



# The Franchise Lawyer

American Bar Association • Forum on Franchising

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## THE FRANCHISE LAWYER

### Editor-in-Chief

Max Schott, II (2013)  
Gray Plant Mooty  
Minneapolis, MN  
[Max.Schott@gpmlaw.com](mailto:Max.Schott@gpmlaw.com)

### Associate Editors

Glenn J. Plattner (2011)  
Bryan Cave  
Santa Monica, CA

Kristy L. Zastrow (2012)  
Dady & Gardner  
Minneapolis, MN

Beata Krakus (2013)  
Greensfelder,  
Hemker & Gale  
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### Forum on Franchising

American Bar Association  
321 N. Clark Street  
Chicago, IL 60654

### [Message from the Chair](#)

How time flies! It seems as if it was only yesterday when I was sitting down to write my first Chair's column – and that was over a year ago. Midway through my term as Chair of the Forum, I could not be more delighted with the progress I feel the Forum has made toward achieving both the short-term and long-term goals set by the Governing Committee over the past few years. [Read more...](#)

### [Message from the Editor-in-Chief](#)

As I begin my term as Editor-in-Chief of *The Franchise Lawyer*, I want to thank my predecessor, Eric Karp, for the invaluable contributions he made to the publication during his tenure, as well as the helpful support he has provided to me as part of my transition. I also want to encourage you to write an article for *The Franchise Lawyer*. We are always looking for potential topics and authors. Please find me or one of the Associate Editors at the Forum, or otherwise contact us, to discuss your ideas. After all, *The Franchise Lawyer* is only as good as the articles we receive from Forum members like you. [Read more...](#)

### [A Tribute to Alexander Konigsberg](#)

Last August, the international franchising community lost one of its pioneers, Alexander Konigsberg. Alex was a highly respected lawyer, scholar and friend to colleagues throughout the world. By way of his numerous speaking engagements, prolific writings and mentorship of others, Alex left an indelible mark on international franchising and will be greatly missed. [Read more...](#)

### [Peaberry: Is the FDD Enough?](#)

For decades, franchisors, prospective franchisees, and their respective attorneys have all been able to rely on federal and state franchise disclosure laws as a guide for what information is, and is not, required to be provided as part of a franchise sale. The recent decision of the Colorado Court of Appeals in *Colorado Coffee Bean, LLC v. Peaberry Coffee Inc.*, however, appears to call this reliance into question. The court in *Peaberry* suggests that even if a franchisor complies with all of the disclosure requirements relating to its FDD, it may still be obligated under a state's common law to disclose additional information to prospective franchisees, like the fact that its parent company has suffered significant financial losses for a number of years. [Read more...](#)

### [The New Block Exemption](#)

The European Commission recently published a new vertical agreement block exemption and Guidelines that revise the existing competition rules for distribution of goods and services within the European Union. The new block exemption applies to all new agreements entered into after June 1, 2010, and parties to existing agreements have until June 1, 2011, to comply with it. While the changes introduced by the new block exemption are not a significant departure from the old block exemption, there are a few notable differences and areas of uncertainty, including those relating to restrictions on franchisee pricing, use of the internet and other territory restrictions, and the enforceability of restrictive covenants. [Read more...](#)

### [Maryland's New Franchise Delivery Requirements are Now in Effect](#)

The new franchise delivery requirements under the Maryland Franchise Law went into effect October 1, 2010. Consequently, by now all franchisors registered in Maryland should have revised their FDD Receipt pages to delete any notice regarding Maryland-specific franchise delivery requirements. [Read more...](#)

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## [New Books from the Forum on Franchising](#)

### [Franchise Litigation Handbook](#)

Dennis LaFiura and C. Griffith Towle, Editors

### [Annual Franchise and Distribution Law Developments 2010](#)

Bethany L. Appleby and William K. Whitner

### [International Franchise Sales Laws - 2010 Supplement](#)

Andrew P. Loewinger and Michael K. Lindsey, Editors

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## Message from the Chair

By Ronald K. Gardner

Forum Chair

How time flies! It seems as if it was only yesterday when I was sitting down to write my first Chair's column – and that was over a year ago. Midway through my term as Chair of the Forum, I could not be more delighted with the progress I feel the Forum has made toward achieving both the short-term and long-term goals set by the

Governing Committee over the past few years.

Short-term, we continue to focus our efforts on excellent programming, expansion of our reach to those who may not know of the opportunities and services we provide, and strong financial stewardship. With respect to all three of these objectives, I am pleased to report extraordinary progress.

Of course, with regard to programming, you likely already know about the wonderful program we have arranged for you at the Hotel Del Coronado in San Diego. Indeed, as you read this column, you might be there already, be on your way, or have recently returned. Through serious and intense planning and commitment, we continue, year after year, to offer new and interesting programs, and to recruit and develop dynamic speakers. These programs also provide Forum members the opportunity to set aside a few days to not only learn about franchise law, but also to experience some of the most luxurious and comfortable locations at an affordable price. Rest assured, we will continue to make this one of our primary objectives.

You probably also are familiar with our quarterly publication of the *Franchise Law Journal*, which is one of the most valuable services we provide to those affiliated with the Forum. I continue to be amazed with the level of scholarship and insight the publication brings to diverse topics surrounding franchising. As a result of the expanded scope of materials included in the *Franchise Law Journal* relating to distribution law over the last several years, we continue to grow the number of regular readers.

The Forum's publication of various books also continues in earnest. Within the next few months alone, we will be publishing the new *Franchise Litigation Handbook*, as well as updating a book that has become indispensable to many of us, the *Franchise Desk Book*. Further, our International Division continues to focus on updating the *International Franchise Sales Laws*, a publication that likely has the greatest geographic reach of any book the Forum has published.

Finally, we continue to use technology to leverage our ability to reach you, as well as those who are not familiar with our activities. By way of the ListServe, our quarterly teleconferences, and our "Fundamentals on the Road" program (where we bring our extraordinarily popular *Fundamentals of Franchising* intensive program to local bar associations), we continue to expand the reach of our programming. We also are exploring the use of webcasts, webinars, and other emerging technologies as a delivery vehicle for our material. These activities demonstrate our commitment to our mission of being the preeminent organization dedicated to educating lawyers about the nuances of franchise law.

As far as being good stewards, the Forum's financial reserves remain strong under the watchful eye of our Finance Officer, Harris Chernow. Indeed, much of what I am reporting to you would not be possible without the strong financial position we continue to maintain.

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Long-term, our goals are not much different – although they are a little bit more targeted. Based on demographic research we gathered from within our own organization through member surveys and other materials provided by the ABA, it became quite clear to the Governing Committee some time ago that we, like the vast population at large, are suffering a "graying" effect. As the population in the United States ages, so too does the population of the Forum. Keenly aware that our future lies in the young lawyers of today, the Forum has made an unprecedented commitment to find, recruit, and develop a new generation of members and leaders of the Forum on Franchising.

For instance, as you likely know, several years ago we instituted a Newcomers' Networking Night at our Annual Forum. The event sets aside an evening to allow new lawyers, particularly younger ones, to meet and network with each other, thereby strengthening their long-term bonds to the Forum.

We have been extremely fortunate to have had a series of Young Lawyers Division leaders on the Governing Committee who have contributed immensely to these efforts. Virtually all of these individuals have gone on to be leaders-at-large on the Governing Committee, including Kerry Bundy, Leslie Curran, and our Chair-Nominee, Joe Fittante. Through the energetic and hard work of these folks, we have begun to establish a culture focused on making the Forum a place that is welcoming and inviting to a younger generation. Likewise, we have established a presence on Facebook (headed up by Kerry Bundy) and continue, with the help of our current Young Lawyers Division Liaison, Rebecca Prince, to look for ways to jointly sponsor events with the ABA Young Lawyers Division.

All of these efforts are laudable and have served us well. However, within the last twelve months, the Governing Committee recognized that perhaps it was not doing enough, particularly in the area of making attendance at the Annual Forum accessible for young lawyers. Accordingly, with perhaps the boldest financial move we have ever made, the Forum this year has offered first- and second-time attendees who are under the age of 36 a \$500 discount off their registration fee. We are convinced that the best thing we do is to bring people together for unparalleled networking opportunities at our Annual Forum. If young lawyers do not attend, either because they simply cannot afford it or do not see the economic justification in taking time away from their offices to do so, they will never experience the thing that draws most of us to stay so loyal to the Forum. Recognizing this fact, we decided in February of this year, at our annual planning meeting, to take this bold step as part of our ongoing push to reverse the "graying" of our membership. Time will tell how effective this step will be in helping us to achieve our goals, but the early results, based on our registration numbers, are promising. I hope to be able to report back to you more specifics about this program in my next Chair's column in the Winter 2010 issue of *The Franchise Lawyer*.

Finally, 2011 will mark the year in which the Forum is required under its by-laws to survey, yet again, its entire membership. Watch these pages for information about where you can find the survey, how you can get it back to us, and how you can play an important role in the long-range planning of the Forum. We will take the responses we get from all of you, compile them, and then discuss them in setting our long-range goals when we get together with the Past Chairs for a day of strategic planning in January or February of 2012.

In the meantime, enjoy San Diego. Deb Coldwell and Kathy Kotel put together an amazing program – one that is not to be missed and certainly one to be fully experienced by everyone. And remember to enjoy fall while you can. After all, time flies.

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## Message from the Editor-in-Chief

By Max J. Schott, II

As I begin my term as Editor-in-Chief of *The Franchise Lawyer*, I want to thank my predecessor, Eric Karp, for his invaluable contributions to the publication during his tenure. Eric oversaw the conversion of *The Franchise Lawyer* to the current user-friendly electronic format. Believe me, this was no simple task. He also ensured that all the issues he edited contained a variety of timely, well-written and provocative articles. Even more importantly, Eric did an excellent job of presenting balanced viewpoints so that attorneys on both sides of the franchisor/franchisee aisle found value in the publication. I intend to continue Eric's balanced approach.

On a personal level, I also want to thank Eric for his patience, advice and encouragement in teaching me how to be a better editor and assisting me with my transition. It is obvious that he cares deeply for *The Franchise Lawyer* and the Forum and has been an exceptional steward for the publication. I am excited about my new position and will do my best to continue and build upon the work of Eric and the other Editors-in-Chief who have preceded me.

*The Franchise Lawyer* is published on a quarterly basis during the first weeks of October, January, April and July. So, what type of articles are we looking for and how can you get involved?

Articles for *The Franchise Lawyer* are meant to be informative and thought-provoking with respect to the latest developments in franchising. Articles are generally 800 to 1,600 words in length (although we now have a little more flexibility under the new electronic format), with minimal in-text citations and no footnotes. In keeping with Eric's balanced approach and the spirit of the Forum, authors should strive to provide something of value to both franchisor and franchisee attorneys and avoid self-promotion.



I am fortunate to be assisted by three talented Associate Editors, Glenn Plattner of Bryan Cave in Santa Monica, [glenn.plattner@bryancave.com](mailto:glenn.plattner@bryancave.com); Kristy L. Zastrow of Dady & Gardner in Minneapolis, [kzastrow@dadygardner.com](mailto:kzastrow@dadygardner.com); and Beata Krakus of Greensfelder, Hemker & Gale in Chicago, [bk@greensfelder.com](mailto:bk@greensfelder.com).

Glenn, Beata and I will be at the Forum, and we encourage you to seek us out with your ideas for articles. Perhaps a new case, law or trend has caught your attention, a recent ListServ exchange has left you wanting more, or a Forum discussion with colleagues (yes, even one of those late-night discussions) will result or has resulted in the inspiration for a potential topic.

If we do not connect at the Forum, please feel free to contact me [max.schott@gpmlaw.com](mailto:max.schott@gpmlaw.com) or any of the Associate Editors with your ideas. We are always looking for potential topics and authors. After all, *The*

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*Franchise Lawyer* is only as good as the articles we receive from Forum members like you.

Just as everyone is thought to have one great novel in them, I am confident that each of you has at least one great article to share. Please set it free.

I look forward to seeing you in San Diego.

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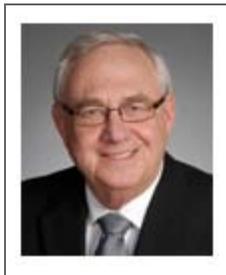
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## A Tribute to Alexander Konigsberg, 1938-2010

By Bruno Floriani

Lapointe Rosenstein Marchand Melançon, L.L.P.

Alexander Konigsberg, a pioneer in the franchising community, passed away on August 9, 2010. Alex was a highly respected lawyer, scholar and friend to colleagues throughout the world, whose absence will be keenly felt. Alex was a founding partner of Lapointe Rosenstein in Montreal, Canada, and his singular passion for business law, and the burgeoning international franchising practice in particular, served as a beacon to others at his firm and in the business and franchise communities.

Alex leaves a significant legacy to the franchise community. He made important contributions to a variety of organizations in the franchising world, including the International Bar Association, where he served as President of the Committee on International Franchising, and the International Franchise Association, where he served as President of the International Legislative Action Group. His work with the Organisation for Economic Co-operation and Development and UNIDROIT, most notably his leadership role in the development of the Model Franchise Disclosure Law as a member of the Committee of Governmental Experts appointed by UNIDROIT, remains an enduring testament to his expertise and influence.

Alex left an indelible mark on international franchising by way of his numerous speaking engagements and prolific writings, not the least of which is his book *International Franchising*, considered one of the leading texts on international franchising. Moreover, anyone who had the privilege of working with, or simply knowing, Alex benefited from his mentorship, as well as his devotion and passion for, and commitment to, the international franchising practice.

Alex was a natural consensus-builder and leader, whose uniquely collaborative approach distinguished him. His mentorship and kindness, his personal touch and infectious humor, and most of all his genuine friendship are traits that will surely be remembered and cherished. We will greatly miss him.

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## Peaberry: Is the FDD Enough?

By Jeffrey A. Brimer and Sarah A. Mastalir\*

Faegre & Benson, LLP

For over 30 years, franchisors have been subject to a comprehensive regulatory scheme governing the information that they are required to disclose to prospective franchisees. Specifically, franchisors' disclosures have been guided by the Federal Trade Commission's ("FTC") Franchise Rule (16 C.F.R. Part 436 *et seq.*, the "FTC Rule") and the North American Securities Administrators Association's Uniform Franchise Offering Circular Guidelines (the "UFOC Guidelines") (collectively, the "Franchise Disclosure Regulations"). These Franchise Disclosure Regulations, which were promulgated to protect prospective franchisees, set forth specific disclosure requirements on the theory that informed investors can determine for themselves whether a particular franchise transaction is in their best interests. See 43 Fed. Reg. 59,614, 59,627-39 (Dec. 21, 1978) (Statement of Basis and Purpose to Franchise Rule). Franchisors, prospective franchisees, and their respective attorneys all rely on the Franchise Disclosure Regulations as a guide for what information is, and is not, required to be provided as part of a franchise sale.

There remains an open question, however: whether a franchisor whose Franchise Disclosure Document (the "FDD," formerly referred to in the franchise industry as the "UFOC") complies with the Franchise Disclosure Regulations can still be subject to liability for failure to disclose *additional* information. This question was recently addressed for the first time by the Colorado Court of Appeals in *Colorado Coffee Bean, LLC v. Peaberry Coffee Inc.*, 09CA0130\_P.3d\_, 2010 WL 547633 (Colo. App. Feb. 18, 2010) ("*Peaberry*"), and will be analyzed here.

### I. Peaberry's Facts

The plaintiffs in *Peaberry*, consisting of ten Peaberry Coffee franchisees (the "Franchisees"), filed various fraud and breach of contract claims against their franchisor, Peaberry Coffee Franchise, Inc. ("*Peaberry*"), its parent company, Peaberry Coffee, Inc. (the "Parent Company"), the Parent Company's COO and sole shareholder, and the Parent Company's vice president of franchising (collectively, the "Peaberry Defendants"). These claims rested largely on alleged misrepresentations and omissions made by the Peaberry Defendants in connection with the sale of franchises. Specifically, the Franchisee's claims involved two distinct nondisclosure theories: (1) failure to disclose that most of Peaberry's company-owned stores were not profitable; and (2) failure to disclose the Parent Company had substantial financial losses each year.

After seeking leave from the court, the Franchisees also filed claims against the law firm that represented the Peaberry Defendants in connection with Peaberry's franchise program. The Franchisees alleged that the firm aided and abetted the misrepresentations and omissions that formed the basis of the Franchisees' claims

against the Peaberry Defendants. These claims, which were derivative of, and eventually bifurcated from, the claims pending against the Peaberry Defendants, will not be addressed here.

## **II. The Trial Court's Findings**

At the conclusion of the plaintiffs' case-in-chief, the trial court dismissed the Franchisees' claims under the Colorado Consumer Protection Act for lack of public impact. At the conclusion of trial, the court entered a decision in favor of the Peaberry Defendants on all claims. In doing so, it expressly found that the disclosures in Peaberry's UFOC – specifically, its "earnings claim" contained within Exhibit J to the UFOC – complied with the FTC's disclosure requirements and were not otherwise misleading or deceptive. But, the trial court nevertheless concluded that a franchisor cannot use its UFOC disclosures to "shield" itself from liability for fraudulent omissions. Rather, the trial court found in favor of the Peaberry Defendants based, in part, on the Franchisees' failure to prove reasonable reliance.

The trial court's findings regarding reasonable reliance were different for each of the Franchisees' distinct nondisclosure theories. With respect to Peaberry's failure to disclose net losses of the company stores, the trial court found that clauses contained within Peaberry's UFOC (in particular, the language in its earnings claim precluded the Franchisees from proving reasonable reliance. In so holding, the trial court looked to: (1) language warning the Franchisees against inferring how their franchises would do based on gross sales of the company stores; and (2) language explicitly stating that the sales information provided to the Franchisees did not reflect costs or operating expenses. The trial court also concluded that because the Franchisees had access to publicly available store expenses, they could have independently determined the profitability of the company stores through reasonable due diligence.

With respect to the Franchisees' second nondisclosure theory relating to the Parent Company's financial information, the trial court found that the exculpatory clauses included in Peaberry's closing acknowledgment and franchise agreement prevented the Franchisees from establishing reasonable reliance. Those exculpatory clauses included an acknowledgement that the Franchisees were "not relying on any promises of [Peaberry] which are not contained in the [franchise agreement]."

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## **III. The Court of Appeal's Decision**

The Colorado Court of Appeals affirmed the trial court's judgment in part, vacated it in part, and remanded it with directions. With respect to the nondisclosure claims, the Court of Appeals first addressed whether the trial court concluded that the Peaberry Defendants were under a duty to disclose the Parent Company's losses and/or the company-owned stores' profits. It was not clear to the Colorado Court of Appeals whether the trial court found such a duty existed, and it remanded the case to the trial court to make more specific findings on that element of the Franchisees' claims.

The Colorado Court of Appeals then turned to the trial court's conclusions regarding reasonable reliance as they related to each of the Franchisees' omission theories. It upheld the trial court's reliance findings relating to Peaberry's failure to disclose net losses of the company stores. However, it reversed the trial court's reliance findings relating to Peaberry's failure to disclose the Parent Company's losses. Specifically, the Court of Appeals concluded that the exculpatory clauses in the closing acknowledgment and franchise agreement – which under Colorado law "must be closely scrutinized" – addressed only affirmative representations outside the transaction documents, not failure to disclose material information altogether.

The Court of Appeals also concluded that the Franchise Disclosure Regulations did not protect the Peaberry Defendants from the Franchisees' nondisclosure claims relating to the Parent Company's financials. It did so despite an FTC Rule explicitly prohibiting franchisors from including a parent company's financial statements in a UFOC unless "(A) the corresponding unaudited financial statements of the franchisor are also provided, and (B) the parent absolutely and irrevocably has agreed to all obligations of the subsidiary." 16 C.F.R. § 436.1(a)(20)(i) (2003). In so holding, the Court of Appeals concluded that the FTC Rule only prohibited franchisors from disclosing a parent company's "financial statements," not other material information such as a parent company's general financial difficulties. Because the Court of Appeals found no conflict between the FTC Rule and the Franchisees' nondisclosure claims, it concluded that there was no federal preemption applicable to the Franchisees' common law claims.

#### IV. Petition for *Certiorari* Review Pending

The Franchisees, the Peaberry Defendants and their attorneys are all seeking *certiorari* review of the Court of Appeals' decision. Two of the issues presented for review relate to the Franchise Disclosure Regulations. As of the date of this article, a decision from the Colorado Supreme Court regarding whether it will grant *certiorari* review of those issues is still pending.

#### V. *Peaberry's* Aftermath

Before *Peaberry*, franchisors and prospective franchisees alike benefited from the certainty created by the clear disclosure guidelines set forth by the FTC (via the FTC Rule) and the states (via the UFOC Guidelines). Franchisors knew what to disclose and prospective franchisees knew what information they were, and were not, getting from franchisors about their franchise opportunities. After *Peaberry*, however, franchisors and franchisees also must look to each state's common law to determine what information, in addition to the information that is disclosed in the FDD, is required to be disclosed to prospective franchisees. This leaves franchisors unable to predict what information they must provide about the franchise, the franchisor, and its affiliates until the courts better define what they will deem necessary for franchise transactions. It also leaves prospective franchisees unable to compare franchise offerings from franchisors in different states because the common law disclosure requirements may vary from state to state.

For example, despite the FTC's prohibition against disclosing a parent company's financial statements unless the parent company guarantees obligations of the franchising subsidiary, *Peaberry* may now require franchisors to disclose "general" financial information about their parent and affiliated companies, whether those companies serve as guarantors or not. This poses problems for franchisors *and* prospective franchisees, especially because the FTC's prohibition against such disclosures was meant specifically to protect prospective franchisees from basing purchase decisions on parent company performance that is not linked to the franchising company's success.

Further, *Peaberry's* guidance regarding what common law disclosures may have been necessary in that case only further complicates the landscape. In addressing the FTC's parent company disclosure requirements, the Colorado Court of Appeals suggested that: "[the FTC Rule's] plain language would not preclude a general comment *especially if provided 'in separate literature,'* such as, 'The franchisor is the wholly owned subsidiary of \_\_\_\_\_, which has not shown a profit during its \_\_\_ years of operation.'" *Peaberry*, 2010 WL 547633 at \*10 (emphasis added). In a franchise sale, a franchisor's representations are usually limited to the FDD and the franchise agreement. Without any further clarification from Colorado's courts, it is unclear what "separate literature" the Colorado Court of Appeals could be referring to or how such "separate literature" should be provided or factor into the franchise sale.

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#### VI. Advice for Prospective Franchisees, Franchisors, and Their Respective Attorneys

The *Peaberry* case provides a good cautionary tale for franchisee attorneys. Prospective franchisees need to know what information is included in the FDD and related documents, *and* what information is *not* included in those documents. Franchisee attorneys should therefore advise their clients about potential *additional* information that may be relevant to a franchise sale, but that may not be included in the FDD. Similarly, franchisee attorneys should be prepared to ask franchisors for such additional information that they think will impact a potential franchisee's purchasing decision. And, if additional information is provided that is material to a franchisee's purchase, franchisee attorneys must make clear in any closing documents that information outside of the FDD and franchise agreement was relied upon by the franchisee in the franchise sale.

Franchisors and their attorneys should likewise note that the basic exculpatory clauses included in their FDDs and franchise agreements may not be sufficient. The trial court's and Colorado Court of Appeals' opinions both spent a considerable amount of time discussing these exculpatory clauses in *Peaberry's* UFOC, franchise agreement and closing acknowledgment. The Colorado Court of Appeals noted that the closing acknowledgment did not disclaim reliance on the Parent Company's financial statements or its financial condition. Thus, if a franchisor uses a closing acknowledgment, questionnaire or similar document to elicit information from prospective franchisees regarding what they were told and what they relied upon to make

their decisions, the franchisor should include questions about whether the prospective franchisee was told or relied upon any information about the franchisor's parent or affiliated companies. A franchisee who states in a closing acknowledgment or questionnaire that it did not rely on the financial condition of a parent or affiliated company will have a more difficult task of claiming that the franchisor should have provided that information.

\*Jeffrey A. Brimer and Sarah A. Mastalir participated in the *Peaberry* appeal discussed in this article as counsel for *amicus curiae*, the International Franchise Association.

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## The New Vertical Agreements Block Exemption Regulation

By John H. Pratt

Hamilton Pratt

### Introduction

The European Commission (the "Commission") has recently published a new vertical agreements block exemption (Commission Regulation 330/2010, O.J. L102, 23.4.2010, p.1-7) and Guidelines (O.J. C130, 19.05.2010, p.1-46) that revise the existing competition rules for distribution of goods and services within the European Union ("EU"). As with the old block exemption, the purpose of the new block exemption is to exempt vertical agreements from Article 101 of the Treaty on the Functioning of the European Union (previously numbered Article 85 and then Article 81), which prohibits anti-competitive agreements and concerted practices that have an effect on trade between EU member states.

Franchise agreements do potentially affect competition, especially if they contain territorial restrictions, pricing obligations and non-compete requirements. As a result, franchise agreements can be subject to Article 101.

The Commission has made it clear by way of a "Notice" (2001/C 368/07) and a "Recommendation" (2003/361/EC) (Notices and Recommendations are legal instruments issued by the Commission, which do not bind other EU institutions) that agreements of minor importance - those between entities with a market share of less than 15 percent - will not, unless they contain a "hardcore" restriction (discussed below), be prohibited by Article 101. Similarly, agreements entered into by small- and medium-sized undertakings - undertakings with less than 250 employees, turnover of less than 50 million Euros (65 million U.S. Dollars), and a balance sheet value of less than 43 million Euros (50 million U.S. Dollars) - will not, again in the absence of "hardcore" restrictions, be prohibited by Article 101. In addition, the third paragraph of Article 101 provides for the exemption of agreements that benefit consumers and do not contain unnecessary restrictions on competition. As a result, a franchise agreement may not be subject to the prohibitions of Article 101 even if it does not comply with the block exemption.

Establishing whether an agreement is regulated by Article 101 and/or is exempted from its coverage, however, is difficult to predict. In contrast, determining whether an agreement complies with the block exemption is a much easier legal task. As a result, most EU lawyers focus their attention on complying with the block exemption.

### Overview of New Block Exemption

The old block exemption safe harbor provisions applied to franchisors whose market share was less than 30 percent. The new block exemption, at least technically, is narrower in scope and applies only to agreements where neither party (*both* franchisor and franchisee) has a market share of 30 percent or more. The franchisor's market share is calculated on the market where the franchisor sells goods and services to franchisees. The franchisees' market shares are not calculated on their local markets, but are calculated on

their market share in relation to the purchase of goods and services which are the subject of the franchise. For instance, if franchisees purchase mobile phones from their franchisor, the wholesale mobile telephone market would be the relevant market. In practice, it is extremely unlikely that franchisees will have a market share anywhere approaching 30 percent.

The block exemption applies to all new agreements entered into after June 1, 2010, and parties to existing agreements have until June 1, 2011, to comply with it. Almost all EC franchise agreements contain a provision that allows the franchisor, on receiving advice that its franchise agreement does not comply with EU legislation, to change the agreement so that it does comply. This clause will enable changes to be made to existing agreements before the June 1, 2011 deadline. The new block exemption expires on May 31, 2022.

In a franchising context, there are three areas covered by the block exemption that are particularly relevant:

- Pricing restrictions;
- Territory restrictions; and
- Internet sales and non-compete obligations.

An analysis of these areas and how the new block exemption has impacted them is provided below.

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### **Price Restrictions**

Setting resale prices is one of the "hardcore" restrictions enumerated in the block exemption. If a franchise agreement contains a "hardcore" restriction, the agreement, as a whole, will not be exempted from Article 101.

Not all price restrictions are prohibited. Franchisors can set maximum prices and can recommend prices, provided that the "recommendations" are not mandatory. Franchisors cannot set minimum prices either by means of express contractual provisions or by indirect methods, such as offering rebates for franchisees who "comply."

Franchisors, however, can now establish minimum or fixed prices for short-term promotions, usually those lasting from two to six weeks. Further, the Commission recognizes that, when new products or brands are being introduced, prices may be set for an "introductory period." Precisely how long that introductory period may be is unclear.

### **Territory Restrictions and Internet Sales**

While franchisors are not prohibited under Article 101 or the new block exemption from granting exclusive territories, the typical exclusive territories that they grant are not quite as "exclusive" as they once were. The reason for this is that the Commission draws a distinction between "active" and "passive" selling.

"Active" sales are sales made by franchisees who have taken active steps to obtain a customer (such as mass mailing or telephone calls to that customer). "Passive" sales are sales made by franchisees as a result of unsolicited inquiries from customers. A franchisor can prevent a franchisee from making active sales to customers outside its territory, but it cannot prevent the franchisee from making passive sales to customers outside its territory.

Under the new block exemption, the Commission has continued its position that internet sales are "in principle" passive sales and, therefore, cannot be prohibited. Nevertheless, the Guidelines distinguish between active and passive online distribution. For example, a franchisee's use of a search engine to optimize its website's rating in territories outside its own allocated territory or the use of "banner" advertisements on third-party websites with respect to territories which have not been allocated to it, could be viewed by the Commission as an "active" sale.

A franchisor cannot prevent its franchisees from having their own websites, but it can set quality standards for those websites in precisely the same way that the franchisor may set quality standards for retail premises or vehicles that its franchisees use. A franchisor also can require its franchisees to participate in the franchisor's website.

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The Guidelines make it clear that the following are prohibited:

- Expressly prohibiting a franchisee from responding to an email inquiry received by its website from outside its territory, or automatically re-routing such inquiries to the appropriate franchisee.
- Using credit card payment facilities to terminate transactions from outside the territory.
- Imposing a requirement to limit online sales, although a franchisor may require its franchisees to have a "bricks and mortar" facility and may set a fixed minimum amount of "bricks and mortar" sales that must be achieved.
- Requiring a higher price for products to be sold online than those to be sold offline, although a franchisor may require a fixed fee support payment for offline sales in recognition that offline sales tend to involve more input from the franchisee in terms of advice and guidance than online sales.

A franchisor can impose restrictions on franchisees from making use of unapproved third-party platforms for their online activities. In addition, a franchisor can require its franchisees that use an approved third-party platform to comply with the related conditions it establishes.

There remain a significant number of areas of uncertainty, including the following:

- Domain name - Can a franchisor prevent its franchisees from using its brand in their domain names? While a "borderline" issue, on balance, I would argue that it is allowed - clearly a view that the Commission is unlikely to share.
- Language - Can a franchisor, for instance, when granting a master franchise in Greece, require the language of the website to be in Greek only? Although it is the Commission's position that any language restriction is not allowed, I disagree. Further, I believe that a franchisor can specify that its franchisees must use country-specific domain names.
- Social networking - The block exemption does not deal with social networking websites. Nonetheless, it is my opinion that a franchisor can prevent its franchisees from using these websites.
- Quality standards - What quality standards may a franchisor establish for its franchisees' websites? Clearly, any quality standards a franchisor establishes must be commercially defensible so that their purpose is not seen as simply to discourage the use of the internet.

In view of the dangers of incorporating a "hardcore" restriction into a franchise agreement, a cautious approach should be taken in relation to these issues.

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### **Non-Compete Obligations**

In-term non-compete obligations are also prohibited, but they are "grey list" restrictions and not "hardcore" restrictions. What this means is that only the clause containing the restriction is void and unenforceable, and not the whole agreement.

A non-compete obligation is, for the purposes of the block exemption, an obligation on a franchisee (i) not to be involved in a similar business, or (ii) to purchase at least 80 percent in value (occasionally volumes can be used) of its required purchases from the franchisor or its nominated supplier.

The Commission recognizes, however, that a non-compete obligation lasting for up to five years (which can be renewed in renewal agreements) should be permitted. Further, if the franchisor owns the premises from which one of its franchisees operates, the non-compete obligation for that franchisee can last for the length of the lease the franchisor grants to the franchisee.

Post-termination non-compete covenants are a "grey list" restriction, unless they are indispensable for the protection of the franchisor's know-how. The know-how must be secret, which means it must not be "generally known or easily accessible." The new block exemption has changed the definition of "know-how" by deleting from the definition under the old block exemption the following language: "as a body or in the precise configuration and assembly of its components." As a result, it appears less likely that a franchisor will be able to argue that, although none of the elements of its know-how are secret, their compilation is secret.

If a franchisor can satisfy a court that it does have know-how which must be protected, it is permissible to

impose post-termination non-compete covenants for a period of one year. A franchisor can prevent its ex-franchisee from being involved in competing goods or services from the "premises and land" that it had previously used. In other words, a franchisor cannot prevent a franchisee from opening next door to the franchised premises, and it would appear that no post-term restrictions can be imposed on van distribution franchises. Irrespective of the enforceability of post-termination non-compete covenants, provided its franchise agreements contain the proper provisions, a franchisor can enforce prohibitions on its franchisees' use or disclosure of know-how

The provisions referred to above relating to post-termination non-compete covenants could, on their face, have a very serious effect on franchising. However, the Court of Justice, which is the ultimate authority on European matters, took a less than "tough" stance on post-termination non-compete covenants in its *Pronuptia* decision (Case 161/84, *Pronuptia de Paris GmbH v. Pronuptia de Paris Irmgard Schillgallis*, 1986 E.C.R. 353. In, *Pronuptia*, the Court indicated that a post-termination non-compete covenant could be enforced if it was essential to prevent the risk that know-how and assistance provided by the franchisor will, after termination, be used to aid the franchisor's competitors. As a result, it may be that franchisors will be able to rely on the Court of Justice's decision rather than the block exemption and Guidelines to impose wider post-termination non-compete covenants.

### Conclusion

Generally, the changes introduced by the new block exemption are not a significant departure from the old block exemption. There are, however, a few notable differences and areas of uncertainty that attorneys and their clients need to keep in mind. These include restrictions on the use of the internet, situations where franchisees' prices can be set by a franchisor, and the enforceability of restrictive covenants in some types of franchise agreement. Attorneys are also reminded that EU franchisors must not only comply with the requirements of Article 101 for any new agreements they enter into, but also must revise their existing agreements by the 2011 deadline.

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## Maryland's New Franchise Delivery Requirements are Now in Effect

By Dale E. Cantone

Assistant Attorney General, Maryland Attorney General's Office, Division of Securities

On October 1, 2010, the new franchise delivery requirements under the Maryland Franchise Law (Section 14-223) went into effect. As a result, Maryland's franchise delivery requirements no longer differ substantively from the FTC Franchise Rule. The new provisions, found at Chapter 168 of the Laws of Maryland of 2010, require a franchisor to deliver the required form of FDD at the earlier of: (a) 14 calendar days before a prospective franchisee signs a binding agreement with a franchisor or pays any consideration relating to the franchise relationship; or (b) a prospective franchisee's reasonable request for a copy of the FDD.

The Maryland Securities Commissioner issued an Interpretive Opinion/No Action Position, dated June 15, 2010, regarding the effect of this new law on franchise disclosure in Maryland. Now that the new delivery requirements have become effective, all franchisors registered in Maryland should have revised their FDD Receipt pages to delete any notice regarding Maryland-specific franchise delivery requirements.

You can find the Interpretive Opinion/No Action Position at:

<http://www.oag.state.md.us/Securities/chapter168.pdf>

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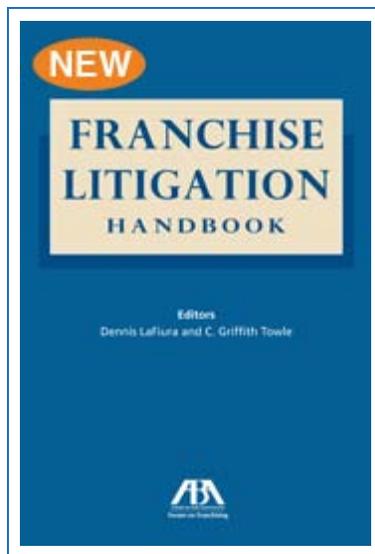
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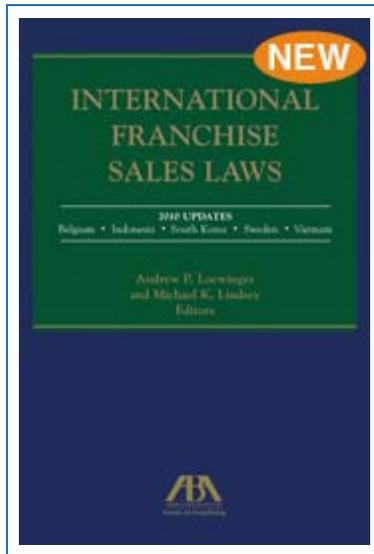
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