to franchising[49].

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[46] This is one of the aspects which justifies the more benevolent treatment recognised by the European Union. The franchise contract will be seen as a beneficial tool in consolidating the common market by enabling independent traders, lacking the experience and economic and financial capacity to create and develop a commercial method, to establish themselves in other markets, benefiting from the distinctive signs, in particular the franchisor's brand, commercial methods. See decision TJEU de 28.01.1986, *Pronuptia de Paris GmbH contra Pronuptia de Paris Irmgard Schillgallis*, cit., point 14. The homogenisation inherent in the franchise network, on the other hand, makes it an effective means of responding to the progressive homogenisation of consumption models within certain sectors of the market, as Maria de Fátima Ribeiro, *O contrato de franquia*, cit., pp. 25-26.

[47] In addition to this advantage, in the wake of Maria de Fátima Ribeiro, *O contrato de franquia*, cit., p. 27, the social function of the franchise by giving the possibility to recent unemployed with no other resources, apart from compensation for the termination of their employment contract and unemployment benefit, to start an economic activity with strong chances of success.

[48] Maria de Fátima Ribeiro, *O contrato de franquia*, cit., p. 26, Pestana Vasconcelos, *O contrato de franquia*, cit., p. 14.

[49] The majority of literature extends the franchise to *the contrat-quadre* contract, since, like the commercial concession, it establishes a stable relationship of collaboration, from which emerges a bundle of rights and obligations of particular and current content assumed by the parties in its conclusion, as Gallego Sanchez, *La franquicia*, cit., p. 81. One of the peculiar aspects of this contract is the fact that both parties assume the obligation to conclude between themselves or, between the franchisee and third parties, which may in some cases be indicated by the franchisor, future contracts. However, such future contracts must comply with the discipline laid down in the franchise contract and must be instrumental and dependent on the franchise contract. Some literature, as Gallego Sanchez, *La franquicia*, cit., p. 80, notes, perceiving this dependence on the initial contract and the future contracts, has renewed the franchise contract to a promissory

In the context of European Union competition law, the definition in Article 1, 3(a) of Regulation 4087/88 is particularly relevant, despite the exclusion of franchise production. This concept includes the granting of a license to exploit industrial property rights with a view to exercising a business activity, accompanied by the communication of know-how and commercial or technical assistance during the term of the contract, in return for the payment of financial compensation and the obligation to use a name or badge and uniform presentation of the premises and/or means of transport used in exercising that business activity.

Before analysing this definition, it is appropriate to recall the concept accepted by the Court of Justice, prior to the Regulation, in the decision of 28.01.1986, known as the *Pronuptia* judgment, whose impact on the fair treatment of franchising by competition law was extremely important.

In that decision, the Court regards the franchise distribution contract as a means of exploiting a body of knowledge financially, without investing capital of its own. The Court considers that, through that system of distribution licences, an

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contract, while another has called for the regulatory contract. The first position died out because the franchise contract was not limited to the obligation to conclude one or two definitive contracts, but gave rise to a varied and complex bundle of obligations ranging from the obligation to transmit know-how, to the trademark license, to the obligation to provide technical assistance. Cfr. Gallego Sanchez, *La franquicia*, p. 80. There are also major difficulties in renewing the contract. As a contract which lays down the rules governing the contracts to be concluded by the parties or between one of the parties and a third party, depending on whether they are bilateral or unilateral, the regulatory contract does not justify the obligation on the franchisee to conclude future contracts, since the legal discipline contained in the regulatory contract is applied only if and when the parties decide to conclude future contracts. The obligation of the franchisor to conclude successive purchase and/or service contracts and/or exclusive supply obligations with third parties is therefore not justified. The coordination contract is also insufficient to justify the complexity of obligations deriving from the franchise contract, in particular the relations to be formed by the franchisee with third parties. The *contrat-quadre* contract, as a technical category capable of assimilating a diversity of economic content, is the one best suited to the complex bundle of obligations resulting from the franchise contract, particularly as regards the obligation on the parties to each other and on the franchisee to conclude future contracts with third parties, the arrangements for which are laid down in advance in the franchise contract. However, as we have already seen, as regards the commercial concession, the fact that it is a framework contract does not prevent it from operating as a bilateral promissory contract for sales contracts to be concluded between the parties and as regards future contracts to be concluded by the franchisee with third parties, a unilateral normative contract. For further developments in this category, see our note *above* 67 to which we refer. In favour of describing the franchise contract as a *the contrat- quadre* contract, cfr. Gallego Sanchez, *La franquicia*, cit., p. 81, Dominguez Garcia, *Aproximación al regimen juridico*, cit., p. 429, Baldi/Venezia, *Il contratto di agenzia*, cit., p. 159. Between us, Pinto Monteiro, *Contratos de distribuição*, cit., p.125, Miguel Pestana Vasconcelos, *O contrato de franquia*, cit., p. 49 ff. Maria de Fátima Ribeiro, *O contrato de franquia.* cit., p. 80, while considering this classification to be more appropriate in the case of a franchise distribution contract in which the parties are obliged to enter into future purchase and sale contracts whereby the franchisee acquires products from the franchisor and the franchisee sells them to him, subject to the discipline laid down in the franchise contract. Some Italian academic writers, such as Di Nuova, *Nuovi contratti*, cit., p. 156, reserve the framework contract solely for franchising distribution, since they consider that it is only in this form that the programmatic nature of the products to be purchased by the franchisee from the franchisor is apparent.

undertaking which has set itself up as a distributor in a market and has perfected a number of commercial methods, gives independent traders, for a fee, the possibility of establishing themselves on other markets, using its badge and the commercial methods which have ensured its success. In addition to the emphasis on the transfer of know-how, the Court considered essential the technical assistance, the licence(s) to exploit industrial property right(s), the existence of financial compensation and the existence of appropriate measures to preserve the identity and reputation of the network[50].

In both concepts, the concept of the franchise is valued as a license to exploit a successful commercial formula, to which intellectual property rights are attached, which the holder becomes financially profitable through the contract. It is also of particular importance that the franchisor is obliged to transmit know-how, provide technical assistance. The franchisee, by the other hand, has the obligation to pay a financial consideration, bear control or supervision, use the knowledge transmitted and preserve his business secrets and know-how.

Another important definition is the European Code of Ethics for Franchising, drawn up by the European Federation of Franchising, according to which franchising is defined as a form of collaboration between legally independent companies which implies: a) the ownership of distinctive signs and know-how made available to the franchisee; b) the availability of a set of products and/or services which must be adopted and used by the franchisee, the formula being based on specific and tried and tested commercial techniques which must be perfected and controlled in order to remain effective and valid ; (c) through the combination of human and financial resources, both parties reap benefits, without their independence being called into question; (d) the payment of a certain amount, in any form, by the franchisee to the franchisor, in return for the use of the distinguishing signs of the trade and know-how of the franchisor[51].

The *Associazione Italiana del Franchising* has also drawn up a concept of franchising, in which it corresponds to "*a form of ongoing collaboration for the distribution of goods or services between a business-franchiser and one or more business-franchisees, legally and economically independent of each other, who enter into a contract: a) the franchisor grants the franchisee the use of his own commercial formula, which includes the right to enjoy his know-how (all the necessary techniques and knowledge) and his own distinctive signs, together with other services and forms of assistance necessary to enable the franchisee to manage his own business with the same image as the franchising company; the franchisee undertakes to adopt as his own the commercial policy and image of the franchisor in the mutual interest and that of the final consumer, as well as to respect freely established contractual conditions".*

The *International Franchise Association* has identified franchising with *"a contractual relationship established between the franchisor and the franchisee, by*

[50] Judgment of the TJ de 28.01.1986, *Pronuptia de Paris GmbH contra Pronuptia de Paris Irmgard Schillgallis*, quoted, point 15.

[51] De Nova, *Nuovi contratti*, cit., p. 179.

which the former provides or undertakes to maintain a continuous business interest in the latter's activity, in areas such as know-how and training, while the franchisee uses the same trademark and other distinctive signs, the business format and methods owned or controlled by the franchisor, making on his behalf a capital investment in the business"[52].

In Italian literature, Frignani sustains that franchising *"is a system of collaboration between the producer or reseller of goods and services (franchisor) and a distributor (franchisee) who is legally and economically independent of one another, but bound by a contract whereby the former grants the latter the right to enter and be part of the distribution chain, with the right to enjoy, subject to certain conditions and the payment of a consideration, various industrial property rights and the know-how of the franchisor, who assumes the obligation to supply goods and services to the franchisee, the latter undertaking to observe in the resale of the goods and services a set of prefixed conduct"*[53].

Zanelli identified the franchise as an aggregate concession by which the franchisor grants the other party the exercise of an activity of production and provision of services, subject to conditions and under the control of the franchisor, with the use of its distinctive signs and other intellectual property rights such as patents, trademarks, accompanied by the transmission of *know-how and* technical assistance, receiving as consideration the payment of a sum, as a rule made up of a fixed portion (entry fee) and a portion proportional to turnover (*royalties)*[54].

These notions are deficient in relation to one of the main notes in the franchise contract, corresponding to the high degree of integration established between the parties in the development of economic activity.

The franchisor not only transmits intellectual property rights, but also carries on an activity of control of the network, which is uniform by virtue of the obligation on the franchisee to adopt common commercial techniques and methods, a characteristic which directly benefits the network image and, indirectly, the franchisor and each of the franchisees.

In that sense, the transfer of intellectual property rights and the use of distinctive signs, the subjection of the franchisee to commercial methods and the franchisor's control are intended to ensure an integrated and homogeneous network, a real added value of the franchise contract.

Between us, one of the first notions given by the literature conceived the contract as *"one in which one of the parties is obliged to bear the use of the distinctive signs of enterprise by the other, to communicate its know-how to it and to provide it with technical assistance, the other party being obliged to pay a consideration and to bear a control, without prejudice to its independence"*[55].

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[52] Cfr. Frignani, *Il franchising di fronte all`ordinamento italiano: spunti per un´ indagine comparatistica*, cit., p. 204, n. 1.
[53] Ibid, p. 204.
[54] Zanelli, *Il franchising*, cit., p. 886.
[55] Isabel Alexandre, *O contrato de franquia*, cit., p. 349.

We follow the literature that considered this definition imprecise as to the essential purpose of the contract, insofar as the integration of the franchisor into the franchisor's network is absent[56].

Maria de Fátima Ribeiro has also offered a very interesting notion, in which she leads the franchise contract to a licence to exploit the trademark image, the image licence, which she identifies with the mediated object of the franchise contract, requiring it to be admitted that the trademark image is, more than an economic value, an intangible asset and, secondly, that that asset may be the object of an exploitation licence[57].

This notion, though, focuses on trademark image, a concept which, although it includes the use of other distinctive signs and intellectual property rights, as advocated by the author, in the wake of Maccioni, thus covering the franchisor's logo, licence of know-how and non-secret technical knowledge, seems to us to be reductive in view of the franchise contract.

This notion, nonetheless of the extent of the trademark image, ignores the integration of the franchisor into the franchisee's network, an element which, as a government structure through which vertical integration is carried out, as we shall see below, will prevail in the justification of the vertical restrictions accompanying the franchise contract.

On the other hand, this trademark image concept also leaves out the added value resulting from the coordinated work of the franchisor and franchisee in applying the methods on which the network is built, including the use of know-how, which underlies the integration of the franchisee into a homogeneous network, a characteristic that we consider essential in franchising[58].

Pinto Monteiro, on the other hand, defines the franchise contract as the *"contract by which someone (franchisor) authorises and enables another (franchisee), in return for compensation, to act commercially, producing or selling products or services in a stable manner, with the former's formula of success (different signs, knowledge, assistance) and appear to the eye with his business image, obliging the latter to act in these terms, to respect the indications given to him and to accept the control and supervision to which he is subject".*

This notion, because of its scope, is the one best suited to the multiple facets that this contract can undertake, reflecting the characteristics that we have regarded as unifying in this contract: the integration of the franchisee into the franchisor's network and the homogeneity of the network, obtained by the use of the franchisor's distinctive signs of trade and by the obligation of the franchisee to follow the guidelines and instructions of the franchisor[59].

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[56] Maria de Fátima Ribeiro, *O contrato de franquia*, cit., p. 151.

[57] Ibid, p. 151.

[58] More than brand image, the franchise contract exploits the commercial image, a more comprehensive concept which is not immune to the effects produced within the framework of the integrated collaboration relationship established between the franchisee and the franchisor and from which benefits result for both parties.

[59] See Pinto Monteiro, *Contratos de distribuição comercial*, cit., p. 121.

5. Conclusion

Franchising, a complex contractual scheme, enables the integration of the distributor into the producer network, accompanied, in different degrees of intensity, by the attribution and recognition of intellectual property rights.

This contract, given the lack of capital, characteristic of post-recessive times, allows the producer to assume the distribution of the products, through a distributor, who will assume the risk of the activity, achieving greater efficiency.

This contract, therefore, can perform a determinant role in the economic recovery of crisis experienced worldwide following the Pandemic COVD 19, allowing that small entrepreneurs to access to the franchisor's experience and network, reducing the business risk.

Meanwhile the consumers will benefit from the increase in the quality of the goods and services provided, by stimulating competition for quality, as an alternative to price competitiveness. A reduction in prices, though, will also be possible as a result of the franchisee's cost reduction resulting from the assistance provided by the franchisor and, in the case of distribution franchising, economies of scale.

The expansion of a successful activity, through small and medium-sized independent companies, will also help the economy to come around, restricting the formation of oligopolies, with advantages in competition

In our opinion, Pinto Monteiro notion of franchise contract is the most suitable, as it is shelters the multiple facets that this contract can take on, reflecting the characteristics that we have regarded as unifying in this contract: the integration of the franchisee into the franchisee's network and the homogeneity of the network, obtained by the use of the franchisee's distinctive signs of trade and by the obligation on the franchisee to follow the guidelines and instructions of the franchisor.

Franchising is, therefore, a contract worthy to be revisited.

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