THE DOs AND DON'Ts OF FRANCHISING IN ROMANIA

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Abstract

The importance of the franchise agreement per se is one which cannot be denied, both by European investors and by Romanian ones, since each business strives to gain the market relevance which characterizes a franchise. Also, more prominent EU franchises are entering Romanian markets while initially obscure Romanian brands are bolding emerging from the minds of visionary entrepreneurs.

While The European Union lacks a common legal framework on franchising, each Member State has established its own rules, which are similar to a certain extent.

This article aims to point out the main rules applicable for franchises established under Romanian laws, which both franchisor and franchisees should be aware of when analysing the potential success of a franchise located in Romania.

The study shall address what is mandatory for the franchisee to perform before setting up a franchise is Romania and while the franchise network is carrying out is business as well as what are the obligations which each franchisee must undertake, both pursuant to contractual norms and stemming from the legally mandatory framework. Also, another of the study's objectives is to determine the most frequent misinterpretations of Romanian franchise legal framework and to propose adequate solutions in order for future investors to avoid them.

Keywords: *franchise, franchisee, same market, publicity, know how, brands, intellectual property, Romanian franchise laws.*

1. Introduction

This paper covers the analysis of the main legal and practical aspects and concepts which should be known and implemented by Romanian businessmen and novices working their way up to building a successful business.

At a mere Google search, there are more than 70,000 results, showcasing several franchises which have either been successful or still wait to be discovered and properly exploited by eager franchisees. This proves the high interest Romanian entrepreneurs have in franchises, which are popular success recipes, attractive due to the already established success on the local market. Doctrine[1] has reflected on the grounds for which franchises have recently seen such overwhelming success, considering that on the one hand, the franchisor has the possibility of creating a franchise network without needing a considerable investment, and, on the other hand, the franchisee enjoys the possibility of implementing a business model that has already been successful on the market, being accompanied in the process of starting a new business by the franchisor's experience.

But with great possibility for success comes great responsibility, which is why both franchisees and franchisers should be aware, from a more practical perspective, what should they expect from each other during the franchise agreement and after its duration expires or the contract is terminated, and which is why the studied matter is important.

Therefore, the franchise is of utter relevance for practitioners and businessmen, since recent amendments to the national legal framework, namely to GO no. 52/1997 regarding the legal regime of franchise (hereinafter "**GO no. 52/1997**") bring new and intricate regulatory aspects which should be firstly understood and then, properly applied.

This study aims to clarify the way in which Law no. 179/2019 should be approached so that it creates a meaningful tool for both the franchisee and the franchisor, and how several types of franchises are impacted, by means of analysing the practical impact of franchise agreements and their clauses.

The novelty of this study, apart from other existent specialised literature, resides in the perspective from which legal provisions are analysed, in the sense that its purpose it to be a practical guide for businessmen and legal scholars alike, in which the results from previous experience of court cases related to franchises are integrated, as good practices.

2. The parties involved in a franchise agreement

While it is easier to assume that the parties to the franchise are the franchisee and the franchisor, what GO no. 52/1997 tells us is that both parties must be

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[1] R.M. Chireac, *The franchise agreement and the exclusivity clause*, in Pandectele Române no. 5/2020.

professional, meaning that they should be registered in a form which allows them to perform commercial activities on a day to day basis.

As such, the franchisee must not fall in the trap of considering that the individual – sole shareholder of the limited liability company established for the purpose of joining the franchise is the franchisee and could benefit from the protection of the rules governing consumers in relation to their counterparts. Franchisees shall be considered to be only the legal entities established by those individuals, either legal entities or professional individuals, established either in compliance with Companies Law no. 31/1990 or with GO no. 44/2008 regarding carrying out economic activities by authorized individuals, individual enterprises and family enterprises.

Given the above, before considering to join a franchise, an individual should choose a proper form in which to perform its economic activities under Romanian legislation.

As far as the franchisor is concerned, GO no. 52/1997 set out its main obligations, which include the following:

a) the franchisor must be the owner of the rights over a registered trademark or over any other intellectual or industrial property right, for a duration at least equal to the duration of the franchise agreement. As such, the law does not impose that the franchisor must be the actual owner of the brands under franchise, since he can receive the right to use the intellectual property rights pertaining to said brand based on a license agreement with the rightful owner of the brand.

b) the franchisor must provide the right to exploit or to develop a business, a product, a technology, or a service.

This provides for a wide range of franchises from which the franchisee may choose the one more appropriate to its own capabilities.

c) the franchisor must ensure that the franchisee has an initial training for exploiting the trademark.

Such obligation stems from the franchisor's previous experience, which is actually one of the pillars of the franchise. The franchisor acts like a protective brother for the franchisee, initiating the latter in the business which the franchisor is already extremely accustomed to. Mention must be made that the franchisor's experience has been defined by his own work in the same franchise so once the franchisee join the franchise, it shall most likely, at a certain extent, split the same market and the same customers with the franchisor.

d) the franchisor must use personnel and financial means in order to promote its brand, to perform research and innovation, to ensure the development and viability of the product.

From this perspective, the franchisor's attributions are more extended than the ones of the franchisee, since the franchisor is the one who introduces the brand to the world and is responsible for the way the brand is received. All actions related to marketing and promotion of the product and the concept of how the business should develop are geared by the franchisor and should be observed by the franchisee, since the purpose of this control with which the franchisor is vested by the law is to create a network of businesses in which the customer cannot distinguish between the franchisor's business and the franchisee's business.

e) the franchisor must prove the specific application of the know-how he has, within a pilot-unit, whose main objectives are to test and to define the business formula.

This obligation to have a pilot – unit has been deemed as necessary by the legislator in order to facilitate the franchisee's understanding of how the business model works and if such business model could be successful if replicated. Additionally, once in this pilot – unit, the franchisee shall have a clearer picture of his own capabilities and limitations whereas growing the business is concerned.

3. The independence of the franchisee from the franchisor

A less thought about aspect regarding the relationship between the franchisee and the franchisor is the independence one has from the other. Although legal rules dispose that the franchisor must provide initial support in view of establishing the franchise and permanent commercial or technical assistance during the contractual relationship, this cannot be interpreted as creating further obligations on behalf of the franchisor, limiting the franchisee's business perspective.

As doctrine[2] has put it, the lack of independence between the franchisee and the franchisor would lead to transforming the franchisee into a mere branch and if the franchisee is an individual, into the franchisor's proxy.

The consequences of such independence are that the franchisee undertakes the risk of becoming insolvent or even the risk to lose the business, if his commercial aptitudes are not sufficiently developed. It is not the franchisor who shall bear such risks, since the franchisor does not undertake result obligations towards the franchisee or towards the success of the franchisee's business.

[2] V. Nemeş, *Commercial Law*, IV[th] ed., Hamangiu Publishing House, Bucharest, 2021, p. 387.

Likewise, the franchisor is independent from the franchisee, which means that the franchisor cannot become more involved in the franchisee's activity than the law allows. Moreover, the franchisor shall not be liable towards third parties for damages created by the franchisees, except if the franchisor bears a separate, individual fault in such damages, which must be proven.

Considering its independence, the franchisee should realistically analyse its actual possibility to carry out its obligations under a franchise agreement, prior to entering into such, since even though the franchisor shall provide guidance, the liability for the success of the business lies with the franchisee.

4. The pre-contractual phase of a franchise agreement

While it is common for contractual parties to be careful with respect to the way they are observing the contractual provisions, insofar as franchise agreements are concerned, the pre-contractual phase is just as important, since it gives the parties the opportunity to be better acquainted with the specifics of the business run by the franchisor and to confirm their decision to collaborate.

Law no. 179/2019 amending GO no. 52/1997 has stressed the importance for the franchisee to receive an information disclosure document, which must comprise specific data with reference to the history and experience of the franchisor, details of the identity of the management of the franchise, the franchisor's and franchisor's management bodies' litigation history, the initial amount which the franchisee must invest, the parties' mutual obligations, copies of the financial results of the franchisor from the past year and the information regarding the pilot-unit.

This means that withholding any information mentioned above triggers the liability of the franchisor towards the franchisee for any proven damages resulted from the breach of such pre-contractual obligations, even if such obligations are not included in the franchise agreement, so special attention should be drawn when negotiating the franchise agreement to these specific conducts which the franchisor should observe. However, if the franchisor proves it complied with these legal dispositions, the franchisee shall not be able to request court damages by arguing that the franchise failed to obtain certain material results or material results similar to the ones of the franchisor, for that matter, since the franchisor's obligations are and remain throughout the franchise relationship obligations of diligence and not obligations of result.

During this pre-contractual phase, the franchisee should request and the franchisor should provide access to the information disclosure document, and should verify if all information included in this document is compliant with the provisions of GO no. 52/1997. In order to protect its interest, the franchisor should include contractual clauses by which the parties agree that all information related to the franchise and its concept, as stipulated under Romanian laws, have been duly disclosed and understood within the pre-contractual phase.

5. The franchise network

The practical result of any franchise is the creation of a franchise network, which shall commence its existence after the franchisor shall have been able to efficiently operate a business concept for a period of at least one year in minimum one pilot-unit.

The establishment of the franchise network shall not lead to the creation of a new legal entity, as legal doctrine[3] has very well pointed out.

Pursuant to art. 1 point 4) of GO no. 52/1997, the franchise network comprises an ensemble of contractual relations between a franchisor and its franchisees, with the purpose of promoting a technology, a product or a service, as well as for the development of production and of distribution of a product or a service.

The franchisor's role in the franchise network is key for its proper functioning, since the franchisor must be able to maintain its common identity and its reputation and also, to protect the franchise network from unlawful acts of know-how disclosure and unfair competition.

The franchisor should therefore establish sound rules in the franchise contract, while emphasizing the importance of the homogeneity of the franchise network, which should be explained by the franchisor and fully understood by the franchisee from the pre-contractual phase of negotiations and discussions. No franchisee is allowed to perform any action or manifest any conduct which is likely to lead to a disruption in the homogeneity of the franchise network, as such is defined by the franchisor, since any such deed is likely to harm the brand itself. Any reduction in sales and business due to infringements committed by a franchisee are likely to affect the entire network of franchisees, given that at the centre of the business is the brand itself so if the latter loses its reputation before consumers, each franchisee is likely to suffer. Consequently, each franchisee is allowed to seek repair of damage from other franchisees who choose not to observe contractual provisions, based on failure to

[3] St.D. Cărpenaru, *Romanian Commercial Law Treaty*, VIth ed., updated, Universul Juridic Publishing House, Bucharest, 2019, p. 589.

adhere to the principle of homogeneity of the franchise network, established under GO no. 52/1997.

From a legal and practical perspective, the franchisor is also obliged to provide continuous commercial and/or technical assistance throughout the contract period, which does not mean in any way that the franchisor takes any responsibility for the results of the franchisee's business. The obligation to provide assistance remains a diligence obligation and should be viewed as a necessary step so that the franchisor continuously ensures that the franchisee could perform its activity at the franchise standard, which is also set by the franchisor. The trademark and the know – how of the franchisor represent the guarantee of the quality of the products and services provided to consumers, so the franchisor is entitled to perform controls within the franchise network to see if the products and services provided by the franchisees live up to the standards set through the franchise.

6. The franchisee's specific obligations

GO no. 52/1997 establishes that the franchisee is selected by the franchisor based on its competence, meaning managerial qualities and financial capacity to exploit the business, as per art. 15.

In order to accomplish the purpose of having a successful and trustworthy franchise network, the franchisor must include several requirements which the franchisee is obliged to observe. To this end, the franchisee must support the development of the franchise network and must maintain its common identity and its reputation. Therefore, the franchisee is not allowed to use materials or products outside of the ones allowed by the franchisor in the franchise network. The same applies to other brands which cannot be used since their usage could determine a confusion in the consumer's perception with respect to the brand the network promotes. Of course, the usage of other brands than the one the franchise network promotes may likely lead to decreases in the quality of products and of services.

Apart from that, the franchisee must provide to the franchisor any information useful to facilitate the disclosure and analysis of the performance and of the real financial status of the franchisee, in order for the franchisor to be able to have an efficient overview of the franchise. Since this type of obligation requires a special conduct from the franchisee and although it is provided under the law, it is useful to include it in the franchise agreement, as well, so that any potential misunderstandings are removed from the start.

One of the main obligations of the franchisees, as set out under art. 4 point 3) of GO no. 52/1997, is not to disclose the know-how obtained from the franchisor to third parties, for the duration of the franchise agreement and afterwards. The secrecy of the know-how must be kept by the franchisee since this know-how, along with the brand and its market awareness, are actually the elements based on which the franchise is based on. Any such disclosure shall likely generate damages both for the franchisor, who should be able to efficiently protect the network, as well as for the other franchisees, who gain their main profit from the success of the franchise network and from the reputation of the brand and only subsequently, from their own business skills.

In order for the franchisor to maintain the homogeneity of the franchise network and to protect the remaining franchisees, it can establish contractual non-competition and confidentiality clauses, which prevent the franchisee from spreading the know-how obtained from the franchisor and are aimed to protect such know-how from leaking in any way outside the franchise. Such clauses can operate for the duration of the franchise agreement and afterwards, taking into account that the majority of franchisees are inclined to use the knowledge gained in a certain field afterwards.

Court practice[4] has shown that non-competition clauses have been established considering the fact that the franchisee benefits from the knowledge and the advantages obtained during the franchise agreement and could afterwards decide to carry out a competitive business, which could prejudice the franchisor. Such an obligation to non-compete includes, as per the court's interpretation, the possibility of the former franchisee to carry out, in its own name, for a period of 3 years after the franchise contract is terminated, a similar activity to the one carried out by the franchisor and for which the franchising agreement had been concluded.

7. Conclusions

While this study focused on the main outcomes of a franchise, meaning the practical implications of establishing a franchise network, the pre-contractual phase, the independence of the parties and the franchisee's obligations, it also shows that in practice parties may encounter difficulties due to the general manner in which the legal norms have been drafted.

Although Law no. 179/2019 has amended key points of GO no. 52/1997, there are still several elements which need to be better regulated, such as the content of the non-competition and confidentiality clause, the way the exclusivity clause operates and the way parties could seek remedies for franchise infringements.

[4] Bucharest Tribunal, IInd civ. s., decision no. 233 2/A/17.11.2017, available at www.rolii.ro, published in Pandectele Române no. 6/2019.

Until the legislator intervenes, practitioners are obliged to create lawful and comprehensive contractual clauses, for safeguarding both the franchisee and the franchisor, as well as the consumer, who is the final beneficiary of the franchise network and the engine of its development.

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