

International Commercial Transactions

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I. Introduction

This survey addresses recent developments in the law pertaining to international commercial transactions. In particular, it addresses franchising in China, the expected revision of the U.S. Federal Trade Commission Franchise Rule, the new Franchise Prior Disclosure Law in Belgium, an update on German Franchise Law, franchising in Spain, and distribution agreement considerations in Argentina.

II. Franchising in China

Chinese franchising law continues to develop. The Ministry of Commerce issued new “Measures for the Regulation of Commercial Franchise”¹ (the Measures), which came into effect on February 1, 2005. These replace the measures issued in 1997 for trial implementation. While the new Measures are more detailed, there are still significant questions about when they apply, what must be disclosed, and the required pilot stores. Court decisions in China are becoming available online, and there is now some guidance on the interpretation of the Measures.

In China, the issue that has generated the most concern is the requirement that a franchisor have at least two company-owned units (or units owned by its subsidiary) in

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1. Shangye Texujingying Li Ban Fa [Measures for the Regulation of Commercial Franchise] (promulgated by the Ministry of Commerce, Dec. 31, 2004, effective Feb. 1, 2005), available at http://dlapiperglobal.admin.hubbardone.com/files/upload/ChinaFranchise_english.pdf.

China for more than one year.² A closely related question is whether foreign franchisors are now permitted to franchise directly in China. The new Measures do contain a section entitled “Special Rules for Foreign Invested Enterprises,”³ but these provisions are not clear. Some commentators suggest that a foreign franchisor may grant a master franchise and have the master franchisee fulfill the requirement for company-owned units,⁴ while others suggest that the franchisor must still fulfill this requirement even when granting a master franchise.⁵

Foreign franchisors considering entry into the Chinese market should pay particular attention to Article 7 of the Measures, which sets out the qualifications required to be a franchisor. Cases in which the franchise agreement is held to be invalid because the franchisor lacked the necessary qualifications are currently more common than cases ordering rescission for failure to disclose. While foreign commentators have focused on the barrier to entry posed by the requirement of having operated two locations in China for at least one year, Chinese commentators and judges have focused on whether the foreign franchisor is duly organized under China’s laws and regulations to offer franchises.

In China, foreign investors are restricted as to the types of industries that they can enter. Until December 11, 2004, foreign-invested enterprises were not allowed to enter the distribution sector, a sector where China considered its domestic players to be weak.⁶ Franchising was restricted to domestic enterprises.

This restriction on franchising was the key to the 2005 decision in *Han Meiyuan v. Beijing Yinqi Baiyi Yinqi Jianmei Ltd.*⁷ In this case, the franchisor defendant, incorporated on February 18, 2003, by South Korean investors as a wholly foreign-owned enterprise⁸ to operate a business in the health sector, did not at the time of the decision have the approval of the authorities to be engaged in franchising. As the court stated:

According to the Regulations regarding Foreign Entity Investment in Industry of the State Council and the Catalogue Guiding Foreign Investment in Industry, franchising is one of the industries that China gradually is opening up, and it was [at the relevant time] listed as “restricted.” It is clear that foreign investment is permitted

2. *Id.* at art. 7(4).

3. *Id.* at arts. 32 -37.

4. See Gary Duvall & Guanxi Zheng, *Rising Affluence and Post-WTO Reforms: Converging Trends Boost Franchising in China*, China’s New Measures for the Regulation of Commercial Franchises, Presentation at ABA Annual Meeting (Aug. 7, 2005).

5. Carl E. Zwisler, *China Franchise Law Raises More Questions as Foreign Franchisors Struggle to Cope with Experience Standard*, 2 HOT BRANDING NEWS 1 (Haynes & Boone, LLP) (Sept. 16, 2005), available at http://www.haynesboone.com/FILES/tbl_s12PublicationsHotTopics/PublicationPDF60/1474/09_16_2005_Hot%20Branding%20News.pdf.

6. See Waishang Touzi Lingyu Guanli Ban Fa [Measures for the Administration on Foreign Investment in Commercial Sector] (promulgated by the Ministry of Commerce, Apr. 16, 2004, effective June 1, 2004), available at <http://www.wecomesh.com/detail.asp?NewsID=762> (last visited Feb. 27, 2007). This was to fulfill part of China’s commitment to remove restrictions on entry to markets within three years of entry into the World Trade Organization. The third anniversary of such entry was December 11, 2004.

7. *Han Meiyuan v. Beijing Yinqi Baiyi Yinqi Jianmei Ltd.*, No. 5967 (Beijing Chaoyang Dist. People’s Ct., Aug. 16, 2005), available at <http://www.lawyer3721.net/index.php3?file=detail.php3&kdir=1657>.

8. The decision describes the enterprise as a “waishang duzi jingying” or “foreign sole-ownership management” enterprise, rather than “waizi qiye” or “wholly foreign-owned enterprise.”

after December 11, 2004. In other words, before December 11, 2004, China did not permit foreign-invested entities to engage in franchising.⁹

Accordingly, the Court found that the franchisor had violated these requirements. Based on Article 52(5) of the Contract Law¹⁰ and Article 10 of the Interpretations of the Supreme People's Court of Certain Issues concerning the Application of the Contract Law,¹¹ the franchise agreement was held invalid, and disputed monies were ordered returned to the plaintiff franchisee.

Articles 32 to 37 of the Measures now set out special rules for foreign-invested enterprises. Notwithstanding this wording, not all Chinese lawyers agree that a foreign franchisor may only enter into a master franchise agreement with a Chinese master franchisee by setting up a foreign-invested enterprise in China.

III. Revised Federal Trade Commission Franchise Rule Expected Soon

The federal franchise regulation, which requires presale disclosure throughout the United States, is expected to be amended in 2007.¹² The Federal Trade Commission (FTC) Franchising Trade Regulation Rule,¹³ initially adopted in 1979, has been under review since the early 1990s with the intention of making it more appropriate for developments in franchising practices. The August 2004 report issued by the FTC staff¹⁴ contained detailed revisions to a draft which was issued in 1999, along with the staff's response to comments which had been made by many lawyers and other franchise community representatives. The final revised rule is expected to closely follow the recommendations made in the staff report. The FTC staff has announced that franchisors will be given a reasonable period within which to begin using the new disclosure format.

How will the proposed rule affect international franchise sales involving the United States? For U.S.-based franchisors, the news is good. The staff has recommended that the rule only apply to sales of franchises to be located in the United States.¹⁵ For foreign

9. Translation by author.

10. Contract Law (promulgated by the Second Session of the Ninth Nat'l People's Cong., Mar. 15, 1999, effective Oct. 1, 1999), art. 52 (P.R.C.), available at <http://www.cclaw.net/download/contractlawPRC.asp> ("A contract is invalid in any of the following circumstances: . . . (v) The contract violates a mandatory provision of any law or administrative regulation").

11. Interpretations of Certain Issues Concerning the Application of The Contract Law of the People's Republic of China (Part One) (adopted by the Sup. People's Ct., Dec. 1, 1999, effective Dec. 29, 1999), art. 10, available at http://www.cclaw.net/download/SPC_Interpretation1.asp ("Where the parties entered into a contract the subject matter of which was outside their scope of business, the People's Court shall not invalidate the contract on such ground, except where conclusion of the contract was in violation of state restriction concerning, or licensing requirement for, a particular business sector, or in violation of any law or administrative regulation prohibiting the parties from participation in a particular business sector").

12. Business Opportunity Rule, 71 Fed. Reg. 19,054 (proposed Apr. 12, 2006) (to be codified at 16 C.F.R. pt. 437).

13. Trade Regulation Rule on Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures, 16 C.F.R. § 436 (2006).

14. FTC, BUREAU OF CONSUMER PROT., STAFF REPORT TO THE FEDERAL TRADE COMMISSION AND PROPOSED REVISED TRADE REGULATION RULE (16 CFR PT. 436), DISCLOSURE REQUIREMENTS AND PROHIBITIONS CONCERNING FRANCHISING (2004) [hereinafter FTC STAFF REPORT], available at <http://www.ftc.gov/os/2004/08/0408franchiserulerpt.pdf>.

15. *Id.* at 72.

companies hoping to sell franchises in the United States, the changes could make entering the market easier. The staff has not recommended any exemptions for foreign franchisors that want to test the U.S. market, but they have recommended a retreat from the current rule's requirement that all franchisors must provide three years of financial statements that comply with U.S. Generally Accepted Accounting Principles (GAAP).¹⁶ The proposed change would allow foreign companies to use statements prepared under their country's GAAP, provided the statements also satisfy criteria published by the U.S. Securities and Exchange Commission (SEC) for the use of foreign financial statements in U.S. securities offerings.¹⁷

Foreign franchisors will need carefully to consider how they structure the entity which will offer franchises in the United States. The staff has recommended that a franchisor's parent company's financial statements be included in disclosure documents if either the parent company commits to perform the franchisor's post-sale obligations to franchisees or the parent guarantees obligations of the franchisor subsidiary.¹⁸

Foreign-based franchisors will benefit from the proposed elimination of the current requirement to deliver disclosure documents at the first personal meeting with a prospective franchisee. That requirement has made testing the U.S. market very expensive for foreign franchisors. The staff report would not require disclosure until fourteen calendar days before an agreement is executed or any fees are paid relating to the franchise.¹⁹

The proposed exemptions for franchise offers made to sophisticated investors also will facilitate access to the U.S. market for franchisors seeking franchisees with resources to grow their franchise through area development agreements or master franchises. These exemptions would be available for: (1) investments exceeding \$1 million, exclusive of real property expenses and financing provided by the franchisor;²⁰ (2) large entity franchisees (i.e., those that have been in business for at least five years and have a net worth of at least \$5 million);²¹ and (3) officers, owners, or managers of a franchisor who have been employed by the franchisor for at least two years before purchasing the franchise.²²

Moreover, the revised rule would adopt a single disclosure format, modeled after the Uniform Franchise Offering Circular (UFOC), which was first developed by state franchise law regulators in the mid-1970s.²³ Although the FTC has approved the use of the UFOC to satisfy federal disclosure requirements, it also has permitted use of a disclosure format published in the rule. The new disclosure format will effectively replace the current UFOC format, although additional disclosures may be required by state laws. Some key changes are set out below:

- *Pre-Signing Contract Review Period*: The current franchise rule requires franchisors to furnish prospective franchisees with a copy of the completed franchise agree-

16. *Id.* at 166-67, 200-02.

17. *Id.*

18. *Id.* at 199.

19. *Id.* at 78.

20. *Id.* at 241.

21. *Id.* at 248-49.

22. *Id.* at 249-50.

23. The UFOC Guidelines consist of Requirements, Instructions, and Sample Answers. The UFOC Guidelines were prepared and adopted by the North American Securities Administrators Association and its predecessor, the Midwest Securities Commissioners Association. See <http://www.nasaa.org>.

ment at least five business days before its execution. The staff has recommended eliminating the contract review period entirely, unless the franchisor has materially altered the terms of its standard franchise contract and such changes were not requested by the prospective franchisee.²⁴ When the exception applies, the franchisor must deliver a completed franchise agreement to the franchisee seven days, instead of five business days, before the agreement is executed.²⁵

- *Item 19: Earnings Claims:* The current franchise rule and the UFOC Guidelines permit, but do not require, franchisors to make earnings claims to prospective franchisees. The staff recommends that earnings claims remain voluntary.²⁶ However, it proposes elimination of the current requirement that the earnings claim have geographic relevance, and also that franchisors disclose the number and percentage of franchisees that have attained the numbers presented in the earnings claim.²⁷
- *Item 20: Outlets and Franchisee Information:* The current requirements for reporting of information about franchise cancellations, transfers, and nonrenewals sometimes lead to double counting due to the tabular format of the required reporting. For example, if a franchisee sells his franchise to a third party, and the franchisor requires the buyer to sign a new franchise agreement, the transaction may be recorded both as a termination of the original franchise and as a transfer. To address this issue, the staff has recommended revision of Item 20 in its entirety to improve the manner in which information about changes in ownership of franchised outlets is presented.²⁸
- *Confidentiality Agreements:* The staff has recommended that if a franchisee has signed a contract containing a confidentiality clause during the last three fiscal years, the franchisor must provide a statement alerting prospects to the fact that some franchisees may not be able to speak openly with prospects because of these clauses.²⁹ The staff does not recommend disclosure of confidentiality clauses that address specific contract negotiation terms and conditions.³⁰

24. *Id.* at 81-82.

25. *Id.* at 82.

26. *Id.* at 159-62.

27. *Id.* at 165.

28. *Id.* at 173-81.

29. *Id.* at 189.

30. *Id.* at 190.

IV. New Franchise Prior Disclosure Law in Belgium³¹

A. THE PRIOR DISCLOSURE REQUIREMENTS OF THE ACT OF 19 DECEMBER 2005

On July 7, 2005, the Belgian Chamber of Representatives adopted the "Act regarding pre-contractual information in the context of commercial partnership agreements" (the Act).³² The Act received Royal assent on December 19, 2005.

The Act is mainly intended to apply to business format franchise agreements, though the vague and broad wording of the Act can be read to cover a broader range of commercial relationships, such as technology licensing arrangements and some distributorship agreements.³³ The Act provides that it shall apply—notwithstanding any provision in the agreement to the contrary—to every agreement that is carried out mainly in Belgium.³⁴ This would appear to exclude master-franchise agreements covering several countries. The Act also provides that all provisions of the franchising agreement must be construed in a way that is the most favorable to the franchisee.³⁵

The Act requires that a franchisor, at least one month before the conclusion of the agreement, provide its franchisee, free of charge, with a draft of the contract that will be concluded as well as with a document containing detailed information, allowing the franchisee to make an informed decision.³⁶

The disclosure document must be divided into two chapters:

The first chapter must draw the franchisee's attention to certain rights and obligations set out in the draft agreement, such as consideration, business restrictions and exclusivity, term, renewal, and termination, the consequences of a party not performing its obligations, whether the franchisor has a right of first refusal on the franchisee's business, and several other issues.³⁷ Any omission of a required disclosure set out in the first chapter of this document will confer on the franchisee the right to declare that omitted provision null and void.³⁸

The second required chapter of the disclosure document concerns information about the franchisor, about the franchised business, and about the market situation and perspectives.³⁹ By and large, the disclosure requirements are similar to those that are in force in other countries such as France or the United States. What is less common is the consequence that follows the violation of these disclosure requirements. The very strict wording of the Act and the (nonbinding) comments made on the draft by the government's

31. This section is partly based on a contribution the author published in the International Commercial Transactions Committee's Newsletter of January 2006 regarding the same law. The article published in the Newsletter referred to the law by the date on which the House of Representatives adopted the law (i.e., July 7, 2005), while the rule in Belgium is to refer to the date on which the law has received Royal assent. At the time the article was written (in November 2005), the law had not yet received Royal assent.

32. Doc. 51-1687/007, Chambre des Représentants de Belgique [Belgian Chamber of Representatives], adopted July 7, 2005, effective Dec. 19, 2005, available at <http://www.lachambre.be/FLWB/pdf/51/1687/51K1687007.pdf> (French and Dutch only) [hereinafter Belgian Commercial Partnership Act].

33. See *id.* at art. 2.

34. *Id.* at arts. 8-9.

35. *Id.* at art. 7.

36. *Id.* at art. 3.

37. *Id.* at art. 4.

38. *Id.* at art. 5.

39. *Id.* at art. 4.

legislative advisory bureau suggest that any violation of the disclosure requirements may result in the annulment of the entire contract at the request of the franchisee, provided the annulment is sought before the expiry of a period of two years following the conclusion of the agreement.⁴⁰ Communications exchanged immediately prior to the adoption of the Act appear to support the view that the legislature viewed the violation of the disclosure obligations with extreme severity, but it is expected that the courts will apply this sanction with caution and moderation.

Belgian courts have exclusive jurisdiction on disputes regarding an agreement governed by the provisions of the Act.⁴¹ A dispute falling within the scope of the Act would likely not be considered arbitrable, unless the arbitrators have the obligation to apply the provisions of the Act. Choice of court agreements designating U.S. courts would also likely be denied any effect. Choice of court agreements designating the courts of a country that is a member of the European Union (EU) or that is a party to the Lugano Convention, however, will be valid and enforceable.

As far as the author of this comment knows, no case has yet been presented to a Belgian court under the provisions of the Act. Moreover, when Parliament adopted the Act in July 2005, it gave itself one year to assess the new law and decide whether a broader law was necessary, affording better and wider protection to the franchisee.⁴² Official action on such assessments has been slow to come, and the author considers it unlikely that any initiative will come from the government or from the parliamentary commission in the immediate future.

B. DRAFT LAW ON FRANCHISING AGREEMENTS: THE SOCIALIST PROPOSAL

On July 10, 2006, a group of one Flemish Socialist and four French-speaking members of Parliament filed a new draft Act "purporting to regulate franchising agreements beyond the pre-contractual phase, in order to encourage better commercial practices in the sector."⁴³ In particular, the authors of the draft urged greater disclosure requirements to protect franchisees, citing an imbalance in the negotiating power of franchisors and franchisees and lack of opportunity for negotiation.

It is unlikely the draft Act will pass or be considered during this legislative session. Whether the discussion moves any further and whether the draft Act has any chance to pass will likely depend on the outcome of the next national elections, scheduled for May 2007.

40. *Id.* at art. 5. See Advice on the draft Act, Doc. 51-1687/001, Chambre des Représentants de Belgique [Belgian Chamber of Representatives], Mar. 22, 2005, at 17-18, available at <http://www.lachambre.be/FLWB/pdf/51/1687/51K1687001.pdf> (French and Dutch only).

41. Belgian Commercial Partnership Act, art. 9.

42. *Id.* at art. 10.

43. Doc. 51-2603/001, Chambre des Représentants de Belgique [Belgian Chamber of Representatives], July 10, 2006, available at <http://www.lachambre.be/FLWB/PDF/51/2603/51K2603001.pdf> (French and Dutch only).

V. Update on German Franchise Law

While more and more European states are regulating franchising through legislation, corresponding legislation continues to be lacking in Germany. Case law on general civil law matters such as consumer protection, competition, antitrust, or trademark law determines the guidelines for franchising in Germany.

Very recently the highest German civil court, the German Federal Supreme Court (BGH), has concerned itself in several decisions with franchise contracts which had an international context. In addition, the European Court of Justice (ECJ) ruled on the protection of services with respect to the distribution of goods that lead to an extended trademark protection practice for German trademarks. Moreover, a new law is of interest for franchise-systems active in Germany.

A. EUROPEAN CASE LAW

It was formerly the case that the services rendered in connection with selling goods could not easily be protected. As a result, from the outset there was a certain interpretation gap in the trademark protection, which has now been rectified by means of a judgment issued by the ECJ in favor of trademark holders.

Through its 2005 decision in *Praktiker Bau- und Heimwertermärkte AG*,⁴⁴ the ECJ has now made it clear that trademark protection for retail services can also be applied for. After this was already possible in some European neighboring countries, the official practice of the German Patent and Trademark Office (DPMA) will also change as a result. The DPMA initially rejected *Praktiker Bau- und Heimwertermärkte AG*'s registration application regarding the "Praktiker" trademark for the service "retail in construction materials, DIY items and garden articles and other consumer goods for the DIY area."⁴⁵

In the view of the ECJ, there is no compelling reason why such services should not be protected because the term "services" in the sense of EU Directive 89/104/EWG encompasses all services that are rendered in the framework of retail in goods.⁴⁶ As a consequence, retailers can now successfully acquire protection for the registered trademark of goods sold, as well as protection for all services related to the goods that they render in retail.

Underlying the ECJ's decision is an awareness of the growing number of consumer services that retailers have begun to offer, beyond the mere sale of goods. As a result, factors such as the selection, composition, and presentation of the goods, as well as the advertising, appearance, and location of the business, are increasingly becoming the focal points of interest, not merely availability and pricing of goods. Accordingly, this series of services is also increasingly becoming a factor in the price calculation. For this reason, in the ECJ's view, the possibility of registration of a service trademark in class 35 for retail services is justified.

The DPMA has recognized other service designations in the interim, including specified wholesale services and, subject to particular prerequisites, shipment of goods and services via the Internet or by means of teleshopping. With regard to the registration,

44. Case C-418/02, *Praktiker Bau- und Heimwertermärkte AG*, 2005 E.C.R. I-05873.

45. *Praktiker Bau- und Heimwertermärkte AG*, at ¶¶ 11-12.

46. *Id.* ¶ 35.

services need not be itemized, but rather it is only necessary to specify the goods or the type of goods to which the services relate.

B. GERMAN FEDERAL CASE LAW

In December 2005, the BGH dealt with the fulfillment of pre-contractual clarification obligations in connection with a U.S. restaurant franchise.⁴⁷ The German franchisee sued for compensation after the profit development of its restaurant lagged behind expectations. Its lawsuit was based, *inter alia*, on its allegations that in the course of the contract negotiations, it had been assured that in the event of failure, the defendant would take over and continue to run the restaurant “as was proper for a large franchise family.”

The lower court did not see a reason for examining the statement by the franchisee more closely or for collecting evidence in this respect. The BGH, however, ruled that the lower court should have taken evidence at that time about the oral assurance and that the decision rejecting the claim of the franchisee was legally erroneous to that extent. Accordingly, the BGH referred the matter back to the lower court for a new decision.

Even if the BGH’s decision is primarily concerned with a procedural issue, it opens the door to the examination of the question of whether the promise that the defendant would take over and continue to run the restaurant in the event of failure “as was proper for a large franchise family” falls within the general precedent that requires that if there is particular personal trust between the parties, then the negotiation leader will be held liable on its own account.

In early 2006,⁴⁸ the BGH dealt with the franchise system of a U.S. car rental company and the issue of whether, on the basis of the franchise contract or an agreement entered into by the franchisor’s German subsidiary with the German franchisee, the franchisor or its subsidiary was obliged to pay the franchisee purchasing advantages that that subsidiary had negotiated with vehicle manufacturers and that it had received from vehicle purchases by the franchisee. In this case, the agreement stated that the franchisor would inform the franchisee on an annual basis about the amount of the special conditions granted by manufacturers, and in the introduction to the agreement, it was stated that the franchisee would participate in the purchasing conditions for automobiles.

In practice, the franchisor forwarded to the franchisee only a portion (the amount of which was determined solely by the franchisor) of the advertising cost subsidies received by it from vehicle purchases by the franchisee and pocketed the difference. The franchisee requested information about the difference and payout to the franchisee.

The BGH rejected claims under the franchise contract, but upheld both the claim for information and also the claim for payment to the franchisee of the total purchasing advantages negotiated by the franchisor’s subsidiary and partially retained, on the basis of the agreement between the subsidiary and the franchisee. Secondly, the BGH determined that an information obligation about the entire purchasing advantages only made sense if the franchisee could also demand the handing over of all purchasing advantages.

47. Bundesgerichtshof [BGH] [Federal Court of Justice] Dec. 13, 2005, KZR 12/04.

48. Bundesgerichtshof [BGH] [Federal Court of Justice] Feb. 22, 2006, VIII ZR 40/04.

The BGH ultimately referred the matter back to the competent appeal court for new hearing and decision. The lower court must now hand down a new decision, taking account of the BGH's stipulations.

C. GENERAL ANTI-DISCRIMINATION ACT

The "Act for the implementation of European Directives regarding the realisation of the principle of equality of treatment"⁴⁹ recently became effective and is now being called the General Anti-Discrimination Act (the AGG). The AGG prohibits discrimination on the basis of ethnic origin, gender, religion, or age. The focus of the AGG is in the area of employment and professions, but civil law is also affected, particularly contracts with the self-employed (such as franchisees), suppliers, service providers, lessors, or contractors. The impact on franchise contracts remains to be seen. Because the AGG provides for compensation claims, as well as evidentiary presumptions in favor of the party allegedly discriminated against, the future AGG could have a particular impact on the configuration of the pre-contractual clarification documentation. In addition, franchisors might be forced to re-define and enlarge their documentation of any transaction with their franchisees to defend themselves against claims based on alleged discrimination.

VI. Legislation on Franchisors' Registry Amended in Spain

The prevalence of franchising arrangements continues to grow in Spain. In 2005, the franchise system in Spain invoiced some 17,909 million euros, which was a 12 percent increase on the previous year, according to the Spanish Franchise System's statistical report prepared by the Spanish Association of Franchisors (La Asociación Española de Franquiciadores) (AEF).⁵⁰ Furthermore, again according to AEF, there were 712 operative brands at December 31, 2005, of which 80 percent (573) were Spanish, and the rest were from other countries, principally France, the United States, and Italy.

The AEF report further states that at the end of 2005, there were 48,302 establishments of franchising companies in Spain, representing a 9 percent increase on the previous year. Of those, 77 percent were franchisees, and 23 percent were the franchisor-owned establishments. During 2005, the franchise system involved 201,977 professional workers, 4.7 percent more than in 2004, of which 75 percent worked in franchised establishments, while 25 percent were in franchisor-owned establishments.

Legislation governing franchising is relatively new in Spain. As a result, the legislature has seen fit to make a number of amendments to the law in recent years.⁵¹ In 2006, the legislature amended the law with respect to the establishment of the Franchisors' Registry (the Registry).⁵² The Registry originally was created in 1998 as a public registry in which all individuals or entities with legal personality who intend to carry out their business

49. BRDrucks 329/06.

50. Spanish Assoc. of Franchisors (La Asociación Española de Franquiciadores) <http://www.franquiciadores.com/>.

51. The Spanish law on franchises is contained in art. 62 of the Commercial Retail Law (B.O.E. 1996, 7). The Regulations developing the law are contained in Royal Decree 2485/1998 (B.O.E. 1998, 2485), as modified most recently by Royal Decree 419/2006 (B.O.E. 2006, 419).

52. Royal Decree of April 7 relating to the regulation of the franchise system and the registry of franchisors (B.O.E. 2006, 419).

activity in Spain through franchising must register prior to commencing their activity.⁵³ At the time the law was promulgated, the need for such a Registry was justified by the convenience of having an up-to-date census on franchises, a business sector that was undergoing enormous growth in Spain.

Royal Decree 419/2006, dated April 7, 2006, amends the existing legislation. This new regulation of the franchise regime seeks to build upon the potential of the Registry as an instrument of certified, accurate, and current information, and also to clarify some of the requirements for allowing a company to be classified as a franchising company. The policy behind the amendments is to improve the information available to companies or persons thinking of investing in a franchised business project. In so doing, the Spanish legislature intends to reinforce the role of the Registry as an efficient instrument of information and transparency in the market.

In particular, the Royal Decree contains a number of new provisions such as the possibility that the interested party seek of its own initiative the incorporation of its data in the Registry, unless the corresponding Autonomous Community requires that this information be provided through the authority in the Autonomous Community. The earlier Royal Decree only allowed the recording in the Registry by application of the Autonomous Community, rather than the interested party.

Another specific change is the requirement of more detailed documentation to obtain registration. Two examples of the novel aspects of the new legislation are: (1) the proof of representation when the application for registration is made by a representative on behalf of the company; and (2) the filing of originals or copies, with an accompanying translation, of the documentation necessary for the registration of a foreign company.

In addition, although registered franchisors were already required to inform the Registry of changes in their data or the cessation of the franchising activity, the new regulation incorporates new obligations to file an annual negative report, in which it is expressly stated that there has been no change in the data recorded in the Registry, in an effort to ensure that the information is up-to-date and effective. The penalty for noncompliance with the existing and new obligations is automatic removal of the franchisor from the Registry, which means cessation of franchising activities.

VII. Distribution Arrangements in Argentina

A. INTRODUCTION

Argentina, like several South American countries, has no specific regulations with respect to commercial distribution activity. Instead, the relationship between producer and distributor is based on general principles established by the civil and commercial codes and specifically on judicial precedent.⁵⁴ In principle, a distribution agreement is subject—almost exclusively—to the terms and conditions agreed upon by the parties. Below are summarized certain laws and precedents that should be taken into consideration when entering into these sorts of arrangements in Argentina.

53. The Franchisors' Registry was originally created by Royal Decree 2485/1998, which amended article 62 of the Commercial Retail Law.

54. See *COD. CIV.* § 1197 (Arg.) (providing that "the conventions made in the contracts are for the parties a rule that shall be honored as the law").

B. MAIN CONCERNS WHEN DEALING WITH LOCAL DISTRIBUTORS

1. *Labor Law Impact*

There are no formal requirements as to the format or specific language to be used in a distribution agreement. In fact, a distribution relationship between producer and distributor may arise from an oral agreement, with no other documentation than purchase orders and invoices. However, it is always advisable for parties to reach an agreement in writing, defining the terms and conditions under which they intend to conduct this activity (i.e., exclusivity, territorial allocation, term of conclusion, etc.).

To avoid having the agreement characterized as creating an employment relationship, there should be a lack of technical, economic, and legal subordination of the representative to that of the enterprise, and the parties should take care to clarify this independence in the agreement. In this regard, it is important to point out that the Employment Agreement Law No. 20,744, as amended (EAL), is protective of workers' rights in general, and sets forth in its Section 23 that the rendering of services generates a presumption of the existence of an employment relationship, except in the event that the particular circumstances may evidence the contrary, including when legal vehicles other than labor agreements are used to govern the relationship, as long as the individual is not considered an entrepreneur.

As mentioned, the EAL creates a *juris tantum* presumption by means of which, once the rendering of services is alleged by the worker, the hiring party has the burden of proof to demonstrate that the relationship between the parties does not constitute an employment relationship in terms of EAL. To determine whether an employment relationship exists, Labor Courts generally consider and jointly evaluate, on a case-by-case basis, facts such as the assumption of risk by the representative, the existence of uniform compensation, economic dependency, submission to the disciplinary power of the producer, and management of the representative of his or her own time, among other issues.

As a result, producers may face the risk that terminating an agreement with a representative will lead to a claim asking the courts to declare the existence of a "covered" employment relationship. If the relationship between the producer and the representative is considered an employment relationship under the EAL, then the producer will be subject to a severance payment as mandated by the Labor Law and, further, to certain penalties provided for employers that fail to register employment relationships with employees.

2. *Term and Termination*

As indicated above, there is no statutory provision in relation to the termination of a distribution agreement. Rather, judicial precedents have come to set forth the limits for the termination, especially in those cases where no term was agreed upon by the parties. As a result, certain steps should be followed when parties (in particular the producer) intend to terminate a relationship with a distributor, and there is a contractually agreed upon term covering termination. In such cases, any party may decide, at its sole discretion, to terminate the relationship. The Supreme Court has stated that in contracts with no stated term, none of the parties is entitled to an indefinite relationship, notwithstand-

ing the good faith requirement all parties are required to honor when terminating a contract.⁵⁵

If the contract contains no term, termination should be preceded by a notice of termination with a reasonable term before conclusion of the relationship. Otherwise, the counterparty may allege damages for breach of contract or even for abusive termination (and consequential damages for such termination). Likewise, in the event that the agreement sets forth the possibility of automatic renewal, its termination at the conclusion of the term (i.e., without being renewed) should be subject to a reasonable prior notice (with or without cause), providing the distributor with sufficient time to restructure his business. The term of the notice is not fixed by law but should be reasonable in light of the length of the contract and its special characteristics. The notice must clearly and unconditionally communicate to the counterparty the decision to end the relationship, with a term determined in accordance to the case.⁵⁶

In general, it is not advisable in Argentina to agree on an automatic renewal provision, as such a provision might be construed, after successive renewals, as an agreement that was entered into for an undetermined period. It is better to execute a new agreement at the end of each term, in which the representative will assume the risks of his or her own business for the upcoming term.

55. See Cód. Civ. § 1198 (Arg.).

56. Cámara Nacional de Apelaciones en lo Comercial de la Capital Federal [CNCom.], 10/06/2004, "Godicer S.A. v. Cervecería y Maltería Quilmas S.A.I.C.A. y G," La Ley [L.L.] (2004-8) (Arg.).

