

BRIEF CONSIDERATIONS ON THE INNOVATIVE ELEMENTS IN FRANCHISING. AN APPROACH OF THE ROMANIAN LEGISLATOR FROM A UNION PERSPECTIVE

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Abstract

At the level of 2022, in the European Union, the presence of fragile, incoherent legislation is noticeable in the matter of franchising. The need for uniform regulation is justified as franchising, in most cases, has a significant cross-border dimension, and therefore directly affects the functioning of the internal market. To the same extent, it is necessary to know the existing self-regulatory instruments both at the Union level and at the level of the Member States, as well as the legislative practices of the Member States in the field of franchises. At the national level, we identify the tendency of the Romanian legislator to “redefine” some terms or “reset” some mechanisms specific to the franchise using legislative instruments but also self-regulatory instruments, suitable for the Union space. The present study aims to make a brief analysis of the above-mentioned aspects with priority reference to the innovative elements in the above-mentioned field.

Keywords: *innovative elements, franchisor, franchisee, know-how, European ethical code, regulation*

JEL Classification: [K2, K20, K33]

1. Introductory aspects regarding the Union and national legislative framework applicable to the franchise

In the European Union, there is no uniform legislative framework in the matter of franchising, applicable to all member states, although some relevant provisions in the matter can be found inserted in instruments that regulate specific aspects to franchising, respectively, European Commission Regulation (EEC) no. 4087/88 of 30 November 1988 on the application of article 85 paragraph (3) of the treaty with reference to the categories of franchise contracts¹.

Also, provisions² relevant to the matter of franchising can be found in Regulation (EU) no. 330/2010 of the Commission of April 20, 2010, on the application of Article 101 paragraph (3) of the Treaty on the Functioning of the European Union to the categories of vertical agreements and concerted practices³.

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¹ JO L 359, 28.12.1988.

² Mainly those that refer to the price charged by the franchisee, because the establishment of a certain price may raise suspicions, for example of market sharing, thus constituting abusive behavior under competition law.

³ JO L 102, 23.04.2010.

In its Resolution of 11 December 2013 regarding the European action plan in the field of retail trade for the benefit of all actors, the European Parliament welcomed franchising as a business model, at the same time drawing attention to the existence of abusive contractual clauses, to the effects that the clauses generate of long-term competition, requesting in this sense the European Commission to evaluate the ban on price-fixing mechanisms in franchise systems⁴.

In the same context, we also mention the Resolution Proposal of the European Parliament regarding the operation of franchises in the retail trade sector from May 2017, in which it is mentioned in point 2 that it is decisive for the member states to apply concerted measures against unfair commercial practices in the field of franchises, stating that between Member States “there are still many divergences and a high level of diversification in this regard”, considering it important, therefore, to implement homogeneous guidelines, even without legislative character, that reflect the best practices regarding the operation franchises in the retail sector. It is important to mention that on this occasion, the European Parliament invited the European Commission to do all the diligence in order to draw up some legislative guidelines in the matter of franchise contracts.

To what extent can we discuss franchise self-regulation in the European Union? We believe that self-regulation stands out as a consequence of the lack of uniform regulation at the Union level. When we talk about self-regulation, we specifically refer to the European Franchise Code of Ethics, created by the European Franchise Federation. The code represents an important document in the development of the franchising system in Europe and implicitly at the level of the European Union, contributing substantially to the regulation of business relations in this sphere of activity. The code of conduct contains a set of directives regarding the franchising system and does not replace the legal provisions of the European Union and the national ones of the states in this field, representing, at the same time, a reference standard for the national legislation in the matter of franchising, but also a starting point in the design of modern regulations regarding the conduct of business in the franchise system. (Molico, Wunder, 2002, p.235)

In Romanian law, the franchise is regulated by Government Ordinance no. 52 of August 28, 1997, republished, regarding the legal regime of the franchise⁵, as amended and supplemented by Law no. 179 of October 10, 2019⁶.

⁴ P7_TA (2013)0580.

⁵ Published in Official Gazette no. 224 of August 30, 1997, approved with amendments by Law no. 79/1998 published in the Official Gazette no. 147 of April 13, 1998, republished, giving the texts a new numbering, in the Official Gazette of Romania, no. 180 of May 14, 1998.

⁶ For the amendment and completion of Government Ordinance no. 52/1997 on the legal regime of the franchise, as well as for the amendment of art. 7 point 15 of Law no. 227/2015 on the Fiscal Code - published in the Official Gazette no. 829 of October 11, 2019.

2. The concepts of “franchise”, “franchise contract”, “franchise system” in the European Union

Regarding the definition of the terms “franchise”, respectively “franchise contract” and “franchise system”, in most of the member states of the European Union the concepts have been adopted in the meaning conferred by the European Commission Regulation (EEC) no. 4087/88.

Specifically, according to the aforementioned provision, “*franchise*” is defined as “a package of industrial or intellectual property rights relating to trademarks, trade names, trademarks, utility models, copyrights, know-how or patents that are to be exploited for the resale of goods or the provision of services to end users”. The same EU framework defines the “*franchise agreement*” or *franchise contract* as an agreement by which one company, the franchisor, grants the other, the franchisee, in exchange for a direct or indirect financial consideration, the right to exploit a franchise for the purpose of commercializing certain types of goods and/or services and which includes at least the following obligations regarding: (i) the use of a common name; (ii) the uniform presentation of the contractual premises and/or the means of transport; (iii) the communication by the franchisor to the franchisee of know-how; (iv) the continuous and constant supply by the franchisor to the franchisee of commercial or technical assistance during the contract. We therefore retain the conceptual demarcation between franchise and franchise contract, as it emerges from the wording of the two previously stated texts. Also, the same Union provision defines the *master franchise agreement*” as an agreement by which an enterprise, the franchisor, grants the other, the main franchisee, in exchange for a direct or indirect financial consideration, the right to exploit a franchise for the purpose of concluding franchise contracts with third parties”.

The operation of a franchise always involves the presence of a “contractual place” which means, as the case may be, either the premises used for the operation of the franchise or, when the franchise is operated outside such premises, the base from which the franchisee operates the means of transport used for the operation of the franchise⁷.

Another definition given to franchising at the European level is regulated in article 1 paragraph (1) called “Definition of franchise” of the European Code of Ethics of Franchising⁸ as representing “a system of commercialization of products and/or services and/or technologies, based on a close and continuous collaboration between distinct and independent legal and financial entities, the franchisor and his/her franchisees, in which the franchisor grants his/her

⁷ We are in the presence of the so-called contractual means of transport; see in this sense, article 1 paragraph (1) letter (e) of the European Commission Regulation (EEC) no. 4087/88.

⁸ European Code of Ethics for Franchising.

franchisees the right, and imposes on them the obligation, to conduct the business in accordance with the franchisor's concept".

Considering the definition mentioned above, some clarifications are required, in the sense in which we believe that the text of Article 1 of the Code of Ethics actually defines the franchise contract considering that the content of the text refers to the "obligatory relationship" between the contracting parties, respectively, franchisor and franchisee.

The same Code of Ethics, regulates closely the relationship with the "franchise contract" and the "franchise network" which it does not define but whose characteristics we can "outline" considering the texts of article 2 entitled "Principles" according to which "The franchisor is the initiator a franchise network made up of the franchisor and his/her franchisees, the franchisor having the task of ensuring the sustainability of the franchise network" and article 6 which states that "The franchise network is made up of the franchisor and his/her franchisees. The franchise network, in its organization and development, contributes to improving the production and/or distribution of products and/or services and/or contributes to the promotion of economic and technical progress, ensuring at the same time that consumers benefit fairly from a share of profit".

We conclude, therefore, that the franchise network is built in the form of a "pyramid system" of a franchisor and several franchisees, based on a set of contractual relationships established between the franchisor and each of the franchisees. The Regulation of the European Commission (EEC) no. 4087/88, although it was not adopted as a framework provision in the matter, still brings clarifications regarding the concept of know-how in relation to a franchise, thus, in the given context, it must be substantial, i.e., include useful information about the goods sold or services provided, necessary for end users. Also, the usefulness of the know-how in relation to the franchisee can be identified from the moment the contract is concluded, as it can improve his competitive position by helping him enter a new market. To the same extent, the text of the regulation recommends that within the franchise agreement "an identification" of the know-how be made, i.e., a description "sufficiently comprehensive" so as to meet the criteria of secrecy and confidentiality. This description can be mentioned, as the case may be, either in the franchise agreement or in a separate document.

The provisions of Regulation (EEC) no. 4087/88 were reiterated in article 1 of the European Code of Ethics, article which defines know-how as representing "a set of practical, non-patented information resulting from the franchisor's experience..." always having an "identified, substantial and secret" character.

What does an identified know-how mean? It means that it must be described either within the franchise contract or later through a separate document so as to allow verification of the fulfillment of the conditions of being secret and substantial.

What are the characteristics of a secret and substantial know-how? A secret know-how means that, either as a whole or referring to a certain configuration of it, it is not generally known or easily accessible, *per a contrario*, the secret does not have to cover every component element or impossible to be obtained only from the franchisor. A substantial know-how means a know-how indispensable to the franchisee.

A know-how to be substantial must be original and specific (Leloup, 1991, p. 30; Gheorghiu & Turcu, 2010, p.110). As for originality, it is identified in the relationship between the franchisor and the franchisee in relation to the set of knowledge transmitted and must always give the franchisee a concrete commercial advantage in relation to its competitors.

Last but not least, in accordance with the provisions of article 1 paragraph (1) letter (g) of Regulation (EU) no. 330/2010, “know-how” is defined as “a secret, substantial and identified set of practical, non-patented information, resulting from the supplier's experience and tested by him: in this context, “secret” means that the know-how is not generally known or readily available; “substantial” means that this know-how is significant and useful to the buyer for the use, sale or resale of the contract goods or services; “identified” means that the know-how is described in a sufficiently comprehensive manner to permit verification of the “secret” and “substantial” conditions.

3. New elements generated by legislative changes in the field of franchising

At the national level, following a comparative approach of the two normative acts (Boghirnea, Dinică & Dinică, 2011, pp. 333-342) regulating the franchise, respectively Government Ordinance no. 52/1997 and Law no. 179/2019 amending the ordinance, we can summarize regarding the innovative elements brought to the matter by the amendment norm, that the tendency of the Romanian legislator is clearly oriented towards a closer approach to the acceptance given to the franchise mechanism by the European Code of Ethics but also in accordance with the provisions of the European Commission Regulation (EEC) no. 4087/88.

Thus, according to article 1 paragraph (1) of Government Ordinance no. 52/1997 as amended by Law no. 179/2019, the franchise represents a “system of commercialization of products and/or services and/or technologies, based on a continuous collaboration between natural or legal persons independent from the point of view of legal and financial point of view. Specifically, under this system, a person, called the franchisor, grants another person, called the franchisee, the right and imposes the obligation to operate a business, in accordance with the concept of the franchisor”. The granting of this right authorizes and obligates the franchisee, in exchange for a direct or indirect financial contribution, to use product and service brands, other protected intellectual or industrial property

rights, know-how, as well as copyright. To these one also added signs of merchants. The franchisee receives constant commercial and technical assistance from the franchisor throughout the duration of the franchise agreement as concluded.

In relation to this new definition, we believe that the legislator regulates, in fact, the franchise contract, and we identify the pillars on which it is based, respectively, the presence of terms and phrases specific to an obligatory legal relationship, “collaboration”, “grant rights” and “imposes obligations”, in accordance with the provisions of article 2 paragraph (1) of the European Code of Ethics.

A reiteration of the regulations⁹ of the European Code of Ethics can also be found in the definition of the concept of “franchise network”, as regulated in the current text of article 1 paragraph (2) point (4) amended by Law no. 179/2019, redefined as follows “The franchise network includes a set of contractual relationships between a franchisor and several franchisees, in order to promote a technology, a product or service, as well as to develop the production and distribution of a product or service. The franchisee is supported by the franchisor, through the continuous contribution of commercial and/or technical assistance, within and during the franchise contract concluded between the parties”.

Another innovative element introduced by Law no. 179/2019 is the term “pilot unit”. This term is regulated in the European Code of Ethics in article 2, point 2.2. entitled “Obligations of Franchisor”. Thus, in this article it is stated that a professional trader in order to be able to operate on a certain market using the franchisor capacity in a determined field, must “have successfully operated the business concept, at least in a pilot unit, for a reasonable period of time, prior to the launch of the franchise network”.

The innovative concept of «pilot unit» as taken from European legislation, is defined in paragraph (5) of Article 1, as amended by Law no. 179/2019 as «the equivalent of a prototype, with the aim of to ensure the easiest way to put into practice the franchisor’s successful network, to test the franchise system and its infrastructure, serving the design of the franchise program and the development of training manuals and daily operations».

The use of the concept of «pilot unit» is found in paragraph (4) of Article 2, as introduced in Government Ordinance no. 52/1997 by Law no. 179/2019 in the sense that in order for a professional trader to be able to develop a business in the franchise system, he must as “until the start of his franchise network, he

⁹ The franchise network is made up of the Franchisor and its Franchisees. The franchise network, in its organization and development, contributes to improving the production and/or distribution of products and/or services and/or contributes to the promotion of economic and technical progress, ensuring at the same time that consumers benefit fairly from a share of profit. See in this sense, article 6 of the European Code of Ethics.

must have operated a business concept, for a period of at least one year, at least one pilot unit”.

Another new element that we find dealt with in the amendment law is the redefinition of the contracting parties, respectively franchisor and franchisee. Specifically, as regards the franchisor, it is redefined in the sense that the term «merchant» is replaced by the concept of “professional”¹⁰, (Piperea, 2012, p. 31) considering the changes brought by the current Civil Code and implicitly by the repeal of the Commercial Code. As Article 1(2) redefines, as amended by Law no. 179/2019, the franchisor is a professional who: (a) owns the rights to a registered trademark or any other intellectual or industrial property right¹¹; (b) confers the right to exploit or develop a business, a product, a technology or a service; (c) provides the franchisee with initial training for the exploitation of the registered trademark; (d) uses personnel and financial means to promote its brand, research and innovation, ensuring the development and viability of the product; (e) demonstrates the concrete application of the knowledge it possesses, within a pilot unit».

Also, when we refer to the contracting party entering into an obligatory legal relationship with the franchisor, the Romanian legislator replaces the term “beneficiary”¹² with the term «franchisee», defining it in point (3) of paragraph (2) of article 1 as follows as amended by Law no. 179/2019 as follows “The franchisee is a professional, natural or legal person, selected by the franchisor who adheres to the principle of homogeneity of the franchise network, as defined by the franchisors”. We retain also in the case of the franchisee the qualified quality of “professional” as defined by the current civil code.

Last but not least, the new franchise law foresees as a novelty the establishment of a National Franchise Registry, meaning that the Methodological Norms of October 21, 2019, on the way of organization and operation of the National Franchise Registry were adopted¹³.

The National Franchise Register is established by the Romanian Franchise Association, an association with the following powers:

- (i) adopting a procedure regarding access to the register;
- (ii) use of the register in compliance with the need-to-know principle;
- (iii) periodic updating of the register;

¹⁰ Article 3, paragraphs (2) and (3) of the Civil Code mentions that a professional is the one who operates an enterprise, the operation of the enterprise being the systematic exercise of any type of activity consisting in the production, administration or alienation of goods or the provision of services, with or not for profit.

¹¹ The rights must be exercised for a duration at least equal to the duration of the franchise contract.

¹² As defined in letter (c), paragraph (1) of article 1 of Government Ordinance no. 52/1997.

¹³ Approved by Order no. 1478 of October 21, 2019, published in the Official Gazette no. 892 of November 5, 2019.

- (iv) archiving in individualized folders in electronic format all the documents that form the basis of the registration of operations in the register;
- (v) protecting the franchisor's security and commercial interests;
- (vi) protecting the confidentiality of the information provided.

What does the National Franchise Register (RNC) represent? Considering the provisions of article 1 paragraph (2) in conjunction with the provisions inserted in articles 2 and 3 of the methodological norms, the National Franchise Register constitutes a unitary instrument for recording the information provided by franchisors/master franchisees, established and managed on the basis of article III from Law no. 179/2019 being established in electronic / online format and including mentions as follows: registration, modification/completion and deletion.

As stipulated in Article 4 of the methodological rules, the main entries to be inserted in the National Franchise Register refer to: (a) data regarding the notifications of the information disclosure document regarding the opening of new franchised units; (b) details regarding the identity of the franchise management; (c) the litigation history of the franchisor/master franchisee and its management; (d) the initial amount that the franchisee must invest; (e) mutual obligations of the parties; (f) copies of the franchisor's financial results for the last year; (g) holding information about the pilot unit, (h) changing/updating information or deleting it.

The methodological norms regulate in articles 8-10 the procedure for registration, completion and deletion of mentions. Thus, as regards the registration of franchisors/master franchisees, this is done electronically, as the case may be, upon notification of natural and/or legal persons subject to the registration obligation. After each registration, a current number is assigned during a calendar year, starting with 001, so that each franchisor entered in the register will make the registration number public.

Completion in the National Franchise Register concerns any mentions subsequent to registration and takes place only after the completed document is sent to the Romanian Franchise Association for prior evaluation.

Regarding the modification of entries in the register, it is done based on the notification of the franchisor/master franchisee or if errors are found during the review process by the Association. Last but not least, the operation of deleting the franchisor/master franchisee from the register takes place either upon request or ex officio and always after a prior analysis of the relevant documents from which the failure to fulfill the franchisor qualification results.

Conclusion

We believe that franchising performs poorly in the European Union compared to the United States of America, because the lack of uniform legislation regulated at the Union level makes it difficult to implement or expand the franchise, especially the franchise for cross-border distribution of goods between member states.

Moreover, when we refer to the existing franchise regulatory framework at the level of the member states, it is important to specify that it is impacted differently by the national commercial legislation (Boghirnea, 2008, pp. 28-38) specific to each member state, which causes an even greater difference in approach to state level of the unique theme called «franchise».

Also, the lack of a harmonized EU regulation generates technical barriers in the penetration of a franchise on the EU market, indirectly affecting the EU commercial market as a whole.

Therefore, the presence of a national legislation in accordance with the instruments applicable in the Union space is welcome, but not sufficient for the European Union to represent a territorial context favorable to the development of the franchise.

As a result, in a positive view, a first step would be the adoption by the union co-legislator of some legislative acts, preferably union regulations, or at least a framework directive, for this last hypothesis, remaining within the competence of the national legislature to analyze to what extent the currently applicable internal norms would be compatible with the Union framework provision or otherwise subject to an amendment as an internal transposition norm.

In conclusion, any of the above variants, in their own view, constitute a solution designed to «set the legal story» of the franchise in the legislative harmony between the European Union and the member states.

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