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Franchise in Sweden

– comments on the SGECC franchise
draft from a Swedish perspective

Thesis
20 points

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1. INTRODUCTION

Franchise first appeared in the late 19th century in the USA and has since then spread across the world, continuously while increasing in popularity. Franchise found its way to Europe in the beginning of the 20th century and the first franchise chain in Sweden was established in 1933. It was however not until the 1970's that the great surge of new franchise chains started.¹

The establishment of new franchise networks all over Europe shows no sign of slowing down and Sweden is no exception. According to one study, franchise accounted to roughly 5% of all retail business in Sweden in 1996.² A more recent estimate puts the yearly turnaround of franchise networks at a total of 100.000.000.000 SEK (11 Bn €), with more 100.000 people employed, accounting for roughly 5% of the Swedish GNP.³

Multinational franchise firms such as McDonalds and 7-eleven co-exist with Swedish firms such as ICA and Pressbyrå; even the Swedish post Office conducts much of its business in the form of franchise. Roughly 80% of the franchise businesses in Sweden are of Swedish origin.⁴

Franchise can so far be described as a success but the method is not without its critics. Even though franchise have existed and expanded for a long time not many countries have implemented specific franchise legislation. Legislation is more often found in the USA than in Europe, quite naturally, since franchise have existed longer in the USA. Within the EU only Spain and France have specific legislation dealing with franchise; in the form of rules regarding disclosure.⁵

Is there a real need for legislation? The success of franchise as a business method is often explained as a result of the *absence* of law. It is claimed that franchise have succeeded because there has been no legislation to complicate the dealings of independent businessmen. Total freedom of contract have enabled companies to come to the most favourable solutions for all parties; franchisor, franchisee and customers.

There are however also arguments to be found in support of legislation. The relationship between the franchisor and the franchisee, though in theory a partnership between two independent and equal partners, is in practise often un-balanced. The franchisee is usually dependant on the franchisor; the franchisee has practically no way to affect the content of the franchise contract. After the contract is signed and the business is up and running, the franchisee might find that his control over his business is not

¹ Franchising – Betänkande av franchiseutredningen, SOU 1987:17, 1987, p50

² Franchising i Sverige 2004, SFF, p4

³ Dahlquist, "Franchising erövrar nya branscher – förenar fördelarna med stort och smått" i Entreprenör, 2003 nr 9, p39

⁴ See K Axberg, Franchising i Sverige 1995-96, 1997, p17

⁵ SGECC comment to Article 3:101, paragraph A

what he expected. The contract often includes extensive rights for the franchisor but more rarely does it contain any clauses to safeguard the concerns of the franchisee.

One can thus conclude that not everything regarding franchise is perfect, but the question remains if problems are grave enough to warrant legislation. Correcting the negative aspects without disturbing or ruining the essence and the advantages of the business-method might be a tough task.

The SGECC draft is an attempt to present a solution, and one with ambition; it is meant to find a common ground and establish general principles for all of Europe, not just one country. The nationality aspect might not be something to linger on though, since business and trade today flows all over the EU with few restrictions. Europe is more financially integrated than ever, even if some differences still exist.

The solution put forth by the SGECC draft imposes some mandatory obligations on the franchisor and might thus seem burdensome on him. However, upon closer inspection his obligations might not be so heavy after all. Most of the rules focus on the flow of information between the franchisor and the franchisee – it is here that the basis of most conflict arises – and usually it is in the franchisors interest that such information is passed on to the franchisee anyway, so that the uniformity and efficiency of the franchise network can be maintained.

2. SUMMARY

All in all, legislation, principles, and commercial conduct in Sweden with regards to franchise are already more or less in line with the SGECC's Draft Proposal.

The reasons for this are several, since Sweden is a member of the EU article 81.3 of the EC Treaty is applicable in Sweden, setting up the same legal ground for Swedish franchise as in the rest of Europe. Further, both the Swedish government as well as the Swedish Franchise Association have had an eye to the development of franchise in the rest of Europe; for example the UNIDROIT Model Franchise Law and the European Ethical Rules.⁶

The Swedish government have recently expressed a renewed interest in implementing, in one way or the other, a franchise act; seemingly with an eye to the work of UNIDROIT. The chances of a future successful application of the SGECC draft in Sweden thus look somewhat favourable. The Swedish Franchise Association has expressed positive opinions regarding the content of the UNIDROIT Model law and has implemented a "checklist" based on the UNIDROIT proposal.⁷ The checklist is to be observed by the Swedish Franchise Association's members before constructing a franchise contract. The Swedish Franchise Association's checklist also corresponds fairly well to the SGECC draft.

Further, several labour unions and groups representing franchisees have also made approving comments both of the UNIDROIT initiative and the prospect of implementing a franchise act in Sweden. The consensus seems to be that it would be worthwhile implementing some kind of franchise regulation in Sweden, even though there naturally are some differences in opinion on how far reaching such legislation should be.

In conclusion, after reviewing the SGECC Draft, applicable law and principles, I can come to no other solution than that the Draft is in good harmony with the current franchise situation in Sweden. An implementation of the Draft would serve to clarify uncertainties regarding the obligations of the parties rather than offer a new set of complicated rules.

In my opinion an implementation of the Draft in Sweden could thus be made without too much trouble for the Swedish franchise industry.

⁶ The UNIDROIT proposal should not to be mixed up with the SGECC draft; the draft is more extensive and goes further than the UNIDROIT proposal. However, the basic articles in the UNIDROIT model law are also present in the SGECC draft.

⁷ The Swedish Franchise Association are however still are sceptical to enforce rules regarding franchise by legislation, they prefer the present situation.

3. OBJECTIVE

The objective of this essay is to provide a comparison on the legal status of franchise in Sweden with the SGECC Draft Proposal of a Franchise Law. Like a guidebook or collection of comments it will explain the articles as well as highlight differences and similarities between Swedish law and the Draft proposal. The implications of an implementation of the Draft into Swedish law will be discussed; I will also add my own comments where I deem them appropriate. Hopefully this essay can be of use in the creation of the National notes to the SGECC draft and perhaps shed some light on the concept of franchise in Sweden.

Each article in the Draft will be analyzed separately; because of this some repetition will occur as many of them are based on common principles. This is intentional as the essay is not exclusively meant to be read as a single document, but rather as a guide or reference-paper where one can easily examine the implications of a specific paragraph without having to read the entire essay.

4. METHOD

The method I will use to approach the subject is by quoting each of the articles in the draft in turn, and after each I will offer my comments. I will explain any legislation that might be directly applicable to an article, if it is possible to apply other legislation by analogy or if there are general principles of (contract) law that might be relevant to the subject. Notice will be given to case-law as well as commercial conduct and legal literature.

The scope of this essay is limited to the Franchise chapter of the SGECC Draft. Though some of the articles make references to the PECL, these will not be examined to any length; this is intentional as both time and space is a constraint. This will unfortunately have the consequence that this essay can not provide a complete description of the scope and application of the Franchise Draft, for that, a closer look at the other chapters might be necessary. Nevertheless I believe that this paper will provide a good overview.

After the articles has been given their due attention, I will offer a brief concluding review of the draft as a whole and put it in context with issues that has been of concern in Sweden with regards to franchise. Many of the concerns are common to franchise everywhere but there are some additional particularities to keep in mind for Sweden; e.g. that of labour law and the employees' ability to influence important decisions in the workplace (a right granted to them by Swedish labour law).⁸

⁸ Lag (1976:580) om medbestämmande i arbetslivet, MBL

5. SWEDISH LAW

Franchising today is a huge and still growing way to conduct business. Everyone has heard of corporations such as McDonalds, 7-Eleven and IKEA. Even though franchising is common and found all over Europe, few countries have any specific franchise legislation. Instead, franchise is usually governed by regular contract law. Such is the situation in Sweden, with the additional problem that actual contract law in Sweden is also somewhat limited. The Swedish Contract Act is very old, dating back to 1915⁹, forcing courts to often rely on legal principles, or analogies to acts not directly applicable to a certain problem, to come to a solution in cases presented to them.

There is no legislation especially applicable to franchise. Instead, franchise is treated as just another form of contract that is used in the business world; freedom of contract is the norm.¹⁰

The Swedish Contract Act is limited and does not offer much guidance to what may be included in a contract. Chapter 3 however contain some important articles concerning threat of use of force¹¹, fraud¹², contracts in breach of “good faith and honour”¹³ and, in article 36, a general clause that takes aim on *unreasonable* terms of contract¹⁴. The scope of the articles are all quite narrow, except for the general clause which instead have a very wide scope. It is mentioned in the second paragraph of article 36 that courts shall show special concern for consumers *or parties that are in a similar unfavourable position in relation to the other party*. Courts are however quite restrictive in applying the article in commercial relationships.

Before any Swedish legislation is adopted, the government issues a commission (which is custom made for the occasion) consisting of experts and/or politicians to examine the issue, conduct research and put forth a proposal of legislation. After the legislation has passed (if it does) these reports are taken into consideration when courts decide how the law shall be interpreted in a case. Basically it can be said that these documents are the Swedish equivalent of the English “preambles”. They thus have some importance when examining the legal system, and can often provide guidance on how certain situations should be interpreted under the law.

In 1984 a commission was issued by the (then social democratic) government to examine the possible need of legislation concerning franchise

⁹ Lag (1915:218) om avtal och andra rättshandlingar på förmögenhetsrättens område, AvtL

¹⁰ J & C Ramberg, Allmän Avtalsrätt, p24

¹¹ Avtalslagen 28 §

¹² Avtalslagen 30 §

¹³ Avtalslagen 33 §

¹⁴ Avtalslagen 36 § ”oskäligt”

and in 1987 the commission published its report.¹⁵ It contained suggestions for a franchise act, research regarding franchise in general as well as franchise in Sweden. The report was heavily criticized by some parties, most prominently by the expert representatives of the Swedish Franchise Association, and the implementation of an act was stalled.¹⁶ In 1991 the newly elected government (this time conservative) decided that the suggestion would not be acted upon and that there was no need for a franchise act.

Since then there have been several motions by individual members of parliament to try to get the government's attention to install a new franchise commission and eventually create a franchise act; all such attempts have however been rejected by the parliament majority.¹⁷ The demands have grown louder during recent years, but have still not lead to any lawmaking actions from the government.

In the rejection of the latest motion the UNIDROIT initiative was mentioned. It was pointed out that in case Sweden should go ahead and consider specific franchise legislation, special attention should be paid to the works of UNIDROIT as well as the legal situation in the rest of Europe; to ease the legal integration of the European countries. So even though a formal recognition of the SGECC draft has not yet taken place, the political climate seems somewhat favourable.¹⁸

In conclusion, there is thus no special legislation for franchise in Sweden. There are however sections in other acts that might be applicable in some situations, or at least provide guidelines on how to treat franchise. In the absence of legislation, franchise is instead mostly regulated by extensive contracts and thus general contract law is applicable. Contract law is, as already stated, sparse; so in order to understand the legal status of franchise in Sweden it is often necessary to fall back on general principles of contract law.

¹⁵ Franchising – Betänkande av franchiseutredningen, SOU 1987:17, 1987

¹⁶ Franchising – Betänkande av franchiseutredningen, SOU 1987:17, 1987, p229

¹⁷ For example “Motion 2001/02:LU322”

¹⁸ N.B. The SGECC draft is not yet finally approved and published.

6. THE SGECC'S DRAFT PROPOSAL

The Study Group on a European Civil Code is a network of academics, from across the EU, conducting comparative law research in private law in the various legal jurisdictions of the Member States. The aim is to produce a codified set of Principles of European Law for the law of obligations and core aspects of the law of property. The published principles will be complete with commentary and annotations.¹⁹

The latest draft on the subject of Long-term Contracts is from June 2003 and the text includes articles on commercial agency, franchise, distribution and other long-term commercial contracts taken from the paper submitted to the Helsinki meeting of the Coordinating Group by the long-term contracts sub-team of the Working Team on Sales, Services and Long-term Contracts.

The chapter regarding long term contracts is written by a Dutch team, the Amsterdam group. The Draft Proposal on Franchise has been supervised by Professor Martijn Hesselink.

A few of the proposed articles are mandatory but many of them are of a non-binding character, enabling the parties to agree on other content if they so wish. On one hand it can be tempting to state that non-mandatory articles make the draft redundant – why have rules that you are not required following anyway? On the other hand it can be argued that the draft will provide a solid background to any franchise contract, offering guidance to what should be achieved with the contract – thus indirectly restraining some of the freedom that franchise enjoys today.

¹⁹ Information quoted from the SGECC webpage, www.sgecc.net

7. Section 1: General

Article 3:101: Scope

This Chapter applies to contracts whereby one party (the franchisor) grants the other party (the franchisee), in exchange for remuneration, the right to conduct a business (franchise business) within the franchisor's network for the purposes of selling certain goods or services on the franchisee's behalf and in the franchisee's name, and whereby the franchisee has the right and the obligation to use the franchisor's trade name or trademark, the know-how and the business method.

Comment

When creating a law about franchise the first problem is that there is no clear definition of what franchise really is. It is thus necessary to define what is to be considered franchise, and that is actually not an easy task – franchise can cover a wide range of contracts.²⁰

The essential elements that characterize a franchise contract according to the SGECC draft are:

- a) the use of know-how and intellectual property rights
- b) selling certain types of goods or certain types of services
(distribution contract)
- c) the franchisee's independence
- d) financial remuneration for the franchisor

It can be noted that providing *assistance* is not considered an essential element, this differs from the definition used in EC rules. The SGECC thus have a slightly wider scope in its application than the EC rules.²¹

Swedish law

The only legal definition of franchise in Swedish law can be traced to article 81 of the EC treaty. Since this essay primarily is concerned with Swedish law, we will have to look to other sources for defining what is to be considered “franchise” in Sweden today.

²⁰ It should be noted that the term “franchise” as used in the Draft defines what is called “business format franchise” in the U.S.A. This is what is usually meant when referring to franchise in Sweden or indeed Europe. In the U.S.A. there is also “trade-name franchising” and “straight product franchising”; in Europe and Sweden those forms are not included when talking about franchise. – S. Sohlberg, *Franchisejuridik*, 2001, p11

²¹ SGECC comment to article 3:101, paragraph A

Other sources

“Franchise” is more or less a business term used for contractual relationships of varying content. The Swedish Franchise Association offers a definition that seems to describe the situation well: Franchising is a form of “concept-co-operation” where one company develops an entire business concept for how a business should be managed, and then rents this concept to other companies in long term contracts, where the other company takes upon them to use the concept for a fee.²²

The Swedish Franchise Commission also offered a definition of franchise. In the proposed act the first article describes what is to be considered franchise: “*franchising is a contractual co-operation between a franchisor and a franchisee, whereby the franchisor allows one or more franchisees to conduct a business using the franchisors brand, trademarks or other special product brands*”.²³ This is in accordance with the SGECC draft, even though the SGECC also specifies that franchise should consist of the know-how and the general business method (see above).

As we can see the definition proposed by the draft is similar to the definitions used by the Franchise Commission and the Swedish Franchise Association.

In the “Radisson” case the Swedish Competition Authority offered the following definition: “*Significant for a franchise contract is that one company, the franchisor, to the other company, the franchisee, grant the rights to use [...] intellectual property rights in return for economic compensation, for example trademarks [...] or know-how.*”²⁴

The two most important facts whether a contract should be considered a franchise contract in Sweden are the franchisee’s duty to use the franchisor’s trademarks, and intellectual property, and that the franchisee undertakes to act according to the franchisor’s business model.²⁵ The definition in the proposed paragraph incorporates both these requirements.

The pre-requisites for defining a business venture as franchise in Sweden thus strongly resemble the proposed article. The approval, and obligation, to use intellectual property and trademarks for the franchisee are considered essential for defining a business as franchise.²⁶

A franchisee’s position can sometimes be said to resemble that of an employee and in rare cases the dependence is so great that the contract may be considered an employment contract. Swedish employment law can be

²² S Sohlberg, Franchisejuridik, 2001, p12

²³ Franchising – Betänkande av franchiseutredningen, SOU 1987:17, 1987, p23

²⁴ Konkurrensverkets beslut, 596/94 Radisson (translation by me)

²⁵ SFF checklista pt 4, 6, 8

²⁶ S Sohlberg, Franchisejuridik, 2001, p32, 41

quite strict (at least when compared to a franchise contract), so such a definition is not at all desired by the franchisor. Swedish courts have considered this problem on a few occasions, and the conclusion seems that there are only in very special cases that a contract can be considered an employment contract. In almost all cases labour law will not interfere with a franchise contract.²⁷

As stated in the general comments to the draft, there is a difference between the proposed draft and the definition used by European Competition rules.²⁸ The proposed article does not include a requirement that assistance should be a part of the contract. As Sweden is a member of the EU, the EC rules are applicable in Sweden, and the proposed draft then of course differs from what can be considered Swedish law in that aspect.

That being said, the requirement that a franchise contract should be more than a distribution contract can hardly be said to be a controversial rule; as shown by the opinions of the Swedish Franchise Association and the Franchise Commission.²⁹

Conclusion

Since there is no legal definition of franchise in Sweden it is not possible to make a statement whether or not the proposed definition is in accordance with Swedish law or not. The proposed article is however similar to the definition used in franchise relationships in Sweden, as well as the definitions used by the Franchise Commission.

The draft article would thus not alter the legal situation in Sweden but would rather serve to clarify what should be considered franchise.

Since the proposed article is so similar to the definitions used to describe franchise in Sweden today, it is also likely that the majority of franchise contracts in Sweden would fall within the scope of the SGECC Draft, should it be implemented in Sweden.

An important question to keep in mind is that since franchise is hard to define there will still be cases where it is difficult to tell if a contract is a franchise contract or not. Thus it is possible that there will be room for unscrupulous companies to avoid the obligations according to the Draft by constructing contracts that fall outside the scope of the definition.

²⁷ AD 1983 nr 89 (Kokosbollar) & AD 1980 nr 24 (Singermälet), Franchising – Betänkande av franchiseutredningen, SOU 1987:17, 1987, p98 ff

²⁸ SGECC comment to article 3:101, paragraph A

²⁹ Franchising – Betänkande av franchiseutredningen, SOU 1987:17, 1987, p40

Article 3:102: Pre-Contractual Information

(1) The obligation to disclose pre-contractual information (Article 1:201) requires the franchisor in particular to provide the franchisee with adequate and timely information concerning:

- (a) the franchisor's company and experience,*
- (b) the relevant intellectual property rights,*
- (c) the characteristics of the relevant know-how,*
- (d) the commercial sector and the market conditions,*
- (e) the particular franchise method and its operation,*
- (f) the structure and extent of the franchise network,*
- (g) the fees, royalties or any other periodical payments,*
- (h) the terms of the contract.*

(2) If the franchisor's non-compliance with paragraph 1 does not give rise to a fundamental mistake under Article 4:103 PECL, the franchisee may recover damages in accordance with Article 4:117(2) and (3) PECL, unless the franchisor had reason to believe that the information was adequate or had been given in reasonable time.

(3) The parties may not derogate from this provision.

Comment

Before any contract is signed it is important that both parties have a good grasp of what they are doing, especially concerning franchise contracts. A franchise relationship is supposed to last a long time and it is therefore important that the parties trust each other and have a common goal with the agreement. If the trust between the parties is damaged or if one party feels mistreated by the other, the franchise relationship normally cannot continue. The best way to avoid such incidents is to keep the other party informed during the negotiations leading up to the contract and continue to share information after the contract has been signed. Only between well informed and trusting partners can a healthy franchise relationship be established.

This article concerns information prior to the signing of a contract, the duty of information after the contract is signed is covered by two other articles (se below).³⁰

If the franchisee gets into fiscal problems and is forced to close down or faces bankruptcy, it is not uncommon for him to feel betrayed and misled by the franchisor. Especially so if he was not given proper information before he entered into the franchise agreement, or if the franchisor has not bothered to keep him informed during the contract; the feeling of betrayal can be strong.³¹

³⁰ Article 3:205 & 3:302

³¹ For one example see: Svenska Dagbladet 23-11-2004

The SGECC Draft imposes requirements of mandatory information that the franchisor must pass on to the franchisee before a contract is signed. The article further specifies what type of information the franchisor shall provide to the franchisee before a contract is signed.

The article also provides the franchisee with remedies in case the franchisor fails to fulfil his obligations – the franchisee then has the right to claim damages. This might be a difference from Swedish law today (see below).

The article basically protects the franchisee's interest in the negotiations leading up to the contract.³² It aims at ensuring that the franchisee has enough information to make a well informed decision before he enters into the business venture. The franchisee is essentially recognised as the weaker party, something that is quite apparent in such early dealings as discussed here. The franchisor is usually a well established and large company with its own legal staff, whereas the prospective franchisee is on his own.

In accordance with the obligation of pre-contractual disclosure in chapter 1:201 PECL the proposed article also offer the franchisee the possibility to seek remedies for mistakes according to the PECL should the franchisor not provide adequate and timely information. There is further a possibility to claim damages according to article 4:106 PECL, under circumstances stated in the article.³³

The present article can thus be considered a special instance of the general pre-contractual duty to inform under chapter 1 PECL.³⁴

Swedish law

The Swedish Contract Act does not contain any articles that regulate the disclosure of information before the signing of a contract. There is thus no formal rule that requires the franchisor to disclose information to the franchisee.

However, if the franchisor, through misleading information or through silence, has led the franchisor to believe something that was incorrect, and thus made him sign a contract he would otherwise not have entered into; it will be possible to claim that the contract should be void because of fraud.³⁵ This is however criminal behaviour and a rare occurrence.

³² SGECC comment to article 3:102, section B

³³ SGECC comment to article 3:102, section G

³⁴ SGECC comment to article 3:102, section D

³⁵ Avtalslagen 30 §

According to article 33 of the Swedish Contract Act, contracts may be also deemed void if it would be contrary to *good faith and honour* to uphold them. The scope of the article is however limited and it is seldom used.

Instead, article 36 provides a broader possibility to modify a contract or a contract clause (contrary to article 33 which is only applicable to the contract as a whole); in case it is deemed *unreasonable*. It is possible that, in the case that a party have withheld information from the other party before the signing of a contract, article 36 may be used to modify the contract.

According to Swedish law both parties of a contract have an obligation to act loyally and in accordance with good faith in their relationship with each other. This is a general principle of contract law. Thus, a party that withholds vital information from the other party might be in breach of the principle of loyalty.

It shall also be noted that when two parties have a more long lasting contractual relationship their obligation to show loyalty to the other party might be enhanced. It is more important to act according to good faith in dealings that are meant to last a long time than in instant transactions.

Thus, if a franchisee would like to receive information from the franchisor, but there is no clause in their contract that grant him that right, he would have to resort to claiming the contract shall be modified by virtue of article 36 of the Swedish Contract Act. He can then claim that he has a right to information, either because such a right is an implied term in any franchise contract; or that that the contract shall be interpreted in such a way as to give him that right, as it would be unreasonable for the contract not to grant him that right. If it can be shown that it is commercial conduct for franchisors to provide information to franchisees, he would have a strong argument that it would indeed be unreasonable.

The parties' duty to inform can also be in its own interest, to void any misconceptions the other party may have. This principle can be found in the Swedish Sales Act.³⁶

If the franchisor do not care to provide relevant information to the franchisee, there is thus a risk that the contract may be attacked at a later stage and deemed void, or modified because unreasonableness.

The legal situation is however uncertain.

³⁶ Köplagen 17§ 3st.

Other sources

The Franchise Commission came to the conclusion that the franchisee was the weaker party, and therefore might need some protection. Their main concern was however not the pre-contractual obligations, but the fact that the contracts often give the franchisor the right to unilaterally modify the appendixes to the contract at a later stage. The Franchise Commission feared that this was a right that the franchisor could be tempted to misuse.³⁷

The Swedish Franchise Association has issued a special document titled “The franchisors responsibility to provide information”³⁸. It stresses the importance that the franchisee gets as much and as correct information as possible before the contract, since becoming a franchisee is not something to be taken lightly. It involves lots of work and commitment and it is recommended that the franchisee seeks out information himself as well.

Added to the document is a checklist which specifies what the parties should consider, and within what areas information should be provided. The information is to be provided to the franchisee at least 14 days prior to the signing of the contract, and it should also come with a pledge of confidentiality that the franchisee should sign, as the document will contain data that the franchisor would like to keep secret from competitors. The information itself should not be older than 12 months.

A comparison with the list in article 3:102 in the SGECC Draft reveals that the provisions (a) through (h) all have their counterparts in the checklist. The Swedish Franchise Association’s list is even somewhat more extensive, also covering several sub-specifications of each requirement.

Finally there is a recommendation to other franchisors, that wish to “act ethically” also follow the steps and the checklist. The compliance with this list within franchise-networks that are not members of the Swedish Franchise Association is however not documented.

The ethical rules and checklist thus strongly resembles the SGECC Draft. This is in part due to the Franchise Association being inspired by the UNIDROIT proposal, which in turn resembles the SGECC Draft.

Conclusion

The proposed article differs from Swedish law in the sense that the Draft article clearly states what information a franchisor shall provide to a franchisee before the signing of a franchise contract. It also provides a clear remedy – compensation is possible according to all the remedies for mistake according to the PECL, as well as according 4:106 PECL under special circumstances.

³⁷ Franchising – Betänkande av franchiseutredningen, SOU 1987:17, 1987, p169

³⁸ SFF, Franchisegivarens upplysningsansvar, 2002

Swedish franchise contracts are governed by legal principles with similar content but the outcome in a particular case is hard to predict. Due to the lack of a clear definition of “franchise” and specific rules regarding pre-contractual information, the outcome will always depend on the discretion of the court.

The views expressed by the Franchise Commission as well as the commercial conduct of most franchise networks are however both in line with the suggested article. This implies that an implementation of the Draft article may serve to legally clarify the responsibilities of the franchisor rather than to place new burdens on him.

8. Section 2: Obligations of the Franchisor

Article 3:201: Intellectual Property Rights

- (1) The franchisor must grant the franchisee a right to use the intellectual property rights to the extent necessary to operate the franchise business.*
- (2) The franchisor must make reasonable efforts to ensure the undisturbed and continuous use of the intellectual property rights.*
- (3) The parties may not derogate from this provision.*

Comment

Intellectual property rights have a core function in franchise agreements. It is by operating under a common name and logo that franchise networks build their image and coordinate their marketing efforts. The individual franchisees gain by being able to make use of the goodwill created by the entire network. The franchisor on his part will easier attract new people willing to join his franchise network and thus expand his business, share of the market, and his profits.³⁹

Article 3:101 states that the franchisee has the obligation to use the franchisor's trade name or trademark, the present article (3:201) is in essence a specification of that requirement.

The purpose of the article is to assure that the franchisor has the legal rights to the intellectual property rights associated with the franchise. It also imposes a duty on the franchisor to act on any copyright infringements that might occur – this is an important rule for the franchisees – if infringement occurs, the goodwill of the network might be damaged and cause serious problems to the franchisees. The duty naturally falls on the franchisor since it is he who owns the intellectual property rights and only he can file suit against infringements.⁴⁰

Swedish law

Since there is no franchise legislation in Sweden general contract law applies; according to the general principle of “freedom of contract” the parties are more or less free to stipulate any terms they wish.⁴¹

³⁹ S Sohlberg, Franchisejuridik, 2001, p30

⁴⁰ SGECC comment to article 3:201, paragraph A

⁴¹ J & C Ramberg, Allmän Avtalsrätt, 2003, p24

Should a franchise contract governed by Swedish law not contain any rules regarding the transfer of intellectual property rights, the situation is thus unclear. The franchisee would have to argue that by virtue of article 36 of the Swedish Contract Act, the contract should be modified to give him a right to use the franchisors intellectual property rights. He could base such a claim on the grounds that it is in the nature of a franchise contract that he should be granted such a right; or that it would be *unreasonable* that he would not be granted a right to use the franchisors intellectual property rights.

Since there is no approved definition of franchise, a claim that it is in the nature of the contract is not guaranteed to succeed. The fact that intellectual property is of such importance to a franchise contract will be in his favour, but on the other hand a franchise contract is a contract between two legal persons, and courts are usually reluctant to modify such contracts to any great extent. There is however indication that the transfer of intellectual property shall be considered commercial conduct, something that strongly would speak in favour for interpreting a franchise contract to include such an obligation (se below).

Other sources

The Franchise Commission did not present any rules dealing with the obligations of the franchisor or the franchisee with regard to intellectual property. Neither were the problems associated with it discussed at any length.

The Swedish Franchise Association states that the use of intellectual property rights is something that should be included in a franchise contract.⁴² The proposed article is basically in line with what is already commercial practice in Sweden.

Know-how and the more formal intellectual property rights are usually discussed in the same context in Swedish franchise, even though there are differences. This can probably be attributed to the fact that most discussion and writings about franchise in Sweden are made out of a business economical perspective and not a legal perspective.⁴³

The transfer of intellectual property is generally deemed to be of outmost importance to a franchise contract in Sweden.⁴⁴

⁴² SFF checklista, pt 7

⁴³ S Sohlberg, Franchisejuridik, 2001, p13

⁴⁴ S Sohlberg, Franchisejuridik, 2001, p31

Conclusion

Swedish law do not contain any article that clearly states that intellectual property have to be transferred from the franchisor to the franchisee, but it might be suggested that such a clause is an implied term in any franchise contract. Even though there is no agreement on an exact definition of franchise, the consensus seems to be that the use of intellectual property is one of the core concepts.

It can be noted that the article almost states the obvious; according to article 3:101 transfer of intellectual property is a requirement for a contract to be characterised as a franchise contract at all, this article is simply a reiteration of that criteria.

Since what seems to define franchise in Sweden is similar to that of the Draft article 3:101, the proposed article will thus not have a great impact on the legal situation concerning franchise in Sweden. It might however serve to clarify the definition of franchise.

Article 3:202: Know-How

(1) Throughout the duration of the contract, the franchisor must provide the franchisee with the know-how which is necessary to operate the franchise business.

(2) The parties may not derogate from this provision.

Comment

The know-how that the franchisor possesses is, together with his trademarks (see article 3:201 above), the most interesting value that the franchisor can offer to the franchisee. It is thus of great importance for the franchisee that he is granted access to that knowledge. This is often accomplished through the handing over of operational manuals and ongoing assistance. The present article means to establish that the franchisor does not only have the right to provide and update the know-how, but also the obligation to do so.⁴⁵

Know-how is also one of the things listed in article 3:101 as a prerequisite for defining a contract as a franchise contract. Article 3:202 is in essence a re-iteration of this criterion.

The obligations to provide know-how is an obligation in the sense of article 8:101 PECL, and in case of non-performance the aggrieved party may resort to the remedies in chapter 9 PECL.⁴⁶

Swedish law

In Sweden the transfer of know-how is regularly included in franchise contracts, usually in the form of manuals or guidebooks that the franchisor provides the franchisee with. The EC definition of franchise also requires a contract to include a transfer of know-how from the franchisor to the franchisee. The new article 81 of the EC treaty however make no mention of franchise is particular, but it is likely that they requirement for the franchisor to transfer know how to the franchisee is still applicable; without it a contract will not be considered a franchise contract.⁴⁷

Transfer of know-how is however so closely tied to the concept of franchise that it might be appropriate to say that a requirement to transfer know-how to the franchisee is something that is *in the nature of the contract*. It is simply something that has to be there for a contract to be a

⁴⁵ SGECC comment to article 3:202, A

⁴⁶ SGECC comment to article 3:202, I

⁴⁷ S Sohlberg, Franchisejuridik, 2001, p15, p34

franchise contract at all. This is in the end however something that must be decided by a court.

A franchisee could also argue that, by virtue of article 36 of the Swedish Contract Act, it would be unreasonable if the franchisor should not be required to support him with the relevant know-how. Considering the importance of know-how in a franchise contract, it is possible that he could succeed with such a claim.

Other sources

In addition to EC law, the Swedish Franchise Association's checklist for franchise contracts state that it is the obligation of the franchisor to provide adequate know-how to the franchisee.⁴⁸ Their ethical rules also mention that the franchisor should give the franchisee an introduction as well as continuously give commercial and technical support throughout the lasting of the contract.⁴⁹

Also, the Swedish Franchise Association's ethical rules state that any contract regarding franchise should include a paragraph that regulates the franchisor's obligations to the franchisee regarding the transfer of know-how and use of intellectual property.⁵⁰ To inform and train retailers is not a feature exclusive to franchise, but it is an essential part of the franchise contract.⁵¹

The Franchise Commission also observed that the transfer of know-how was something that was always present in franchise contracts (this was even before Sweden became a member of the EC).⁵²

Conclusion

The proposed article is in line with current Swedish law and commercial practice. Transfer of know-how is also so closely tied to the concept of franchise, that it might be appropriate to say that a requirement to transfer know-how to the franchisee is *in the nature of the contract*.

The proposed article is of a mandatory character, something that in theory might be a slight difference from the situation today, but in practise probably would have no effect (since as mentioned know-how is so closely tied to the definition of franchise).

⁴⁸ SFF, checklista pt 3

⁴⁹ SFF, etiska regler pt 2.2

⁵⁰ SFF, etiska regler pt 5.4

⁵¹ S Sohlberg, Franchisejuridik, 2001, p33

⁵² Franchising – Betänkande av franchiseutredningen, SOU 1987:17, 1987, p56

Article 3:203: Assistance

(1) The franchisor must provide the franchisee with assistance in the form of training courses, guidance and advice, in so far as necessary for the operation of the franchise business, without additional charge for the franchisee.

(2) The franchisor must provide further assistance, in so far as reasonably requested by the franchisee, at a reasonable cost.

Comment

Franchisees are often persons who otherwise might not start their own businesses; they usually have the entrepreneurship and willingness to run a business but might be lacking in accounting, logistical and other administrative skills that is needed to manage a company. By joining a franchise network they can concentrate on running the shop (or whatever franchise they are involved in) while letting the franchisor take care of the more administrative tasks of bookkeeping etc.

However, they still need to have a general grasp of how to run things, not to mention that they need training on exactly how a specific franchise should be run. The franchisor has a concept and wants it to be used by all his franchisees; often the franchisee will get a huge package of information and directives on how to organise things.

It is thus important for the franchisee that he receives any training and assistance that he might require to run a successful business, and to get it without having to pay extra. Ideally it is in both parties interest to make sure that such assistance is given. In case it is not, this article is to act as a safeguard for the franchisee.⁵³

This article does not only give the franchisee the right to information and assistance when setting up the franchise, but also to request additional assistance during the contract. It is thus somewhat different from article 3:202 concerning know-how (above), since it only requires the franchisor to provide the know-how – the current article also makes it his obligation to help the franchisee understand and use the information correctly.⁵⁴

The franchisor will thus have a burden placed on him, since it requires him to continuously collaborate actively with the franchisees in order to guarantee that they operate the business correctly. This is however also in

⁵³ SGECC comment to article 3:203, paragraph B

⁵⁴ SGECC comment to article 3:203, paragraph A

the franchisor's interest, since a uniform performance of all the franchisees is positive for the entire network, and thus also the franchisor.⁵⁵

Swedish law

According to general principles of contract law there is a requirement of the parties of a contract to act loyal in their relation to each other.⁵⁶ A party must act in accordance with the contract, *pacta sunt servanda*.⁵⁷

If this also includes an obligation for the franchisor to provide assistance to the franchisee in case there is no contract that explicitly gives him such an obligation is however more difficult to answer. It is true that the franchisee can have a great interest in receiving such assistance, and that it might be important for the network that he does, but without contract the franchisor may not have such an obligation.

It can be argued that assistance to the franchisee is of such great importance for the network that is something that the franchisor should be required to provide according to the principle of loyalty.

Another possibility is to argue that it is in the nature of a franchise contract that the franchisor shall provide assistance to the franchisee. This is however uncertain, especially since there is even no clear definition of franchise at all in Sweden.

According to article 36 of the Swedish Contract Act there is also the possibility that it would be unreasonable if no such obligation existed. If a requirement that the franchisor shall be obliged to provide assistance can be proved to constitute commercial conduct, a franchise contract brought before a court would be likely to be interpreted so that such a requirement shall be included in the contract.⁵⁸

The legal situation is however uncertain.

Other sources

To lend support to the franchisees with training courses and information is almost always an integral part a franchise contract in Sweden.⁵⁹ To what extent the franchisor should do so varies, however. The quality of the

⁵⁵ SGECC comment to article 3:203, paragraph B

⁵⁶ J & C Ramberg, *Allmän Avtalsrätt*, 2003, p40

⁵⁷ J & C Ramberg, *Allmän Avtalsrätt*, 2003, p24

⁵⁸ J & C Ramberg, *Allmän Avtalsrätt*, 2003, p202

⁵⁹ S Sohlberg, *Franchisejuridik*, 2001, p34

support can hardly be qualified in the contract. The extent and frequency of the information that the franchisor should provide is easier to regulate.⁶⁰

The Swedish Franchise Association's list of ethical rules states that the franchisor should give the franchisee an introduction education as well as continuously give commercial and technical support throughout the contract.⁶¹ Further, it also states that any contract regarding franchise should include paragraphs that regulate the franchisor's obligations to the franchisee regarding the transfer of know-how and use of intellectual property.⁶²

Conclusion

The proposed article differs from Swedish law in that it establishes a right for the franchisee to receive assistance in cases where the issue have not been regulated through contract. Assistance is however something that almost always is included in Swedish franchise contracts today.⁶³ The proposed article is thus in line with commercial practise in Sweden.

The proposed article would in any case serve to clarify the situation regarding the franchisor's duties, even though the actual situation will probably stay the same.

Since the article is not of a mandatory character it would not affect the possibility of the parties to regulate assistance in the contract. There will however be some additional burden placed on franchisors in cases where assistance has not been regulated.

⁶⁰ S Sohlberg, Franchisejuridik, 2001, p33

⁶¹ SFF, etiska regler pt 2.2

⁶² SFF, etiska regler pt 5.4

⁶³ SFF, checklista pt 3

Article 3:204: Supply

(1) When the franchisee is obliged to purchase goods or services from the franchisor, or from a supplier designated by the franchisor, the franchisor must ensure that the goods or services ordered by the franchisee are supplied within a reasonable time, insofar as practicable and provided that the order is reasonable.

(2) Paragraph 1 also applies to cases where the franchisee, although not legally obliged to purchase from the franchisor or from a supplier designated by the franchisor, is in fact required to do so.

(3) [The parties may not derogate from this provision.]

Comment

An obligation for the franchisee to buy his goods or services from a source specified by the franchisor is common in franchise contracts.⁶⁴ It binds the franchisee to acquire his supply of goods from the franchisor or from a supplier approved by the franchisor. It is an important article in the sense that the franchisor wants to be able to control what is sold by the franchisees, since he desires that the products sold are of the same quality and brand.⁶⁵

If the franchisee has the obligation to only buy from the franchisor, it is quite natural to also place some burden on the franchisor – he must be able to provide the franchisee with the requested goods. This is what the proposed article aims to make sure.

The franchisor is however only obliged to supply reasonable orders from the franchisee, and only in so far as it is practicable to do so.⁶⁶

Swedish Law

The Swedish Contract Act is based on the principle that the parties of a contract should be loyal in their dealings with each other; this might imply that they have some sort of obligation to provide information to the other party under certain circumstances. How far-reaching this duty is will be decided by a court in a particular claim; there is no definitive article that describes the situation.

⁶⁴ SGECC comment to article 3:204, paragraph A

⁶⁵ Franchising – Betänkande av franchiseutredningen, SOU 1987:17, 1987, p57-58

⁶⁶ SGECC comment to article 3:204, paragraph B

In the Swedish Sales Act there is however a provision that might be applicable by analogy. Article 9 of the Sales Act state that if no time of delivery has been agreed, the seller shall instead deliver the goods within a “reasonable” time.

Other sources

This rule has no corresponding article in the checklist provided by the Swedish Franchise Association. The ethical rules, 5.4.3, state that the parties should include in the contract if there are any special rules regarding the goods and/or services that the franchisee should use in his business.

Conclusion

The proposed article will, with its mandatory character, impose a burden on the franchisor regarding the time he has to deliver the goods to the franchisee. However, there are several vague statements in the article that will make it hard to interpret.

The difference from the situation according to Swedish law might not be great anyway. The Swedish Sales Act already state that a seller must deliver within a reasonable time in case the parties have not agreed on a date of delivery.

The draft article will in any case offer some guidance on the franchisor’s duties within the scope of a franchise contract.

Article 3:205: Information during the Performance

The obligation to inform (Article 1:203) requires the franchisor in particular to provide the franchisee with information concerning:

- (a) market conditions,*
- (b) commercial results of the franchise network,*
- (c) characteristics of the goods and services,*
- (d) prices and terms for the sale of goods or services,*
- (e) any recommended prices and terms for the resale of goods or services,*
- (f) relevant communication between the franchisor and customers in the territory,*
- (g) advertising campaigns.*

Comment

According to article 1:202 PECL (not discussed further in this essay) both parties to a contract have the obligation to cooperate in order to give full effect to the contract. It is important that both parties provide each other with information; it can make their performance easier and more successful.⁶⁷

This particular article is aimed at the franchisor; since it is he who possesses the relevant information regarding the franchise network, the duty to inform is more intense for him. At the same time the obligation to inform the franchisees also benefits the franchisor, since by providing such information to the franchisor makes sure that the franchisees operate the business in a uniform manner.⁶⁸

Swedish law

There are no specific requirements in the Swedish Contract Act that require a party to provide information to the other party, but there is a general principle of loyalty that is applicable to the parties of a contract. They are obliged to act in good faith when dealing with each other.

If a franchisee would like to receive information from the franchisor, even though there are no clause in their contract that grant him that right, he would have to claim that the contract shall be modified by virtue of article 36 of the Swedish Contract Act. He can then claim that he has a right to information, either because such a right is an implied term in a franchise contract, or because that the contract shall be interpreted in such a way as to

⁶⁷ SGECC comment to article 3:205, paragraph B

⁶⁸ SGECC comment to article 3:205, paragraph B

give him that right as it would be unreasonable for the contract to not grant him that right. If it can be shown that it is commercial conduct for franchisors to provide such information to franchisees, he would have a strong argument that it would indeed be unreasonable.

The legal situation is however uncertain.

Other Sources

The Franchise Commission found that all the contracts they had studied in their work contained articles that regulated the duty of the franchisor to provide information to the franchisee.⁶⁹ They did however not propose any articles to regulate the subject. The Commission did not stress the importance of information (their focus was on other issues) to any length.

In Sweden a company's annual report is open to the public, anyone is therefore free to examine the details of the company within the extent of what the law provides that the annual report must contain. The Swedish Franchise Association has expressed that in their opinion this give the franchisee a good possibility to acquire information regarding the financial state of the franchisor.⁷⁰

Conclusion

The proposed article in essence describes what is already included in many franchise contracts in Sweden; the non-mandatory character of the rule would also mean that the article could be excluded from a franchise contract should the franchisor find it to burdensome. The most likely effect of the article would be to serve as a reminder to the franchisor about what information that the franchisees are most likely need.

Thus, the article resembles commercial conduct in Sweden and does not contradict any Swedish legislation. The proposed article is not mandatory, and would only be applicable in cases where the parties have not regulated the issue of information during the performance.

⁶⁹ Franchising – Betänkande av franchiseutredningen, SOU 1987:17, 1987, p56

⁷⁰ SFF Remissivar beträffande motionerna LU 2001/02: L257, L270, L282, L335, L345; p10

Article 3:206: Warning of Decreased Supply Capacity

(1) When the franchisee is obliged to purchase goods or services from the franchisor, or from a supplier designated by the franchisor, the franchisor must warn the franchisee within a reasonable time when the franchisor foresees or ought to foresee, that the franchisor's supply capacity or the supply capacity of the designated suppliers will be significantly less than the franchisee had reason to expect.

(2) Paragraph 1 also applies to cases where the franchisee, although not legally obliged to purchase from the franchisor or from a supplier designated by the franchisor, is in fact required to do so.

(3) the parties may not derogate from this provision to the detriment of the franchisee.

Comment

This article is a specification of what information a franchisor should provide to the franchisee. It aims to protect the franchisee since he entirely depends on the supply capacity of the franchisor and his designated suppliers. By getting advance warning from the franchisor the franchisee will be able to adapt his business to lower supply, for instance he will be able to decline orders from customers that would not be able to fulfil because of the unavailability of goods from the franchisor.

This also benefits the franchisor and the network as a whole since everyone benefits if the reliability of the franchise network can be maintained.⁷¹

Swedish law

According to Swedish law there is a general principle of loyalty applicable to the parties of a contract; they shall act in good faith when dealing with each other. It is also recognized that this principle contains an obligation for a party to help mitigate damages that the other might suffer if you fail to comply with the contract.⁷² This principle can be found in the Swedish Sales Act article 70; it is generally agreed that this is indeed the expression of a general principle.⁷³

Also, article 28 of the Swedish Sales Act state that if a seller is hindered from delivering the goods in time, he shall notify the buyer thereof. The reasoning is that the buyer shall have the possibility to limit his

⁷¹ SGECC comment to article 3:206, paragraph B

⁷² J & C Ramberg, Allmän Avtalsrätt, 2003, p40

⁷³ Köplagen 70 §

losses and be able to modify his business accordingly. If the franchisee is unable to deliver to the franchisor he will thus be liable to compensate the franchisee's losses.⁷⁴

Even without contract the franchisee has the right to receive information from the franchisor that, if provided, will save the franchisee from losses or additional costs. If no actual loss occurs for the franchisee however, he would not have a claim of damages solely based on the fact that no information was provided.

Other sources

The problem of the franchisee's dependence of the franchisor when it comes to the supply of goods was not mentioned by the Franchise Commission, and neither has the Swedish Franchise Association touched the subject.

Conclusion

The proposed article is in accordance with the general principle of loyalty and the principle that a party have to help the other party mitigate his damages. The Draft article thus resembles applicable Swedish law.

⁷⁴ Köplagen 28 §

Article 3:207: Reputation of Network and Advertising

(1) The franchisor must make reasonable efforts to promote and maintain the reputation of the franchise network.

(2) In particular, the franchisor must design and co-ordinate the appropriate advertising campaigns aiming at the promotion of the franchise network.

(3) The activities of promotion and maintenance of the reputation of the franchise network are to be carried out without additional charge to the franchisee.

Comment

The purpose of this article is to guarantee that the franchisor spends enough effort on promoting and marketing the franchise network. The franchisor is required not only to design and co-ordinate promotional campaigns but also to pay all the expenses concerning the advertising when it responds to the franchisor's initiative.⁷⁵

Swedish law

According to the general principle of loyalty parties shall act in good faith when dealing with each other. To claim that performing advertising free of charge is within the scope of that principle may be stretching things however.

In the comment to the SGECC Draft it is claimed that “The obligation to adequately advertise the franchise business appears to be a standard obligation Europe-wide”, this might be a bit too bold description concerning the situation in Sweden.

If a franchise contract in Sweden do not contain a clause that state similar conditions to what the Draft article proposes, the franchisee would have to claim that the contract shall be interpreted by the court to have included such benefits anyway – by virtue of article 36 of the Swedish Contract Act that is possible; but it is in no way guaranteed.

The franchisee would have to argue either that it is in the nature of a franchise contract that the franchisor shall promote the network and provide advertising, or that it would be unreasonable that he should not be required to do so. Both ways of arguing have their problems.

⁷⁵ SGECC comment to article 3:207, paragraph B

Since there is no clear legal definition of what franchise actually *is* in Sweden there might be a problem to show what is “in the nature of a contract”. It is true that the franchisor often provides advertising for the franchise network, but in Swedish franchise the franchisee often has to pay a special marketing fee for that service.⁷⁶ It is possible that a court may find that a franchisor has the obligation to provide reasonable marketing and promotion, but that the franchisor would not have to do so without compensation from the franchisee.

To argue that a franchise contract is unreasonable because it does not contain a clause that require the franchisor to promote the network is another possibility, but that is not a clear cut case either. The contract is between two business owners and as stated in chapter 4 (above) courts are restrictive when applying article 36 of the Swedish Contract Act in commercial relationships.

It is possible that a claim under article 36 may be successful, but it is not certain and I would not dare to say that there is a general principle of law that will oblige the franchisor to promote the franchise network and pay for advertising.

Other Sources

An important difference between franchising and other forms of sale-supporting merchandising is that marketing is often an integral part of the franchise contract. In other forms of business the marketing by the producer is often made freely.⁷⁷

Commercial practise in Sweden today, in contrast to the default rule according to the proposed article, usually involves an obligation for the franchisees to pay a special “marketing fee” for the franchisors effort with regards to marketing. It can be noted that such special fees would still be allowed, but it is still shift of policy with regards to how marketing shall be regulated.⁷⁸

Conclusion

The article differs slightly from the legal situation in Sweden insofar as it clearly states that it is the franchisor’s obligation to provide marketing and promote the franchise network. This might be the case in Sweden already, but the situation is uncertain. In any case it is doubtful that the franchisor would be required to do so without compensation, as commercial conduct in

⁷⁶ SFF, checklista pt 12

⁷⁷ S Sohlberg, Franchisejuridik, 2001, p32

⁷⁸ SGECC comment to article 3:207, paragraph F

Sweden today is that the franchisee pays a special fee for marketing campaigns.

The non-mandatory character of the rule might however have the result that the article will not have such a big impact on the legal situation in Sweden.

In any case the article will clarify the franchisors obligations with regards to marketing and promotion of the network in cases where the parties have not agreed on anything in the contract. Then the franchisor will have to provide the stated services free of charge, something that as stated probably is a difference from the legal situation in Sweden today.

9. Section 3: Obligations of the Franchisee

Article 3:301: Fees, Royalties and Other Periodical Payments

(1) The franchisee must pay to the franchisor fees, royalties or other periodical payments agreed upon in the contract.

(2) If fees, royalties or any other periodical payments are to be determined unilaterally by the franchisor, Article 6:105 PECL applies

Comment

The payment of money from one party to the other is often the essence of a contract – franchise contracts are no different. The first paragraph simply states that the franchisee is obliged to pay the fees agreed upon in the contract.

Since franchise contracts often state that the fees are to be determined at a later stage by the franchisor unilaterally, the second paragraph contains a rule that refers to 6:105 PECL. According to 6:105, if the franchisor determines a price that is deemed to be unreasonable, it shall be substituted for a reasonable price.⁷⁹

Swedish Law

In Swedish contract law a principle of loyalty is applicable, that is, a party must act in accordance with the contract and is bound by the agreement. Thus he is obliged to pay any fees he has agreed to pay. That is no different than the first paragraph of the proposed article.

Freedom of contract is the norm and it is also allowed to include clauses that allow one party (the franchisor) to determine fees unilaterally at a later stage. However, should the franchisee not be happy with the fee established by the franchisor, he can call for it to be modified, by virtue of article 36 of the Swedish Contract Act. This is just the kind of situation in which article 36 is meant to be used, since it is there to safeguard against *unreasonable* contracts.

It must be noted that it is not sufficient that the price is higher than what the franchisee had expected – it must be of such magnitude that it cannot be justified even considering that the franchisee is not a consumer but an independent business owner. Courts are more restrictive in applying article 36 in commercial relationships.

⁷⁹ SGECC comment to article 3:301, paragraph A

Other sources

Terms similar to the article are in practice what today is already incorporated into franchise contracts in Sweden. The Swedish Franchise Association includes payment of fees in an article in their checklist for franchise contracts.⁸⁰

Conclusion

The proposed article does not differ from the legal situation in Sweden today. That a party should pay the fees in accordance with what have been agreed upon in a contract is not a controversial rule. The safety vent against unreasonable fees by the reference to article 6:105 PECL is similar of what is possible to achieve with article 36 of the Swedish Contract Act.

⁸⁰ SFF, checklista pt 4

Article 3:302: Information during the Performance

The obligation to inform (Article 1:203) requires the franchisee in particular to provide the franchisor with information concerning:

- a) claims brought or threatened by third parties in relation to the franchisor's intellectual property rights.*
- b) infringements by third parties of the franchisor's intellectual property rights.*
- [c) claims brought or threatened by third parties in relation to matters of general interest to the network.]*

Comment

This article regulates the franchisees obligation to supply information (while article 3:205 covers the franchisors duty to provide information to the franchisee); it specifies what kind of information the franchisor has an interest in receiving from the franchisee.

The core of a franchise network is usually its business method, and closely tied to it are trademarks and other intellectual property rights. It is on those that the network build its reputation and it is by the trademarks that consumers and customers are supposed to recognise and chose a particular franchise.

It is thus important to discourage any competitors that might be tempted to take advantage of the good name of the franchisor. Also, copyrights and brands need to be defended; otherwise they run the risk loosing their status as copyrighted material. In conclusion, it is very important for the franchisor, and indeed of the entire franchise network, that any infringements are made known to the franchisor as soon as possible so that he can take action against them.

Swedish law

Under Swedish law both parties to a contract have an obligation to act loyally and in accordance with good faith in their relationship with each other. This is a general principle of contract law.

It shall also to be noted that when two parties have a more long lasting contractual relationship their obligation to show loyalty to the other party might be enhanced. It is more importance to act according to good faith in dealings that are meant to last during several years than in instant transactions.

However, the Swedish requirement to act loyally is a more uncertain requirement than what the Draft article proposes. If there is no contract clause that grants the franchisee such an obligation as described in the Draft, the franchisor would have to resort to article 36 of the Swedish Contract Act to claim that the contract should be interpreted to include such an obligation.

Since the franchisor is the stronger party to the contract, it might be harder for him to have the contract interpreted in his favour. It is also in almost all cases the franchisor that has formulated the contract.

The principle of loyalty can seldom be used as an independent base for claims; instead it is more of a supporting principle to when interpreting laws and contracts.⁸¹ The fact that the contract is a franchise contract might imply that there is a greater duty to keep the other party informed but in the end a court will have to decide.

The legal situation is however uncertain.

Other sources

The Swedish Franchise Association's checklist for franchise contracts recommend that a franchise contract shall contain a clause that obliges the franchisee to assist the franchisor in guarding the identity of the network.⁸²

Conclusion

The proposed article in essence describes what is already included in many franchise contracts in Sweden; the non-mandatory character of the rule would also mean that the article could be excluded from a franchise contract.

Thus, the article resembles commercial conduct in Sweden and does not contradict any Swedish legislation. The proposed article is not mandatory, and would only be applicable in cases where the parties have not regulated the issue of information during the performance, but in those cases it would provide a clarification of what duty a franchisee has within the scope of a franchise contract.

⁸¹ J & C Ramberg, *Allmän Avtalsrätt*, 2003, p40

⁸² SFF ckcklista, pt 7

Article 3:303: Business Method and Instructions

(1) The franchisee must make reasonable efforts to operate the franchise business according to the business method of the franchisor.

(2) The franchisee must follow the franchisor's reasonable instructions in relation with the business method and the maintenance of the reputation of the network.

(3) The franchisee must take reasonable care not to harm the franchise network.

(4) The parties may not derogate from this provision

Comment

This article establishes that the franchisee has the obligation to actually use the trademarks and follow the instructions given to him by the franchisor. This means that the franchisee may be obliged to do things that are not explicitly stated in a contract; it is in a sense a right for the franchisor to alter the contract after it has been signed. This is motivated by the fact that it is impossible to foresee all possible future situations when creating a contract, and that it is necessary for the franchisor to be able to issue instructions to maintain the efficiency of the franchise network.

These are fundamental principles of the franchise concept: the franchisor has a business method that he rents to the franchisees, and if the franchisee is not willing to adhere to that method, he should not enter into a franchise contract at all.

Instructions provided by the franchisor however have to be *reasonable*. This means that the instructions must be: a) motivated to guarantee the quality standards of the network, b) not change the method articulated through intellectual property rights, know-how and assistance, and c) not hinder the legal status of the franchisee as an independent entrepreneur.⁸³

Swedish law

According to general principles of contract law there is a requirement of the parties of a contract to act loyally in relationship towards each other.⁸⁴ An obligation of the franchisee to actually act according to the business method described by the franchisor is thus something that is required by Swedish law. A party must act in accordance with the contract, *pacta sunt*

⁸³ SGECC comment to article 3:303, paragraph E

⁸⁴ J & C Ramberg, *Allmän Avtalsrätt*, 2003, p40

servanda.⁸⁵ This includes a requirement for the franchisee to not harm the franchise network (as stated in paragraph 4 of the proposed article).

If this also includes a right for the franchisor to issue instructions to the franchisee in case there is no contract that explicitly gives him such a right is however more difficult to answer. It is true that the franchisor can have a great interest in that the franchisees follow his instructions, and that it might be important for the network that they do, but without contract the franchisor may not have such a right.

It can be argued that instructions concerning issues of great importance for the network shall be something that the franchisee is required to follow according to the principle of loyalty. The more important the franchisee's compliance is for the network, the greater the chance that he might be required to oblige. For example: if the franchisee's refusal will have great negative consequences on the entire network it is possible that the principle of loyalty will require him to adhere to the instructions. On the other hand, if the instructions simply are that from now on paper cups have to be stored under desk instead of on shelves, odds are that the franchisor cannot force the franchisee to comply.

It would also be possible to argue that it is in the nature of a franchise contract, that the franchisor shall have a right to issue instructions to the franchisee. This is however uncertain, especially since there is no clear definition of franchise at all in Sweden.

More likely is the possibility that the franchisee's requirement to follow instructions from the franchisor can be considered commercial conduct. If that would be the case, according to article 36 of the Swedish Contract Act, a franchise contract brought before a court can be interpreted so that such a requirement shall be included in the contract.⁸⁶

The legal situation is however uncertain.

Other sources

One of the concerns of the Franchise Commission was that, in their view, a franchise contract borders on the realm of employment contracts. This was also a concern of the Swedish labour unions that in general tend to have a sceptical view of franchising.

⁸⁵ J & C Ramberg, *Allmän Avtalsrätt*, 2003, p24

⁸⁶ J & C Ramberg, *Allmän Avtalsrätt*, 2003, p202

The problem is that in Sweden an employee has a right to influence decisions that affect the workplace. There is a law that calls for the owner of a company to negotiate with the union which the employees of his workplace belongs to, before carrying through any substantial changes to the workplace or the company (see chapter 10 for more details).⁸⁷

Conclusion

The proposed article is similar to Swedish law in the sense that a franchisee is already required to act loyal with regards to the contract, but it differs in that it requires the franchisee to also follow instructions from the franchisor even if there is no clause in the contract to that effect. The legal situation with regards to the latter is uncertain in Sweden and the proposed paragraph would thus clarify the issue.

⁸⁷ Lag (1976:580) om medbestämmande i arbetslivet, MBL

Article 3:304: Inspection

(1) The franchisee must grant the franchisor reasonable access to the franchisee's premises to enable the franchisor to check that the franchisee is complying with the franchisor's business method and instructions.

(2) The franchisee must grant the franchisor reasonable access to the accounting books of the franchisee.

Comment

This article serves to give the franchisor the possibility to check whether the franchisee manage the franchise business in accordance with the guidelines provided by the franchisor. It is in the interest of both the franchisor and the franchise network as a whole that everyone follows the business method so that the common image and reputation of the network is maintained.⁸⁸

Swedish law

There is no article in the Swedish Contract Act that grants a party a right to access the other party's books or premises, only if explicitly stated in a contract can such actions be allowed.

This does not mean that it would be impossible for the franchisor to ever access the franchisees books; it would however be a quite burdensome task for him to do so. For example; if the franchisor suspects the franchisee of meddling with the books, he can sue the franchisee before a court. The court will then consider the case, and it will be possible for the claimant to ask the court for *edition*, that is; that the other party shall be obliged to turn over, or make accessible, certain documents that might contain information vital to the case.⁸⁹

There is thus some support for a duty of the franchisee to grant the franchisor access to information and the premises, but it is uncertain if the strength of the above argument is enough to elevate that to a general principle.

Other sources

The right of inspection is commonly recognized in Swedish franchise contracts.⁹⁰ It is a sensitive subject however, since it is clearly an intrusion of the independence of the franchisee and something he most likely would

⁸⁸ SGECC comment to article 3:304, paragraph B

⁸⁹ Rättegångsbalken 38:2-3, also Ekelöf, Rättegång IV, 1992, p216-221

⁹⁰ S Sohlberg, Franchisejuridik, 2001, p34, 47

like to be without. On the other hand the franchisor is interested in this information, and he might find it difficult to conduct his business without it. The franchisor is thus keen on having enforceable means to gain access to the franchisee's premises and accounting books.

Commercial conduct on this matter indicates that inspections are a common and accepted part of franchise contracts in Sweden. The Swedish Franchise Association checklist calls for the contract to include a clause that allows the franchisor to inspect the franchisees economy.⁹¹

The Swedish Franchise Association ethical rules also allow inspections. "The franchisee shall provide the franchisor with the information he needs to get a good view of the franchisee's economy, and should also allow the franchisor or his representatives to have access to the franchisee's premises so they can conduct on-site inspection, as long as they are made within reasonable hours. The franchisee shall also allow the franchisor to have access to his financial books/records."⁹²

Conclusion

Swedish law does not directly grant the franchisor a right to inspect the franchisees business or books. Neither can it be established that there is a legal principle to support such a right. Even if commercial conduct resembles the proposed article it would probably not be possible to interpret a franchise contract, by use of article 36 Swedish Contract Act, to grant the franchisor such a right.

That being said there are ways for the franchisor to get access to the franchisee's premises or books, but they take time and effort and require a court order.

The proposal article would thus go a bit further than current Swedish law, but would not alter it to any great extent; it would rather help to clarify the legal situation.

⁹¹ SFF, checklista pt 11

⁹² Quote from the Swedish Franchise Association Ethical Rules 2.3 point 2

10. SWEDISH LABOUR LAW

A special problem concerning franchise is that in Sweden the employees of a company shall have the ability to influence decisions that affect the workplace.

It should be noted that labour unions in Sweden have since long been supporters of a franchise act, however their concern is mainly the weakened influence of the employees (in reality the unions) over the actions of their employer (the franchisee), because he often have to act according to the will of the franchisor. The proposed Draft contains no rules to strengthen the rights of the employees of the franchisee and does not give them any right against the franchisor. The dependence of the franchisee's role as employer would in other words remain.

This issue was the core focus of the Franchise Commission in 1985 and it is also a topic that has been in constant focus on the labour unions agenda with regard to franchise in Sweden. Although recently the franchise discussion in Sweden seems to have shifted to the problems some franchise networks have had with their capability to make decent profits for the franchisees (in fact, many of them have been loosing money), the issue of employee influence still remains.

The reason why the independence / dependence of the franchisee have caused such a debate in Sweden can be explained by how the Swedish labour market works. It is mainly unregulated by the state, containing no legislation regarding minimum wages or other similar protective rules. Instead the labour unions and their counterparts on the corporate side have been given extraordinary powers to agree, by contracts, on the working conditions of the Swedish labour market.

That is not to say that the Swedish labour market is completely unregulated, there are some acts, in this case most notably an act of "co-decision", usually referred to as MBL.⁹³ It grants no rights to individual employees but instead to the labour union to which the employee is a member. The act calls for the owner of a company to negotiate with the union of the employees that his workplace belongs to, before carrying through any substantial changes to the workplace or the company.⁹⁴ The act does not force the employer to actually act upon the opinion of the employees, but it forces him to listen to their opinions. Should he not negotiate at all the union may sue him for compensation.⁹⁵

⁹³ Lag (1976:580) om medbestämmande i arbetslivet, MBL

⁹⁴ MBL 10 §

⁹⁵ MBL 54 §

Because of the way that a franchise contract limits a franchisee's options on what to do with his own business, or even requiring him to follow orders from the franchisor (with the risk of losing his contract if he does not), the labour unions see their right of influence eroded. Since the franchisee must obey the franchisor, the labour unions right to negotiate with the franchisee becomes an empty shell.

The Franchise Commission suggested that labour unions should have the right to negotiate directly with the franchisor before any such changes that were covered by the MBL.⁹⁶ This caused an outrage from the Swedish Franchise Association – they did not like the idea to reduce the franchisee's control of his business. The franchisee's rights over his own company would be even more reduced than before, since he could now be bypassed by the union who could negotiate directly with the franchisor. In the Swedish Franchise Association's views that was totally unacceptable, and also uncalled for.⁹⁷

In the end the Franchise Commission's proposal did not result in any legislation, but whenever the issue of franchise is discussed in Sweden, the unions are keen to call for greater rights with regards to their right of negotiation. If that actually will have any effect on a future Swedish franchise act remains to be seen. It is clear however that if Sweden adopts the SGECC Draft and abstains from adding any national specific rules (perhaps abstaining in the name of European harmonisation) the unions will not get what they want.

On the other hand an implementation of the SGECC Draft does not exclude the Swedish government from adding rules to the MBL with the effect of strengthening the labour unions rights. The Draft only regulates the dealings between the franchisor and the franchisee; it would probably be possible to create rules that deal with the franchisors/franchisees relationship to the labour unions without interfering with the essence of the Draft. There is thus no reason to oppose the Draft just because it contains no rules to that effect.

⁹⁶ Franchising – Betänkande av franchiseutredningen, SOU 1987:17, 1987, p23

⁹⁷ Franchising – Betänkande av franchiseutredningen, SOU 1987:17, 1987, p235

11. RECENT FRANCHISE ISSUES IN SWEDEN

During the autumn of 2004, when most of this essay was written, there have been several reports of franchise business having troubles in Sweden. Low profits or even a large percentage of franchisees losing money or facing bankruptcy led to bad publicity for the franchise industry. 7-Eleven being the biggest and most known company in trouble; several of the franchisees voiced dissatisfaction with their franchisor, complaining about “slave contracts”, high royalty fees and false promises of easy profits from their franchisor.

A survey conducted by a major Swedish newspaper showed that more than 20% of the franchisees in Stockholm were having such grave problems that they might face bankruptcy in the near future. Among the companies in trouble were both Swedish firms as well as international networks such as Burger King and (as mentioned) 7-eleven. Only McDonalds had no franchisees with negative results.⁹⁸

This has lead several organizations, such as labour unions and franchisees to once again raise claims that Sweden needs a franchise act. And indeed, there is a government appointed official working on a review if Sweden shall adopt the UNIDROIT proposal (though the study was ordered before any of the recent issues emerged).⁹⁹

The report is not yet finished so I will not speculate what it will contain or what its conclusions will be, but one can note that franchise is yet again in the focus for a discussion whether it should be regulated by law or not.¹⁰⁰

⁹⁸ Svenska Dagbladet 12/11-2004

⁹⁹ Gudmund Toijer, judge at Svea Hovrätt, is conducting a study wheter Unidroits model-law is to be incorporated into Swedish law, on behalf of the Swedish Department of Justice

¹⁰⁰ During the work on this eassy, the report was published, Ds 2004:55, Upplyst Franchising”.

12. CLOSING NOTES

Swedish legal principle and practice seem to correspond to the SGECC Draft. There are no major discrepancies, and the consequences of implementing the Draft would thus not entail any major changes.

The Swedish Franchise Association and many experts within the field of franchise have over the years held a negative view of legislation in this particular area. The freedom that the franchise format offers is perceived as the foundation on which the business thrives, and by adopting a franchise act some of that freedom would be lost. If legislation is a bad thing for franchise in general is hard to make predictions about, especially since the proposed draft seems to be in accordance with current principles anyway.

The way chosen by the SGECC to regulate franchise is not the only imaginable way. UNIDROIT have put forth a Model law focusing on disclosure: the franchisor must provide some specific information easily so that it is easily accessible by third parties.¹⁰¹ The SGECC have chosen a broader approach though, and in my opinion it offers a solution that calls for a sound set of rules that deserves to be acted upon.

The Swedish Franchise Association have expressed a positive attitude of the initiative of UNIDROIT (they have not yet commented on the SGECC draft); and as mentioned above even adopted some of the suggested rules regarding information into recommendations to be followed by its members. If this is because of a genuine enthusiasm for legislation in franchise or simply an adaptation to the most likely future development for franchise is debatable. The important thing is that everyone seems to be pulling in the same direction.

The SGECC draft will have some opportunity to influence the future of franchise legislation in Sweden (and maybe even Europe). The non-mandatory character of many of the articles however raises the question if there is an actual need for an act which may so easily be derogated from; if the rules are not mandatory why have them at all? They would only be applicable in cases where the parties did not contract specifically about the situation they regulate; something that considering the nature and scope of franchise contracts (and the fact that such contracts in practise always are written by established law-firms or the legal staff of franchisors) seems highly unlikely.

I would tend to agree that in many cases it is better to have no legislation at all than an act that is not used, but sometimes there are advantages by having legislation even if it is not mandatory. By setting up a base of core principles with regards to franchise, the Draft sends a signal of what is to be considered good ethics and measures when dealing with

¹⁰¹ UNIDROIT, Model Franchise Disclosure Law, 2002

franchise. Not only will the mandatory rules offer some protection to franchisees in areas where they are most vulnerable; the non-mandatory rules will also in their turn hopefully guide authors of future franchise contracts.

On the question whether the Draft should be adopted into Swedish law or not my opinion have swayed many times during the writing of this essay. My basic premise when I started to write was that the Draft was a good initiative and much welcomed. However, after spending more time considering all the obstacles, the general vagueness of what franchise actually is, and the frequent failure of acts to actually solve what they are meant to solve led me to think that the Draft maybe never should be implemented as legislation. As time went by and after seeing how well the draft seemed to fit in the established framework of franchise already in place, I have now come full circle and is yet again in the opinion that the Draft is a good idea.

Even if though many of the articles do not have a mandatory character (and thus would be easy to avoid should the parties so desire) an implementation of the Draft would at least provide a solid background and a good source where to look for information regarding franchise. The legal situation today can at best be described as “uncertain”; with a franchise act, mandatory or not, at least there would be some source when trying to find answers to questions concerning franchise.

My conclusion is thus that the Draft is a well authored and balanced suggestion. It identifies and specifies the different issues that define franchise without creating too many complications for the parties; that is a rare thing, and deserves to be acted upon.

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(The Contract Act)

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(The Law of Procedure in Court)

Lag (1976:580) om medbestämmande i arbetslivet "MBL"
(The Law of Co-decision on the labour market)

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(The Sales Act)

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