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Franchising legal frameworks: a comparative study of the DCFR, US law and Australian law regarding franchise contracts

Sriporm, C.

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3 | Regulation of pre-contractual information obligations of the franchisor

3.1 INTRODUCTION

Contract law's operation usually does not reach the pre-contractual sphere. Accordingly, the parties in a contract negotiation typically incur no obligation to the other, particularly the duty to provide pre-contractual information.¹ This assumption holds true in the context of making a franchise contract. However, purchasing a franchise requires a considerable investment from a franchise purchaser. In this case, it would be imperative for a prospective franchisee to be provided with material and qualified information to make a well-informed decision on whether to enter into a franchise contract with a franchisor. As will be seen, the Draft Common Frame of Reference (DCFR), the United States of America (USA), and Australia have established the franchise legal framework regulating a pre-contractual relationship between a franchisor and a prospective franchisee. One of the most intriguing features of these legal frameworks is the regulation of the franchisor's pre-contractual information duties. This regulatory aspect will be the subject of the examination of chapter three.

The third chapter will examine the franchise legal framework of the DCFR, the USA, and Australia to answer the three sub-research questions developed in chapter one.² Section 3.2 will explore the chosen legal systems' franchise legal framework to explore how a franchisor is required to provide a prospective franchisee with material information about a franchise before concluding a franchise contract. Then, section 3.3 will examine how the franchise legal framework of the chosen legal systems requires a franchisor to ensure the currency and truthfulness of the pre-contractual information. Next, section 3.4 will explore the potential private law remedies that permit an aggrieved franchisee to compel the franchisor's performance, claim monetary compensation, and cancel a franchise contract in the case of contravention of the regula-

1 For the sake of clarity, this chapter will synonymously use the terms 'obligation' and 'duty'. In other words, these two terms will be used interchangeably, meaning action or inaction that a person is legally bound to perform towards the other person.

2 See section 1.5.2 in chapter one.

tion of the franchisor's pre-contractual information duties.³ In the end, section 3.5 will conclude on the findings of chapter three.

3.2 DUTY OF PRE-CONTRACTUAL DISCLOSURE

3.2.1 Introduction

As mentioned in the introduction, the DCFR, the USA, and Australia have the franchise legal framework regulating the franchisor's pre-contractual duties. Among other things, these legal frameworks regulate the franchisor's pre-contractual disclosure obligation. In this chapter, a disclosure obligation should be understood as an obligation to provide information before the conclusion of a franchise contract. Section 3.2 will focus on the construction of the franchisor's pre-contractual duty of disclosure. This section will examine franchise-specific law rules regulating the franchisor's duty of pre-sale disclosure under the three legal systems in sections 3.2.2, 3.2.3, and 3.2.4, respectively. Section 3.2.5 then juxtaposes and discusses the chosen legal systems' approaches to regulating the pre-contractual disclosure obligation to develop guidelines for formulating franchise rules regulating the franchisor's disclosure duty under comprehensive franchise law.

3.2.2 The Draft Common Frame of Reference (DCFR)

3.2.2.1 Introduction

The DCFR regulates the franchisor's disclosure duty through two model rules on pre-contractual information duties in Part E of Book IV. According to IV.E. – 2:101, in conjunction with IV.E. – 4:102(1), a franchisor has an obligation to provide a prospective franchisee with specific pre-contractual information items a reasonable time before a franchise contract is concluded. This requirement aims to enable the prospective franchisee to enter into the contract with full knowledge of all relevant facts.⁴ Consequently, this pre-contractual obligation is mandatory and cannot be excluded by agreement.⁵ This section will break down the franchisor's obligation into six elements and examine all the com-

3 For the sake of clarity, this chapter intends the phrase 'cancelling a franchise contract' to mean putting an end to a franchise relationship utilizing certain legal mechanisms. After a franchise contract is legally canceled, a franchise relationship will be dissolved or annulled.

4 Christian von Bar and Eric Clive, *Principles, Definitions and Model Rules of European Private Law: Draft Common Frame of Reference (DCFR): Full Edition* (Vol.3, Oxford University Press 2010) 2387.

5 The DCFR, IV.E. – 4:102(3).

ponents of the obligation in subsection 3.2.2.2. Subsection 3.2.2.3 will conclude on the contents and nature of the franchisor's pre-sale disclosure duty.

3.2.2.2 Elements of the pre-contractual information duty

– Provider of pre-contractual information

According to IV.E. – 4:102(1), the franchisor is obliged to provide the prospective franchisee with pre-contractual information enumerated in this article. Thus, the franchisor is a pre-contractual information provider in light of IV.E. – 4:102. As examined in chapter two, the DCFR does not explicitly define the term 'franchisor'.⁶ In this case, the franchisor can impliedly be defined to mean a party to a franchise contract who grants the franchisee the right to conduct a franchise business and the right to use the franchisor's intellectual property rights, know-how, and business method, in exchange for remuneration.

Although the franchisor assumes the obligation to provide pre-contractual information under IV.E. – 4:102, the franchisor is not obliged to perform the obligation in person. In other words, this pre-contractual information duty may be performed by a third person. Under the DCFR, III. – 2:107 permits the performance of a non-personal obligation by a third person. In my view, the duty of disclosure in the pre-contractual phase is inherently not a personal obligation and is assignable. Thus, according to paragraph (1)(a) of III. – 2:107, the franchisor may assign other persons, such as the franchisor's representative, agent, and employee, to act on its behalf in providing the prospective franchisee with the required pre-contractual information. In this case, the franchisor's pre-contractual information duty will be discharged by the due performance of those third persons by virtue of III. – 2:107(2).

– Contents of pre-contractual information

As can be seen, the DCFR requires the franchisor to provide qualified information peculiar to a franchise business.⁷ In this case, IV.E. – 4:102(1) delineates the qualified information by enumerating a list of eight disclosure items. These eight disclosure items are items of information concerning (1) the franchisor's company and experience, (2) the relevant intellectual property rights, (3) the characteristics of the relevant know-how, (4) the commercial sector and the market conditions, (5) the particular franchise method and its operations, (6) the structure and extent of the franchise network, (7) the fees, royalties or any other periodical payments, and (8) the terms of the franchise contract. The scope of each item of information is further elaborated by the drafters of the DCFR in Comment C to IV.E. – 4:102. For example, the drafters provide that

6 See section 2.2.2 in chapter two.

7 Bar and Clive (n 4) 2388.

information about the terms of the contract should include the rights and obligations of the respective parties, the duration of the agreement, the fee system, the conditions for termination and the renewal of the contract, economic considerations, exclusivity arrangements, and restriction on the free disposal of the business by the franchisee.⁸

It should be noted that the disclosure of the eight pre-contractual information items is a minimum requirement. This statement has three implications. First, the franchisor cannot provide less information than that required by IV.E. – 4:102(1).⁹ Second, the franchisor may be required to provide the prospective franchisee with more information. According to IV.E. – 2:101, the franchisor may be required to provide additional information items, provided that good commercial practice requires the franchisor to do so.¹⁰ For example, the franchisor may have to furnish the franchisee with information about litigation history. The reason is that the franchisor's involvement in any legal proceeding can substantially influence the franchisee's investment decision.¹¹ Third, the franchisor may, by its initiative, give the prospective franchisee additional information items that reasonably inform the franchisee about a franchise. This assertion can be deduced from IV.E. – 2:101, providing that a party who is engaged in negotiation for a franchise contract has a duty to provide the other party with information that is sufficient to enable the other party to decide to enter into the contract on a reasonably informed basis.

– *Format of pre-contractual information*

The DCFR imposes no formality in disclosing pre-contractual information. Neither IV.E. – 2:101 nor IV.E. – 4:102 requires any specific format of the franchisor's disclosure of pre-sale information. Additionally, the drafters of the DCFR do not mention the formality of the disclosure in the pre-contractual phase. According to III. – 2:105(1), therefore, the franchisor may choose to provide the franchisee with the required pre-contractual information orally or in writing.¹² For example, the franchisor may decide to provide the

8 Ibid 2390.

9 Ibid 2388.

10 Neither IV.E. – 2:101 nor its commentaries define 'good commercial practice'. Thus, this phrase opens room for courts to construct on a case-by-case basis, taking into account the usages in particular businesses.

11 If considering some European franchise regulations, it is not unusual for a franchisor to be obliged to disclose a history of legal proceedings. For instance, the Italian franchise law requires the franchisor to provide a short description of any final court or arbitration proceedings concerning the franchise system commenced against the franchisor and concluded during the last three years. See The Law No.129/2004, article 4(f).

12 Notes IV to IV.E. – 4:102 show that the DCFR differs from the UNIDROIT Model Law, as well as franchise-specific law of some European countries, such as France, Italy, and Spain, in that those legal systems require the franchisor to furnish the information in writing. See Bar and Clive (n 4) 2392-393.

prospective franchisee with a disclosure document containing the required items of pre-contractual information. The franchisor may choose to give the franchisee the disclosure document in a paper or digitized format.

– *Delivery of pre-contractual information*

Neither the model rules of the DCFR nor their commentaries specify a method for delivering pre-contractual informational items to a prospective franchisee. In this case, it could be said that the franchisor has discretion in selecting a means for furnishing the prospective franchisee with the required items of pre-contractual information. Thus, the delivery methods can be manifold, which ordinarily relates to the disclosure format chosen by the franchisor. Assume that the franchisor chooses to give the franchisee a digitized disclosure document containing pre-contractual information items. In this case, the franchisor may decide to deliver the digitized document to the franchisee via email. Alternatively, the franchisor may ask the franchisee to download the digital file of a disclosure document through the franchisor's website.¹³ In other cases, the franchisor may choose to provide the franchisee with pre-contractual information verbally if it is plausible to do so. In this case, the franchisor may disseminate the information by phone or at an in-person meeting with the franchisee.

– *Timing for disclosing pre-contractual information*

The DCFR sets an indefinite period for disclosing the required pre-contractual information. According to IV.E. – 2:101, the franchisor shall perform a pre-contractual information obligation within a reasonable time before concluding a franchise contract. Since the reasonableness is indiscernible, the drafters of the DCFR provide that a court can decide if the franchisor provides pre-contractual information in a reasonable time by considering the circumstances of the case or any applicable usage.¹⁴ More importantly, the franchisor should allow the franchisee to have sufficient time to process the information given and decide whether to enter into a franchise contract. However, whether the timing is sufficient must be decided on a case-by-case basis. In European countries that regulate a franchise, the time frame for the disclosure of pre-contractual information ranges from 20 days to one month. For example, Italy adopts a period of 30-day, while France and Spain opt for a 20-day period.

13 It should be mentioned that the DCFR does not contain model rules regulating the electronic transmission of information.

14 Bar and Clive (n 4) 2287.

Belgium requires a one-month period for the disclosure.¹⁵ Additionally, the UNIDROIT Model Law sets a 14-day period for the disclosure timing.¹⁶

– *Recipient of pre-contractual information*

According to IV.E. – 4:102(1), a franchisee is a person with whom a franchisor must provide the required pre-contractual information. Although IV.E. – 4:102(1) uses the word ‘franchisee’, the term should not be taken literally because no franchise agreement has been concluded at the time of the disclosure of pre-sale information. The term ‘franchisee’ should be understood as a prospective franchisee, not as an actual franchisee. Nevertheless, IV.E. – 4:102 does not define the word ‘prospective franchisee’. Despite the lack of definition, the drafters of the DCFR seem to conceive a ‘prospective franchisee’ as a person who approaches a franchisor for the right to conduct a franchise business and will conclude a franchise contract with the franchisor.¹⁷ However, the drafters of the DCFR do not provide criteria for determining the point at which a prospective franchisee legally exists in light of IV.E. – 4:102(1). The lack of criteria will pose several questions. For example, a question arises whether the franchisor has to provide pre-contractual information to a person who reaches the franchisor by phone for information about a franchise.

3.2.2.3 *Conclusions*

Under the DCFR, Part E of Book IV is the legal framework that establishes the franchisor’s duty to provide pre-contractual information. This disclosure duty is mandatory and aims to ensure that a prospective franchisee has full knowledge of facts before entering into a franchise contract. In Part E, the franchisor is required to provide the prospective franchisee with a minimum of eight information items at a reasonable time prior to the conclusion of a franchise contract. These informational items are essentially pieces of information relevant to a franchisor and a franchise business. The DCFR does not impose formality in disclosing the required pre-contractual information. Therefore, the franchisor is free to choose the disclosure format and a means for disseminating the information.

15 Mark Abell, ‘The regulation of franchising in EU Member States’ (2012) 10(2) *International Journal of Franchising Law* 17, 19-24.

16 The UNIDROIT Model Law, Art. 3.

17 Bar and Clive (n 4) 2387-390.

3.2.3 The United States of America (USA)

3.2.3.1 Introduction

In America, federal and state franchise sale laws regulate the initial phase of a franchise relationship. At the national level, the Federal Trade Commission promulgates the Disclosure Requirements and Prohibitions Concerning Franchising (FTC Rule) as the federal legislation applying throughout the country. At the state level, sixteen states (franchise sale states) have enacted state franchise sale law to regulate pre-sale conduct in franchising.¹⁸ These state statutes apply in the states on the condition that the laws are inconsistent with the FTC Rule. In case of inconsistency, it must afford franchisees equal or greater protection.¹⁹ As will be seen, the federal and franchise sale legislation of fifteen franchise sale states imposes on the franchisor the duty of disclosure.²⁰ This section will break down the franchisor's obligation under the federal and state franchise sale laws into six elements and examine all the elements in subsection 3.2.3.2. Subsection 3.2.3.3 will summarize the contents and nature of the franchisor's pre-contractual information duty under the US legal system.

3.2.3.2 Elements of the pre-contractual information duty

– Provider of pre-contractual information

(1) Federal Law

The FTC Rule requires a franchisor to prepare and disclose pre-contractual information to a prospective franchisee. The federal regulation defines the term 'franchisor' to mean a person who grants a franchise and participates in the franchise relationship. Thus, the franchisor's employee, representative, agent, and broker are generally not regarded as franchisors and not required to prepare and provide pre-sale disclosures to the potential franchisee.²¹ Nevertheless, the FTC Rule requires these third persons to give the prospective franchisee pre-sale information in exceptional cases. Under the FTC Rule, section

18 Those states are: California, Florida, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Oregon, Rhode Island, South Dakota, Virginia, Washington, and Wisconsin.

19 72 FR 15462 (March 30, 2007). It should be noted that twenty-five states have their business opportunities law that may apply to pre-contractual franchise relationship. For example, Alaska has the sale of business opportunities statute that require the disclosure of pre-contractual information. See AK ST § 45.66.080. Arizona has the trade and commerce law requiring the pre-sale disclosure. See AZ ST § 44-1276.01.

20 Franchise sale law of Florida does not contain disclosure rules because it only regulates misrepresentation in selling a franchise. See FL ST § 817.416.

21 72 FR 15462 (March 30, 2007).

436.9(e) provides that a franchise seller has to provide a prospective franchisee with the franchisor's copy of a disclosure document earlier in the sales process than required under the Rule, upon reasonable request. Section 436.1(j) defines the 'franchise seller' to mean a person who offers for sale, sells, or arranges for the sale of a franchise. In particular, the franchise seller is defined to include the franchisor's employee, representative, agent, and third-party broker involved in the activities of franchise sales. Thus, these third persons have to disclose pre-sale information in the case of earlier disclosure upon request.

(2) *State laws*

In fifteen franchise sale states, a franchisor is similarly responsible for making certain disclosures.²² Franchise sale law of all states defines the term 'franchisor' to mean a person who grants a franchise.²³ However, in some states, third persons may be held responsible for making pre-contractual disclosures. For example, in California, Glen said that a franchise broker must give each potential franchisee a copy of the entire disclosure document under the California Franchise Investment Law.²⁴ However, Glen does not elaborate on the expression 'must'. Thus, it might be questioned whether a franchise broker is legally required to provide a prospective franchisee with the franchisor's franchise disclosure document. In any case, the Californian court and other commentators interpreted that the franchise investment law only requires the franchisor to provide the prospect with a disclosure document.²⁵

22 California: CA CORP, § 31119(a); Hawaii: HI ST, § 482E-3(a); Illinois: IL ST CH 815, § 705/5(2); Indiana: IN ST, 23-2-2.5-9(2); Maryland: MD BUS REG, § 14-223 and 216; Michigan: MI ST, 445.1508(1); Minnesota: MN ST, § 80C.06(Subd.5); New York: NY GEN BUS, § 683(1); North Dakota: ND ST, 51-19-08(1); Oregon: OR ADC, 441-325-0020(2); Rhode Island: RI ST, § 19-28.1-8(a); South Dakota: SD ST, § 37-5B-17(1); Virginia: VA ST, § 13.1-563, in conjunction with § 13.1-565, and 21 VA ADC, 5-110-55; Washington: WA ST, 19.100.080(1); Wisconsin: WI ST, 553.27(4).

23 California: CA CORP, § 31007; Hawaii: HI ST, § 482E-2; Illinois: IL ST CH 815, § 705/3; Indiana: IN ST, 23-2-2.5-1; Maryland: MD BUS REG, § 14-201; Michigan: MI ST, 445.1502; Minnesota: MN ST, § 80C.01; New York: NY GEN BUS, § 681; North Dakota: ND ST, 51-19-02; Oregon: OR ST, § 650.005; Rhode Island: RI ST, § 19-28.1-3; South Dakota: SD ST, § 37-5B-1; Virginia: VA ST, § 13.1-559; Washington: WA ST, 19.100.010, and Wisconsin: WI ST, 553.03

24 Robin Day Glenn, 'Chapter 1: Franchises' in Alan S Gutterman, *California Transactions Forms Business Transactions*, at § 1:16, Westlaw, March 2020 Update.

25 *Migliore v Dental Fix Rx, LLC*, 2016 WL 7655768 (CD Cal, 2016) 1; Douglas L Carden and Phyllis Alden Truby, 'California' in W Michael Garner (ed), *Franchise Desk Book: Selected State Laws, Commentary and Annotations* (Vol 1, 3rd edn, American Bar Association 2019) at CA-117.

– Contents of pre-contractual information

(1) Federal law

The FTC Rule imposes on a franchisor an obligation to furnish a prospective franchisee with its current disclosure document (FDD).²⁶ According to section 436.5, the franchisor shall disclose twenty-three individual items of information in the FDD. These twenty-three disclosure items are information concerning the franchisor, the franchise system, the franchise business, and the terms of a franchise contract.²⁷ Each item is broken down into bite-sized pieces of pre-sale information. For example, the franchisor is required to include item three in the FDD, furnishing information about litigation relating to the franchisor and other specified persons.²⁸ In disclosing this item, the franchisor must elaborate on the litigation history, including pending actions, past actions involving the franchise relationship, convictions during the past ten years, as well as injunctions and restraining orders.²⁹

In principle, the franchisor must respond to all the required items affirmatively. The franchisor must state negatively if the information items are inapplicable.³⁰ It should be noted that the list of twenty-three informational items is inclusive. According to section 436.6(d) of the FTC Rule, the franchisor is prohibited from providing any information other than those required or permitted by the FTC Rule or state franchise law not preempted by the Rule. This prohibition is said to ensure that the franchisor will not furnish the potential franchisee with any non-material, confusing, or distracting information in the FDD, such as testimonials or general promotional information, by claiming that the provision of this information is not expressly prohibited by the laws.³¹

(2) State laws

Providing material information required by the FTC Rule is also obligatory in the sale states. For example, in Illinois and Oregon, a franchisor shall prepare the disclosure statement following the FTC Rule's requirements.³² It means that the franchisor must provide twenty-three items of information in the state disclosure document. In some states, the franchisor may be required

26 16 CFR, § 436.2(a).

27 David W Oppenheim and Rebekah Prince, 'Chapter 3: Franchise Disclosure Issues' in Ropert M Barkoff and others (eds), *Fundamentals of Franchising* (4th edn, American Bar Association 2016) 98.

28 16 CFR, § 436.5(c).

29 Brett Lowell, 'Chapter 9: Disclosure' in Alexander M Meiklejohn (ed), *Franchising: Cases, Materials, & Problems* (American Bar Association 2013) 406-07.

30 The analysis of section 436.6(c) provides an example that if the franchisor has no history of litigation, the franchisor could state that: "The franchisor has no litigation required to be disclosed by Item 3." See 72 FR 15515 (March 30, 2007).

31 72 FR 15515-15516 (March 30, 2007).

32 Illinois: IL ST CH 815, § 705/16 and Oregon: OR ADC, 441-325-0020(1).

to disclose additional, state-specific information in the disclosure document.³³ For instance, in California, the administrative regulation requires the disclosure statement to include additional paragraphs to item 17 required by the FTC Rule.³⁴ The extended paragraphs shall mention that the California Franchise Relations Act provides the franchisee's rights concerning termination and non-renewal. If a franchise contract contains terms that are inconsistent with the law, the law will override the contract's terms.³⁵

– *Format of pre-contractual information*

(1) *Federal law*

The FTC Rule sets a format of the pre-sale information disclosure. Under the FTC Rule, a franchisor must disclose pre-sale information in the form of the franchise disclosure document or FDD.³⁶ In formatting the FDD, the FTC Rule imposes a formal requirement that the franchisor must ensure the accessibility and the durability of the FDD.³⁷ First, the franchisor must organize the required information items clearly, legibly, and concisely in one document using plain English. According to section 436.1(o), the expression 'plain English' is defined to mean the organization of information and language usage, which is understandable by people unfamiliar with the franchise business. Second, the FDD format must permit a prospective franchisee to store, download, print, or otherwise maintain the document for future reference. In this case, the franchisor cannot provide the FDD in the form of video presentations or transmit the FDD through the internet in a format that is incapable of being downloaded or printed out.³⁸

33 It is claimed that eleven franchise sale states require some specific addenda in the disclosure document. Those states are California, Hawaii, Illinois, Maryland, Michigan, Minnesota, New York, North Dakota, Rhode Island, Virginia, and Washington. See John R F Baer, 'Chapter 10: State Franchise Sales Laws' in Alexander M Meiklejohn (ed), *Franchising: Cases, Materials, & Problems* (American Bar Association 2013) 480.

34 The FTC Rule sets item 17 to disclose information about contractual provisions addressing renewal, termination, transfer, and dispute resolution.

35 10 CA ADC, § 310.114.1(c)(5).

36 As of 1 July 2008, the franchisor is required to prepare the FDD, following the instructions set forth in Subpart C and D of the FTC Rule. According to section 436.6(a) of the FTC Rule, the franchisor's failure to follow those instructions would be regarded as an unfair or deceptive act in light of the FTC Act. Thus, to assist a franchisor in preparing the FDD, the Federal Trade Commission has issued the Franchise Rule Compliance Guide (Compliance Guide), which includes a part of the overview of the disclosure document. This part provides explanations and samples for each item of information required by the FTC Rule. The electronic version of the Compliance Guide can be accessed at <<https://bit.ly/3dARHoZ>>.

37 16 CFR, § 436.6(b).

38 16 CFR, § 436.6(d) and 72 FR 15515 (March 30, 2007).

(2) *State laws*

State franchise sale laws similarly require a franchisor to furnish pre-sale information documentarily. Under the state statutes, a disclosure document may be called differently, such as a disclosure statement, offering prospectus, and an offering circular. Nevertheless, the disclosure states can no longer depart from the FTC Rule format since the FTC Rule's requirements concerning the preparation of a disclosure document are mandatory.³⁹ Thus, the franchisor has to follow the FTC Rule's instructions when preparing the disclosure document unless the state legislation imposes additional, specific requirements for formatting the document.

– *Delivery of pre-contractual information*

(1) *Federal law*

The FTC Rule does not specify delivery methods. In this respect, the franchisor may choose several means of furnishing the FDD to a prospective franchisee. The franchisor can mail a hard copy of the FDD to the prospect.⁴⁰ Furthermore, the franchisor may transmit the FDD by electronic means. In the latter case, there are three different options for the franchisor. That is, the franchisor may (1) email a PDF file of the FDD to the prospective franchisee, (2) send a CD-ROM with a PDF file of the FDD to the prospective franchisee, and (3) give the prospective franchisee access to a website containing the FDD.⁴¹ In these three cases, the franchisor must ensure that the digitized document permits the prospective franchisee to store, download, print, or otherwise maintain the document for future reference.⁴²

(2) *State laws*

The state sale statutes do not differ from the FTC Rule. A franchisor is free to select a delivery method for furnishing a disclosure document. Some franchise sale states closely regulate some specific means of transmission. Taking California as an illustration, the franchise investment statute explicitly provides that a franchisor is not prevented from furnishing a copy of an offering circular to prospective franchisees through electronic means.⁴³ Nevertheless, the California administrative regulation contains the rule regulating pre-sale disclosure by electronic means.⁴⁴ According to the rule, the franchisor may deliver a disclosure document over the internet, or by other electronic means,

39 Baer (n 33) 469.

40 Oppenheim and Prince (n 27) 123.

41 Baer (n 33) 483.

42 16 CFR, §436.6(b).

43 CA CORP, § 31119(b).

44 10 CCR, § 310.114.4.

or in machine-readable media. However, the franchisor has to follow some requirements when disseminating the disclosure document electronically.⁴⁵

– *Timing for disclosing pre-contractual information*

(1) *Federal law*

The FTC Rule provides that the franchisor has to furnish a prospective franchisee with a copy of the current disclosure document at least 14 calendar days before the prospective franchisee signs a binding agreement with the franchisor or makes any payment to the franchisor or an affiliate in connection with the proposed franchise sale.⁴⁶ The count of a 14-day period will be triggered when the disclosure document is delivered to the prospective franchisee. In this case, the franchisor can sign a franchise contract, or the prospective franchisee can make the payment on the fifteenth day after the delivery date. In case a paper or tangible electronic copy of the disclosure, such as CD-ROM, was sent to the potential franchisee by first-class United States mail, the franchisor must add additional three calendar days to the waiting 14-day period.⁴⁷ This requirement is claimed to ensure that the prospective franchisee will have some time to review the disclosures.⁴⁸

Upon a reasonable request, a franchisor may be required to make an earlier disclosure than the 14-day standard. According to section 436.9(e), it is an unfair or deceptive act or practice for the franchisor to fail to furnish a copy of the franchisor's disclosure document to a potential franchisee earlier in the sales process than the period of 14-day if the potential franchisee makes a

45 Those requirements are as follows.

First, before the delivery, the franchisor is required to advise the potential franchisee of the formats in which the document is available and any prerequisites or conditions necessary for receiving or reviewing it in a particular form.

Second, the franchisor must prepare the disclosure document that conforms with the requirements of law, and that has no extraneous content beyond what is required or permitted by the law except for the sole purpose of enhancing the prospective franchisee's ability to maneuver through the digitized document. In any case, all other features are prohibited, including audio, video, 'pop-up' screens, and links to external documents.

Third, the franchisor must deliver the disclosure document as a single, integrated document or file. In this case, the franchisor must furnish the document or file in the form that intrinsically enables the recipient to store, retrieve, and print the document.

Fourth, the franchisor must be able to prove that it electronically delivers the disclosure document in compliance with the rule. The franchisor must also keep records of the electronic delivery of the document and make those records available on demand by the Department of Business Oversight.

46 16 CFR, § 436.2(a).

47 16 CFR, §436.2(c)(3).

48 72 FR 15469 (March 30, 2007).

reasonable request.⁴⁹ In the section-by-section analysis of part 436, the Federal Trade Commission provides that the reasonableness of the request will be assessed on a case-by-case basis, taking into account the timing and manner in which the request is made. In this respect, the Commission has exemplified some instances of an unreasonable request. For example, it may be unreasonable for a potential franchisee to request a disclosure document by leaving a message with the doorman at the franchisor's headquarters.⁵⁰

(2) *State laws*

The timing for disclosure under state franchise sale laws is similar to that of the FTC Rule. In seven franchise sale states, the law requires the franchisor to provide the prospective franchisee with a disclosure document at least 14 days before the execution of a franchise agreement or the receipt of any consideration by the franchisor.⁵¹ The remaining jurisdictions adopt a shorter period than 14 calendar days.⁵² For example, in Indiana, Michigan, and New York, the franchisor is required to provide a prospective franchisee with a disclosure document at least ten days before the execution of a binding franchise contract by the prospective franchisee or before the receipt of any consideration by the franchisor.⁵³ However, this lesser time requirement is no longer valid since the FTC Rule has preempted the state laws.⁵⁴ Therefore, in those states, the franchisor must furnish the potential franchisee with a copy of the disclosure document at least 14 calendar days before the execution of a binding franchise contract by the prospective franchisee or before the receipt of any consideration by the franchisor.

As mentioned previously, a franchisor may have to disclose pre-sale information earlier than 14 days. Upon a reasonable request, the franchisor is required to furnish the potential franchisee with the disclosure document earlier in the sales process than 14 days. This conclusion results from the fact

49 This requirement aims to prevent the prospective franchisee's loss by enabling the prospect to review the franchisor's disclosure document before committing itself to pay money to advance the sale, such as travel costs to visit the headquarters of the franchisor. See 72 FR 15532 (March 30, 2007).

50 72 FR 15532 (March 30, 2007).

51 California: CA CORP, § 31119(a); Illinois: IL ST CH 815, § 705/5(2); Maryland: MD BUS REG, § 14-223 and 216; Oregon: OR ADC, 441-325-0020(2); Rhode Island: RI ST, § 19-28.1-8(a)(2); Washington: WA ST, 19.100.080(1); Wisconsin: WI ST, 553.27(4).

52 Hawaii: HI ST, § 482E-3(a); Indiana: IN ST, 23-2-2.5-9(2); Michigan: MI ST, 445.1508(1); Minnesota: MN ST, § 80C.06(Subd.5); New York: NY GEN BUS, § 683(8); North Dakota: ND ST, 51-19-08(6); South Dakota: SD ST, § 37-5B-17(2); Virginia: VA ST, § 13.1-565(3).

53 It should be noted that the franchise sale statute of Michigan and New York expressly adopt the standard of 'business' days.

54 Susan Grueneberg, 'Chapter 9: Inbound Transactions: Introducing a Non-U.S. Franchise Program to the United States' in Will K Woods (ed), *Fundamentals of International Franchising* (2nd edn, American Bar Association 2013) 343; Warren Lee Lewis, 'Chapter 1: Overview of the FTC Rule and Related Authorities' in Susan Grueneberg and Ann Hurwitz (eds), *The FTC Franchise Rule* (3rd edn, American Bar Association 2019) 11.

that the FTC Rule is also applicable in the disclosure states.⁵⁵ In New York, the franchisor may also be required to make an early disclosure in the case of the first face-to-face meeting.⁵⁶ Under the first face-to-face meeting rule, the franchisor must provide the prospective franchisee with a disclosure document at the earlier of the first face to face meeting between the franchisor and the prospective franchisee, which is held for the purpose of discussing the sale of a franchise.⁵⁷

– *Recipient of pre-contractual information*

(1) *Federal law*

The FTC Rule sets a prospective franchisee as a recipient of a disclosure document. The Rule defines a prospective franchisee to mean any person (including any agent, representative, or employee) who approaches or is approached by the franchise seller to discuss the possible establishment of a franchise relationship.⁵⁸ As can be seen, the FTC Rule permits the franchisor to make the agency disclosure. That is, the provision of the franchisor's disclosure document can be made to an agent, representative, or employee of the prospective franchisee. In this case, it is suggested that there must be the existence of a formal relationship between a representative and principal or the establishment of a fiduciary relationship by law, rules, or codes of conduct.⁵⁹ Besides, a franchisor has to disclose pre-contractual information to a prospective franchisee, who is already in the sales process. In other words, the franchisor has no duty towards any person who approaches the franchisor just for some general information.⁶⁰

(2) *State laws*

State franchise sale laws provide that a franchisor must provide a prospective franchisee with a disclosure document.⁶¹ No state laws define the term 'pros-

55 Some franchise sale states, such as Maryland, may explicitly duplicate the FTC Rule's requirement in their sale statute. See MD BUS REG, § 14-223(3).

56 The first meeting rule was adopted in Rhode Island. However, the state has abandoned this requirement since 2016. Therefore, New York is currently the only disclosure jurisdiction that has adopted the first meeting rule.

57 NY GEN BUS, § 683(8).

58 16 CFR, § 436.1(r).

59 Mary Beth Warman and Joel R Buckberg, 'Chapter 4: Delivery and Updating' in Susan Grueneberg and Ann Hurwitz (eds), *The FTC Franchise Rule* (3rd edn, American Bar Association 2019) 92.

60 72 FR 15532 (March 30, 2007).

61 In Virginia, section 13.1-559 of the Retailing Franchise Act requires that a disclosure document must be furnished to a 'franchisee'. This stipulation seems to be slightly confusing since the law defines the term 'franchisee' to mean a person to whom a franchise is granted and sold. However, this confusion might be marginal since commentators understand that the law requires the disclosure document to be given to the prospective franchisee. See Cory J Covert, 'Virginia' in W Michael Garner (ed), *Franchise Desk Book: Selected State Laws, Commentary and Annotations* (Vol 1, 3rd edn, American Bar Association 2019) at VA-27-28;

pective franchisee'. Only South Dakota and Washington franchise sale statutes expressly duplicate the FTC Rule's definition of a prospective franchisee.⁶² However, the FTC Rule's definition of a prospective franchisee would apply in the rest of state franchise sale laws by default. Thus, at the state level, a prospective franchisee can be any person (including any agent, representative, or employee) who approaches or is approached by the franchise seller to discuss the possible establishment of a franchise relationship.

3.2.3.3 Conclusions

The FTC Rule is a federal regulation that mainly regulates the franchisor's pre-sale disclosure duty throughout the USA. Although fifteen franchise sale states have their own franchise sale law, the statutes will apply insofar as they afford franchisees equal or greater protection. The franchisor's disclosure duty under the federal and state laws can be summarized as follows. First, the franchisor is primarily responsible for preparing a so-called 'franchise disclosure document', containing essential information about the franchisor, the franchise system, the franchise business, and the terms of a franchise contract. Second, the franchisor or the franchise seller shall provide the prospective franchisee with the disclosure document at least 14 calendar days before the execution of a franchise agreement or the franchisee's payment made to the franchisor. Federal and state sale laws do not require any specific means for delivering the disclosure document. Since the pre-sale disclosure duty is regulated and mandatory, the franchisor and prospective franchisee cannot agree to exclude the performance.

3.2.4 Australia

3.2.4.1 Introduction

The Franchising Code of Conduct (the Code) devotes its Part 2 to regulating the franchisor's pre-contractual information duties. In Part 2, the franchisor's pre-sale obligations include the duty to provide a disclosure document and

Philip F Zeidman, *Legal Aspects of Selling and Buying*: § 9:89. What do state registration/disclosure laws require?, Westlaw, September 2017 Update.

⁶² In Washington, the Bill (SB 6172) amended the Franchise Investment Protection Act in 2012 to conform to the FTC Rule's terminology. As a result of the amendment, the term prospective franchisee has replaced the previous term offeree throughout the Act. See Senate Bill Report SB 6172 (February, 2012) at <<https://bit.ly/3ps4HTh>>.

In South Dakota, Bill SB 52 was proposed to enact a new franchise statutory scheme in 2008. This Bill was eventually passed as Chapter 37-5B – Franchise Investment Act, replacing the old Chapter 37-5A. The term 'prospective franchisee' was put in place at the time the Bill was introduced. See Section 1 of Chapter 203 (SB 52) at <<https://bit.ly/2Kwefy4>>.

the duty to provide a key facts sheet.⁶³ Section 3.2.4 will collectively examine these two duties as a sole disclosure obligation. This section will break down the franchisor's obligation into six elements and then examine all the components in subsection 3.2.4.2. Subsection 3.2.4.3 will conclude on the contents and nature of the franchisor's pre-contractual information duty under the Australian legal system.

3.2.4.2 Elements of the pre-contractual information duty

– Provider of pre-contractual information

Under the Code, a franchisor is a provider of pre-contractual information. That is, the Code obligates a franchisor to perform a disclosure obligation by giving a prospective franchisee the documents mentioned in subclause (1A), including a disclosure document and a key facts sheet.⁶⁴ Under the Code, the term 'franchisor' is given specific meanings. Clause 4 defines the term 'franchisor' to mean five groups of persons.⁶⁵ In essence, a franchisor is understood as a person who grants a franchise or otherwise participates in a franchise as a franchisor.⁶⁶ Thus, a franchisor must be a person who can confer a prospective franchisee the right to operate a franchise business.⁶⁷

– Contents of pre-contractual information

The Code requires a franchisor to formulate, among other things, a disclosure document and a key facts sheet with specified contents.

First of all, a franchisor is required to create a disclosure document relating to a franchise that includes the informational items in Annexure 1 of the

63 The Code also requires a franchisor to provide a prospective franchisee with an information statement relating to franchising that is published on the ACCC's website before giving other disclosure-related documents. Nevertheless, the information statement is not intended to furnish a potential franchisee with any information about a specific franchisor or a franchise network. Instead, it helps encourage the prospective franchisee to conduct proper due diligence by getting legal, accounting, and business advice, reading all the documents carefully, and getting to know their rights under the Code. *See* Explanatory Statement, Select Legislative Instrument No.168, 2014, at 25. Thus, this section will not examine this obligation in detail.

64 The Code, cl. 9(1), in conjunction with cl. 9(1A).

65 Clause 4 states that franchisor includes the following:

- (a) a person who grants a franchise;
- (b) a person who otherwise participates in a franchise as a franchisor;
- (c) a subfranchisor in its relationship with a subfranchisee;
- (d) a subfranchisor in a master franchise system;
- (e) a subfranchisor in its relationship with a franchisee.

66 *Swevenings Pty Ltd v Ferguson Consolidated Holdings Pty Ltd (No 5)*, [2010] FMCA 63 [88].

67 *Dorrian v Rushlyn Pty Ltd*, [2013] FMCA 101 [236].

Code.⁶⁸ In Annexure 1, there are twenty-five items of essential information, which are broken down into fragments. For example, item 2 deals with the franchisor's details. In this second item, the franchisor should provide information about the name and address, or addresses, of registered office and principal place of business in Australia; the name under which the franchisor carries on business in Australia relevant to the franchise; a description of the kind of business operated under the franchise; the number of years that the franchise or franchise system has operated in Australia, to name a few. All informational items are intended to offer a comprehensive overview of the franchise, which helps a prospective franchisee make a reasonably informed decision and provides the prospective franchisee with current information that is material to the running of a franchised business.⁶⁹

Clause 8(3)(b)(ii) implies that a franchisor does not have to provide a prospective franchisee with all the disclosure items required by Annexure 1. The franchisor may delete some particular items from the disclosure document if applicable information does not exist for those items. The explanatory statement exemplifies that the franchisor may exclude the heading for item 12 from the disclosure document if the franchisor does not make goods or services available online and the franchisor does not intend to do so.⁷⁰ The franchisor may be allowed to provide more items of information in the disclosure document. According to clause 8(3)(a)(iii), the franchisor may add additional information under the heading 'Updates'.

Secondly, a franchisor is required to prepare a key facts sheet relating to a franchise that is in the form published on the Australian Competition and Consumer Commission (ACCC)'s website.⁷¹ More importantly, the franchisor must include in the key facts sheet the information required by the ACCC's form and the information about the matters relating to the franchise that is included in the disclosure document relating to the franchise.⁷² For example, in a key facts sheet, the franchisor must provide information about the name of the franchisor, the duration that the franchisor has operated the franchise system in Australia, the franchisor's financial viability, current legal proceedings, to name a few. The key facts sheet does not aim to replace the disclosure document. According to the Explanatory Statement to the Competition and Consumer (Industry Codes- Franchising) Amendment (Fairness in Franchising) Regulation 2021, this document is intended to get a prospective franchisee to pay attention to the most significant information in the disclosure documents.⁷³

68 The Code, cl. 8(1).

69 The Code, cl. 8(2).

70 Explanatory Statement, Select Legislative Instrument No.168, 2014, at 20.

71 The Code, cl. 9A(1)(a). The format of a key facts sheet can be accessed at <<https://bit.ly/3HORxKj>>.

72 The Code, cl. 9(A)(1)(b) and (c)(i).

73 Explanatory Statement to the Regulation 2021, at 10.

– *Format of pre-contractual information*

The Code requires the pre-contractual information to be disclosed in writing. This formal requirement can be inferred from clause 9(1) that the franchisor must provide a prospective franchisee with the documents, including a disclosure document and a key facts sheet, before entering into a franchise agreement. The disclosure document and the key facts sheet are standardized; that is to say, the franchisor must format the documents following the requirements imposed by the Code. Regarding the disclosure document, clause 8(1), in conjunction with clause 8(3)(a)(i)(ii), provide that the franchisor must create the document that conforms with the content, order, headings, and numbering set out in Annexure 1.⁷⁴ Concerning the key facts sheet, clause 9A(1)(a) requires the franchisor to make the sheet in the form published by the ACCC.

– *Delivery of pre-contractual information*

The Code does not specify methods for furnishing a disclosure document and a key facts sheet. Nor does the Explanatory Statement suggest how a franchisor should deliver the documents. Accordingly, it could be said that the franchisor can decide to provide a prospective franchisee with printed copies of the documents by mail. Alternatively, the franchisor may choose to transmit the documents electronically. In the latter case, Giles and Ward suggest that the franchisor has to comply with the following two threshold requirements imposed by the Electronic Transaction Act 1999 (Cth).⁷⁵ First, the information must be readily accessible in order to be useable for subsequent reference. Second, a person to whom the information is provided consents that the information is to be given by means of electronic communication.⁷⁶

The Code permits a prospective franchisee to specify the delivery of a disclosure document and a key facts sheet. According to clause 9(2C), the franchisee may request the franchisor send the documents in a printed form, electronic form, or both. In this case, the franchisor is obliged to comply with the franchisee's request. If the franchisor has already given the franchisee the documents in one of those forms, the franchisor does not have to comply with the franchisee's request for the other form. To illustrate, a prospective franchisee may ask a franchisor to send a copy of a disclosure document and a key facts sheet digitally. In this case, the franchisor must comply with the franchisee's request. Suppose the franchisor has already provided the prospect-

74 The ACCC has created a recommended format for the disclosure document that conforms to Annexure 1 of the Code. This model disclosure document can be accessed at <<https://bit.ly/37eLIDR>>.

75 Stephen Giles and Penny Ward, 'Australia' in Andrew P Loewinger and Michael K Lindsey (eds), *International Franchise Sale Laws* (2nd edn, American Bar Association 2016) 10.

76 The Electronic Transaction Act 1999 (Cth), sec. 9(1)(a) and (d).

ive franchisee with printed copies of the documents. In that case, the franchisor may refuse to provide the franchisee with the documents in an electronic format if the franchisee demands these.

– *Timing for disclosing pre-contractual information*

The Code adopts a 14-day time frame for disclosing pre-contractual information in a disclosure document and a key facts sheet. Clause 9(1) of the Code requires a franchisor to give a prospective franchisee a copy of the disclosure document and the key facts sheet at least 14 days before either of the following two triggering events. First, a prospective franchisee enters into a franchise agreement or an agreement to enter into a franchise agreement.⁷⁷ Second, a prospective franchisee makes a non-refundable payment of money or of other valuable consideration to the franchisor or an associate of the franchisor in connection with the proposed franchise agreement.⁷⁸ In this respect, the period of 14-day must be counted backward from the point at which the franchise agreement will be concluded or the point at which the prospective franchisee makes a non-refundable payment to the franchisor.⁷⁹

– *Recipient of pre-contractual information*

A prospective franchisee is a person to whom a franchisor must furnish a disclosure document and a key facts sheet.⁸⁰ Clause 4 defines a prospective franchisee to mean a person who deals with a franchisor for the right to be granted a franchise. According to Giles, the expression 'a person who deals with a franchisor' is susceptible to be construed to include other persons, such as a professional adviser and an agent of a franchisee.⁸¹ As far as case law is concerned, the definition offered by the Code is intended to be exhaustive.⁸² For example, the court in *Rafferty v Madgwicks* states that:

77 The Code, cl. 9(1)(a).

78 The Code, cl. 9(1)(b).

79 The nature of non-refundable payment was discussed by the court in the case *Palis Victoria v Gelare International*. According to the court, a question of whether the prepayment is required and whether it is refundable may partly be addressed by a disclosure document. Furthermore, a question of whether the advance is refundable should be considered in connection with clause 26 of the Code, dealing with termination in the cooling-off period. In sum, the prepayment is non-refundable if the franchisee does not cool off within the specified period or if the condition for a refund under the disclosure document is not satisfied. See *Palis Victoria Pty Ltd v Gelare International Pty Ltd*, [2015] FCCA 2785 [310] – [314].

80 The Code, cl. 9(1).

81 Stephen Giles, *Annotated Franchising Code of Conduct* (2nd edn, LexisNexis Butterworths 2021) 27.

82 *SPAR Licensing Pty Ltd v MIS QLD Pty Ltd (No 2)*, [2012] FCA 1116 [102] – [103].

'[T]his distinct definition makes sense in the light of the fact that it is meant to capture persons who are considering the purchase of or participation in a franchise, but who have not yet been granted or become involved in a franchise (that is, who are not yet actual franchisees).'⁸³

Thus, a prospective franchisee in light of the Code must be a person who will be an actual franchisee after the conclusion of a franchise agreement.

3.2.4.3 Conclusions

The Franchising Code of Conduct regulates the franchisor's disclosure obligation by requiring a franchisor to provide a prospective franchisee with a disclosure document and a key facts sheet containing the information relating to a franchise specified by the Code. In this case, the franchisor must provide the prospective franchisee with copies of the documents at least 14 days before the prospective franchisee enters into a franchise agreement or before the prospective franchisee makes a non-refundable payment to the franchisor. However, the Code does not regulate all aspects of the performance of the disclosure duty. Thus, the franchisor may decide some aspects of the performance, such as a delivery method. In this case, the franchisor may have to comply with the electronic transaction law rules if the franchisor opts for the electronic transmission of the documents. Since the franchisor's disclosure duty is mandatory, the parties cannot agree to exclude or deviate from the rules regulating the performance of the pre-contractual obligation.

3.2.5 Comparative analysis

3.2.5.1 Introduction

The franchise legal framework of the DCFR, the USA, and Australia establishes the franchisor's pre-contractual duty of disclosure toward a prospective franchisee because of a concern over the problem of asymmetric information inherent in a franchise relationship. From the descriptive examinations, the disclosure obligation imposed by the legal framework of the selected legal systems can generally be broken down into the following five components: (1) the provider of pre-contractual information, (2) the contents of pre-contractual information, (3) the format of pre-contractual information, (4) the delivery of pre-contractual information, (5) the timing for disclosing pre-contractual information, and (6) the recipient of pre-contractual information. This section will juxtapose and discuss those six elements of the franchisor's disclosure duty in subsection 3.2.5.2. Subsection 3.2.5.3 will conclude and put

83 *Rafferty v Madgwicks* [2012] FCAFC 37 [146].

forward key recommendations for comprehensive franchise law to regulate the franchisor's pre-contractual disclosure obligation.

3.2.5.2 Comparison and discussion

– Provider of pre-contractual information

(1) Similarity

The DCFR, the USA, and Australia similarly obligate a franchisor to prepare and provide a prospective franchisee with pre-contractual information.⁸⁴ Under the chosen legal systems, a franchisor denotes a person who grants the right to conduct a franchised business and participates in a franchise relationship as a franchisor. In this respect, other third persons, such as the franchisor's agents or representatives, are generally not required by the laws to prepare and, in particular, disclose pre-contractual information. The rationale behind this construction is straightforward; the franchisor is an owner of a franchise business who ordinarily possesses material information about the business. Thus, the franchisor is in a perfect position to prepare for disclosing such substantial information.

(2) Difference

Unlike the DCFR and Australia, the US legal system imposes the disclosure duty on third persons other than a franchisor in specific circumstances. In the case of responsive disclosure upon request, the US federal regulation – the FTC Rule – requires a franchise seller to give a prospective franchisee a copy of the franchisor's disclosure document. In terms of a definition, the federal legislation defines a franchise seller to include the franchisor's representatives, agents, employees, and brokers. In this case, those third persons can be required to perform the disclosure duty.⁸⁵ This requirement results from the Federal Trade Commission's concern that franchise agents may deceive some prospective buyers of a franchise. In America, franchise brokerage services are ubiquitous businesses. Under some circumstances, some franchise brokers may influence potential franchisees to make an investment decision before examining the franchisor's disclosure document. Therefore, the FTC Rule formulates this third-party disclosure to protect prospective franchisees in the sales process.

(3) Discussion

The three selected legal systems commonly accept that an owner of a franchise business or a franchisor shall primarily be responsible for preparing and disclosing qualified information to prospective purchasers during the pre-contractual phase. According to Buchan, a franchisor is a key source of pre-

⁸⁴ See subsections 3.2.2.2, 3.2.3.2, and 3.2.4.2.

⁸⁵ See subsection 3.2.3.2.

contractual information.⁸⁶ Thus, the requirement that the franchisor must provide a prospective franchisee with the information should incontestably be adopted under comprehensive franchise law. A franchisor may not be the only actor in this regard. The US legal system shows that the disclosure duty can be imposed on other third persons connected with the franchisor, such as the franchisor's brokers and consultants. In the USA, the involvement of those persons in a franchise sales process seems commonplace because franchisors often benefit from brokerage services in franchise sales activities. For instance, franchise recruitment consultants may help find and pre-screen potential franchisees for franchisors to select.⁸⁷

In my opinion, comprehensive franchise law should require pre-sale disclosure by franchise agents and brokers only for exceptional purposes. A seemingly acceptable goal is to protect prospective franchisees against misbehaviors in franchise sales. In this case, legal systems should ensure that they have supportive evidence indicating that the use of franchise agents and brokers in franchise sales is pervasive, and the third parties' misconduct is probable. For example, there should be a considerable number of cases showing that franchise brokers fraudulently induce prospective buyers to purchase franchises by not having an opportunity to study pre-sale information before the conclusion of franchise agreements. Without firm evidence of this incident, the imposition of a third parties' disclosure obligation would be unnecessary and redundant. Moreover, it would cause uncertainty about who is responsible for disclosing pre-contractual information to prospective franchisees.

In case of third-party disclosure, I suggest that comprehensive franchise law makes the following three points explicit. First, the law should impose the disclosure duty on third persons who are authorized to engage in franchise sales activities on the franchisor's behalf. In practice, there are various types of intermediaries, such as agents, brokers, and consultants. This requirement aims to designate the persons to whom prospective franchisees may approach for the disclosure of pre-sale information. Second, the law should strive to eliminate any potential confusion about the information given. Typically, the franchisor's agents, brokers, and employees do not hold or possess essential information about a franchise themselves. In this case, the law should provide that the designated third persons are required to provide prospective franchisees with the information that is prepared by the franchisor. Otherwise, the information provided by those persons might be susceptible to inaccuracy and outdatedness. Third, the law should provide that the third-party disclosure of pre-sale information amounts to the franchisor's disclosure so that any claim

86 Jenny Buchan, 'Ex ante information and ex post reality for franchisees: The case of franchisor failure' (2008) 36 *Australian Business Law Review* 407, 419.

87 Don Daszkowski, 'The Rise of Franchise Brokers and Consultants' IFA (31 March 2017) <<https://bit.ly/2MC8lsz>> accessed 17 February 2023.

arising out of the failure to perform the duty can be raised against the franchisor.

– *Contents of pre-contractual information*

(1) *Similarity*

The DCFR, the USA, and Australia are similar in that their franchise legal framework draws up a list of pre-contractual information items that a franchisor needs to provide. The DCFR makes a list of eight informational items, and the American and Australian laws list twenty-three disclosure items.⁸⁸ In any event, these listed disclosure items are material information that enables prospective franchisees to enter into a franchise contract with full knowledge of relevant facts about a franchise under consideration. In this respect, the contents of pre-sale information required by the selected legal systems are relatively comparable. That is, the franchise legal framework of the chosen legal systems requires a franchisor to provide a prospective franchisee with information about the franchisor, the franchise system, the franchise business, and the terms of a franchise agreement.

(2) *Difference*

The USA differs from the DCFR and Australia in that the list of informational items to be disclosed in the FDD is inclusive. This conclusion is drawn from the fact that the FTC Rule prohibits the franchisor from including any materials or information other than those required or permitted by the Rule or state law not preempted by the Rule.⁸⁹ This prohibition aims to ensure that a franchisor will not provide immaterial and irrelevant information to prospective franchisees. Conversely, providing additional information is permissible under the DCFR and Australian legal system. Under the DCFR, a franchisor may, by its initiative, provide a prospective franchisee with additional informational items that would enable the franchisee to decide on a reasonably informed basis whether or not to enter into a franchise contract. The franchisor may be required to provide additional information other than the eight disclosure items, provided that good commercial practice is required.⁹⁰ Likewise, the Australian Franchising Code of Conduct allows a franchisor to provide additional information in a disclosure document. In general, the franchisor has to respond to twenty-five disclosure items set out by Annexure 1 in the disclosure document. The franchisor may add further information under the heading 'Update' in the document.⁹¹

88 See subsections 3.2.2.2, 3.2.3.2, and 3.2.4.2.

89 See subsection 3.2.3.2.

90 See subsection 3.2.2.2.

91 See subsection 3.2.4.2.

(3) *Discussion*

The rationale for disclosing pre-contractual information to a prospective franchisee is to enable the latter to make an informed decision whether to enter into a franchise contract with a franchisor. In this respect, the information to be given should be material; it should sufficiently enhance the prospective franchisee's understanding of a franchise and the franchisor before the conclusion of a franchise agreement. From the comparison, the disclosure items required by the DCFR, the USA, and Australia's franchise legal framework are relatively similar. In short, the franchisor is required to disclose material information about the franchisor, the franchise system, the franchise business, and the fundamental rights and obligations under a franchise contract.

The franchisor's disclosure may not be user-friendly as the disclosure items required by franchise legal frameworks can be highly intricate. Taking the US legal system as an illustration, a franchisor must prepare the disclosure document containing twenty-three items of the information prescribed by the FTC Rule. Under the Rule, each informational item is then broken down into a substantial number of sub-items to which the franchisor is instructed to respond fully.⁹² Following those instructions dutifully would end up creating an intimidating disclosure document containing an enormous amount of pre-contractual information. This assumption is not exaggerated. Karp and Stern claim that the entire franchise disclosure document in practice could exceed 300 pages, which would be terrifying to prospective franchisees.⁹³

The example given above shows that a single disclosure document would contain detailed and elaborate pre-sale information. This lengthy document would prevent a prospective franchisee from assimilating and finding helpful information. According to Emerson and Benoliel, most prospective franchisees are inexperienced business owners. When studying complex disclosure items, those inexperienced prospects could face the following three problems: awareness, screening, and comprehension problems. First, prospective franchisees may not be able to look for legal and commercial risks involving a franchised business. Second, prospective franchisees may find it difficult to differentiate between relevant and irrelevant information about the franchise. Third, prospective franchisees may not be able to comprehend and evaluate the complex pre-contractual information.⁹⁴ A cumbersome amount of pre-sale information provided to the potential franchisees could intensify those three problems.

The difficulties identified in the preceding paragraph would cause a state of ignorance, meaning a prospective franchisee lacks relevant information before the conclusion of a franchise agreement. To avoid informational ignor-

⁹² 16 CFR, § 436.6(c).

⁹³ Eric H Karp and Ari N Stern, 'A Proposal for a Mandatory Summary Franchise Disclosure Document' (2016) 35 *Franchise Law Journal* 541, 543.

⁹⁴ Robert W Emerson and Uri Benoliel, 'Are Franchisees Well-Informed: Revisiting the Debate over Franchise Relationship Laws' (2012) 76 *Albany Law Review* 193, 209-12.

ance, a prospective franchisee may have to hire some specialists, such as legal advisors and accountants, to do due diligence by evaluating potential risks and extracting significant information contained in a disclosure document. Hiring specialists could be detrimental to the franchisee's finances because their services can be notoriously expensive. For example, in Australia, the cost of legal advice is claimed to be 500 AUD per hour.⁹⁵ This cost seems to be prohibitive as it is said that a franchisee may not undertake proper due diligence because of reluctance to incur a professional service's cost.⁹⁶ Thus, the franchisee would jump to make an investment decision without reviewing the disclosed pre-contractual information.⁹⁷

As can be seen, the franchise legal frameworks may inadvertently restrain a prospective franchisee's decision-making by requiring the franchisor's detailed and complex disclosure. In remedying that deficiency, comprehensive franchise law should streamline the franchisor's disclosure of pre-contractual information to facilitate the franchisee's utilizing the information. In doing so, the law may require a franchisor to provide a reasonable number of informational items. This reasonableness requirement could help a prospective franchisee comprehend the disclosure items at marginal cost. In any event, I suggest that the law does not compromise the materiality of the pre-contractual information. That is, the comprehensive franchise law should ensure that it equips the prospective franchisee with full knowledge about the franchisor, the franchise system, the franchise business, and the fundamental rights and obligations under a franchise contract.

Based on the suggestion mentioned above, I believe that the DCFR's approach offers an excellent example for demarcating the amount of the pre-contractual information to be provided. The descriptive section shows that the DCFR requires a franchisor to provide a prospective franchisee with a non-exhaustive list of eight informational items.⁹⁸ In my view, these items of information sufficiently offer insights into the franchisor, the franchise system, the franchise business, and the franchise contract terms to be concluded. Since the DCFR does not require the provisions of detailed disclosures, as the American and Australian legal systems do, the franchisor's disclosure of the information could be made with a high degree of conciseness that facilitates a prospect-

⁹⁵ Explanatory Statement, Select Legislative Instrument No.168, 2014, at 93.

⁹⁶ Lorelle Frazer and others, 'Pre-contractual Due Diligence by Franchisees and Independent Small Business Buyers' (2018) 46 *Australian Business Law Review* 157, 158.

⁹⁷ The franchisee's unrealistic optimism would escalate this assumption. Empirical studies show that a franchisee tends to be overly optimistic about the future, which makes the franchisee disinterested in reading a disclosure document. *See* Uri Benoliel and Jenny Buchan, 'Franchisee's Optimism Bias and the Inefficiency of the FTC Franchise Rule' (2015) 13 *DePual Business & Commercial Law Journal* 411, 411-31; Uri Benoliel, Jenny Buchan, and Tony Gutentag, 'Revisiting the Rationality Assumption of Disclosure Laws: An Empirical Analysis' (2017) 46 *Hofstra Law Review* 469, 469-88.

⁹⁸ *See* subsection 3.2.2.2.

ive franchisee's effective use of the information given. Thus, comprehensive franchise law may follow the DCFR in listing the informational items to be provided in a disclosure document.

The Australian model in introducing a mandatory key facts sheet could also help prevent prospective franchisees from relinquishing studying disclosed information.⁹⁹ Under the Australian Franchising Code of Conduct, this document is intended to guide the franchisee to essential information contained in a disclosure document. In this case, the franchisee would be equipped with some knowledge about a franchise before studying the disclosure document. Nevertheless, the descriptive section shows that the Code requires a specific format of a key facts sheet. That is, the franchisor has to prepare the document following the form published by the ACCC, an Australian franchise regulator. Thus, this model would work well in legal systems that have established similar regulatory authorities that will be assigned to prepare and publish a format of a key facts sheet.

– *Format of pre-contractual information*

(1) *Similarity*

In terms of the disclosure format, the USA and Australia are similar in that their franchise legislation requires the disclosure of pre-sale information to be made in writing. Under these jurisdictions, a franchisor is required to prepare a written document, commonly known as a 'disclosure document'. This disclosure document is created to contain the informational items required by the laws. In preparing the document, the American and Australian legal systems similarly require a franchisor to follow instructions prescribed by franchise-specific laws. In light of the instructions, a disclosure document usually begins with a cover page stating, among other things, the title of the document and the name and contact information of the franchisor. The document also has a table of contents regarding disclosure items. The main body of the document contains details about each pre-sale information item required by the laws. If applicable, there can be an attachment to the disclosure document.

(2) *Difference*

Unlike the US and Australian legal systems, the DCFR does not require formatting informational items to be disclosed. Strictly speaking, the DCFR does not obligate a franchisor to create a written document, as do the counterpart jurisdictions. Because there is no formal requirement, it could be concluded that, under the DCFR, a franchisor may provide a prospective franchisee with pre-contractual information enumerated by IV.E. – 4:102(1) in any form. For example, a franchisor may organize the pre-contractual information in the form

⁹⁹ See subsection 3.2.4.2.

of an audio or video presentation uploaded onto YouTube's website. Despite the lack of formality, it could be argued that a franchisee may request the franchisor's disclosure to be made in writing. According to IV.E. – 2:402, a party to a franchise contract may request a signed document containing the terms of the contract. This provision aims to entitle parties to a franchise contract to obtain evidence of the contract.¹⁰⁰ Thus, this article may be utilized by analogy to permit a prospective franchisee to ask for the disclosure of pre-contractual information in a written format.

(3) *Discussion*

From the comparison, the approach to formatting the disclosure of pre-contractual information is twofold.

First, there is no formality regarding the disclosure of pre-contractual information. Among the selected legal systems, the DCFR seems to adopt this approach. Because of the lack of formal requirements, a franchisor may give a potential franchisee pre-contractual information orally unless the franchisee requests the disclosure to be made in writing. In terms of advantages, a verbal format of the disclosure would help some prospective franchisees get access to pre-sale information on an equal footing. Strictly speaking, prospective franchisees with visual impairments or dyslexia will be able to use and understand the information given more efficiently if the audio format of disclosure is permissible under a franchise legal framework.

The second approach to which the USA and Australia adopt is that the franchisor's disclosure of pre-sale information must be made in writing. In this respect, a franchisor usually has to create a so-called 'disclosure document' containing the required informational items. Because of its durability, a written format of the disclosure can be advantageous to prospective franchisees in that the franchisees may keep the disclosure document for future reference before concluding a franchise contract. After the conclusion of the contract, the franchisees may present the document as documentary evidence when legal actions against the franchisor are brought to court. In short, a written form of pre-sale disclosure can serve an evidentiary function *ex ante* and *ex post*.

Regarding a formality issue, I propose that comprehensive franchise law adopts the American and Australian approach; the law should require the franchisor's disclosure of pre-contractual information to be made in writing. Specifically speaking, a franchisor should be required to provide a prospective franchisee with the information included in a so-called 'disclosure document'. Providing pre-sale information in a disclosure document would benefit a prospective franchisee in the following two aspects.

100 Bar and Clive (n 4) 2334-335.

First, a disclosure document could serve an evidentiary role. In negotiating a franchise contract, a prospective franchisee may need to refer back and forth to some essential information to decide whether to enter into the contract. In this regard, a disclosure document would permit the franchisee to utilize the information given several times until or even after signing a franchise contract. In contrast, it would not be feasible for a potential franchisee to do so if pre-sale information is presented verbally.

Second, a disclosure document would be a proper medium in terms of informational transmissibility. Assuming that the franchise legal framework requires the disclosure of a considerable amount of pre-sale information, the franchisor could put all items of information more efficiently. In this respect, an oral disclosure might not be proper because it would be impractical for the franchisor to provide the franchisee with detailed informational items verbally. Conversely, a disclosure document would visibly record all pieces of material pre-contractual information. Thus, the information would be provided to the prospective franchisee effectively when the disclosure takes a written form.

Legal requirements for creating a disclosure document can be too intricate. As can be seen in the US and Australian franchise laws, a franchisor must comply with a myriad of instructions when preparing a disclosure document. Some instructions might aim at something other than providing material information for a prospective franchisee to decide whether to engage in a franchise relationship with a franchisor. For example, in Australia, Annexure 1 of the Franchising Code of Conduct requires the first page of the disclosure document to include the document title in a bold upper case; the franchisor's name, business address and phone number; etc. It also requires the inclusion of a relatively long statement that aims to urge some caution to a prospective franchisee. These requirements would protect a prospective franchisee in that they hinder the franchisor from presenting a disclosure document in the guise of a marketing brochure that would distract the prospective franchisee.

Despite the benefit mentioned previously, I suggest that the format of a disclosure document should be simplified and streamlined so that the document is made user-friendly. In other words, a disclosure document should not be complicated and intimidate the franchisee's attempt to utilize the pre-contractual information given. As can be seen, the chosen legal systems agree that the primary goal of providing a prospective franchisee with the disclosure document is to equip the franchisee with essential information about a franchise and a specific franchisor. In this regard, I propose that disclosure rules of comprehensive franchise law diminish some excessive formality that does not aim at disseminating substantial information to the prospective franchisee. For example, the rules may not restrict the fonts or sizes of the letters in a disclosure document. Suppose some statements, such as cautions, need to be added on the first page to encourage the prospective franchisee's usage of the document. In that case, I recommend that warning messages quickly capture

the franchisee's attention and allow the franchisee to comprehend within a short time. In this respect, warning messages should be effective; they should be simple, accurate, and specific, resulting in achievable actions.¹⁰¹

In the meantime, the disclosure rules should ensure that the structure of a disclosure document is readable and well-organized to facilitate the prospective franchisee's usage. In doing so, the rules may obligate the franchisor to put the disclosure items addressing essential information about the franchisor, the franchise system, the franchise business, and the terms of a franchise contract in a logical order. The rules of comprehensive franchise law should also ensure that every prospective franchisee can have an equal chance to access pre-contractual information. Strictly speaking, the disclosure rules should require that a disclosure document is created in a manner that is reasonably accessible for individual franchisees. In other words, the rules should instruct the franchisor to present the required pre-sale information in an accessible manner, taking into account the individual franchisee's capacity to access such pre-sale information. For those people with visually impaired abilities, the franchisor may have to digitize a disclosure document that would be compatible with some assistant devices, such as a document reader. For foreign franchisees, the franchisor may have to present the disclosure document in a language that the franchisee may understand well. These examples illustrate that the comprehensive franchise law may help ensure the franchisee's unobstructed access to pre-contractual information in reality.

– *Delivery of pre-contractual information*

(1) *Similarity*

The DCFR, the USA, and Australia do not specify a means for delivering pre-contractual information required by the laws. The absence of such a specification could be explained by the fact that the delivery methods will generally relate to the required format of the disclosure of pre-sale information. Under the DCFR, there is no formal requirement for the disclosure of pre-contractual information. In particular, no written form of disclosure is required. In theory, a franchisor may give a prospective franchisee the disclosures verbally. In the USA and Australia, a franchisor is obliged to provide a prospective franchisee with a copy of a disclosure document. Since no specific delivery method is required, the franchisor may send a copy of the document in several ways, including hand-delivering at a face-to-face meeting, post, or through electronic means. This conclusion holds true for the DCFR if a franchisor chooses to provide a prospective franchisee with a disclosure document.

101 Sally Potter, 'Why some people don't respond to warnings: writing effective short warning messages' (2021) 36 *Australian Journal of Emergency Management* 29, 30.

(2) *Difference*

When it comes to providing pre-sale information electronically, the US and Australian legal systems differ from the DCFR in that the former two jurisdictions have legal rules regulating the electronic transmission of the disclosure to some extent. In America, franchise sale law of some states, such as California, impose specific requirements for delivering a disclosure document through electronic means.¹⁰² Australia has the Electronic Transaction Act 1999 (Cth), which is currently in force.¹⁰³ Some commentators argue that a franchisor must comply with the electronic transaction law's requirements when sending the disclosure document electronically.¹⁰⁴ In contrast, the DCFR does not contain any model rule regulating the electronic transmission of pre-contractual information in the franchising context.

(3) *Discussion*

From the comparison, the DCFR, the USA, and Australia do not regulate how a franchisor delivers pre-contractual information. It might be because the delivery methods ordinarily relate to a form of pre-sale disclosure required by franchise-specific law's disclosure rules. Suppose a franchisor is obliged to give a prospective franchisee a copy of a disclosure document containing the required informational items. In that case, the franchisor may choose various means for providing such a copy, including paper-based and electronic dissemination. Thus, I suggest that comprehensive franchise law adopts the same approach; it should allow a franchisor to choose methods that it sees fit for delivering pre-contractual information.

As illustrated in the preceding paragraph, a franchisor may prepare a digital copy of a disclosure document for its franchisees. This practice is not unusual in this Digital Era, where advanced technology is dominant in our daily lives. From my experience, many businesses choose to make use of electronic papers or documents in current commercial practices. This holds true in the context of franchise businesses. Some franchisors may disseminate their documents, including disclosure documents, to franchisees electronically. Nevertheless, there is a problem; those digitized materials may be transient because a digital disclosure document may last for a short time.

In the context of electronic transmission, I suggest that disclosure rules of comprehensive franchise law regulate the franchisor's provision of an electronic disclosure document to some degree.¹⁰⁵ This suggestion rests on

102 See subsection 3.2.3.2.

103 See subsection 3.2.4.2.

104 Giles and Ward (n 75) 10.

105 It should be noted that the creation of a digital franchise disclosure document can be subject to national electronic transaction law that governs information generated, sent, received, or stored by electronic means. In this case, the disclosure rules of comprehensive franchise law may leave this technical issue to that electronic regulation. The sample of the electronic

the fact that a digital copy of the document provided to a prospective franchisee usually is non-physical and needs supportive devices to read it. In this case, the electronic format of the document would obstruct a prospective franchisee from utilizing the information given effectively. For example, a prospective franchisee may not be able to access an electronic disclosure document because the franchisee's computer device is not compatible with that digital document.

In regulating the provision of a digital disclosure document, I propose that the disclosure rules impose the following three requirements to ensure a prospective franchisee's effective use of pre-contractual information sent electronically.

First, the rules should require a franchisor to create an electronic disclosure document in a durable format. This durability of the electronic information will ensure that a potential franchisee can utilize the information in the future until the conclusion of a franchise contract. Inspired by the US FTC Rule, a disclosure document should be required to be delivered in the format that enables the prospective franchisee to store, download, print, or otherwise maintain the document for future use. For instance, a disclosure document may be prepared in a PDF or MS Word format. This requirement is said to enable a potential franchisee to study the document independently or pass this document to its consultants.¹⁰⁶

Second, the rules should require a franchisor to ask for a prospective franchisee's prior consent to the electronic transmission of the document. This requirement aims to prompt a prospective franchisee that a disclosure document will be delivered electronically so that the franchisee prepares for the delivery. This condition is vital as a potential franchisee may not be ready for the electronic transmission for some technical reasons. Thus, the franchisor should be permitted to furnish the potential franchisee with a digitized disclosure document only upon the potential franchisee's consent to the electronic delivery.

Third, in asking for the franchisee's consent, the rules should require the franchisor to consult and inform the franchisee of any precondition for reviewing the document in a digital format. For instance, the franchisor may have to advise the prospective franchisee that the franchisor will deliver a PDF version of a disclosure document through a website portal. In getting that PDF file, the prospective franchisee may be required to create an account on the site. These requirements would ensure that the prospective franchisee will be well prepared to receive pre-contractual information sent electronically.

transaction rules can be found in the UNCITRAL Model Law on Electronic Commerce, which is accessible at <<https://bit.ly/37D6wFk>>.
106 72 FR 15515 (March 30, 2007).

– *Timing for disclosing pre-contractual information*

(1) *Similarity*

The DCFR, the USA, and Australia agree that a prospective franchisee should have sufficient time to study pre-contractual information provided by a franchisor. Thus, the chosen legal systems similarly impose a waiting period in the sense that the franchisor is required to provide the prospective franchisee with the required items of information for a certain period before the triggering event specified by franchise-specific law. Besides, the three legal systems generally accept that the point at which a franchisor and a prospective franchisee conclude a franchise contract is regarded as the triggering event by which the franchisor has to give the franchisee the required pre-sale disclosures.

(2) *Difference*

The DCFR markedly differs from the US and Australian legal systems in terms of a waiting period. Unlike the two jurisdictions, the DCFR does not prescribe a fixed period for a franchisor to disclose pre-contractual information. Under the DCFR, a franchisor is required to provide pre-contractual information within a reasonable time before the conclusion of a franchise contract. Conversely, America and Australia fix the timing for disclosure by adopting a waiting period of 14 days. In these countries, the franchisor must provide a copy of a disclosure document at least 14 days before the prospective franchisee enters into a franchise contract.¹⁰⁷ The USA differs from Australia in that the franchisor may be required to furnish the prospective franchisee with the disclosure document earlier than 14 days in the case of a reasonable request by the franchisee.

(3) *Discussion*

From the comparison, the selected legal systems accept that a prospective franchisee should have sufficient time to review pre-sale information given by a franchisor. Thus, the selected legal systems set a waiting period within which a franchisor has to provide a prospective franchisee with pre-sale information and allow the franchisee to study the information before the conclusion of a franchise contract. However, the timing for disclosure varies among the legal systems. Despite the variation, the prescription of the waiting period can be divided into two cases as follows.

Firstly, a waiting period is not fixed by the law. In other words, the timing for disclosure may be subject to the determination of some open standards. As can be seen, the DCFR requires the period for disclosure to be reasonable. This reasonableness standard is elusive, which will be determined on a case-by-

¹⁰⁷ It should be noted that the Australian Franchising Code of Conduct allows a franchisee to terminate a franchise agreement in a 14-day cooling-off period. *See* The Code, cl. 26(1).

case basis. From my viewpoint, this approach creates no realistic expectation for a prospective franchisee. That is, the franchisee may not be able to expect when it is reasonable for the franchisor to furnish the franchisee with pre-contractual information before the conclusion of a franchise contract. In this case, the franchisee may have to rely upon case law in which courts offer a clear-cut answer by specifying the timing for disclosure by a franchisor.

Relying on case law may not be useful for two reasons. First, there may be no relevant case law on this point. In many legal systems, courts usually decide cases upon lawsuits filed by parties to a franchise contract. Thus, the judges cannot lay down any concrete guidelines if no party raises an issue regarding the time frame for franchise disclosure to courts for adjudicating. Second, court decisions may be contradictory in the sense that the judges in different cases may concretize the reasonableness standard inconsistently. For instance, while courts in some cases may deem 14 days reasonable, courts in other like-cases may consider 30 days reasonable. This inconsistency would result in uncertainty that might discourage investors from entering into franchise businesses.

Secondly, a waiting period is fixed or predetermined by the law. The USA and Australia embrace this model. I believe that this model would protect a prospective franchisee because of certainty. Thus, I suggest that disclosure rules of comprehensive franchise law adopt a fixed-period approach. A clear and predictable disclosure time frame would allow a prospective franchisee to anticipate the duration within which the franchisee may study pre-contractual information before concluding a franchise agreement. Nonetheless, a period fixed by franchise-specific law may vary from legal system to legal system. This divergence raises a question as to the appropriate extent of timing for disclosure. As can be seen, the USA and Australia adopt a 14-day standard. In this regard, one may assume that the 14-day standard is appropriate.¹⁰⁸

However, I remain skeptical of whether a 14-day period is an appropriate disclosing period for legal systems to adopt, considering that no uniformity concerning the disclosure timing among the countries regulating franchise sales exists. In Europe, France and Spain obligate a franchisor to provide required information to potential buyers at least 20 days before the conclusion of a franchise contract.¹⁰⁹ Unlike those European countries, Italy and Belgium adopt a period of 30 days and one month, respectively.¹¹⁰ Similarly, the

108 Mark Abell, *The law and regulation of franchising in the EU* (Edward Elgar 2013), at [5.30]. A further piece of literature on waiting and cooling-off periods for franchise agreement is Courtenay Atwell's PhD thesis. See Courtenay Atwell, 'Early withdrawal rights in franchise contracts: A comparative study of their role and effectiveness in Australia, England and France' (DPhil thesis, UNSW Business School 2018).

109 Article L.330-3 of the French Commercial Code and Article 3 of the Spain Royal Decree 201/2010 of 26 February.

110 Article 4(1) of the Italian Law No 129/2004 and Article X.27 of the Belgian Code of Business Law.

Netherlands imposes a 4-week disclosure period.¹¹¹ In other regions, Malaysia and Brazil require a franchisor to provide a prospective franchisee with a copy of a disclosure document at least ten days before signing a franchise contract.¹¹² Conversely, China and Mexico opt for a minimum of 30 days.¹¹³ In sum, the timing for disclosure under franchise regulations can range from 10 days to one month.

Despite the discrepancy in a timing requirement, I suggest that comprehensive franchise law adopts a one-month disclosure period. In the course of one month, I believe that time constraints are eliminated; hence, a prospective franchisee will have sufficient time to study, consult, and decide.¹¹⁴ First, the franchisee will be able to digest all pre-contractual informational items given in a disclosure document. The more items the law requires to provide to the franchisee, the more time is needed. Second, the franchisee can seek specialists' advice on some informational items. Taking the DCFR as an example, a franchisor must provide a prospective franchisee with information about the terms of a franchise contract. In this case, a prospective franchisee may need a lawyer to offer opinions on those contractual clauses. Third, the franchisee must have enough time after studying and consulting to decide whether to conclude a franchise contract. Thus, a one-month disclosure period would allow a prospective franchisee to execute a series of these three steps.

Furthermore, a question may be raised about the event or point in time that will trigger a one-month disclosure period. From the comparison, the DCFR, the US, and Australian legal systems agree that the point at which a franchisor and a prospective franchisee conclude a franchise contract is considered the triggering event. This condition seems to be a standard requirement as other jurisdictions with franchise disclosure law, such as Belgium and the Netherlands, adopt the same condition.¹¹⁵ Thus, I suggest comprehensive franchise law follows this commonality. A franchisor should be required to provide a prospective franchisee with a disclosure document at least one month before the conclusion of a franchise contract. For instance, if a franchise contract is to be signed on 15th June 2023, the franchisor must provide pre-sale information required by the law to the franchisee by 15th May 2023.

The USA and Australia also require a franchisor to disclose pre-contractual information before the prospective franchisee's payments. This requirement seems to suit the franchising practice that a potential franchisee may be

111 Article 7:914(1) of the Dutch Civil Code.

112 Section 15(1) of the Malaysia Franchise Act of 1998 and Article 4 of the Brazilian Law no.8.955 of December 15, 1994.

113 Article 21 of the Chinese Regulations on Administration of Commercial Franchise of 2007 and Article 142 of the Mexican Industrial Property Law.

114 In general, it is claimed that time constraints would restrict the purchaser's ability to effectively evaluate the business proposal. *See* Frazer and others (n 96) 159.

115 Article X.27 of the Belgian Code of Business Law and Article 7:913(1) of the Dutch Civil Code.

required to pay some money or other considerations before making a franchise contract. In my view, the decision to pay money or other considerations is undoubtedly an investment decision. Accordingly, the franchisee should also be informed of all relevant material information before making such a decision. Thus, I suggest that comprehensive franchise law adopt this approach by requiring a franchisor to provide a prospective franchisee with a disclosure document at least one month before the prospective franchisee's prepayment to the franchisor too. For example, a franchise contract is to be signed on 15th June 2023. However, if a prospective franchisee is required to pay an initial fee on 7th June 2023, the franchisor must furnish the franchisee with pre-sale information required by the law by 7th May 2023, not 15th May 2023.

– *Recipient of pre-contractual information*

(1) *Similarity*

The DCFR, the USA, and Australia similarly accept that pre-contractual information required by the law must be provided to a prospective franchisee. In other words, a prospective franchisee must be a recipient of the information because it will end up in concluding a franchise agreement as an actual franchisee with a franchisor. The selected legal systems commonly accept that the prospective franchisee is vulnerable to risk losing its money in investing in a franchise business because of the lack of material information for making an investment decision. With these concerns in mind, the chosen legal systems obligate a franchisor to furnish a prospective franchisee with the disclosure items before the franchisee concludes a franchise contract or makes any payment to the franchisor.

(2) *Difference*

The US legal system differs from the DCFR and Australia in that the former broadly defines the term 'prospective franchisee'. In America, the FTC Rule defines the term 'prospective franchisee' to mean any person who approaches or is approached by a franchise seller to discuss the possible establishment of a franchise relationship. That person can be any agent, representative, and employee of an actual franchisee. In contrast, the DCFR and the Australian legal system seem to understand that a 'prospective franchisee' is a person who will be an actual franchisee. Literally speaking, a franchisor cannot deliver the disclosure items to the franchisee's agent and employee since they are not regarded as prospective franchisees.

The difference among the selected legal systems in defining the term 'prospective franchisee' would not affect the eventual outcome. Under the DCFR and the Australian legal system, the franchisee's agent or employee can be the recipient of pre-contractual information. These representatives may receive the disclosures on behalf of the franchisee by virtue of the law of agency or mandate. Taking the DCFR as an illustration, Part D of Book IV contains model

rules concerning mandate contracts. Under the rules, the franchisee may authorize its agent by a mandate contract to negotiate and conclude a franchise contract between the franchisee and the franchisor, or lead to or facilitate the conclusion between those people.¹¹⁶ Thus, under the DCFR, the franchisor may disseminate the disclosure items to the franchisee's agent or employee if the franchisee's agent or employee is authorized to receive those disclosures.

(3) *Discussion*

Franchise law's disclosure rules always designate a person who is entitled to receive pre-contractual information. From the comparison, the chosen legal systems commonly accept that a recipient of pre-contractual information is a person commonly known as a 'prospective franchisee'. In my view, comprehensive franchise law should adopt this element and define the term 'prospective franchisee'. From the comparison, the DCFR, the USA, and Australia agree that a person who approaches a franchisor for a right to conduct a franchise business is regarded as a prospective franchisee. To put it another way, a prospective franchisee is a person who intends to engage in a franchise relationship as an actual franchisee after the conclusion of a franchise contract with a franchisor. Thus, I propose that comprehensive franchise law follows this common approach and defines the word "prospective franchisee" to mean a person who approaches, or is approached by, a franchisor for the right to conduct a franchise business.

One might raise a question as to when a person is considered approaching a franchisor or being approached by a franchisor. In response to this question, I propose that comprehensive franchise law provides a useful yardstick for determining the existence of the status of a prospective franchisee. Setting that criterion aims to ascertain the point at which a franchisor owes the disclosure duty towards a prospect. Unfortunately, the disclosure rules of the DCFR, the US, and Australian franchise laws offer no guide in this regard. Despite the absence of guidance, I suggest that comprehensive franchise law deems a person who expresses its intention to negotiate for the right to conduct a franchise business to be a prospective franchisee in light of the law. In this case, a person showing general interest in a franchise business might not be considered a prospective franchisee until it states an intention to negotiate for a franchise contract. However, whether that intention exists must be decided on a case-by-case basis.

The comparison of the selected legal systems also shows that the agency disclosure is allowable, meaning a franchisor may disclose pre-contractual information to a third person other than an actual franchisee. Thus, it is questioned whether the term 'prospective franchisee' should be defined to include some types of third persons, in particular, the franchisee's agent and employee. From my perspective, this issue is a matter of legal policy; hence,

116 The DCFR, IV.D. – 1:101(1).

no clear-cut answer could be given in response to this question. In some legal systems, a prospective franchisee may be confined to an actual franchisee. In this regard, a franchisor is obliged to furnish that person with pre-contractual information. In other words, it is not obligatory for the franchisor to provide other third persons with pre-sale information.

Nevertheless, it does not mean that a franchisor is prevented from furnishing a third person with pre-sale information. Under certain circumstances, the franchisor may have to do so if that third person is authorized to negotiate for a grant of a franchise on the franchisee's behalf. In this case, legal systems should have mechanisms to ensure that an actual franchisee is kept informed of any material information acquired by its representative. This issue would be marginal in practice since legal systems ordinarily have the law of agency or mandate normally dealing with these mechanisms. Taking the DCFR as an example, the rule regulating a mandate contract requires an agent to reasonably inform the principal of the existence of, and the progress in, the negotiations or other steps leading to the possible conclusion or facilitation of the prospective contract.¹¹⁷ The drafters of the DCFR provide that this rule aims at requiring the agent to keep its principal informed of all relevant information received during the performance.¹¹⁸

3.2.5.3 Conclusions

– Concluding remarks

The DCFR, the USA, and Australia have a common perception that a franchise purchase is an investment. Accordingly, the selected legal systems agree that a prospective franchisee should have some material information to make a reasonably informed decision. A wise decision would prevent the franchisee from facing financial disasters because of investing in the wrong business. With this viewpoint, the DCFR, the USA, and Australia formulate franchise law's disclosure rules establishing the franchisor's pre-contractual duty to provide information to a prospective franchisee. In essence, the disclosure obligations under the DCFR and the US and Australian legal systems are fundamentally similar. Under the chosen legal systems, the franchisor is required to provide a prospective franchisee with pre-sale informational items within a certain period before the conclusion of a franchise contract. Nonetheless, the DCFR, the USA, and Australia slightly differ in terms of the format and delivery of pre-contractual information and the requirement as regards the waiting period.

117 The DCFR, IV.D. – 3:401.

118 Bar and Clive (n 4) 2156.

– *Key recommendations*

(1) *Establishment of the pre-contractual information duty*

Because of informational asymmetry, a prospective franchisee should be furnished with materially relevant information about a franchise. The goal is to enable a prospective franchisee to make a sensible investment decision. In reaching that objective, legal systems should formulate disclosure rules under comprehensive franchise law. The rules should establish the franchisor's disclosure duty that obligates the franchisor to provide material information to a prospective franchisee before the sale of a franchise.

(2) *Definition of a prospective franchisee*

It is suggested that comprehensive franchise law defines the term 'prospective franchisee'. Defining that word would facilitate a search of a person entitled to receive the disclosures provided by a franchisor. The law should define 'prospective franchisee' to mean a person who approaches or is approached by a franchisor for the right to conduct a franchise business. It is also advised that comprehensive franchise law provides a criterion for determining the existence of a prospective franchisee. In this case, the law should deem a person who expresses its intention to negotiate for the right to conduct a franchise business to be a prospective franchisee.

(3) *Contents of pre-contractual information*

Comprehensive franchise law's disclosure rules should specify items of pre-contractual information required to be provided. In principle, the disclosure items should sufficiently provide insights into the franchisor's identity, the franchise system, the franchise business, and the fundamental rights and obligations under a franchise contract. Most importantly, the rules should require a franchisor to provide a reasonable amount of informational items. The DCFR's approach would be considered a good model in this regard.

(4) *Format of pre-contractual information*

Comprehensive franchise law's disclosure rules should require the franchisor's disclosure of pre-contractual information to be made in writing in the form of a disclosure document. The rules should simplify and streamline the disclosure document's format so that the document is made user-friendly. The rules should also instruct the franchisor to disclose pre-sale informational items in the format and language that can be accessed by a prospective franchisee, considering the individual franchisee's capacity to access the information.

(5) *Delivery of pre-contractual information*

Comprehensive franchise law's disclosure rules should permit a franchisor to choose methods for delivering a disclosure document as it sees appropriate. The franchisor may opt for paper-based or electronic communication. In the

latter case, the rules should regulate the electronic transmission of a disclosure document by imposing three requirements as follows. First, the rules should require a franchisor to create an electronic disclosure document in a durable format. Second, the rules should require a franchisor to ask for a prospective franchisee's prior consent to the electronic transmission of the document. Third, the rules should require a franchisor to consult and inform a prospective franchisee of any precondition for reviewing a digitized document.

(6) *Timing for furnishing pre-contractual information*

Comprehensive franchise law's disclosure rules should fix a time frame within which a franchisor must provide pre-sale information and allow a prospective franchisee to study the information. The waiting period should sufficiently allow a prospective franchisee to study, consult, and decide. Thus, adopting a one-month period is suggested. The rules should require a franchisor to provide a prospective franchisee with a disclosure document at least one month before the conclusion of a franchise contract or the prospective franchisee's prepayment to the franchisor, depending upon which event happens first.

3.3 DUTY TO PROVIDE COMPLETE, CURRENT AND ACCURATE INFORMATION

3.3.1 Introduction

Section 3.3 will examine how the franchise legal framework of the DCFR, the USA, and Australia regulates the establishment of the franchisor's duty to provide complete, current and accurate pre-sale information. The descriptive examination of the franchise legal frameworks will be conducted in sections 3.3.2, 3.3.3, and 3.3.4, respectively. Section 3.3.5 will compare, contrast, and discuss the approaches to establishing the franchisor's duty to provide complete, current and accurate information taken by the chosen legal systems to offer guidelines for developing franchise rules regulating the franchisor's duty under comprehensive franchise law.

3.3.2 The Draft Common Frame of Reference (DCFR)

3.3.2.1 Introduction

The duty to provide complete, current and accurate information is not recognized under the DCFR as a distinct obligation compared to the disclosure obligation. No model rules establish the duty to provide complete, current and accurate information as IV.E. – 2:101, in conjunction with IV.E. – 4:102(1), constitutes the duty of disclosure. Nevertheless, the construction of this duty could be implied; a franchisor may be required to ensure the correctness,

completeness, and transparency of pre-contractual information required to be provided. This implication can be taken from applying the disclosure rule in Part E of Book IV and the rule governing the requirement of good faith and fair dealing in Book III. This section will elaborate on the application of the rules in subsections 3.3.2.2 and 3.3.2.3, respectively. Conclusions about the nature and contents of the franchisor's duty to provide complete, current and accurate information will be made in subsection 3.3.2.4.

3.3.2.2 *Disclosure rule*

Neither IV.E. – 2:101 nor IV.E. – 4:102(1) explicitly requires that the franchisor ensures the correctness, completeness, and transparency of pre-contractual information required to provide to a prospective franchisee. It would seem that the drafters of the DCFR intend the franchisor to owe the duty to provide complete, current and accurate information towards the franchisee. This intention can be observed in the Comments to IV.E. – 2:101. The commentaries provide that the provision of pre-contractual information aims to enable the recipient of the information to decide on a reasonably informed basis whether to conclude a contract on the terms under consideration. Accordingly, the DCFR would require the franchisor to ensure that the information to be provided is correct, complete, and transparent.¹¹⁹

It should be mentioned that the duty to provide complete, current and accurate information would not be peculiar in the context of national franchise law in Europe. A franchisor may be required to ensure the truthfulness of pre-contractual information to be given under franchise legislation. For instance, in Spain, article 62.3 of the Retail Trade Act and article 3 of the Royal Decree 201/2010 require the franchisor to disclose pre-contractual information to a prospective franchisee. In complying with that obligation, it is said that the franchisor must provide the required information which is truthful and not misleading.¹²⁰ Thus, it could be argued that the franchisor's disclosure of pre-contractual information under the DCFR should follow this direction too.

3.3.2.3 *Rule relating to good faith and fair dealing*

The principle of good faith and fair dealing recognized by the DCFR may require the franchisor to ensure the correctness, completeness, and transparency of pre-contractual information. Under the DCFR, III. – 1:103(1) formulates a fundamental principle that a person has to act in accordance with good faith

119 Bar and Clive (n 4) 2287.

120 Jaume Martí Miravalls, 'Spanish Legal System on Disclosure in Franchise Networks: Problem and Proposals for an Improved Regulation' (2014) 25 *European Business Law Review* 943, 948; Mónica Esteve Sanz and others, 'Chapter 42: Spain' in Mark Abell (ed), *The Franchise Law Review* (2nd edn, Law Business Research Ltd 2015) 542.

and fair dealing in performing an obligation.¹²¹ In the franchising context, it could be said with certainty that the franchisor's performance of the disclosure obligation must correspond to the standard of conduct in good faith and fair dealing. However, there is a question: how does a franchisor perform the disclosure duty in accordance with good faith and fair dealing?

In Book I of the DCFR, I. – 1:103(1) defines the expression 'good faith and fair dealing' to mean a standard of conduct characterized by honesty, openness, and consideration for the interests of the other party to the relationship in question. In this respect, the drafters of the DCFR clarify these three determinants as follows.¹²² First, 'honesty' is understood by its normal meaning. According to the dictionary, telling the truth is characterized as an example of being honest.¹²³ Second, the term 'openness' points out transparent behaviors. Third, consideration for the other party's interests depends on the circumstances of the case. In the context of negotiating for a franchise contract, it seems to me that a franchisor should help a prospective franchisee to conclude the contract with no false assumptions. Therefore, after taking into account all the determinants, it could be concluded that a franchisor has an obligation in good faith and fair dealing to ensure that the pre-sale information to be disclosed is correct, complete, and transparent.¹²⁴

3.3.2.4 Conclusions

The DCFR does not contain specific provisions that establish the duty to provide complete, current and accurate information as a duty distinct from the franchisor's disclosure obligation. However, the rules regulating the pre-contractual disclosure duty and the duty of good faith and fair dealing can be utilized to constitute the franchisor's duty. In this case, the duty to provide complete, current and accurate information would be regarded as an auxiliary duty requiring the franchisor to perform the pre-contractual disclosure obligation with a certain degree of care. In other words, a franchisor would be required

121 Despite the auxiliary nature, the franchisor's duty to provide complete, current and accurate information is obligatory in light of III. – 1:102(1).

122 Christian von Bar and Eric Clive, *Principles, Definitions and Model Rules of European Private Law: Draft Common Frame of Reference (DCFR): Full Edition* (Vol.1, Oxford University Press 2010) 89.

123 Diana Lea and Jennifer Bradbery, *Oxford Advanced Learner's Dictionary* (10th edn, Oxford University Press 2020) 747.

124 Some European countries utilize the principle of good faith to ensure the currency and truthfulness of pre-contractual information in the franchising context. For example, in Germany, some regional courts have concertized the general principle of good faith to create the duty to provide complete, current and accurate information. As far as court decisions are concerned, three Higher Regional Courts held that the franchisor has to give the franchisee the correct and full information concerning the profitability of the franchise system. See OLG München, 16.09.1993, 6 U 5495/92, OLG Düsseldorf, 25.10.2013, I-22 U 62/13 and OLG Frankfurt, 03.06.2016, 13 U 107/14.

to provide a prospective franchisee with pre-contractual information, which is correct, complete, and transparent. Thus, the franchisor's non-performance of the duty would amount to the non-performance of the pre-contractual duty of disclosure that allows an aggrieved franchisee to seek private law remedies under the DCFR.

3.3.3 The United States of America (USA)

3.3.3.1 Introduction

Federal and state franchise sale laws do not distinctively establish the franchisor's duty to provide complete, current and accurate information. Nonetheless, the establishment of this duty could be implied from federal and state franchise sale law rules regulating disclosure requirements, updating requirements, and prohibitions against unlawful conduct. As will be seen, these franchise rules may, directly and indirectly, ensure the accuracy, currentness, and completeness of pre-contractual information to be disclosed. This section will examine how the rules regulating disclosure requirements, updating requirements, and prohibitions against unlawful conduct constitute the franchisor's duty to provide complete, current and accurate information in subsections 3.3.3.2, 3.3.3.3, and 3.3.3.4, respectively. Subsection 3.3.3.5 will conclude on the nature and contents of the franchisor's duty in the USA.

3.3.3.2 Disclosure requirements

– Federal law

The FTC Rule does not contain any provision that imposes the duty to provide complete, current and accurate information as a distinct duty on a franchisor. Nevertheless, providing complete and accurate information to a prospective franchisee is indeed one of the FTC Rule's objectives. This assumption can be inferred from the court decision in *FTC v USA Beverages*. In this case, the court acknowledged that the FTC Rule intended to ensure that prospective franchisees receive complete and accurate information necessary for making an investment decision.¹²⁵ As described in section 3.2.3, the FTC Rule requires a franchisor to disclose the required information in a disclosure document.¹²⁶ According to section 436.1(d), the term 'disclose' is defined to include presenting all material facts accurately. For example, the franchisor is obliged to include accurate information about the principals of the company, litigation history,

¹²⁵ *Federal Trade Commission v USA Beverages, Inc*, 2006 WL 8432509 (SD Fla, 2006) 12.

¹²⁶ 16 CFR, §436.6(b).

and lists of previous buyers in the disclosure document.¹²⁷ Thus, it could be concluded that a franchisor has the duty to disclose accurate information to a prospective franchisee under the federal legislation.

– *State laws*

In some franchise sale states, franchise-specific law rules carefully regulate the truthfulness of statements in a disclosure document. For example, in Illinois, the franchise disclosure law rule mandates that all statements in the disclosure document must be of the following three qualities. First, they must be free from any false or misleading statement of a material fact. Second, they must not omit to state any material fact required to be stated or necessary to make the statements not misleading. Third, they must be accurate and complete as of the effective date thereof.¹²⁸ Accordingly, a franchisor could be said to have the duty to ensure that statements or representations, such as sales projections, are not false or omitting to state any material fact or are accurate and complete.¹²⁹ Otherwise, the franchisor's failure to comply with these three requirements would be actionable under the disclosure statute.

3.3.3.3 *Updating requirements*

– *Federal law*

Not only does the FTC Rule regulate the accuracy of the disclosure items, but the Rule also oversees their currentness. In regulating the disclosure items' currentness, the Rule requires a franchisor to furnish a prospective franchisee with an up-to-date disclosure document.¹³⁰ This inference is drawn from sections 436.2(a) and 436.7(a), requiring that the franchisor's disclosure document must be current as of the close of the franchisor's most recent fiscal year. In keeping all information in the disclosure document up-to-date, the FTC Rule sets out the instructions for updating the disclosures as follows.¹³¹

First, a franchisor shall make an annual update. That is, the franchisor must prepare a revised disclosure document within 120 days after the close of the fiscal year.¹³² For example, if the franchisor's fiscal year of 2022 adheres to a calendar year, the franchisor must update the disclosure document version 2022 by the 1st May 2023. After the annual revision is made, the franchisor and other franchise sellers are required to distribute a disclosure document

127 *FTC v Holiday Enterprises, Inc*, 2008 WL 953358, (ND Ga, 2008) 8.

128 IL ST, CH 815 § 705/16.

129 *Team Tires Plus, Ltd v Heartlein*, 2004 WL 3406090, (D Minn, 2004) 9.

130 *Family Wireless #1, LLC v Automotive Technologies, Inc*, 2016 WL 183475 (D Conn, 2016) 2.

131 72 FR 15518 (March 30, 2007).

132 16 CFR, §436.7(a).

version 2023 in the sales of a franchise during the rest of 2023. For instance, the franchisor must furnish the prospective franchisee with a 2023 franchise disclosure document if a franchise contract is to be concluded on the 1st October 2023.

Second, a franchisor shall also make a quarterly update. Nonetheless, this quarterly update is exceptional and required only in certain circumstances. That is, the franchisor must prepare revisions to reflect any material change to information included in the disclosure document within a reasonable time after the close of each quarter of the fiscal year.¹³³ The Compliance Guide to the Franchise Rule exemplifies that material changes include the fact that the franchisor recently files a bankruptcy petition or the franchisor is filed a legal action that may harm the franchisor's financial condition.¹³⁴ In this case, at the time of disclosure, a prospective franchisee must be furnished with the franchisor's current disclosure document and the quarterly revisions made to the information contained in the document.

– *State laws*

Likewise, state franchise sale statutes may ensure the currentness of pre-sale disclosure items. In other words, the state statutes may require a franchise disclosure document to be current as of the franchisor's most recent fiscal year. The laws may impose updating requirements equivalent to those required by the FTC Rule. For example, in South Dakota, the franchise sale law requires a franchisor to revise its disclosure document within 120 days after the close of the fiscal year. The franchisor is also required to prepare revisions to the disclosure document to reflect any material change to the disclosures within a reasonable time after the close of each quarter of the fiscal year.¹³⁵

Some franchise sale states may lay down updating requirements stricter than those of the FTC Rule.¹³⁶ For example, in Hawaii, the franchise investment law provides that an offering circular containing disclosure items shall expire three months after the end of the franchisor's fiscal year. In this case, a franchisor must apply for renewal by submitting the most recent amended offering circular within sixty days before the expiration date.¹³⁷ In contrast, the FTC Rule does not establish a like-renewal procedure. In Illinois, the franchise disclosure law articulates that a franchisor shall make quarterly revisions to reflect any material change to the disclosures within 30 days after the close

133 16 CFR, §436.7(b).

134 The Compliance Guide to the Franchise Rule (2008), at 126 <<https://bit.ly/3hUBg9N>> accessed 21 January 2022.

135 SD ST, § 37-5B-7(2) – (4).

136 Baer (n 33) 528.

137 HI ST, § 482E-3(d).

of each quarter of the franchisor's fiscal year.¹³⁸ Conversely, the FTC Rule merely requires the revisions to be made within a reasonable time.

3.3.3.4 Prohibition against misrepresentations

– Federal law

The FTC rule contains provisions that aim to prevent the communication of misleading statements and preserve the integrity of information in a disclosure document.¹³⁹ For example, section 436.9(a) makes it unlawful for a franchisor to make any verbal, visual, and written claim or representation that contradicts the information required to be disclosed. Furthermore, according to section 436.9(b), it is unlawful for the franchisor to make some misrepresentations specified by the Rule. Besides the FTC Rule, some provisions of the Federal Trade Commission Act (FTCA) apply to the franchisor's disclosure of pre-sale information in the sales of a franchise. For instance, under the FTCA, any unfair or deceptive practices in commerce or affecting commerce is unlawful and actionable.¹⁴⁰ As far as case law is concerned, the rules of the FTCA can be applied to cases where a franchisor made untrue statements, such as false income claims.¹⁴¹

– State laws

Franchise sale law of all sixteen franchise sale states similarly prohibits making misrepresentations or untrue statements by a franchisor through a so-called 'antifraud provision'.¹⁴² For example, California franchise investment law provides that it is unlawful for a franchisor willfully to make any untrue statement of a material fact in any statement disclosed in the disclosure document. It is also unlawful for a franchisor willfully to omit to state in any such statement any material fact which is required to be stated in the disclosure document.¹⁴³ In light of the antifraud regulation, some courts assume that

138 IL ST, CH 815 § 705/11.

139 72 FR 15531 (March 30, 2007).

140 15 USCA, § 45(a)(1), in conjunction with § 57b(a)(1).

141 *USA Beverages* (n 125) [11]; *Federal Trade Commission v American Entertainment Distributors, Inc*, 2012 WL 12964783, (SD Fla, 2012), [6].

142 California – CA CORP, § 31202; Florida: FL ST § 817.416(2)(a); Hawaii – HI ST, § 482E-5(b)(1); Illinois – IL ST, CH 815 § 705/6(c); Indiana – IN ST, 23-2-2.5-27(2); Maryland – MD BUS REG, § 14-229(a)(2); Michigan – MI ST, 445.1505(b); Minnesota – MN ST, § 80C.13; New York – NY GEN BUS, § 687; North Dakota – ND ST, 51-19-11(2)(b); Oregon – OR ST, § 650.020(1)(b); Rhode Island – RI ST, § 19-28.1-17; South Dakota – SD ST, § 37-5B-25(1); Virginia – VA ST, § 13.1-563(2); Washington – WA ST, 19.100.170(2); Wisconsin – WI ST, 553.41(4).

143 CA CORP, § 31202.

the franchisor owes the franchisee a duty to disclose truthful and non-misleading information in a disclosure document.¹⁴⁴

3.3.3.5 Conclusions

At the federal and state levels, the US franchise sale law does not explicitly require a franchisor to ensure that the disclosures are accurate, complete, and current. Nevertheless, the FTC Rule and state franchise sale laws have several provisions that would ensure the disclosure's accuracy, completeness, and currentness. First of all, federal and state franchise legislation typically require a franchisor to disclose accurate information in a disclosure document. Secondly, the federal and state franchise sale laws impose on a franchisor the duty to update its disclosure document, either annually or quarterly, to ensure that a prospective franchisee receives current information. Lastly, the federal and state franchise sale laws' antifraud provision prevents a franchisor from engaging in unlawful conduct, including making misrepresentations or untrue statements. These rules would ensure that the disclosure items are accurate, complete, and current.

3.3.4 Australia

3.3.4.1 Introduction

The Franchising Code of Conduct (the Code) does not explicitly constitute the franchisor's the duty to provide complete, current and accurate information as a distinct obligation. However, the Code contains several provisions that could be utilized to ensure that the disclosure items are current and candid. These provisions are associated with the franchisor's duty to maintain a disclosure document and the duty to act in good faith. Apart from the Code, the Australian Consumer Law (ACL) can also prohibit a franchisor from engaging in misleading conduct. This competition and consumer law would also ensure the currentness and accuracy of pre-contractual information. This section will examine the rules regulating the duty to maintain a disclosure document, the duty to act in good faith, and the prohibition against misleading conduct in subsections 3.3.4.2, 3.3.4.3, 3.3.4.4, respectively. Conclusions about the nature and contents of the duty will be made in subsection 3.3.4.5.

3.3.4.2 Duty to maintain a disclosure document

As described in section 3.2.4, a franchisor owes a pre-contractual information obligation towards a prospective franchisee. That is, the Code requires the

144 *Abbo v Wireless Toyz Franchise, LLC*, 2014 WL 1978185 (Mich App, 2014) 8.

franchisor to give the prospective franchisee a disclosure document containing the information set out in Annexure 1. The franchisor must also provide the franchisee with a key facts sheet containing the information disclosed in the disclosure document. In furnishing the franchisee with pre-sale information, the underlying principle is that the information must be up-to-date. This concept is derived from paragraph (b) of clause 8(2), providing that the franchisor's disclosure is intended to give a prospective franchisee current information. The currentness concept is also re-formulated in clauses 9(1A)(b)(i) and 9(1A)(c)(i), requiring a franchisor to give a prospective franchisee an updated disclosure document and an updated key facts sheet.¹⁴⁵

Additionally, the Code imposes updating requirements to ensure that a disclosure document and a key facts sheet contain current pre-contractual information. These requirements are mainly outlined by clauses 8 and 9A. According to clauses 8(6) and 9A(2), a franchisor must update a disclosure document and a key facts sheet within four months after the end of each financial year. Suppose the franchisor's financial year ends on 30 June 2023. In this case, the franchisor must revise the disclosure document and the key facts sheet by 31 October 2023.¹⁴⁶ Under certain circumstances, the franchisor needs not to update these two documents after the end of the financial year. These situations are prescribed by clauses 8(7) and 9A(3). In the previous example, the franchisor does not have to update the disclosure document and the key facts sheet by 31 October if the franchisor does not intend to enter into a franchise contract or conclude one franchise agreement during 2023.¹⁴⁷

3.3.4.3 Duty to act in good faith

The Code expressly requires the parties to a franchise agreement to act towards the other party with good faith.¹⁴⁸ Clause 6(1) regards this requirement as an obligation to act in good faith. According to clause 6(2)(b), the obligation

¹⁴⁵ Some court decisions seem to affirm this concept. For example, the Federal Court in *SPAR Licensing v MIS QLD* held that the franchisor must ensure that the disclosure document is current at the time the franchise agreement is made or at least 14 days before the conclusion of the contract. See *SPAR Licensing Pty Ltd v MIS QLD Pty Ltd*, [2014] FCAFC 50 [40].

¹⁴⁶ In updating a disclosure document, it is said that some items of information need to be incorporated into the document. Those items include the additional financial statements for the last completed financial year, the independent audit report, the table of transfers and terminations of a franchise in the previous fiscal year, the list of newly-granted franchisees, and any changes in the structure of the board of directors of the firm. See Corrinne Attard and Denial Jepson, 'Australia: Franchise disclosure update time is here again' (*Mondaq*, 16 August 2018) <<https://bit.ly/314t7cM>> accessed 22 January 2022.

¹⁴⁷ The Code, cl. 8(7)(a) and cl. 9A(3)(a).

¹⁴⁸ Clause 6(3) offers two standards for determining whether the party acted in accordance with good faith. Firstly, the party may be deemed to act in good faith if it acted honestly and not arbitrarily. Secondly, the party may be deemed to act in good faith if it cooperated to achieve the purposes of a franchise agreement.

to act in good faith also applies to a person who negotiates for the proposed franchise agreement. Although clause 6(2)(b) imposes an obligation to act in good faith on both parties: the franchisor and prospective franchisee, this provision is said to have an objective of controlling the franchisor's opportunistic conduct and redressing the imbalance of bargaining power.¹⁴⁹ Therefore, in negotiating for a franchise contract, the franchisor will be required to act honestly and not arbitrarily or capriciously.¹⁵⁰ Furthermore, the franchisor will be required to act cooperatively, such as disclosing information to the other party, listening to the other, and negotiating in good faith.¹⁵¹

The obligation to act in good faith under clause 6(2)(b) is characteristically elusive. Accordingly, the good faith obligation under the Code could be construed to cover several sub-duties. Among other things, it could be argued that the franchisor's duty to provide complete, current and accurate information is an instance of the obligation to act in good faith. This good faith duty would require a franchisor to ensure that the information included in a disclosure document is accurate and not misleading. According to Buberis, the ACCC in the case *Ultra Tune* used to allege that the franchisor's false and misleading misrepresentation made in a pre-contractual stage was a contravention of the obligation to act in good faith under clause 6, and the court accepted that allegation.¹⁵² This result seems to suggest that the obligation to act in good faith can be a genesis of the obligation in which the franchisor needs to ensure that the disclosures are correct and candid.¹⁵³

On the other hand, the franchisor is allowed to act in its legitimate commercial interests.¹⁵⁴ In theory, the franchisor may argue that it has no duty to be truthful because of intending to protect its legitimate interests. However, Giles points out that the scope of legitimate commercial interests in franchising remains uncertain and arguable.¹⁵⁵ Despite this uncertainty, I believe that the Code would not allow any party to argue for its own legitimate interests to act opportunistically or unfairly due to two reasons. First, the notion of legitimate interests is understood by Australian courts that a party needs not to act in the interest of the other party or subordinate its legitimate interests

149 Explanatory Statement, Select Legislative Instrument No.168, 2014, at 18; Alan Wein, Review of the Franchising Code of Conduct (2013), at 63.

150 *Kiraig Pty Ltd v Rent the Roo Pty Ltd*, [2017] FCCA 1493 [156].

151 *Macquarie International Health Clinic Pty Ltd v Sydney South West Area Health Service*, [2010] NSWCA 268 [16].

152 Peter Buberis, *Australian Franchising Code of Conduct: A Critical Analysis with Current Case law* (Emerald Publishing 2020) 163.

153 This conclusion conforms with other Australian commentators who contend that a seller of any business has the duty not to mislead or deceive. See Frazer and others (n 96) 175.

154 The Code, cl. 6(6).

155 Giles (n 81) 43.

to the other's.¹⁵⁶ Second, it is said that the obligation to act in good faith is established under the Code to address serious misconduct, such as opportunistic and unfair conduct.¹⁵⁷ This idea should be considered strict in that the parties' performance of an obligation in good faith cannot be excused by personal interests, albeit legitimate in a commercial sense. Thus, the Code would not permit the franchisor to provide the prospective franchisee with outdated and inaccurate pre-sale information by arguing for its own legitimate interests since this conduct would be considered unfair.

In addition, the franchisor would have the duty to ensure that the disclosures are up-to-date by virtue of clause 6(2)(b). In this case, one commentator offers some practical illustrations. Required by good faith, Schaper suggests that a franchisor may be required to inform a prospective franchisee of any significant change to the existing disclosure document before updating the document is completed. Schaper explains that the Code requires the franchisor to update the disclosure document within four months after the end of the financial year. However, there is a possibility that, during the period, the disclosure document provided is not the latest or updated version.¹⁵⁸ Consequently, the franchisor has the duty of good faith to inform the prospective franchisee of a change of material information that is necessary for a prospective franchisee to make a reasonably informed decision.¹⁵⁹

3.3.4.4 Prohibition against misleading conduct

The franchisor's conduct in the pre-contractual phase can also fall within the ambit of the Australian Consumer Law (ACL).¹⁶⁰ For example, it is accepted that section 18 of the ACL applies to regulate the franchisor's behaviors.¹⁶¹ Section 18(1) of the ACL would prohibit a franchisor from engaging in conduct in trade or commerce that is misleading or deceptive or is likely to mislead or deceive. This provision does not define the expression 'misleading or

156 Alicia Hill, 'Good Faith: Enforcement in Australia' (2013) 11 *International Journal of Franchising Law* 29, 38. See also Digby J's opinion in *Delahunt v Swim Loops Pty Ltd*, [2018] VSC 269 [55].

157 Giles (n 81) 42.

158 Michael Schaper was the Deputy Chair of the ACCC. He aired his view on the webinar hosted by the ACCC. This webinar, titled 'The new Franchising Code – what you need to know and do now', has been uploaded on the ACCC's YouTube channel <<https://youtu.be/mK7TnjDVutA>>.

159 For example, a franchisor may have to inform a prospective franchisee of a change in majority ownership of the franchisor or the franchise system. See ACCC, 'Franchisor obligations when giving information' <<https://bit.ly/3GsGhSF>> accessed 21 January 2022.

160 The purpose of the legislation is to promote informed commercial activity based on accurate information. See *Bullabidgee Pty Ltd v McCleary* [2011] NSWCA 259 [69].

161 Wein (n 149) at 12; Brendan Sweeney, Mark Bender, and Nadine Courmadias, *Marketing and the Law* (5th edn, LexisNexis, 2015) 670- 72. The ACL is set out in Schedule 2 of the Competition and Consumer Act 2010. The electronic version of the ACL can be accessed at <<https://bit.ly/2B0bO1H>>.

deceptive'. Despite the absence of the definition, some court interpretations can be followed.¹⁶² In *Parkdale Custom Built Furniture*, Gibbs CJ provided that the words 'mislead' and 'deceive' mean 'to lead into error'.¹⁶³ Therefore, in light of the ACL, the franchisor would have to ensure that pre-contractual information to be provided is not misleading and does not induce the prospective franchisee to make an error.

The ACL would specifically regulate the franchisor's misleading representations about future matters. A future matter is said to be a prediction or projection of anything that will occur in the future.¹⁶⁴ In this case, section 4(1) of the ACL requires the franchisor to have reasonable grounds for making a representation with respect to any future matter.¹⁶⁵ For example, suppose the franchisor states that it will pay a franchisee \$4,000 every month. In that case, the court in the case *South East Melbourne Cleaning* provides that the franchisor must:

[h]ave a source of funds sufficient to pay the promised amount, a business system capable of collecting payments from its customers and actually paying its franchisees on time, and a willingness to implement such a system and to pay franchisees in accordance with their entitlements under their franchise agreements.¹⁶⁶

Therefore, under section 4(1) of the ACL, a franchisor will be taken to make a misleading representation about future incomes if it does not have the reasonable grounds illustrated above in support of making the representation.

3.3.4.5 Conclusions

The Franchising Code of Conduct and the Australian Consumer Law may establish the franchisor's the duty to provide complete, current and accurate information. First, this franchisor's duty exists under the Code in the form of the duty to maintain a disclosure document and the duty to act in good faith. In the former case, a franchisor is required to create a disclosure document including current information about franchising. In ensuring that the information in the disclosure document is up-to-date, the Code requires the franchisor to update the document annually. In the latter case, a franchisor has an obligation to act in good faith. This duty would require the franchisor

162 Explanatory Memorandum to Trade Practices Amendment (Australian Consumer Law) Bill (No.2) 2010, at [3.14], <<https://bit.ly/3dIKk3W>> accessed 21 January 2022.

163 *Parkdale Custom Built Furniture Pty Ltd v Puxu Pty Ltd* [1982] HCA 44; 149 CLR 191 [8].

164 *P C Yarak Pty Ltd & Anor v Quick Cash Advance Pty Ltd & Anor* [2018] SADC 26 [144].

165 Failure to have reasonable grounds for making a representation as to a future matter will be considered misleading by virtue of section 4(1) of the ACL. See *Carazi Pty Ltd v Blow Dry Bar Franchising Pty Ltd (in liq) (No 2)*, [2015] NSWSC 108 [36] – [37].

166 *Australian Competition and Consumer Commission v South East Melbourne Cleaning Pty Ltd*, [2015] FCA 25 [97].

to provide accurate and current pre-sale information to a prospective franchisee. In this case, the franchisor could not refuse to perform the duty by arguing for its legitimate commercial interests. The Australian Consumer Law would also help ensure the truthfulness of any statement made by a franchisor. Under the ACL, the franchisor must refrain from engaging in misleading or deceptive conduct, leading a prospective franchisee to make errors. This requirement implies that the franchisor must provide the prospective franchisee with truthful information. Otherwise, the franchisee may allege the franchisor of breaching the ACL's rule.

3.3.5 Comparative analysis

3.3.5.1 Introduction

From the descriptive examinations, a general impression is that the DCFR, the USA, and Australia do not have rules explicitly establishing the franchisor's the duty to provide complete, current and accurate information as a distinct pre-contractual duty. The selected legal systems are similar in that the duty to provide complete, current and accurate information could implicitly be constituted under their franchise legal framework. In other words, the franchise legal framework of the DCFR, the USA, and Australia provide several rules to ensure the integrity and truthfulness of the pre-sale information to be provided. In this case, the franchisor would be required to ensure that the disclosure items are accurate, complete, and current. However, the rules or mechanisms to be utilized may vary. This section will compare, contrast, and discuss the applicable rules of the franchise legal framework of the DCFR, the USA, and Australia in subsection 3.3.5.2. Subsection 3.3.5.3 will conclude on the findings and enumerate key recommendations for formulating rules under comprehensive franchise law.

3.3.5.2 Comparison and analysis

– Similarity

The DCFR, the USA, and Australia seem to regard the duty to provide complete, current and accurate information as a sub-duty of the franchisor's disclosure obligation. In other words, the chosen legal systems seem to contemplate this duty as a manner in which the franchisor performs the pre-contractual disclosure obligation. Under the DCFR, the drafters comment on IV.E. – 2:101 that the pre-contractual information to be provided must be current, complete, and accurate. Besides, a franchisor has an obligation in good faith and fair dealing to ensure that the information is correct, complete, and transparent. Accordingly, when performing the pre-contractual obligation, the franchisor must ensure

that the informational items required to provide a prospective franchisee contain current, complete, and accurate information.

In America, the FTC Rule requires a franchisor to disclose pre-sale information accurately. This conclusion holds true for the state franchise sale laws. For example, the Illinois franchise disclosure law requires that all statements in a disclosure document must be accurate, complete, and not misleading. In addition, the FTC Rule and state franchise sale statutes require a franchisor to furnish the franchisee with information, which is current as of the close of the franchisor's most recent fiscal year. In Australia, the Franchising Code of Conduct requires a franchisor to create a disclosure document containing the information, which is up-to-date. Furthermore, the Code imposed on the franchisor the obligation to act in good faith, which would obligate the franchisor to ensure that the information included in a disclosure document is current and accurate.

– *Difference*

The DCFR markedly differs from the US and Australian legal systems in the following two aspects.

First, the DCFR does not offer model rules on updating pre-contractual information, as do the USA and Australia. As can be seen in the descriptive sections, America and Australia require franchisors to make an annual update. In the USA, a franchisor must revise a disclosure document within 120 days after the close of its fiscal year. Likewise, in Australia, a franchisor is required to update a disclosure document and a key facts sheet within four months after the end of its financial year. In terms of updating requirements, Australia slightly differs from the USA in that the Australian Franchising Code of Conduct does not stipulate the rule concerning a quarterly update to reflect any changes to the disclosure document as the US franchise disclosure laws do. Despite the lack of this requirement, the obligation to act in good faith under the Australian Code would require the franchisor to revise its documents addressing any changes before delivering the documents to a prospective franchisee.

Unlike the USA and Australia, no franchise law rule of the DCFR requires a franchisor to make annual and quarterly updates.¹⁶⁷ Unfortunately, the

¹⁶⁷ It should be noted that franchise-specific laws of some European countries, such as France, Spain, and Italy, do not impose either annual updating requirements or quarterly updating requirements. See Rémi Delforge and Gilles Menguy, 'France' in Andrew P Loewinger and Michael K Lindsey (eds), *International Franchise Sale Laws* (2nd edn, American Bar Association 2016) 184; Alberto Echarri and Gonzalo Ulloa, 'Spain' in Andrew P Loewinger and Michael K Lindsey (eds), *International Franchise Sale Laws* (2nd edn, American Bar Association 2016) 446; Aldo Frignani and Francesca Turitto, 'Italy' in Andrew P Loewinger and Michael K

drafters of the DCFR do not explain the absence of updating mechanisms. In my opinion, the probable explanation might be that the DCFR is drafted based on the code-like structure, employing a comprehensive approach similar to civil codes of civilian systems.¹⁶⁸ In this respect, the DCFR's franchise law in Part E of Book IV would focus on laying down specific contract law rules creating rights and obligations for the parties to the contract. In other words, the DCFR's franchise law might not aim to regulate the parties' conduct closely to the same degree as industry-specific regulations do. Thus, imposing updating requirements might be deemed redundant in the eye of the drafters of the DCFR.

Second, unlike the US and Australian laws, the DCFR does not contain model antifraud provisions that can be utilized to prevent the dissemination of misleading pre-contractual information. In the USA, both federal and state disclosure laws contain provisions regulating misleading or deceptive conduct by a franchisor. For example, at the federal level, the FTC Rule makes it unlawful for a franchisor to make any verbal, visual, and written claim or representation that contradicts the information required to be disclosed. Furthermore, state franchise sale statutes typically have antifraud provisions prohibiting the franchisor's misleading or deceptive behaviors. For instance, the Californian franchise law prohibits a franchisor from willfully making any untrue statement of a material fact in a disclosure document. In Australia, the Australian Consumer Law's rules can be used to govern some fraudulent practices by a franchisor. This consumer regulation would prohibit a franchisor from engaging in misleading or deceptive conduct or conduct that is likely to mislead or deceive.

In contrast, the DCFR's franchise law in Part E of Book IV does not have any equivalent antifraud rules. The plausible explanation would be the same as is in the former case; that is to say, the law may not primarily intend to regulate unlawful conduct of the parties to a franchise contract. Consequently, the DCFR may hesitate to enumerate antifraud provisions under franchise law. Nevertheless, it does not mean that the DCFR does not contain rules addressing fraudulent conduct. In the DCFR, the contract and tort law rules may establish *ex-post* sanctions against any misleading or deceptive conduct by a franchisor. In contract law, II. – 7:205(1) would permit the franchisee to avoid a franchise contract if the franchisor induced the former party to conclude the agreement by fraudulent misrepresentation or fraudulent non-disclosure. In tort law, a franchisor may be held responsible for reparation under tort law for fraudulent misrepresentation by virtue of VI. – 1:101, in conjunction with VI. – 2:210.

Lindsey (eds), *International Franchise Sale Laws* (2nd edn, American Bar Association 2016) 253.

168 Esther van Schagen, 'The Draft Common Frame of Reference and Multilevel Governance' (2010) 1 *Edinburgh Student Law Review* 74, 76.

– *Discussion*

From the comparison, the DCFR, the USA, and Australia constitute the franchisor's disclosure obligation to facilitate a prospective franchisee to acquire some essential information about a franchise that enables the franchisee to make a reasonably informed decision in the sales process. The comparison of the franchise legal frameworks conducted in this section shows that providing pre-contractual information, which is current, complete, and accurate, is imperative to get franchise prospects well informed about a franchise under consideration. This acknowledgment implies that a franchisor should be required to ensure the integrity and currentness of the pre-sale information. As an underlying policy, I suggest that comprehensive franchise law contains disclosure provisions establishing the franchisor's duty to provide complete, current and accurate information to prevent a prospective franchisee from receiving false, misleading, or out-of-date information. Without that duty, I am inclined to believe that the franchisee could not make a reasonable investment decision on whether to purchase a franchise.

The underlying policy mentioned above raises a question of the nature and contents of the franchisor's duty to provide complete, current and accurate information under comprehensive franchise law. As can be seen, the comparison shows that the DCFR, the USA, and Australia do not establish the duty to provide complete, current and accurate information as a self-contained obligation. In my view, comprehensive franchise law should contain a provision establishing a distinct obligation that requires a franchisor to exercise a certain degree of truthfulness when disclosing pre-contractual information in light of the law. In performing the duty, the comprehensive franchise law's rule should require the franchisor to ensure that the information to be provided is qualified. That is, the disclosures must be current, complete, and accurate at the date of the disclosure. This proposal would be advantageous to a prospective franchisee as it helps the franchisee undertake pre-purchase due diligence more effectively.¹⁶⁹ Imposing the franchisor's duty to provide complete, current and accurate information would also enable the franchisee to examine whether the franchisor has exercised due care up to a point. In this case, any franchisor's performance that falls short of the required standard would entitle the franchisees to civil remedies under the law.

The selected legal systems assure that a franchisor will have to ensure that the information to be disclosed is current, accurate, and complete in several ways. From my perspective, some approaches could be utilized to strengthen the franchisor's compliance with the duty proposed in the preceding paragraph.

169 For example, Buchan says that due diligence will be restrained if the disclosures are inaccurate. See Jenny Buchan, 'Franchising: A Honey Pot in a Bear Trap' (2014) 34 *Adelaide Law Review* 283, 312.

Firstly, the DCFR and Australia illustrate that the obligation to act in good faith can be imposed on parties in a pre-sale relationship. This obligation would establish a standard of conduct that would require a franchisor to act honestly and cooperatively towards a prospective franchisee in negotiation for a franchise sale. For example, an Australian commentator exemplifies that the obligation of good faith under the Australian Franchising Code of Conduct would require a franchisor to inform any material changes to the disclosures provided to a prospective franchisee.¹⁷⁰ In short, the franchisor would have a duty of good faith to ensure the currentness of the disclosures. Thus, I recommend that comprehensive franchise law also contain a provision establishing the duty to act in good faith and fair dealing that applies to a pre-contractual relationship. The law should also provide criteria that can be used to determine whether the parties act in good faith.

Secondly, the USA and Australia show the incorporation of antifraud provisions in the laws applicable to franchising. For instance, some US state franchise sale laws contain statutory provisions prohibiting a franchisor from making any untrue statement of material facts that could mislead a prospective franchisee. In my opinion, these prohibitive rules would help create *ex-ante* disincentives that deter the franchisor from engaging in any opportunistic conduct associated with the disclosure of pre-sale information. Among other things, the franchisor will have to avoid providing information, which is false or inaccurate. In reality, the antifraud provision can be drafted variously. In other words, there is no uniformity in stipulating this kind of provision. If comprehensive franchise law embraces antifraud provisions, I suggest that the law precisely specifies what types of the franchisor's conduct will be prohibited.¹⁷¹

3.3.5.3 Conclusions

– Concluding remarks

The comparative examination finds that the duty to provide complete, current and accurate information is not regarded as a distinct obligation under the DCFR, the USA, and Australia's franchise legal framework. Nevertheless, the selected legal systems provide certain rules to ensure that a franchisor cannot disregard the truthfulness and currentness of pre-contractual information to be disclosed. As can be seen, the franchise legal framework of the selected legal systems regards the duty to provide complete, current and accurate information as a sub-duty of the disclosure obligation. Performing this duty

¹⁷⁰ See subsection 3.3.4.3.

¹⁷¹ Taking an antifraud provision of the California franchise investment law as an example, the statute makes it unlawful for a franchisor to willfully make any untrue statement of a material fact in a disclosure document.

is considered a manner in which the franchisor executes the pre-contractual disclosure duty. In addition, the DCFR, the USA, and Australia have several law rules that would implicitly constitute the franchisor's duty to provide complete, current and accurate information, such as the rules governing the obligation to act in good faith, the duty to update a disclosure document, and prohibitions against deceptive or misleading conduct. These rules would ensure that a prospective franchisee will receive pre-sale information, which is current, complete, and accurate.

– *Key recommendations*

(1) *Establishment of the duty to provide complete, current and accurate information*

Comprehensive franchise law should ensure that a prospective franchisee gets current, complete, and truthful pre-contractual information. In this respect, the law should contain disclosure provisions constituting the duty that requires a franchisor to provide a prospective franchisee with the pre-contractual information, which is current, complete, and accurate at the date of the provision of the information. This duty should be obligatory in the sense that some private law remedies may follow the non-performance of the obligation.

(2) *Reinforcing mechanisms*

Comprehensive franchise law may contain provisions establishing legal mechanisms that would strengthen the performance of the duty to provide complete, current and accurate information. These reinforcing mechanisms may include the requirement of good faith and fair dealing and the prohibitions against fraudulent conduct. First, the law may require parties in a sale process to act in accordance with good faith and fair dealing. Second, the law may impose prohibitions that would prevent a franchisor from impairing the integrity of pre-contractual information.

3.4 PRIVATE LAW REMEDIES

3.4.1 Introduction

The preceding sections 3.2 and 3.3 demonstrate that the franchise legal framework of the DCFR, the USA, and Australia regulate the franchisor's pre-contractual duties to redress information asymmetry between a franchisor and a prospective franchisee. Some franchisors may fail to perform the pre-contractual obligations imposed by the franchise legal frameworks. In these cases, the question shifts from what the franchisors were supposed to perform to what sanctions are imposed against the breaching franchisors. One would question: what are private law remedies that enable an aggrieved franchisee

to compel the franchisor's performance, claim monetary compensation, and cancel a franchise relationship? Section 3.4 will examine the remedial system under the franchise legal framework of the DCFR, the USA, and Australia in sections 3.4.2, 3.4.3, and 3.4.4, respectively. Section 3.4.5 will compare, contrast, and discuss the remedies under the chosen legal systems to formulate advice on constructing a remedial regime under comprehensive franchise law.

3.4.2 The Draft Common Frame of Reference (DCFR)

3.4.2.1 Introduction

The DCFR contains rules offering private law remedies for a (prospective) franchisee in the case of the franchisor's non-performance of the disclosure duty and the duty to provide complete, current and accurate information. Under the DCFR, the potential remedies are essentially threefold; the franchisee may enforce the franchisor's specific performance, claim damages, and cancel a franchise contract. This section will examine the rules governing three types of private law remedies in subsections 3.4.2.2, 3.4.2.3, and 3.4.2.4, respectively. Subsection 3.4.2.5 will conclude on the remedial regime of the DCFR that would enable the franchisee to seek the three private law remedies in the case of the franchisor's non-performance of the pre-contractual obligations.

3.4.2.2 Enforcement of performance

In theory, a prospective franchisee may resort to III. – 3:302 to enforce a franchisor to disclose pre-contractual information or to provide the information, which is correct, complete, and transparent. Paragraphs (1) and (2) of III. – 3:302 formulate a fundamental principle that the creditor is entitled to enforcing specific performance of a non-monetary obligation if the debtor fails to comply with the terms regulating an obligation. According to III. – 1:102(5), the terms regulating an obligation may be derived from law. Under the DCFR, the disclosure duty and the duty to provide complete, current and accurate information are created by IV.E. – 2:101, in conjunction with IV.E. – 4:102(1). Thus, the franchisor's non-performance of these duties would permit the franchisee to enforce specific performance under III. – 3:302(1) and (2).

In enforcing the franchisor's performance, a prospective franchisee may have to prove that the franchisor fails to provide all or part of informational items or provides out-of-date or inaccurate information. In doing so, the prospective franchisee needs not to prove the franchisor's fault in the non-performance of these obligations as the DCFR does not require this internal element for the recourse to this remedy. Furthermore, the prospective franchisee needs not to demonstrate its losses as the right to enforce specific performance is not conditional upon loss or damage suffered by the creditor.

In sum, the prospective franchisee only has to constitute that the franchisor owes the franchisee the pre-contractual information obligations, and the franchisor fails to perform these duties.

It should be mentioned that the right to enforce specific performance may be excluded under certain circumstances. This exclusion of the right to specific performance is enumerated by paragraphs (3) and (4) of III. – 3:302. For example, under III. – 3:302(3)(a), a prospective franchisee may not compel a franchisor to perform the disclosure obligation if the performance of this duty would be unlawful or impossible. Under III. – 3:302(4), a prospective franchisee may not enforce the franchisor's performance if the franchisee does not request the performance within a reasonable time after the franchisee has become, or could reasonably be expected to have become, aware of the franchisor's non-performance. In any event, a franchisee may be entitled to a remedy to damages as the exclusion of the right to enforce specific performance does not preclude the monetary remedy.¹⁷²

3.4.2.3 *Monetary compensation*

A prospective franchisee who suffers any loss or damage caused by the franchisor's non-performance of the disclosure duty and the duty to provide complete, current and accurate information may claim monetary compensation in the form of damages. Under the DCFR, the franchisee may resort to some contract law rules in seeking an award of damages. In particular, the franchisee may claim damages for the franchisor's non-compliance with the pre-contractual duty of information under IV.E. – 4:102(2), in conjunction with II. – 7:214(2) and (3). Requirements for recovery of damages and principles governing a measure of damages under those model rules will be addressed in the following two italicized headings.

– *Requirements for recovery of damages*

IV.E. – 4:102(2) formulates a fundamental principle that a prospective franchisee may claim damages if the franchisor fails to comply with the pre-contractual information obligation. In seeking an award of damages under that provision, the franchisee must generally satisfy the following three conditional elements.

First, a prospective franchisee must establish the franchisor's non-compliance with the pre-contractual duty to provide information. In this case, the franchisee may claim that the franchisor failed to perform a disclosure obligation by not providing adequate and timely information on the items listed in IV.E. – 4:102(1).¹⁷³ For example, the prospective franchisee may allege that

¹⁷² The DCFR, III. – 3:303.

¹⁷³ Bar and Clive (n 4) 2390.

the franchisor did not provide the franchisee with the informational items wholly or partly. The franchisee may also allege that the franchisor did not furnish the franchisee with the required information within a reasonable time before the conclusion of a franchise contract. Additionally, the prospective franchisee may claim that the franchisor furnishes incorrect or out-of-date information on the required items in IV.E. – 4:102(1).

Second, a prospective franchisee must demonstrate its loss suffered due to the franchisor's non-compliance with the pre-contractual duty to provide information. This element can be drawn by reading IV.E. – 4:102(2) and II. – 7:214(1) collectively. Thus, the right to damages under IV.E. – 4:102(2) presupposes the existence of loss suffered by a prospective franchisee. According to the Comments to II. – 7:214, the term 'loss' covers both economic and non-economic loss. The commentaries further explain that economic loss includes lost income or profits, burdens incurred, and a reduction in the value of the property. Moreover, non-economic loss includes pain and suffering and impairment of the quality of life.¹⁷⁴

Third, there must be a causal link between the franchisor's non-compliance with a pre-contractual information obligation and the loss sustained. According to IV.E. – 4:102(2) and II. – 7:214(1), a prospective must prove that it suffers loss or damage as a consequence of the franchisor's failure to perform the duty. In this case, the franchisee cannot recover damages for any loss, which does not attribute to the franchisor's non-performance of the duty. Concerning the proximity of damage, there may be a question of whether an aggrieved franchisee can recover damages for the loss of chance or opportunity. To put it differently, it is questionable whether the franchisee can argue that the franchisor's non-performance of the pre-contractual information obligations causes the franchisee to lose an opportunity to get a favorable franchise contract from other franchisors.

No commentaries to IV.E. – 4:102 nor the comments to II. – 7:214 addresses the loss of chance issue. Accordingly, it remains unclear whether a prospective franchisee may establish a link to recover damages for the lost chance under the DCFR's contract law. Nevertheless, the drafters of the DCFR seem to concede that courts may characterize the loss of chance as a special form of damage reparable under the law of contract, as well as the law relating to non-contractual liability, under the DCFR.¹⁷⁵ In any case, the loss of chance issue is among the topics left for further discussion and development.¹⁷⁶

174 Bar and Clive (n 122) 530.

175 Bar and Clive (n 4) 3195.

176 Christian von Bar, 'Chapter 16: The Notion of Damage' in Arthur S Hartkamp and others (eds), *Towards a European Civil Code* (4th edn, Kluwer Law International 2011) 399.

– *Principles governing a measure of damages*

IV.E. – 4:102(2) refers to II. – 7:214(2) and (3) when it comes to measuring recoverable damages. The rules under these paragraphs can be summarized as follows.

Firstly, II. – 7:214(2) prescribes a general rule that damages are compensatory. This paragraph provides that an award of damages must place an aggrieved party as nearly as possible in the position in which that party would have been if the contract had not been concluded. I conceive that this underlying principle should be re-formulated so that it fits the franchising context. That is, in the context of the disclosure in franchising, an award of damages must place an aggrieved franchisee as nearly as possible in the position in which the franchisee would have been if the franchisor had, adequately and timely, furnished the franchisee with pre-contractual information or provided current and accurate information.

Secondly, II. – 7:214(3) provides that the rules on damages for non-performance of a contractual obligation apply with any appropriate adaptation. For example, III. – 3:701(3) will be referred to define the word ‘Loss’ since II. – 7:214 does not define that term. The franchisee may not claim damages for positive loss, such as the lost profits or incomes, because the aim of II. – 7:214(2), in conjunction with IV.E. – 4:102(2), is to put the party in the same position as if the franchisor has performed the disclosure duty. Thus, the recovery of damages for loss of expectation, which is a normal case in the event of non-performance, would not be permitted.¹⁷⁷ In addition, III. – 3:705 will also be applied to reduce damages by virtue of II. – 7:214(3).¹⁷⁸ According to III. – 3:705(1), an amount of monetary compensation to be awarded to an aggrieved franchisee may be reduced to the extent that the franchisee could have reduced the loss by taking reasonable steps. Furthermore, the franchisee would not recover any expenses reasonably incurred in attempting to reduce the loss as a result of paragraph (2) of III. – 3:705.

3.4.2.4 *Cancellation of a contract*¹⁷⁹

The fact that a franchisor does not perform the disclosure duty or the duty to provide complete, current and accurate information may provide a basis for a franchisee to cancel a franchise contract. Under the DCFR, the franchisee may have to resort to the rules governing vitiated consent in Book II to avoid

¹⁷⁷ Bar and Clive (n 122) 529.

¹⁷⁸ Ibid 531.

¹⁷⁹ The DCFR provides the franchisee with special remedies upon the cessation of a franchise relationship. Strictly speaking, the DCFR allows the franchisee to get compensation for a transfer of goodwill and to reimburse for stock, spare parts and materials. These special remedies will be explored in subsection 5.5.2.5 in chapter 5 of the book.

a franchise agreement. Because of the franchisor's non-disclosure or the franchisor's disclosure of incorrect or out-of-date information, the franchisee may conclude the contract under misapprehension. If this is the case, the franchisee may choose to invalidate the franchise agreement on the ground of mistake under II. – 7:201 or fraud under II. – 7:205.¹⁸⁰ This subsection will examine the essential prerequisites for avoiding a franchise contract for mistake and fraud. This subsection will also make remarks on particular rules related to avoiding a franchise contract.

– *Avoidance of a franchise contract for mistake*

Kronman provided that information is the antidote to the mistake.¹⁸¹ This idea implies that the franchisor's non-disclosure of pre-sale information or providing inaccurate or outdated information would induce the franchisee's mistake. Under the DCFR, the franchisee may avoid a franchise agreement for a mistake by satisfying the prerequisites set out in II. – 7:201(1). These conditions are as follows.

First, according to paragraph (a) of II. – 7:201(1), the franchisee needs to plead that it has concluded a franchise contract by serious mistake. Initially, the franchisee must demonstrate that it mistakes the facts or the laws affecting the franchise contract. More importantly, the misapprehension must be serious or material in the sense that, without mistake, the franchisee would not have entered into a franchise agreement or would have done so on fundamentally different terms. In this case, the franchisee also has to prove that the franchisor knew or could reasonably be expected to have known that the franchisee made a material mistake.

Second, according to paragraph (b) of II. – 7:201(1), the franchisee shall demonstrate that the franchisor caused it to make a serious mistake. In the context of disclosure, the franchisee may show that the franchisor caused the franchisee to conclude a franchise contract under a serious misapprehension by failing to comply with the pre-contractual information duty imposed by IV.E. – 2:101, in conjunction with IV.E. – 4:102(1). For example, the franchisee may avoid a franchise contract for mistake, claiming that the franchisor caused

180 In some European countries, courts may determine the validity of a franchise contract based on rules concerning defective consent. For example, in France, the French Supreme Court (*Cour de Cassation*) decided that the franchisor's failure to provide the required information could render a franchise contract void because of a defect in the franchisee's consent. *See* Cass, com, Dec 5, 2000, pourvoi n°97-21.631. Furthermore, some commentators suggest that an ill-informed party may avoid a contract for mistake and fraud in the case of non-performance of the disclosure duty. *See* Nils Jansen and Reinhard Zimmermann (eds), *Commentaries on European Contract Laws* (Oxford University Press 2018) 499-500.

181 Anthony T Kronman, 'Mistake, Disclosure, Information, and the Law of Contracts' (1978) 7(1) *The Journal of Legal Studies* 1, 4.

the franchisee to enter into a franchise agreement by furnishing the franchisee with untrue statements about profit projections.

It should be noted that the franchisee's right to avoid a franchise contract may be excluded in two following cases under II. – 7:201(2). First, the franchisee cannot avoid a franchise agreement if the mistake was inexcusable under the circumstances.¹⁸² In other words, the franchisee would not be able to avoid the contract for its careless mistakes.¹⁸³ Second, the franchisee cannot avoid the contract if it assumed the risk of the mistake or, in the circumstances, the mistake should be borne by the franchisee.¹⁸⁴ The drafters of the DCFR exemplify that a party may not be able to avoid a contract if it willingly concludes a contract without knowledge of an important matter surrounding the agreement.¹⁸⁵

– *Avoidance of a franchise contract for fraud*

The franchisor's non-disclosure or disclosure of incorrect or out-of-date information could be fraudulent. Under the DCFR, the franchisee may avoid a franchise agreement for fraud by satisfying the requirements prescribed in II. – 7:205. According to II. – 7:205(1), the franchisee may avoid the franchise contract by showing that the franchisor induced the conclusion of the contract by fraudulent non-disclosure of any information which the disclosure duty requires the franchisor to disclose. The franchisee may avoid the franchise agreement by proving that the franchisor induced the conclusion of the contract by fraudulent misrepresentation. II. – 7:205(2) further elaborates that, in the former case, the non-disclosure is fraudulent if it is intended to induce the person from whom the information is withheld to make a mistake. In the latter case, the misrepresentation is fraudulent if it is made with knowledge or belief that the representation is false and is intended to induce the franchisee to make a mistake.¹⁸⁶ Thus, the right to avoid a contract for fraud under II. – 7:205 would suitably be exercised in the cases of non-performance of the disclosure duty and the duty to provide complete, current and accurate information.

182 The DCFR, II. – 7:201(2)(a).

183 The drafters of the DCFR suggest that the careless mistake should not prevent the avoidance if it is not bothersome for the second party to point out the mistake. *See* Bar and Clive (n 122) 462-63.

184 The DCFR, II. – 7:201(2)(b).

185 Bar and Clive (n 122) 463.

186 The drafters of the DCFR seem to adopt reliance as another prerequisite in the case of fraudulent misrepresentation. Thus, a franchisee can avoid a franchise contract for fraudulent misrepresentation if the franchisee has relied on incorrect information given, thereby deciding to conclude the agreement. In other words, the franchisee may not be able to avoid the contract if the franchisee has never read the fraudulent statement provided before entering into the contract. *See* *ibid* 494.

– *Remarks on particular rules relating to avoidance of a franchise contract*

There are some remarks as regards exercising the right of avoidance, partial avoidance, effects of avoidance, and election of remedies as follows.

(1) *Exercise of the right of avoidance*

According to II. – 7:209, a franchisee may avoid a franchise contract by giving the franchisor notice of avoidance. In this case, the commentaries to this article explain that the franchisee needs not to bring a lawsuit against the franchisor for a judicial order of avoidance.¹⁸⁷ Pursuant to II. – 7:210, the notice of avoidance must be given within a reasonable time, with due regard to the circumstances, after the franchisee knew or could reasonably be expected to know of mistake or fraud. During that reasonable period, II. – 7:211 prevents the franchisee from avoiding a franchise contract if the franchisee confirms the continuation of the contract expressly or impliedly.

(2) *Partial avoidance*

In theory, a franchisee may be confined to avoid particular terms of the agreement. According to II. – 7:213, if a ground of avoidance affects particular terms of a franchise contract, an aggrieved franchisee cannot avoid the entire contract. Suppose the franchisor provides false or incorrect information that causes the franchisee to agree to specific terms of a franchise agreement by misapprehension. In this case, the franchisee can only avoid those affected clauses. Nevertheless, II. – 7:213 makes some exceptions, which allows the avoidance of the entire franchise contract. For instance, the franchisee may avoid an entire franchise contract if it is unreasonable to uphold the remaining contract, giving due consideration to all the circumstances of the case. According to the Comments to II. – 7:213, a fraud case may be considered reasonable to allow an aggrieved party to avoid the whole contract.¹⁸⁸ In my view, partial avoidance of a franchise contract would be scarce as a franchisee typically concludes a franchise agreement in its entirety. Thus, a situation that the franchisee's mistake affects particular clauses of the agreement would be unlikely.

(3) *Effects of avoidance*

In general, the effects of avoidance, as prescribed by II. – 7:212, are threefold.

Firstly, avoiding a franchise contract or particular clauses of a franchise contract will invalidate the contract or the clauses with a retrospective effect.¹⁸⁹ In other words, the avoidance will cancel the contract or those clauses as if they had not been concluded.¹⁹⁰ In this case, a franchise contract

187 Bar and Clive (n 122) 494.

188 Ibid 527.

189 The DCFR, II. – 7:212(1).

190 Bar and Clive (n 122) 524.

or the terms of a contract, which has been avoided by a franchisee, will be set aside at the beginning.

Secondly, the rules on unjustified enrichment will regulate the parties' right to the return of whatever has been transferred or supplied under an avoided contract.¹⁹¹ For example, when avoiding the entire franchise agreement, a franchise relationship is dissolved. In this case, a franchisee may claim a return of an initial fee paid under a franchise contract by virtue of VII. – 1:101, in conjunction with VII. – 5:101.

Thirdly, the transfer of property rules will apply to the ownership of property which has been transferred under an avoided contract.¹⁹² For instance, after avoiding the whole franchise agreement that ends a franchise relationship, the ownership of property will be treated as never having passed to the transferee as a result of VIII. – 2:202(2).

(4) *Election of remedies*

In some cases, the franchisor's conduct that allows avoidance may inflict loss or damage to the franchisee. For example, the franchisor's fraudulent non-disclosure under II. – 7:205(1) may cause financial loss to the franchisee. One may raise the question of whether the franchisee can avoid an entire franchise contract for fraud and concurrently claim damages suffered as a result of fraud. In this case, II. – 7:214(1) makes clear that a franchisee who has the right to avoid the contract is entitled to damages, whether the agreement is indeed avoided or not. Thus, the franchisee needs not to elect one of these possible remedies in the event of the franchisor's non-performance of the disclosure duty or the duty to provide complete, current and accurate information. To put it another way, the franchisee may avoid an entire franchise contract and claim damages for any loss arising out of the mistake or fraud.¹⁹³

3.4.2.5 *Conclusions*

Contract law rules of the DCFR offer three types of civil law remedies in the occurrence of the franchisor's non-performance of the disclosure duty and the duty to provide complete, current and accurate information. Under the remedial regime, a prospective franchisee may compel a franchisor to provide current and transparent information on the required items before entering into a franchise contract. After a franchise agreement is concluded, a franchisee may cancel a franchise contract by avoiding the agreement, entirely or partially, based on mistake or fraud. In either case, the (prospective) franchisee is not

¹⁹¹ The DCFR, II. – 7:212(2).

¹⁹² The DCFR, II. – 7:212(3).

¹⁹³ According to II. – 7:214(2), an amount of monetary compensation will be awarded to place an aggrieved franchisee as nearly as possible in the position that the franchisee would have been if the contract had not been concluded.

precluded from claiming monetary compensation for any loss caused by the franchisor's failure to perform the obligations. Nevertheless, a general principle for calculating damages differs slightly when the franchisee decides to enforce specific performance or avoid an entire franchise contract. In the former case, the franchisee will be placed as nearly as possible in the position in which the franchisee would have been if the franchisor had performed the duties correctly. In the latter case, damages will put the franchisee as nearly as possible in the position in which the franchisee would have been if the contract had not been concluded.

3.4.3 The United States of America (USA)

3.4.3.1 Introduction

In case of non-performance of the franchisor's pre-contractual information duties, a franchisee may bring an action against a franchisor for civil law remedies under state laws.¹⁹⁴ In the sixteen franchise sale states, the franchisee may resort to the rules of franchise sale law and common law for private law remedies. Strictly speaking, the franchisee may rely on the rules on the following types of civil law relief: the enforcement of the franchisor's performance, monetary compensation, and cancellation of a franchise contract. This section will explore the rules governing those threefold remedies in subsections 3.4.3.2, 3.4.3.3, and 3.4.3.4, respectively. Conclusions about the US remedial regime will be provided in subsection 3.4.3.5.

3.4.3.2 Enforcement of performance

State franchise sale statutes ordinarily offer two types of private law remedies: damages and rescission of a contract.¹⁹⁵ For example, in Michigan, the court in *Coffee Beanery v Albert* upholds that Michigan franchise investment law only

194 At the federal level, the Federal Trade Commission Act (FTCA) provides a wide range of civil actions for a violation of the FTC Rule. According to section 19(b) of the FTCA, the available relief includes, but shall not be limited to, rescission or reformation of contracts, the refund of money and return of the property, the payment of damages, and public notification respecting the rule violation or the unfair or deceptive act or practice. Nevertheless, an individual franchisee cannot bring a lawsuit under the FTCA for those remedies as the US courts have correspondingly held that the FTCA exclusively delegates the right to commence a civil action to the Federal Trade Commission. See eg *Holloway v Bristol-Myers Corp*, 485 F.2d 986, 991, 158 US App DC (CADDC 1973) 212; *Friend v Fryberger, Buchanan, Smith & Frederick, PA*, 2012 WL 503796, (D Minn, 2012) 4; *Nixon v Brent Manning's Quality Preowned, Inc*, 2016 WL 6090735 (W D Ark, 2016) 3. Thus, the examination of private law remedies under federal regulation will be omitted in this section.

195 Joseph J Fittante, Jr and Suzanne Trigg, 'Chapter 4: Registration', in Rupert M Barkoff et al (eds), *Fundamentals of Franchising* (4th edn, American Bar Association 2016) 171.

permits two types of remedies for a violation of the law: the remedies of damages and rescission.¹⁹⁶ Thus, no special relief is made available that permits a prospective franchisee to enforce the disclosure duty under the disclosure laws.¹⁹⁷ Strictly speaking, no specific remedy would enable the franchisee to compel the franchisor's disclosure of pre-sale information.

In Hawaii, Minnesota, North Dakota, and Washington, the franchise sale statute contains a remedial provision offering catch-all relief. Under the rule, a franchisee may sue a franchisor for other relief as the court may deem appropriate.¹⁹⁸ However, state courts in those jurisdictions have not yet clarified the expression 'other relief as the court may deem appropriate'.¹⁹⁹ Nor do commentaries on this remedial provision provide further explanation. Thus, a series of sanctions that the court may order remains questionable. In my view, this catch-all relief could be interpreted to compel the franchisor to provide pre-sale information or to ensure the truthfulness of the information. This interpretation is given to effectuate the goal of the sale law that aims to equip a prospective franchisee with essential information before concluding a franchise contract. Without this specific way of interpreting, the franchisee would never get the information for deciding whether to enter into a franchise agreement in reality.

It should be noted that the proposed franchise bill could warrant enforcement of specific performance at a state-wide level. Currently, a new Bill cited as 'Fair Franchise Act of 2017' has been introduced to the House of Representatives. The Bill aims to establish certain standards of fair conduct in franchise business relationships.²⁰⁰ Under the Bill, private rights of action are provided in section 11. Unlike the existing disclosure laws, section 11 expressly provides that a franchisee has the right to be awarded injunctive relief in case of a violation of sections of the Bill and the FTC Rule. Since the injunctive relief is used to enjoin any violation or threatened violation of the mentioned statutes, it would employ to enforce a franchisor to comply with the disclosure

196 *Coffee Beanery, Ltd v Albert*, 2006 WL 1330326, (Mich App, 2006) 2.

197 As can be seen, the disclosure duty is not the duty created by an agreement. Instead, it is the legal duty constituted by franchise-specific regulation. Therefore, a remedy of specific performance in contract law would not be applicable as the non-performance of the statutory duty does not amount to a breach of contract that is an important ground for an order of specific performance. See E Allen Farnsworth, 'Legal Remedies for Breach of Contract' (1970) 70(7) *Colum Law Review* 1145, 1149-151; Alan Schwartz, 'The Case for Specific Performance' (1979) 89(2) *Yale Law Journal* 271, 272.

198 Hawaii: HI ST, § 482E-9(b); Minnesota: MN ST, § 80C.17(Subd.1); North Dakota: ND ST, 51-19-12(1); Washington: WA ST, 19.100.190(2).

199 The court in Minnesota has ever denied a claim for punitive damages relying upon this remedy. However, this court has not taken this opportunity to elaborate the scope of the relief. See *Cherrington v Wild Noodles Franchise Company, LLC*, 2006 WL 8443100 (D Minn, 2006) 3.

200 The text of the Bill and its summaries can be retrieved at <<https://bit.ly/3k1k1cC>>.

rules; for example, to provide a disclosure document or update the document.²⁰¹

3.4.3.3 Monetary compensation

A franchisee may sue a franchisor for damages based on several counts under state franchise sale law and common law. This subsection will elaborate on the legal bases on which the franchisee may request an award of damages. This subsection will also address some principles relating to a measure of damages under statutory and common laws.

– Statutory claims

Under state franchise sale laws, a franchisee may claim damages for a violation of disclosure rules and antifraud rules by a franchisor.

(1) Violation of disclosure rules

In twelve franchise sale states, a franchisee may claim damages alleging that a franchisor has violated the disclosure rules.²⁰² In demanding an award of damages, a franchisee must establish that a franchisor did not furnish pre-contractual information in a manner required by the disclosure rules. For example, in *Chicago Male Medical Clinic v Ultimate Management*, the court found that the franchisor violated the rule of the Illinois Franchise Disclosure Act as it failed to deliver a disclosure document containing required informational items to the franchisee.²⁰³ Besides the violation of the disclosure rules, the franchisee must prove that the franchisor's alleged conduct has caused the franchisee to suffer loss or damage.²⁰⁴ In the case *Coffee Beanery*, the court

201 This approach is not a brand-new concept. Injunctions, either preliminary or permanent injunctions, are now made available under section 13(b) of the FTCA. The Federal Trade Commission may file a complaint to seek an injunction that would bar a franchisor from violating the FTC Rule. Since the FTCA does not grant a private right of action to individual franchisees, an aggrieved franchisee must complain to the Commission about potential conduct by a franchisor in violation of the FTC Rule. This complaint would persuade the Commission, upon a reasonable belief, to take a legal action against the franchisor under section 13(b) to enjoin the franchisor's unlawful conduct.

202 California: CA CORP, § 31300; Hawaii: § 482E-9(b); Illinois: IL ST CH 815, § 705/26; Michigan: MI ST, 445.1531; Minnesota: MN ST, § 80C.17(Subd.1); New York: NY GEN BUS, § 691; North Dakota: ND ST, 51-19-12(1); Oregon: OR ST, § 650.020; Rhode Island: RI ST, § 19-28.1-21; South Dakota: SD ST, § 37-5B-49; Virginia: VA ST, § 13.1-571(a); Washington: WA ST, 19.100.190(2).

203 The franchisor will be liable for damages only in the case of non-disclosure of the required items of information. In *Dunkin' Donuts v HWT*, the franchisee's claim for damages was dismissed because the franchisor is not required to disclose the location of competing franchisees. See *Dunkin' Donuts v HWT Associates*, No 91-08312, 181 AD 2d 711, 712, 581 NYS 2d 363, 364, 1992 WL 43611, (NY AD 2 Dept, Mar 09, 1992) 712.

204 *RWJ Management Co, Inc v BP Products North America, Inc*, 2011 WL 101727, (ND Ill, 2011) 3.

held that the franchisees failed to show that the franchisor's late disclosure inflicted damage by pointing out that the franchisor tried to enforce unsavory and unanticipated contractual clauses.²⁰⁵ Without the loss sustained, the franchisee would not secure an award of damages.

In terms of culpability, it should be noted that a claimant franchisee may not have to prove that a franchisor intended to violate the disclosure rules. For example, in California, the California Court of Appeals in *Dollar Systems v Avcar Leasing Systems* affirms the district court's judgment holding that there is no requirement of culpability or scienter under the remedial rule. That is, section 31300 of the California Franchise Investment Law does not require a violation of the statute's provisions was made with an intent to violate the law, to injure the franchisee, or to acquire any undue advantage.²⁰⁶ Nevertheless, the district court in the case *Dollar Systems* stated that the franchise investment law required the violation was made knowingly and intentionally. Thus, in recovering damages under the law, the franchisee may have to show that the franchisor's contravention of the disclosure rules was willful.

(2) *Violation of antifraud rules*

A franchisee may also seek an award of damages claiming that a franchisor has violated the antifraud rules. As can be seen in subsection 3.3.3.4, state franchise sale laws' antifraud rule typically prohibits a franchisor from making misrepresentations or untrue statements. In this respect, a franchisee may claim damages alleging the franchisor of making untrue statements of material facts. In doing so, it is said that the franchisee shall demonstrate the following two conditional elements: (1) the franchisor made an untrue statement of a material fact, and (2) the franchisee suffered loss or damage caused by having relied on that statement.²⁰⁷

The first element of the formulation is the franchisor's misrepresentation of a material fact. The franchisee must prove that the franchisor made false statements, not merely predictions and opinions collectively called puffery. For instance, in *Teng Moua v Jani-King of Minnesota*, the Minnesota court held that the franchisor's statements that a franchise was a good business that would continue for a long time were puffery; hence, these statements could not be regarded as untrue.²⁰⁸ However, predictions and opinions can establish misrepresentations in some exceptional cases. For example, in *Governara v. 7-Eleven*, the New York court provided that statements of prediction, such as projections of potential earnings, could be considered misrepresentations if

205 *Coffee Beanery* (n 196) 3.

206 *Dollar Systems, Inc v Avcar Leasing Systems, Inc*, 890 F 2d (CA9 (Cal), 1989) 173.

207 See eg *Enseroco, Inc v Indiana Securities Div*, 623 NE 2d 416 (Ind, 1993) 425; *Samica Enterprises LLC v Mail Boxes Etc, Inc*, 460 Fed Appx 664, 665, 2011 WL 6000718, (CA9 (Cal), 2011)1; *Governara v 7-Eleven, Inc*, 2014 WL 4476534 (SDNY, 2014) 4; *Coraud LLC v Kidville Franchise Co, LLC*, 121 F Supp 3d (SDNY, 2015) 393.

208 *Teng Moua v Jani-King of Minnesota, Inc*, 810 F Supp2d (D Minn, 2011) 890.

they implied present facts. In this case, the franchisor had conducted its own analysis of the store's potential earnings, and the estimated annual sales were consistent with these projections. Thus, the court decided that the projections of potential earnings were construed as misrepresentations.

In recovering damages based on the allegation of making misrepresentations, a plaintiff franchisee may not have to demonstrate the franchisor's culpability. For instance, in Indiana, the Supreme Court in *Enservco, Inc v Indiana Securities* concluded that there was no requirement about culpability when alleging the franchisor of making untrue statements of a material fact because the rule focuses on prohibiting the nature of the conduct or its effect, rather than the mind of the violator.²⁰⁹ Likewise, in New York, the court in *Governara v 7-Eleven* provided that the plaintiff franchisees did not have to prove that the misrepresentation or omission of a material fact was made with knowledge of falsity.²¹⁰

Secondly, a franchisee must prove that it suffers loss or damage because of reliance on false statements. Apart from damage suffered, the proof of reliance is a pre-requisite for an award of damages even though franchise disclosure laws do not expressly provide in an antifraud provision.²¹¹ In practice, state courts typically require a claimant franchisee to show that it reasonably relied upon false statements made in the disclosure document.²¹² In deciding whether the franchisee's reliance is reasonable, state courts may take different viewpoints. For example, the court in *Coraud v Kidville* provided that New York adopts a contextual view. That is, the courts will take into account some determinative factors associated with a franchisee, including the acceptance of a clear and direct sign of falsity, the ability to access relevant information, the delivery of written confirmation of the representations' truthfulness, and the franchisee's sophistication.

– *Common law claims*

In common law, tort law could be resorted to for civil law remedies.²¹³ One of the remedies available under common tort law is monetary compensation

209 *Enservco* (n 207) 422-25. The other Indiana court has affirmed this Supreme Court's decision in the subsequent. See *Gre-Ter Enterprises, Inc v Management Recruiters International, Inc*, 329 F Supp 3d (SD Ind, 2018) 679.

210 *Governara* (n 207) 4.

211 *Simos v Embassy Suites, Inc*, 983 F 2d (CA7 (Wis), 1993) 1410.

212 See eg *Lee v General Nutrition Cos, Inc*, 2001 WL 34032651, (CD Cal, 2001) 6; *U-Bake Rochester, LLC v Utecht*, 2014 WL 223439, (D Minn, 2014) 8.

213 It should be noted that, in the USA, common tort law is the law of the state. Thus, state tort law's rules or theories may vary from state to state. See H Beau Baez III, *Tort Law in*

for damage caused by another.²¹⁴ In claiming damages in tort, an aggrieved franchisee may constitute several causes of action. In the context of violation of franchise sale regulations, the franchisee may claim damages alleging the franchisor of committing fraudulent concealment by silence and fraudulent misrepresentations.

(1) *Fraudulent concealment or deceit by silence*

The first possible cause of action is fraudulent concealment. A franchisee may sue a franchisor based on this theory in some states. For example, in Maryland, the court in *Hanley v Doctors Express Franchising* held that the franchisee might claim damages for the franchisor's fraudulent concealment.²¹⁵ According to the court, the theory of fraudulent concealment encompasses intentional failure to disclose facts that the defendant is legally required to disclose. In claiming damages based on this theory, the plaintiff franchisee needs to plead that the defendant franchisor owed the franchisee the duty to disclose a material fact but failed to disclose that fact with an intention to defraud or deceive the plaintiff.²¹⁶ The franchisee must also show that it took action in justifiable reliance on the concealment, thereby suffering damages as a result of the defendant's concealment.²¹⁷

(2) *Fraudulent misrepresentations*

A franchisee may seek an award of damages alleging a franchisor of engaging in fraudulent misrepresentations. In this case, the plaintiff franchisee must plead that the defendant franchisor misrepresented a material fact, and the franchisor knew that representation was false. Furthermore, the franchisee must demonstrate that the franchisor made that false representation to induce the franchisee's reliance, and the franchisee did reasonably rely upon that

the United States (3rd edn, Kluwer Law International, 2020) 29-30. One example of the variation is that the Virginia courts provided that the state does not recognize any tort liability for negligent misrepresentation. See *Haigh v Matsushita Elec Corp of America*, 676 F Supp (ED Va, 1987) 13; *Joyce v Lincoln Nat Life Ins Co*, 845 F Supp (ED Va, 1993) 354; *Bentley v Legent Corp*, 849 F Supp (ED Va, 1994) 434. Thus, this subsection will not generalize tort rules or theories to represent American tort law of all states. Instead, this subsection will examine these rules or principles by way of example, showing how tort law rules or principles would operate in the franchising context.

214 Sylvia A Law, 'Torts' in Alan B Morrison (ed), *Fundamentals of American Law* (Oxford University Press, 1996) 239.

215 *Hanley v Doctors Exp Franchising, LLC*, 2013 WL 690521, (D Md, 2013) 21-23.

216 One may raise a question as to how to plead the franchisor's culpability. According to the court in *Silvercreek Management v Citigroup*, a plaintiff must state sufficient facts to give rise to a strong inference of fraudulent intent. In establishing that strong inference, the plaintiff may show the facts constituting strong circumstantial evidence of conscious misbehavior or recklessness. See *Silvercreek Management, Inc v Citigroup, Inc*, 248 F Supp 3d (SDNY, 2017) 438-39.

217 *Hanley* (n 215) 21-23.

misrepresentation.²¹⁸ In this case, the franchisee has to state a respondent franchisor's scienter; that is to say, the respondent had knowledge of the falsity of the statement made and an intent to defraud.²¹⁹ More importantly, the franchisee must show that it has suffered injury as a result of the reliance on the misrepresentation.²²⁰

– *Principles governing a measure of damages*

This subsection examines two following rules or principles associated with a measure of damages.

First, under state franchise sale statutes, the nature of damages is twofold: compensatory and punitive damages. In general, damages are of compensatory character as they are awarded to compensate loss or damage sustained by an aggrieved franchisee. In some franchise sale states, courts are confined to award compensatory damages. For example, in New York, the court in *Coraud v Kidville* held that the New York Franchise Sale Act did not permit a franchisee to seek punitive damages because the law was not designed to punish a franchisor.²²¹

Some franchise sale states make an exception to the general principle mentioned above. In Hawaii, South Dakota, and Washington, franchise sale laws introduce the treble-damages scheme, which is a specific form of punitive damages.²²² Under the treble-damages regime, the court may, in its discretion, increase the award of damages to an amount not to exceed three times the actual damages sustained. Nonetheless, it is said that a mere violation of the franchise laws may not warrant the imposition of punitive damages. In some cases, the court may require the franchisor to commit tort involving willful misconduct.²²³

In common tort law, damages can be compensatory, nominal, and punitive.²²⁴ In general, damages are of compensatory character; they are awarded to redress the loss or injury sustained by a plaintiff.²²⁵ In an exceptional case,

218 *Schwartzco Enterprises LLC v TMH Management, LLC*, 60 F Supp3d (EDNY, 2014) 344.

219 See eg *Schlaifer Nance & Co v Estate of Warhol*, 119 F 3d (CA2 (NY), 1997) 98; *Crigger v Fahnestock and Co, Inc*, 443 F 3d (CA2 (NY), 2006) 234; *Silvercreek Management* (n 216) 438.

220 *Whitestone Sav & Loan Ass'n v Allstate Ins Co*, 34 AD2d 787, 787, 311 NYS 2d (NYAD 2 Dept, May 04, 1970) 77.

221 *Coraud* (n 207) 625.

222 Hawaii: HI ST, § 482E-9(c); South Dakota: SD ST § 37-5B-49; Washington: WA ST 19.100.190(3).

223 Mark McLaughlin and Javier H Rubinstein, 'Addressing the Threat of Punitive Damages Claims in Franchise and Dealer Litigation' (1995) 15(1) *Franchise Law Journal* 11, 11. See also *Tom Pappas Toyota, Inc v Toyota Motor Distributors, Inc*, 729 F Supp 71 (ED Mo, 1990) [72].

224 See eg *Murphy v United Steelworkers of America Local No 5705*, AFL-CIO, 507 A2d (RI, 1986) 1346; *Calise v Hidden Valley Condominium Ass'n, Inc*, 773 A 2d (RI, 2001) 839.

225 Richard A Epstein, *Torts* (Aspen Law & Business, 1999) 436.

damages may not be compensatory; they may be awarded as nominal or punitive damages. In the former case, nominal damages will be awarded when the plaintiff shows that it has suffered loss but cannot provide evidence to ascertain the volume of the damage sustained. In the latter case, punitive damages will be awarded to punish a wrongdoer who acted with malice and deter future misconduct. In some states, a claimant may recover punitive damages in fraud claims. For example, in Kentucky, the courts accepted that punitive damages were recoverable if a party had been induced by fraud to conclude a contract.²²⁶ In my view, these revealed principles would be applicable in the franchising context too.

Second, under the statutory and common laws, a general principle of measurement of compensatory damages is that damages will be awarded to recover the actual loss. In general, damages will recover the actual loss, including reliance loss or out-of-pocket loss. This principle can be observed in several state court decisions. For example, in Minnesota, the Supreme Court in *Hughes v Sinclair Marketing* held that the actual damages for misrepresentation to be awarded under the disclosure statute were ordinarily confined to the loss of out-of-pocket, which was compensable under common law misrepresentation. The court provided that it aimed to avoid speculative damages and assured that the damages were measured by the natural and proximate loss suffered by the defrauded party.²²⁷

In exceptional cases, damages may be awarded to recover the expectation loss. In *Hughes v Sinclair Marketing*, the court provided that damages for loss of future profits might be awarded when damages for reliance loss could not return a party to *status quo*.²²⁸ As can be implied from the court decision, if the misrepresentation made by the franchisor caused damage to the franchisee's business, the franchisee may recover damages for the loss of future profits, as the actual loss for fraud, under the franchise statute. This exception would be the same in common law as it is said that most American states allow a plaintiff to recover expectation loss in case of deceit.²²⁹

Regarding recoverable loss, a question arises whether an aggrieved franchisee can recover damages for the lost opportunity. In some cases, the franchisee may argue that it suffers the loss of chance because the franchisee would have chosen another favorable franchise business if, for example, the franchisor had provided the franchisee with a disclosure document containing pre-contractual information. In this case, the recourse will be made to the

226 See eg *Wiley v Adkins*, 48 SW 3d (Ky, 2001) 23; *Raleigh v Edgewood Mobile Homes, Inc*, 2014 WL 505579 (Ky App, 2014) 5; *Karon v Elliott Aviation*, 937 NW 2d 334, 349 (Iowa, 2020) 349.

227 *Hughes v Sinclair Marketing, Inc*, 389 NW 2d (Minn, 1986) 199.

228 *Ibid*.

229 Victor E Schwartz, Kathryn Kelly, and David F Partlett, *Prosser, Wade and Schwartz's Torts* (14th edn, Foundation Press 2020) 1074.

doctrine of loss of chance.²³⁰ In general, the loss of chance doctrine is an approach to causation that is regularly utilized in medical malpractice cases. This doctrine allows a plaintiff to recover damages even though the party cannot prove causation between the defendant's negligence and damage suffered so long as the claimant establishes that the respondent's negligence reduced the chance to recover from the illness.²³¹ In reality, it would seem that courts are reluctant to extend the application of the doctrine in other contexts than medical malpractice cases.²³² Thus, it remains nebulous whether the lost chance doctrine can be applied to lessen the proximate cause in tort lawsuits in the franchising context.

3.4.3.4 Cancellation of a contract

A franchisee may cancel a franchise contract by way of rescission under the state franchise sale statutes and common contract law.²³³ This subsection will address the rescission of a franchise contract based on statutory and common law claims and make remarks on particular rules concerning the rescission relief.

– Statutory claims

Under the franchise sale laws, a franchisee may bring an action against a franchisor to rescind a franchise contract for the two following reasons.

(1) Breach of disclosure rules

Except for Florida, Indiana and Maryland, thirteen franchise sale states recognize a private right of action for rescission for the franchisor's violation of disclosure rules.²³⁴ In this case, a franchisee generally has to plead that a franchisor violated the rules concerning the disclosure of pre-sale information.

230 It should be noted that some states, such as Indiana, has not adopted the theory of the loss of chance. See *McKain v Bisson*, 12 F 3d (CA7 (Ind), 1993) 696.

231 *Crosby v US*, 48 F Supp 2d 924, 926 (D Alaska, 1999) 926; *Hancock v Diamond Offshore Drilling, Inc*, 2008 WL 3501015, (ED La, 2008) 3; *Mann v United States*, 300 F Supp 3d (NDNY, 2018) 422.

232 See eg *Hancock*, *ibid*; *Lyons v American College of Veterinary Sports Medicine and Rehabilitation, Inc*, 997 F Supp 2d (D Mass, 2014) 115.

233 Rescission is defined to mean a party's unilateral unmaking of a contract for a legally sufficient reason. This definition is adopted under both statutory and common law. See *Cusamano v Norrell Health Care, Inc*, 607 NE 2d 246, 250, 180 Ill Dec 352, 356, 239 Ill App 3d 648 (Ill App 4 Dist, 1992) 653; *Jensen v Quik Intern*, 820 NE 2d 462, 466, 289 Ill Dec 686, 690, 213 Ill 2d (Ill, 2004) 127.

234 California: CA CORP, § 31300; Hawaii: HI ST, § 482E-5(b); Illinois: IL ST CH 815, § 705/26; Michigan: MI ST, 445.1531; Minnesota: MN ST, § 80C.17; New York: NY GEN BUS, § 691; North Dakota: ND ST, 51-19-12; Oregon: OR ST, § 650.020(1); Rhode Island: RI ST, § 19-28.1-21; South Dakota: SD ST, § 37-5B-49; Virginia: VA ST, § 13.1-565; Washington: WA ST, 19.100.190; Wisconsin: WI ST, 553.51.

For example, the franchisee may rescind a franchise contract by alleging that the franchisor did not provide the franchisee with a disclosure document before concluding the contract. In other cases, the franchisee may rescind a franchise contract by claiming that the franchisor furnished the franchisee with a disclosure document, which was not amended to reflect material changes in the information contained in the document.

Besides the franchisor's violation, state franchise sale laws may require a franchisee to prove some additional elements when seeking an order of rescission of a franchise contract. For instance, California and New York franchise disclosure laws require the franchisee to show that the franchisor's contravention of disclosure rules is willful. The definition of willfulness in these state laws is identical. In California, the courts provide that the franchisor's violation is willful if the franchisor committed an act or made an omission knowingly and intentionally.²³⁵ Likewise, in New York, the courts understand the term 'willfulness' to mean voluntary and intentional, as opposed to inadvertent.²³⁶

In addition, New York and Wisconsin franchise sale statutes require the franchisee to illustrate that the franchisor's contravention of disclosure rules is material. Under the laws, the materiality requirement entails a significant effect on the franchisee's purchase decision. In New York, the court provided that the materiality test is satisfied if the franchisee can prove that the franchisor's violation of the disclosure rule had an important effect on the franchisee's investment decision. That is, the franchisee must prove that the franchisee would not have gone forward with the franchise sale if he had known the fact of the violation.²³⁷ Thus, the court would dismiss the case if the franchisee cannot show the materiality of the franchisor's violating conduct.²³⁸ This consideration is the same in Wisconsin; the franchisor's contravention must be material to the franchisee when making a decision to buy a franchise.²³⁹

It should be noted that courts would not permit the rescission of a franchise contract if the franchisor's violation of the disclosure rules is technically marginal. For example, in *Two Men and a Truck*, the Michigan court held that the franchisees were not entitled to rescinding the franchise agreement even though the franchisor failed to comply with the disclosure rule by providing

235 *Dollar Systems* (n 206) 172-73; *Migliore* (n 25) 7.

236 *Reed v Oakley*, 661 NYS 2d 757, 759, 172 Misc 2d 655, (NY Sup, 1996) 658; *Mister Softee, Inc v Amanollahi*, 2014 WL 3110000 (DNJ, 2014) 10.

237 *BMW Co, Inc v Workbench, Inc*, 1988 WL 45594, (SDNY, 1988) 2.

238 *A Love of Food I, LLC v Maoz Vegetarian USA, Inc*, 70 F Supp 3d 376, 409 (DDC, 2014) 412.

239 *Braatz, LLC v Red Mango FC, LLC*, 2015 WL 1893194, (ND Tex, 2015) 4-5; *Burger Dynasty, Inc v Bar 145 Franchising, LLC*, 2019 -Ohio- 4006, ¶ 37, 2019 WL 4757420, (Ohio App 6 Dist, 2019) 6.

an offering circular of less than ten business days before the franchise sale.²⁴⁰ In a similar vein, the court in *A Love of Food I v Maoz Vegetarian USA* contended that rescission would be inappropriate if the franchisor's eventual disclosure is a minor deviation from the disclosure timing required under the statute and causes no damage to the franchisee.²⁴¹

(2) *Breach of antifraud rules*

In some franchise sale states, such as Maryland, a franchisee may also rescind a franchise contract for statutory fraud under the franchise sale statutes.²⁴² In Maryland, a statutory misrepresentation claim is considered a fraud claim. Thus, a franchisee may allege the franchisor's fraud or misrepresentation under franchise sale law for a judgment of rescission of a franchise contract. In holding the franchisor liable for rescission under the Maryland franchise law, the court states that the claimant franchisee must prima facie demonstrate that the respondent franchisor made a false or untrue statement, which was material to the franchisee's decision to purchase the franchise. Furthermore, the franchisee must prove that it reasonably relied on that misrepresentation without knowing that the misstatement was false or misleading.²⁴³

– *Common law claims*

In some exceptional cases, a franchisee may cancel a franchise agreement by rescission under common contract law. In contract law, a contract induced by misrepresentation, regardless of whether that misrepresentation is fraudulent, is voidable.²⁴⁴ In the franchising context, if the franchisor's non-performance of pre-contractual duties misled and induced the franchisee to conclude a franchise agreement, the franchisee could avoid or rescind the contract for

240 *Two Men and a Truck/International Inc v Two Men and a Truck/Kalamazoo, Inc*, 949 F Supp (WD Mich, 1996) 506. It should be mentioned that, in drawing such a conclusion, the court considered the other two factors: (1) the franchisees failed to rescind the agreement in a timely manner, and (2) the franchisees were in default of the contract when they tried to avoid the agreement.

241 *A Love of Food I* (n 238) 413.

242 In other franchise sale jurisdictions, such as Illinois, Indiana, Rhode Island, South Dakota, and Wisconsin, the sale laws do not confer the remedial right of rescission on an aggrieved franchisee in the case of violation of antifraud provisions. In this event, the franchisee may only seek the recovery of damages under the statutory laws. However, it might be viable that the franchisee resorts to the right of rescission under contract law rules.

243 *A Love of Food I* (n 238) 404.

244 Marvin A Chirelstein, *Concepts and Case Analysis in the Law of Contracts* (7th edn, Foundation Press, 2013) 88. See also *Russell v Industrial Transp Co*, 258 SW 462, 462, 113 Tex 441 (TEX 1924) 450; *First Nat Bank in Lenox v Brown*, 181 NW 2d 178 (Iowa 1970) 182; *Citizens Standard Life Ins Co v Muncy*, 518 SW 2d 391 (Tex Civ App, 1974) 394; *Matter of Topco, Inc*, 894 F2d 727, 739 (CA5 (Tex), 1990) 739.

fraudulent and innocent misrepresentation.²⁴⁵ For example, the Texas court provided that the franchisee might avoid its obligations under the franchise agreement if the franchisor negligently misrepresented facts in a disclosure document.²⁴⁶

In rescinding a contract for fraudulent and innocent misrepresentation, the franchisee has to prove the elements of both misrepresentations imposed by state law. For example, under Michigan law, the franchisee must prove that the franchisor made false representations of past or existing facts.²⁴⁷ Furthermore, the franchisee must show that it relied on these misrepresentations when concluding a contract.²⁴⁸ In case of fraud, the franchisee must also prove that the franchisor knew or should have known that the representations were false and the franchisor intended the franchisee to act upon them.²⁴⁹ Ultimately, the franchisee must demonstrate that it has suffered an injury because of reasonable reliance on the franchisor's misrepresentation.²⁵⁰

– *Remarks on particular rules concerning rescinding a contract*

There are some remarks as regards exercising the power of rescission and avoidance, rescission and avoidance for parts of a contract, effects of rescission and avoidance, and election of remedies.

(1) *Exercise of the right of statutory and common law rescission*

The requirements for rescinding a franchise contract under state disclosure laws may vary from state to state. Some franchise sale states may allow a franchisee to rescind or avoid a franchise contract at its option. In Virginia, the Virginia Retail Franchising Act permits the franchisee to declare a franchise contract void if the franchisor acted in contravention of the law's rules.²⁵¹ In this case, the franchisee must send a written declaration of avoidance to

245 In this case, the terms 'rescission' and 'avoidance' have the same sense; they are remedies for common law misrepresentation that cancel a contract or agreement from its inception. See *Dow Chemical Co v US*, 226 F 3d 1334, 1345 (CA Fed, 2000) 1345.

246 *Carousel's Creamery, LLC v Marble Slab Creamery, Inc*, 134 SW 3d 385 (Tex App Houston [1 Dist], 2004) 404.

247 See eg *Hi-Way Motor Co v International Harvester Co*, 247 NW 2d 813, 816, 398 Mich 330, 336 (Mich 1976) 336; *Marrero v McDonnell Douglas Capital Corp*, 505 NW 2d 275, 279, 200 Mich App 438 (Mich App, 1993) 444; *Cook v Little Caesar Enterprises, Inc*, 210 F 3d 653, 658 (CA6 (Mich), 2000) 658; *Bucciarelli v Nationwide Mut Ins Co*, 662 F Supp 2d 809, 815 (ED Mich, 2009) 815; *Fuller v Shell Point Mortgage Servicing*, 2017 WL 4326100 (WD Mich, 2017) 9.

248 See eg *Nieves v Bell Industries, Inc*, 517 NW 2d 235, 238, 204 Mich App 459 (Mich App, 1994) 464; *Fuller*, *ibid*.

249 See eg *Novak v Nationwide Mut Ins Co*, 599 NW 2d 546, 553, 235 Mich App 675 (Mich App, 1999) 688; *Fuller*, *ibid*.

250 See eg *State-William Partnership v Gale*, 425 NW 2d 756, 761, 169 Mich App 170 (Mich App, 1988) 178; *Novak*, *ibid* 688; *Fuller*, *ibid*.

251 VA ST, § 13.1-565.

the franchisor via registered or certified mail to avoid a franchise contract.²⁵² Conversely, other states seem to require a franchisee to bring a rescission claim to courts. For example, the North Dakota franchise investment law states that a franchisee may bring an action for rescission for the franchisor's violation of the law.²⁵³ According to the North Dakota Supreme Court, the franchisee is not entitled to automatic rescission of a franchise agreement.²⁵⁴ In other words, the franchisee must bring the claim to the court for an award of rescission of a franchise contract.

Unlike the franchise sale regulations, the requirements for rescinding a contract under state common law seem to be identical; a franchisee may not be able to rescind a franchise contract *ex curia*. For example, in Michigan, rescission for misrepresentation is an equitable remedy.²⁵⁵ Thus, the Michigan courts have correspondingly contended that rescission is not a matter of right. Instead, rescission is a remedy that a court may grant within its discretion. In this case, the court must balance the equities to determine if the claimant is entitled to an award of rescission. In other words, the court is not required to grant the relief, but it must determine if a grant of rescission is sound and proper under the circumstances of each particular case.²⁵⁶

(2) *Partial rescission and avoidance*

Neither state franchise sale statutes nor judicial decisions on the laws mention the possibility of partial rescission of a franchise agreement. In my view, the rules in this regard might follow common contract laws, which seem to address the partial rescission issue in a similar fashion. For example, in California, a general rule is that the rescission of a contract must be total; an aggrieved party must rescind an entire contract and cannot reserve any favorable right under the contract. The total rescission requirement will be exempted in the case of the severability of contractual terms. An aggrieved party may rescind a contract partially if an agreement is severable and divisible. The test for determining the severability is that a contract is not divisible if the parties intend to treat

252 The franchisee is confined to certain temporal limitations. Suppose the franchisee aims to declare a franchise contract void because the franchisor failed to furnish a disclosure document at least 72 hours before the conclusion of a franchise contract. In that case, the franchisee has to send a written declaration of avoidance within 30 days after the execution of the contract. See VA ST, § 13.1-565(3).

253 ND ST, 51-19-12(1).

254 *Peck of Chehalis, Inc v C K of Western America, Inc*, 304 NW 2d 91 (ND, 1981) 98.

255 *Titan Ins Co v Hyten*, 817 NW 2d 562, 569, 491 Mich 547 (Mich, 2012) 558; *Northland Radiology, Inc v USAA Casualty Insurance Company*, 2020 WL 3394549, (Mich App, 2020) 3.

256 *Amster v Stratton*, 244 NW 201, 202, 259 Mich 683 (Mi 1932) 687; *Bazzi v Sentinel Insurance Company*, 919 NW 2d 20, 30, 502 Mich 390 (Mich, 2018) 409; *Northland Radiology*, *ibid*.

the agreement as an entire contract.²⁵⁷ Likewise, in Iowa, the Supreme Court stated the rules that, in general, rescission must be of the entire contract. However, partial rescission may be made in the case of severable provisions, which depend upon the parties' intention.²⁵⁸

(3) *Effects of rescission and avoidance*²⁵⁹

Both statutory and common law rescission produce the same effects; they will annul a franchise relationship as if it never exists and restore the parties to their initial status.²⁶⁰ For example, in Illinois, the court in *Cusamano v Norrell Health Care* defined the word 'rescission' under the Franchise Disclosure Act of 1987 to mean the cancellation of a contract and restoration of the parties to their initial status.²⁶¹ In this case, the rights of the parties under the agreement will be vitiated or invalidated after the rescission of the contract takes place.²⁶² Besides, the parties have to make the restoration; they will be required to return any consideration received and set off any benefits received under the contract.²⁶³ In common, it is widely accepted that the rescission or avoidance for misrepresentation will revoke a contract and restore the parties to *status quo ante*. In this respect, both parties are entitled to the restitution of any benefits received under the agreement.²⁶⁴

(4) *Election of remedies*

In some cases, particularly fraud cases, an aggrieved party may be entitled to concurrent private law remedies: damages and rescission. In these events, a classical rule of common law is that an injured party has to make a prompt election because the party cannot seek both damages and rescission awards for the same alleged conduct. For instance, in *Merritt v Craig*, the court affirmed the election rule that, upon the discovery of fraud, the party must either choose to seek rescission and restoration or ratify the contract and claim damages.²⁶⁵

257 *Simmons v California Institute of Technology*, 209 P2d 581, 587, 34 Cal 2d 264 (CAL 1949) at 275; *Yeng Sue Chow v Levi Strauss & Co*, 122 Cal Rptr. 816, 822, 49 Cal App3d 315 (Cal App 1975) 326; *IMO Development Corp v Dow Corning Corp*, 185 Cal Rptr 341, 345, 135 Cal App 3d 451 (Cal App, 1982) 458.

258 *Karon* (n 226) 349.

259 Some franchise relationship states offer a franchisee the auxiliary remedies upon the cessation of a franchise relationship. These remedies will be explored in subsection 5.5.3.5 in chapter 5.

260 See eg *Horan v Blowitz*, 148 NE 2d 445, 449, 13 Ill 2d (Ill 1958) 132; *Rudman v Cowles Communications*, 330 NY S2d (NY, Feb 09, 1972) 43; *Damon v Groteboer*, 937 F Supp 2d (D Minn, 2013) 1087; *Pardo v Mecum Auction Inc*, 77 F Supp 3d (ND Ill, 2014) 711.

261 *Cusamano* (n 233).

262 *Koretz v All Am Life & Cas Co*, 243 NE 2d 586, 589, 102 Ill App 2d 197 (Ill App 1968) 203.

263 *Felde v Chrysler Credit Corp*, 580 NE 2d 191, 199, 162 Ill Dec 565, 573, 219 Ill App 3d 530 (Ill App 2 Dist, 1991) 542.

264 Williston on Contracts (4th ed), § 69:47, West Law, May 2021 Update.

265 *Merritt v Craig*, 746 A 2d 923, 927, 130 Md App (Md App, 2000) 358.

In the context of franchise sale regulation, courts seem to adopt the rule of the election of remedies as well.²⁶⁶ Thus, if the franchisee retains the right to damages and rescission for the franchisor's violation of the franchise sale statute, the franchisee must elect to affirm the agreement and claim damages or rescind the contract and claim restitution.

3.4.3.5 Conclusions

In the USA, the remedial regime that permits an aggrieved franchisee to seek private law remedies can be divided into statutory and common law regimes. In franchise sale states, the franchisee may seek certain civil law relief under the state statutes. Generally, the franchisee may recover damages and rescind a franchise contract if the franchisor violates the rules of franchise sale laws. In some jurisdictions, the franchise sale statute offers a catch-all remedy, which would enable the franchisee to apply for the remedy of enforcement of performance. Nevertheless, this assumption has not been affirmed by state courts yet. Additionally, an aggrieved franchisee may resort to common law rules to recover tort law damages and rescind a franchise contract for misrepresentation. The franchisee may do so since the franchise sale statutes do not exclude the possibility of recourse to other remedial regimes. Resorting to the common law remedies would also be a conventional approach in other states that have not introduced their franchise sale law.

3.4.4 Australia

3.4.4.1 Introduction

The franchisor's non-performance of pre-contractual duties under the Franchising Code of Conduct permits an aggrieved franchisee to resort to private law remedies under the Competition and Consumer Act 2010 (CCA) and the Australian Consumer Law (ACL). This inference is affirmed by the High Court of Australia in *Master Education Service v Ketchell* providing that a contravention of the Franchising Code of Conduct gave rise to remedies under the Trade Practices Amendment (Fair Trading) Act 1998 (Cth).²⁶⁷ Under the CCA and the ACL, the franchisee may seek remedies to compel the franchisor's action, claim monetary compensation, and set aside a franchise contract. Furthermore,

266 *Geris West, Inc v Ferrall*, 505 NE 2d 1348, 1351, 106 Ill Dec 557, 560, 153 Ill App 3d 579 (Ill App 2 Dist, 1987) 584; *WW, LLC v Coffee Beanery, Ltd*, 2013 WL 3776944, (D Md, 2013) 10.

267 This statute is the predecessor of the CCA and the ACL.

common law would secure the latter two remedies.²⁶⁸ This section will examine the possibility of seeking the three mentioned remedies in subsections 3.4.4.2, 3.4.4.3, and 3.4.4.4. Subsection 3.4.4.5 will conclude on the remedial system under the Australian legal system.

3.4.4.2 *Enforcement of performance*

A franchisee may seek an order of injunctions under the CCA and the ACL to compel the franchisor's action and inaction.

– *Injunctions under the CCA*

Section 80 of the CCA empowers the court to grant, upon application, an injunction in such terms as the court determines to be appropriate in case of actual and anticipated contraventions of provisions of the CCA. According to Bruce, the court may grant a mandatory injunction that requires a person to engage in certain conduct, according to paragraph (5) of section 80.²⁶⁹ In the context of disclosure, a prospective franchisee may seek an order under section 80 to compel the franchisor's specific actions before the conclusion of a franchise agreement. For example, a prospective franchisee may enforce a franchisor to perform the disclosure duty by providing the franchisee with some missing items of information in the disclosure document. Moreover, a prospective franchisee may enforce the franchisor to furnish the franchisee with the most updated and accurate pre-sale information.

In seeking the injunctive relief in the cases exemplified above, the prospective franchisee needs to ensure that it satisfies the constituent element prescribed by paragraph (1)(ii) of section 80. That is, the applicant franchisee must demonstrate that the alleged franchisor has engaged or is proposing to engage in conduct that constitutes or would constitute a contravention of section 51ACB prohibiting a corporation from infringing an applicable industry code in trade or commerce. As the Code is a mandatory industry code made by virtue of section 51AE, a franchisor's violation of the Code would, in turn, violate section 51ACB of the CCA. Thus, the franchisor's non-performance of the disclosure duty and the obligation of good faith imposed by the Code will be considered a contravention of section 51ACB. In this case, the franchisee may compel the franchisor by an injunction to provide the franchisee with the missing

268 Since the disclosure duties of information are not contractual obligations, the franchisee may not seek an order of specific performance and injunctions under common contract law. See J W Carter, *Contract Law in Australia* (7th edn, LexisNexis 2018) 923.

269 Alex Bruce, *Australian Competition Law* (4th edn, LexisNexis 2021) 349.

informational items.²⁷⁰ The franchisee may also compel the franchisor by injunctive relief to provide the informational items, which are current and accurate.

However, if a prospective franchisee seeks a grant of interim or interlocutory injunctions under section 80(2), the franchisee must also satisfy additional threshold requirements to secure the interlocutory injunctions.²⁷¹ As far as case law is concerned, Australian courts have not laid down any specific requirements in the context of non-performance of the disclosure duties. In this case, it could be argued that the court decisions articulating the general requirements for seeking interim injunctive relief can be utilized by analogy. For example, the requirements summarized by Digby J in *Delahunt v Swim Loops* could be followed.²⁷² In summary, an applicant franchisee must, in general, demonstrate the existence of a serious issue, a likelihood of success at trial in respect of the issue, the injury to be suffered, which damages would not adequately redress, and the balance of convenience that favors the grant of the injunction.²⁷³

– *Injunctions under the ACL*

In practice, it would seem that franchisor's certain conduct towards its franchisees may fall within the ambit of prohibitions by the ACL. For example, a franchisor can be alleged of misleading prospective franchisees in violation of the ACL.²⁷⁴ Thus, the civil sanctions imposed by the ACL may apply in the context of negotiation for a franchise agreement. In this case, a prospective franchisee may compel the franchisor's action by applying for a grant of an

270 It should be noted that there has been no case where a potential buyer of a franchise applies for injunctions to enforce the execution of the franchisor's duty of disclosure. Nevertheless, the injunctive relief has been applied by the Australian Competition and Consumer Commission (ACCC) to compel the franchisor to include some mandatory items of information in the disclosure document. For example, in *ACCC v Morild*, the respondent franchisor was ordered to include information about the relevant business experience of the franchisor's officers in its future disclosure documents. See *Australian Competition and Consumer Commission v Morild Pty Ltd*, [2017] FCA 1308 [161].

271 *Castlemaine Tooheys Limited v The State of South Australia* (1986) 161 CLR 148, 153; *Australian Broadcasting Corporation v Lenah Game Meats Pty Limited* (2001) 208 CLR 199 [9]-[13]; *W Hoy Pty Ltd v WTH Pty Ltd*, [2018] FCA 310 [4]; *ACCC v Ultra Tune Australia Pty Ltd* [2019] FCA 12.

272 In this case, the franchisees were seeking interlocutory injunctions because the franchisor terminated the franchisee and license deeds and re-possessed the franchise business.

273 *Delahunt* (n 156) [39]. See also *Girchow Enterprises Pty Ltd v Ultimate Franchising Group Pty Ltd* [2021] FCA 1579, citing Gummow and Hayne JJ in *Australian Broadcasting Corporation v O'Neill* [2006] HCA 46; (2006) 227 CLR 57 [65].

274 ACCC, '\$4.2 million in penalties ordered against former car wash franchisor Geowash and two executives' (ACCC, 24 January 2020) <<https://bit.ly/3hkvZKo>> accessed 21 January 2022; ACCC, 'Geowash franchise appeal dismissed' (ACCC, 22 June 2021) <<https://bit.ly/3hkvZKo>> accessed 21 January 2022.

injunction under section 232 of the ACL. In obtaining the injunctive relief under section 232, the franchisee must allege that the franchisor's conduct constitutes or would constitute, among other things, a contravention of a provision of Chapter 2, 3, or 4 of the ACL. In this regard, one possible legal basis is section 18 of the ACL prohibiting misleading or deceptive conduct in trade or commerce.

In applying for injunctive relief based on section 18, a prospective franchisee must pointedly plead that the franchisor engaged in conduct in trade or commerce. For example, the franchisee may allege that the franchisor omitted from providing the franchisee with certain informational items in a disclosure document. As far as case law is concerned, the franchisor's deliberate omission from disclosing the information would establish the element of engaging in conduct in trade or commerce.²⁷⁵ The franchisee needs to demonstrate that the franchisor's intentional omission was misleading or deceptive or was likely to mislead or deceive. Australian courts seem to have a common precept that silence can constitute misleading or deceptive conduct. In particular, the failure to perform the duty to disclose information would be considered misleading after having regard to all the relevant circumstances.²⁷⁶ This tenet would arguably be applied in the context of non-disclosure in franchising. Thus, in theory, it would be said that the franchisee may compel the franchisor by an injunction under the ACL to disclose information so that the franchisee is not misled or deceived.

3.4.4.3 Monetary compensation

In the case of non-performance of the disclosure duty and the duty to provide complete, current and accurate information, a franchisee may hold a franchisor accountable for damages under the CCA and the ACL. The franchisee may also claim damages under common tort and contract law since the specific legislation does not preclude the application of the pre-existing civil remedies.²⁷⁷ This subsection will examine legal bases on which the franchisee may seek an award of damages. This subsection will also address some principles governing a measure of damages under statutory and common laws.

– Statutory claims

An injured franchisee may recover damages by virtue of section 82 of the CCA, as well as section 236 of the ACL. These two provisions constitute an action

275 *Spedley Securities Ltd (in liq) v Bank of New Zealand* (1991) 26 NSWLR 711.

276 *Rhone-Poulenc Agrochimie SA v UIM Chemical Services Pty Ltd* (1986) 12 FCR 477; *Australian Competition and Consumer Commission v CC (NSW) Pty Ltd*, [1999] 92 FCR 375 [205]; *National Australia Bank Ltd v Meeke*, [2003] WASC 235 [13].

277 *Giles and Ward* (n 75) 27.

for damages that allows a person to recover the amount of loss or damage sustained as a result of a contravention of a provision of the statutes. In seeking an award of damages, the claimant franchisee must satisfy the conditional elements of the provisions. Under section 82 of the CCA, the franchisee needs to prove that the franchisor's contravention of provisions of the Franchising Code of Conduct occurs, thereby inflicting the loss or damage to the franchisee. Under section 236 of the ACL, the franchisee must demonstrate that the franchisor violated provisions of the ACL, such as section 18, resulting in the franchisee's loss or damage. As can be seen, the loss or damage sustained is the gist of an action for monetary compensation. The claimant franchisee must prove a causal link between the franchisor's contravening conduct and the loss or damage suffered.²⁷⁸

– *Common law claims*

An injured franchisee may bring an action for deceit or fraudulent misrepresentation to claim tortious damages in some exceptional cases. In common law, the franchisee must demonstrate that the franchisor made false representations of material facts by not performing the duty to disclose facts or affirmatively misrepresenting facts to induce the franchisee to conclude a franchise agreement. More importantly, the franchisee has to prove that the franchisor made those false representations of facts fraudulently. That is to say, the franchisee made representations without belief in the truth of the representations, or the franchisor made representations by not caring whether the representations were true. In this case, the franchisee needs to prove the franchisor's state of mind.²⁷⁹ Eventually, the franchisee must show that it has suffered loss or damage due to the reliance on the franchisor's fraudulent misrepresentations.²⁸⁰

The franchisee may bring an action for breach of contract to claim damages. Claiming damages on this basis is feasible if pre-contractual representations are subsequently incorporated into the terms of a franchise contract. In *Alati v Kruger*, the High Court held that the plaintiff might sue for damages for breach of contract if the pre-contractual statement was clearly formed one of the terms of the contract.²⁸¹ In this case, the franchisee needs to plead that the franchisor makes a representation in the course of negotiation and that representation forms part of a franchise agreement as a clause or term of the agreement. For example, a franchisor may describe that a franchisee will conduct a franchised business in an assigned territory without other competing franchised businesses. If that representation is also assured in a franchise

278 *Multigroup Distribution Services Pty Ltd v TNT Australia Pty Ltd*, [1996] WL 34917309.

279 *Carter* (n 268) 376-88.

280 *Clancy v Prince*, [2001] NSWSC 85 [61].

281 *Alati v Kruger* [1955] HCA 64; 94 CLR 216.

contract, the franchisee may plead that the assurance is false to claim damages for breach of warranty, which is a breach of contract.

– *Principles governing a measure of damages*

This subsection examines the principles associated with the aims and measure of damages as follows.

First, concerning the aims of damages, statutory and common law damages are compensatory; the money will be awarded to compensate for actual loss or damage sustained.²⁸² Nevertheless, the statutory and common law damages differ in terms of awarding punitive damages. Under Australian common law, damages in tort law can be awarded as exemplary damages to punish a defendant.²⁸³ This type of damages is said to be available when the defendant's conduct is malicious and shows a contumelious disregard of the plaintiff's rights. Accordingly, exemplary damages are frequently awarded for intentional torts, such as the tort of deceit. Additionally, punitive damages can be granted if the defendant has intentionally or recklessly infringed the plaintiff's rights to make profits or to cut expenses.²⁸⁴ In contrast, the CCA and the ACL do not permit courts to award punitive damages for any violation of the laws.

Second, statutory and common law damages may differ regarding a measure of damages. In common law, a measure of tortious damages is well established; it is said that damages in tort intend to put the plaintiff as nearly as possible into the same position as the plaintiff would have been if the wrongful conduct had not been done.²⁸⁵ In contract law, damages will be awarded to put the injured party in the same position as he or she would have been in had the contract been performed.²⁸⁶ Conversely, section 82 of the CCA and section 236 of the ACL do not lay down a standard for measuring statutory damages. Taking the CCA as an example, Gaudron J in *Marks v GIO Australia Holdings* articulates that an action for damages in the CCA is not confined by analogy with actions in tort.²⁸⁷ This articulation implies that a measure of damages in tort law may not necessarily be utilized to calculating

282 *Wardley Australia Ltd v Western Australia*, (1992) 175 CLR 514, 526.

283 *XL Petroleum (NSW) Pty Ltd v Caltex Oil (Aust) Pty Ltd* (1985) 155 CLR 448, 472.

284 Joanna Kyriakakis and others, *Contemporary Australian Tort Law* (Cambridge University Press 2020) 501-04.

285 *Ibid* 498. See also *Registrar of Titles (WA) v Spencer* (1909) 9 CLR 641, 645.

286 See eg *Wenham v Ella*, [1972] HCA 43, per Gibbs J; *Commonwealth v Amann Aviation Pty Ltd* [1991] 174 CLR 64, 98; *Darmody v National Centre Automotive* [2003] FMCA 358 [a]; *Roluke Pty Ltd v Lamaro Consultants Pty Ltd* [2008] NSWCA 323 [78].

287 *Marks v GIO Australia Holdings Ltd* [1998] 196 CLR 494 [17] per Gaudron J.

statutory damages.²⁸⁸ In this case, courts may arguably find a proper measure for the damages.²⁸⁹

Concerning the calculation of damages, a question arises as to whether a claimant franchisee can recover damages for the loss of chance under the statutes and tort law. From a statutory viewpoint, it remains uncertain whether an injured party may be awarded damages for the lost chance by virtue of section 82 of the CCA and section 236 of the ACL. As mentioned in the preceding paragraph, courts may find an appropriate measure to calculate damages. In this respect, the recovery of damages for the lost chance would be possible. In tort law, it is said that the loss of the chance of the better outcome, which is valuable, can be recoverable.²⁹⁰ Thus, it would be likely that the franchisee recovers damages for the loss of opportunity under tort law rules.

3.4.4.4 Cancellation of a contract

A franchisee may cancel a franchise contract by way of rescission under the CCA and the ACL, and common contract law. This subsection will address the rescission of a franchise contract based on statutory and common law claims and offer remarks on particular rules concerning the relief.

– Statutory claims

Under section 87 of the CCA and section 238 of the ACL, a franchisee may seek an order declaring a contract to be void. Taking the CCA as an example, paragraph (2) of section 87 provides that a court has authority to order a wide range of orders, including a rescission order declaring the whole or any part of a contract to be void.²⁹¹ In seeking the declaration of avoidance under the CCA, the franchisee has to demonstrate that the franchisor violates the Franchising Code of Conduct's provisions. For example, the Full High Court of Australia in *SPAR Licensing v MIS QLD* decided that the franchisor contravened the Franchising Code of Conduct by failing to give the franchisee a disclosure document at least 14 days before the entry into a franchise contract. In this case, the court held that setting aside a franchise agreement was an appropriate

288 In case of statutory misrepresentation, some courts may regard a measure of damages in the tort of deceit as a proper measure that will be used by analogy. See eg *Argy v Blunts & Lane Cove Real Estate Pty Ltd*, [1990] 26 FCR 112 per Hill J.

289 Arlen Dukes, *Corones' Competition Law in Australia* (7th edn, Thomson Reuters 2018) at [18.230].

290 Caroline Sappideen and Prue Vines (eds), *Fleming's The Law of Torts* (10th edn, Thomson Reuters 2011) 239-41.

291 In avoiding a contract, the court may, if it thinks fit, order that the contract is void *ab initio* or at all times on and after the specific date. See The CCA, s. 87(2)(a).

remedy for the breach of the Code, and the contract was rescinded from the date of judgment on appeal.²⁹²

Under both statutes, an applicant franchisee must also demonstrate its actual or anticipated suffering of loss or damage caused by the franchisor's contravening conduct. Taking the CCA as an illustration, the court can declare a franchise contract to be void in whole or in part only if the declaration will compensate, prevent, or reduce the franchisee's loss or damage.²⁹³ In the CCA, section 87(1A)(c) provides that the court must consider that an order concerned will compensate the claimant in whole or in part for the loss or damage or prevent or reduce the loss or damage. In this case, the court may issue an order under section 87 insofar as the order will compensate, prevent, or reduce the identified or future loss or damage.²⁹⁴ That formulation applies to the issuance of the declaration of avoidance under section 87(2)(a) as well.

– *Common law claims*

A franchisee may rescind a franchise contract for misrepresentation as it renders a contract voidable. In this case, rescission is considered the main remedy for that misrepresentation.²⁹⁵ In rescinding a contract for misrepresentation, it is accepted that an aggrieved party may rescind a contract for either a fraudulent or innocent misrepresentation.²⁹⁶ In any case, a plaintiff franchisee needs to satisfy the elements of the misrepresentation, which ordinarily include a false statement of facts; the intention to induce reliance, and materiality. From these conditions, the non-performance of the duty of disclosure required by law could amount to a misrepresentation.²⁹⁷

– *Remarks on particular rules concerning rescinding a contract*

(1) *Exercise of the right of rescission*

The rules on rescission under the CCA and the ACL and common law may differ in some cases. On the one hand, statutory rescission is considered rescission

292 *SPAR Licensing* (n 82) [161]-[165].

293 In ordering rescission under section 87, the court may consider some equitable principles as guidelines for the exercise of its discretion. However, it is said that those equities are not necessarily exclusive. For example, in *Munchies Management v Belperio*, the court concluded that the presence or absence of fraudulent conduct might be vital when it comes to ordering rescission at common law. Nevertheless, those matters may not be significant in the exercise of the power to order an appropriate remedy under section 87. See *Munchies Management Pty Ltd v Belperio* [1988] 58 FCR 274.

294 See eg *Deane v Brian Hickey Invention Research Pty Ltd* [1988] ATPR 49,608, [17]; *Rafferty and Another v Madgwicks* [2012] 203 FCR 1 [225].

295 Carter (n 268) 374.

296 *Nadinic v Drinkwater*, [2017] NSWCA 114 [23]-[33].

297 Carter (n 268) 376-86.

in equity.²⁹⁸ Thus, in rescinding a franchise contract under the CCA and the ACL, a franchisee needs to apply for the court's declaration of avoidance. On the other hand, common law rescission for fraudulent misrepresentation is regarded as rescission at law.²⁹⁹ In this case, an aggrieved party may disaffirm a contract.³⁰⁰ This statement implies that rescission at law is a self-help remedy, meaning the innocent party may elect to rescind a contract on his/her own.³⁰¹ Based on this notion, the franchisee will not have recourse to a court judgment declaring that the election of rescission is effective.³⁰² In electing to rescind a franchise contract, the franchisee would have to manifest its intention to rescind and communicate that intention to the franchisor.³⁰³ For example, in the case *Blow Dry Bar Franchising*, the franchisee alleged the franchisor of inducing the conclusion of a franchise agreement by misrepresentations about the profitability of a franchised business. Because of false representations, the franchisee rescinded the franchise agreement, and the court affirmed that the franchisee was entitled to rescind the agreement.³⁰⁴

(2) *Partial rescission*

In principle, statutory and common law rescission will set aside or annul an entire franchise contract.³⁰⁵ However, avoiding parts or specific terms of a franchise contract seems to be allowable by partial avoidance under statutory laws. Section 87(2) of the CCA and section 243(a) of the ACL identically state that the court can declare the whole or any part of a contract to be void. In this respect, upon the application, the court may avoid a franchise contract partially. In practice, Australian courts may avoid a particular contractual clause on the basis of an unfair contract term. In this case, the rest of the terms remain applicable.³⁰⁶ In addition, partial rescission of a contract is possible under common contract law. Nevertheless, the partial rescission can be made

298 *Carbone v Metricon Homes Pty Ltd*, [2018] NSWCA 296 [39].

299 *Nadinic* (n 296) [28].

300 See eg *Alati* (n 281) 223-24; *Munchies Management Pty Ltd v Belperio*, (1988) 58 FCR 274; *Highfield Property Investments Pty Ltd v Commercial & Residential Developments (SA) Pty Ltd*, [2012] SASC 165 [284]; *Gutnick v Indian Farmers Fertiliser Cooperative Ltd*, [2016] VSCA 5 [21].

301 Janet O'Sullivan, 'Rescission as a Self-Help Remedy: A Critical Analysis' (2000) 59 Cambridge Law Journal 509, 511-12.

302 *Carter* (n 268) 394-95.

303 See eg *Car and Universal Finance Co Ltd v Caldwell* [1965] 1 QB 525, 550; *Wagdy Hanna and Associates Pty Ltd v National Library of Australia* (2012) 267 FLR 356, 373; *Highfield Property Investments* (n 300) [284].

304 *Carazi* (n 165) [2],[30],[40], and [49].

305 *Gutnick* (n 300) [24].

306 ACCC, 'Contracts' <<https://bit.ly/3YBkTnC>> accessed 19 December 2022. An example of an unfair contract term in a franchise agreement can be found in the case *Back In Motion Physiotherapy*. See ACCC, 'Back In Motion Physiotherapy to remove alleged unfair contract terms for franchisees' (ACCC, 21 September 2020) <<https://bit.ly/3YLkxLx>> accessed 19 December 2022.

in limited cases where the affected contract terms are severable and justice so demands.³⁰⁷

(3) *Effects of rescission*

Statutory and common law rescission of an entire franchise contract will similarly annul the contract. After a contract is rescinded, *restitutio in integrum* is required; the parties are to be rehabilitated and restored, as far as may be, to the position they occupied before the contract was made.³⁰⁸ Moreover, statutory and common law rescission will generally avoid the contract at its inception or *ab initio*.³⁰⁹ Section 87(2) of the CCA and section 243(a) of the ACL concurrently provide that the court may declare the contract to be void *ab initio*. Nevertheless, the statutes permit the court to declare the avoidance of the contract as it thinks appropriate against the person who engaged in the conduct that infringed the laws. For example, the court may declare the agreement to have been void at a specified date.³¹⁰ In some cases, therefore, the agreement may not be avoided at the beginning.

(4) *Election of remedies*

In common contract law, if a claimant may rescind a contract and claim damages for breach of contract under the circumstances, the principle seems to be settled by the Australian court decisions that these two remedies are alternative. That is, the claimant needs to either set aside the contract or affirm the contract and claim monetary compensation for the loss suffered. In other words, the plaintiff cannot seek a combination of both remedies unless the plaintiff can establish a claim on the basis of tort of fraudulent misrepresentation.³¹¹ This election principle also applies in the case of the election of statutory rescission and damages.³¹² In *Argy v Blunts & Lane Cove Real Estate*, the Federal Court discussed the election of rescission and damages under the former Trade Practices Act. The court maintained that the doctrine of election applied where the rights to both damages and to rescind were made available to the applications. Thus, the applications needed to choose to pursue either of the two inconsistent rights.³¹³

307 M W Bryan, V J Vann, and S Barkehall Thomas, *Equity and Trusts in Australia* (2nd edn, Cambridge University Press 2017) 70-74. See also *Vadasz v Pioneer Concrete (SA) Pty Ltd*, [1995] 184 CLR 102, 105.

308 *A H McDonald and Company Pty Ltd v Wells* (1931) 45 CLR 506, 512-513 per Rich, Starke, and Dixon JJ; *McDonald v Dennys Lascelles Ltd* (1933) 48 CLR 457, 476-77 per Dixon J.

309 *Highfield Property Investments* (n 300) [283].

310 The CCA, s. 87(2); The ACL, s. 243(a).

311 Carter (n 268) 374.

312 *Sibley v Grosvenor*, [1916] 21 CLR 469 per Griffith CJ; *Brown v Smitt*, [1924] 34 CLR 160 per Knox CJ, Gavan Duffy and Starke JJ.

313 *Argy* (n 288).

3.4.4.5 Conclusions

The private law regime, in the case of the franchisor's non-performance of the disclosure duty and the duty to provide complete, current and accurate information, is fundamentally a statutory regime. As the non-performance of these duties is customarily considered a violation of the provisions of the Franchising Code of Conduct, this contravention lays a basis for resorting to private law actions under the CCA. Under the CCA, an aggrieved franchisee may seek a court decree to enforce the franchisor's action, recover damages, and declare a franchise contract to be void. Suppose the non-performance of these duties amounts to misleading or deceptive conduct. In that case, the franchisee may resort to those three statutory remedies under the ACL, which arguably applies to franchise relationships. In addition to the competition and consumer statutes, a franchisee may seek some civil law remedies under common law. In theory, the franchisee can claim damages for the tort of misrepresentation or breach of contract. Alternatively, the franchisee may elect to rescind the franchise agreement based on the theory of innocent or fraudulent misrepresentation.

3.4.5 Comparative analysis

3.4.5.1 Introduction

The descriptive examinations show that the DCFR, the USA, and Australia have the legal frameworks offering private law remedies for an aggrieved franchisee in the event of the franchisor's non-performance of the disclosure duty and the duty to provide complete, current and accurate information. Under the selected legal systems, the franchisee may resort to remedial rules of the legal frameworks for enforcing the franchisor's performance, recovering monetary compensation, and cancelling a franchise agreement. However, the selected legal systems' remedial rules vary. Thus, this section will compare, contrast, and discuss the rules governing the three civil law remedies in subsection 3.4.5.2. Subsection 3.4.5.3 will offer concluding remarks on the remedial regime under the chosen legal systems and key recommendations for constructing a remedial system under comprehensive franchise law.

3.4.5.2 Comparison and analysis

– Enforcement of performance

(1) Similarity

The DCFR and Australia are similar in the sense that both legal systems have a legal basis that would permit an aggrieved franchisee to seek the enforcement

of the franchisor's pre-contractual duties of information. Under the DCFR, the disclosure obligation and the duty to provide complete, current and accurate information are obligatory under IV.E. – 2:101, in conjunction with IV.E. – 4:102(1). In this case, any non-performance of these obligations would allow the franchisee to enforce the franchisor's performance under III. – 3:302. According to the drafters of the DCFR, this provision is a catch-all rule governing the non-performance of both a contractual obligation and a pre-contractual obligation.

In Australia, it could be argued that a prospective franchisee may enforce the franchisor's performance of the pre-contractual duties under the Franchising Code of Conduct by way of injunctions under the CCA and the ACL. Under the statutes, a court may, upon an application, grant the injunctive relief ordering the franchisor to engage in certain conduct, such as disclosing some informational items required by the Code or updating its disclosure document. This assumption is drawn from theoretical inference. In other words, enforcing the franchisor's pre-contractual duties of information might be rare in reality as many potential franchisees would resort to other appropriate remedies or sanctions against the franchisor, such as damages or administrative penalties.

(2) *Difference*

It is uncertain that the enforcement of the franchisor's disclosure duty is doable under the US state franchise sale regulations. This uncertainty results from the fact that the state franchise sale laws do not explicitly provide a mechanism that could be used to enforce the performance of the pre-sale obligations. However, some state sale laws offer a catch-all remedy, which could be interpreted to allow the court to order the execution of the disclosure duty. Despite the existence of a catch-all remedy, there has been no court decision showing the acceptance of that interpretation.³¹⁴ In my view, the absence of the prospective franchisee's claim to enforce the franchisor's performance of pre-contractual duties under the statutes might result from two factors.

Firstly, bringing lawsuits to obtain pre-sale information required by the franchise legislation may be hindered due to financial reasons attributed to two peculiar practices in the USA. The first reason is that, under the American Rule, a private litigant is typically responsible for its own litigation costs and legal fees.³¹⁵ These expenses can be very costly. For instance, the hourly fees rate of a senior partner in the law firm may exceed 500 US dollars.³¹⁶ The high fees rate could dissuade a franchisee from bringing its claim to courts. Second, US attorneys might be unwilling to take the job because of the slight possibility of arranging contingent fees. This contingency-fee arrangement

314 See subsection 3.4.3.2.

315 Arthur T von Mehren and Peter L Murray, *Law in the United States* (2nd edn, Cambridge University Press 2007) 268.

316 Peter Hay, *The Law of the United States: An Introduction* (Routledge 2017) 65.

allows a lawyer to share some portion of compensation awarded by the court. Thus, this arrangement relies heavily upon a claim for considerable amount of damages, particularly in personal injury actions.³¹⁷

Secondly, bringing lawsuits to obtain pre-sale information required by the franchise legislation may be constrained by time and agreement. First, it would be too late to bring a lawsuit to acquire the pre-contractual information. In many instances, a franchisee may uncover the franchisor's non-disclosure or misleading conduct after a franchise contract has been concluded. For example, in *Coraud v Kidville*, the court decision demonstrated that the franchisee discovered that the estimation of the expenses was misleading after the conclusion of a franchise agreement.³¹⁸ This example shows that it would not be possible to enforce the performance of the pre-contractual information duties before the sale of a franchise is made. Second, many franchisees may be barred by the terms of a franchise contract from suing a franchisor. In some cases, a franchise contract may prohibit a franchisee from engaging in a class action litigation, which usually is affordable to the franchisees, against a franchisor.

(3) Discussion

From the comparison, the right to enforcement of the franchisor's pre-contractual duties of information seems to be a mystery in the realm of the franchise sale law. Strictly speaking, no franchise legal framework of the DCFR, the USA, and Australia explicitly provides for a mechanism to compel the franchisor's performance of the obligations. Instead, several rules have to be employed to confer the right to enforce the performance to a prospective franchisee to acquire some informational items before concluding a franchise agreement. For example, under the DCFR, the rule on enforcing specific performance of a non-monetary obligation has to be argued to apply in this context.

In my view, comprehensive franchise law should resolve such a mystery by establishing private law relief, enabling a prospective franchisee to enforce the franchisor's performance of the disclosure duty and the duty to provide complete, current and accurate information. For example, under the law, the franchisee should have the right to compel the franchisor to provide the required information or to disclose current and accurate information. This idea would not be strange as one commentator says that an obligation must be enforceable to be truly effective, whether it is a contractual obligation or not.³¹⁹ Thus, pre-contractual duties of information should equally be enforced

317 Stephen Gillers, 'The American Legal Profession' in Alan B Morrison, *Fundamentals of American Law* (Oxford University Press 1996) 169.

318 *Coraud* (n 207) 393.

319 Oliver Remien, 'Enforced Performance in European Contract Law: The Story of the Poor Banabans and the Hope for Happier Europeans' in Katharina Boele-Woelki and William Grosheide (eds), *The Future of European Contract Law* (Kluwer Law International 2007) 321.

in the same manner as the enforcement of contractual obligations. However, there may be a question of why the remedy should have a place in comprehensive franchise law.

In my opinion, this specific relief would help effectuate the franchisor's disclosure of pre-sale information, which is the central goal of all franchise sale laws. As can be seen, this chapter proposes that comprehensive franchise law should regulate the pre-contractual stage of making a franchise contract. One of the proposed regulations is that the law should establish disclosure duties obligating a franchisor to provide pre-sale information, which is transparent, accurate, and current. This regulation aims to enable a prospective franchisee to acquire qualified information from the franchisor prior to the conclusion of a franchise agreement.³²⁰ Thus, comprehensive franchise law should provide a mechanism that would help achieve that goal; that is to say, a remedy of enforcement of performance in kind.

It would seem that the remedy of enforcement of performance in kind is not an unusual remedy in the field of private law. Many legal systems seem to have profoundly established the enforcement of performance as a civil law remedy, particularly under the law of obligations or the law of contract.³²¹ For example, this relief has been made available in jurisdictions, such as France, Germany, and The Netherlands.³²² In those countries, an aggrieved party may bring a claim for performance of an obligation under article 1143 of the French Civil Code, section 241 of the German Civil Code, and section 3:296(1) of the Dutch Civil Code. Furthermore, in common law countries, such as the USA, specific performance has been developed to be one of the common law remedies for breach of contract claims.³²³ Therefore, legal systems would not face many hurdles when incorporating this enforcement remedy into comprehensive franchise law, which governs private aspects of a franchise relationship.

Based on the abovementioned idea, I suggest that comprehensive franchise law contains the rule governing the remedy of enforcement as a standalone

320 See sections 3.2 and 3.3.

321 Hein Kötz, *European Contract Law* (Gill Mertens and Tony Weir trs., 2nd edn, Oxford University Press 2017) 198, 202.

322 Janwillem Oosterhuis, *Specific Performance in German, French and Dutch Law in the Nineteenth Century: Remedies in an Age of Fundamental Rights and Industrialisation* (Martinus Nijhoff Publishers 2011) 221.

323 See eg *Berryhill v Hatt*, 428 NW 2d 647 (Iowa, 1988) 657; *Clemente v Pearle Vision Inc* 762 F Supp 1518 (D Me, 1991) 1519; *Reed v Triton Servs, Inc*, 15 NE 3d 936, 938, 2014 -Ohio- 3185, (Ohio App 12 Dist, 2014) 938-39; *Minnesota Vikings Football Stadium, LLC v Wells Fargo Bank, National Association*, 193 F Supp 3d 1002, (D Minn, 2016) 1014; *H B Fuller Co v Hamm*, 2018 WL 4047122 (D Minn, 2018) 4; *Homeland Energy Solutions, LLC v Retterath*, 938 NW 2d 664 (Iowa, 2020) 693. It should be noted that a grant of specific performance in the USA will be subject to several tests as it is regarded as an equitable remedy. Thus, the availability of this remedy in common law countries will be limited compared to that in civil law systems.

remedial mechanism under the law. The incorporation of this remedial rule would enable a prospective franchisee to compel the delivery of pre-sale information on the required items without having recourse to other remedial regimes, such as contract law regimes. Resorting to the remedy of specific performance under contract law would be improper when enforcing pre-sale disclosure obligations because these information duties are typically created by specific legislation, not by contracts. Thus, the enforcement of specific performance, which is regarded as a remedy for breach of contract or non-performance of a contractual obligation, would not apply.³²⁴

In incorporating the remedy of enforcement of performance in kind, I suggest that the factual requirements for non-performance of the disclosure obligations are transparent and coherent. In this regard, the disclosure rules establishing the information duties must be precise enough to help a prospective franchisee ascertain the point at which a non-compliance of the obligations accrues. For example, I have proposed in this chapter that the rules should explicitly require that a franchisor must disclose pre-contractual information to a prospective franchisee by providing the franchisee with a disclosure document including some informational items.³²⁵ This duty will be considered an obligation of result. Thus, the prospective franchisee would be allowed to initiate a claim for performance if the franchisor did not provide the disclosure document or omitted to disclose some informational items in the document.

Additionally, I have suggested that the timing for disclosure is fixed. In this case, it would economically be viable for a prospective franchisee to identify the franchisor's failure to perform the disclosure duties for the sake of litigation. As can be seen, I have proposed a one-month waiting period.³²⁶ For example, if a franchisor sets to sign a franchise contract on 30 April 2023, the franchisor must provide a disclosure document no later than 31 March 2023. Suppose the signing date has passed, and the franchisee has received nothing from the franchisor. In that case, the prospective franchisee may, at its option, choose to compel the delivery of the disclosure document. In the meantime, the parties may extend the signing of the franchise contract to another day. Enforcing the franchisor's performance in this hypothetical situation would be possible when a franchise contract to be concluded is a lucrative agreement where a prospective franchisee is unwilling to leave the negotiation just because of the franchisor's non-disclosure.

324 Kötz (n 321) 197; Hugh Beale and others, *Cases, Materials and Text on Contract Law* (3rd edn, Hart Publishing 2019) 840.

325 See subsection 3.2.5.2.

326 See subsection 3.2.5.2.

– *Monetary compensation*

(1) *Similarity*

The DCFR, the USA, and Australia are similar in four aspects as follows.

First, the chosen legal systems make available for a franchisee a remedy of damages in the event of the franchisor's non-compliance with pre-contractual information duties. To put it differently, if the franchisor breached the disclosure rules under franchise sale law, the franchisor might be held liable for damages for the loss caused to the franchisee. Under the DCFR, the franchisee may resort to specific contract law rules in Part E of Book IV for the right to claim damages. In America, the franchisor's contravention of the disclosure and anti-fraud rules typically lays a basis for an action for statutory damages under the state sale statutes. Likewise, in Australia, the franchisor's violation of the Franchising Code of Conduct would permit an aggrieved franchisee to claim statutory damages under the CCA and the ACL.

Second, the selected legal systems commonly accept that a remedy of damages serves a compensatory purpose. That is, this monetary compensation aims to redress loss or damage sustained by a franchisee as a result of the franchisor's breaching conduct. Under the DCFR, damages are compensatory since they will be awarded to place an aggrieved party as nearly as possible in the position in which the franchisee would have been if the franchisor had performed the duty of disclosure or the duty to provide complete, current and accurate information satisfactorily. In the USA, the court contended that damages must be awarded to compensate the franchisor for the loss suffered; hence, the franchisee will not be permitted to seek punitive damages from the franchisor. Similarly, Australian laws provide that damages will be awarded to compensate for actual loss or damage sustained by the franchisee. Thus, the three legal systems generally do not allow an injured franchisee to claim punitive or exemplary damages from a franchisor.

Third, the selected legal systems would generally agree that an injured franchisee may recover damages for reliance or out-of-pocket loss caused by the franchisor's non-performance of pre-contractual information duties. Under the DCFR, the compensable loss includes economic loss, which is meant to cover burdens incurred. It could be said that this specific category of economic loss is identical to reliance loss. In the USA, some state courts, such as the Minnesota Supreme Court in *Hughes v Sinclair Marketing*, implicitly held that the recoverable loss under the disclosure statute typically included the reliance damage.³²⁷ In Australia, it is accepted that the court may find a proper measure of damages under the CCA and the ACL. The flexibility in assessing damages would allow the court to award damages to redress the franchisee's reliance loss.

327 *Hughes* (n 227) 199.

Fourth, it is unlikely that the loss of chance is recoverable in the chosen legal systems. Under the DCFR, the recovery of damages for the lost chance is not extensively discussed. Moreover, the drafters of the DCFR seem to wait for courts to materialize this issue. Thus, whether a franchisee can be compensated for the loss of opportunity must follow one of the underlying principles for recovering damages; the loss must be caused by the failure to perform. If there is no causation between the failure in performance and the loss suffered, the injured party would not be able to claim damages.³²⁸ Likewise, in the USA and Australia, the loss of chance is a matter of causation. In theory, a franchisee will recover damages insofar as it proves that the franchisor's breaching conduct causes the franchisee's injury or damage. However, recovering damages for the lost chance in the franchising context remains questionable because the US and Australian courts seem to allow the recovery of damages for the lost chance in medical and professional malpractice tort cases.³²⁹

(2) *Difference*

The DCFR differs from the US and Australian legal systems in the following two cases.

First, the DCFR does not allow an injured franchisee to resort to the law on non-contractual liability as an alternative basis for recovering damages. Under the DCFR, the right to claim damages is constituted under contract law rules. In this case, the right to seek damages in tort will be excluded by virtue of VI. – 1:103. Paragraph (c) of this provision provides that the non-contractual liability rule in VI. – 1:101 does not apply if its application would contradict the purpose of the other private law rules. According to the commentaries to VI. – 1:103, this paragraph (c) implies the priority of contract law liability over tort law liability in case of a conflict in value between those remedial regimes.³³⁰ In my opinion, IV.E. – 4:102(2) aims to establish a special basis for recovering damages in the case of non-performance of a pre-contractual information duty.³³¹ In this case, the value of contractual liability would contradict that of non-contractual liability, thereby excluding the recourse to non-contractual liability rules for recovering damages.³³²

In contrast, the USA and Australia would, at least in theory, permit an injured franchisee to seek common law damages if the franchisor does not perform the disclosure duty or the duty to provide complete, current and accurate information. In America and Australia, the possible common law

328 See subsection 3.4.2.3.

329 See subsections 3.4.3.3 and 3.4.4.3.

330 Christian von Bar and Eric Clive, *Principles, Definitions and Model Rules of European Private Law: Draft Common Frame of Reference (DCFR): Full Edition* (Vol.4, Oxford University Press 2010) 3119.

331 See subsection 3.4.2.3.

332 It should be noted that the drafters of the DCFR do not have a clear explanation for this issue. Thus, this paragraph reflects my own view on the issue.

cause of action for damages is identical; the franchisee may claim tort law damages by alleging the franchisor of fraudulently misrepresenting facts.³³³ In claiming damages based on the tort of deceit, the claimant franchisee usually needs to prove that the defendant franchisor misrepresented material facts to induce the franchisee's reliance. Moreover, the franchisee must show that it reasonably relied upon that misrepresentation when concluding a franchise contract. Additionally, the heart of a fraudulent misrepresentation claim is the representor's state of mind. The US and Australian legal systems would require the franchisee to demonstrate the franchisor's dishonesty in misrepresenting the facts.

Second, the DCFR does not permit a court to award punitive damages. This conclusion is apparent when considering a general measure of damages under II. – 7:214(2) indicating that an award of damages aims to compensate for the loss sustained, not to punish an injuring party. Conversely, this type of damages would be allowable in the USA and Australia. As mentioned in the preceding paragraph, the two legal systems would permit a claim for damages based on the tort of fraudulent misrepresentation. In the realm of common tort law, a court may award punitive or exemplary damages in some exceptional cases where the defendant committed wrongful conduct maliciously.³³⁴ In the USA, some franchise sale states also permit an award of statutory punitive damages. In Hawaii, South Dakota, and Washington, punitive damages can be awarded in the form of treble damages in the case of a willful violation of the franchise sale statutes.³³⁵

(3) Discussion

From the comparison, the recovery of damages is a private law remedy common among the chosen legal systems. This remedy is vital to redress any detriment sustained by a franchisee because of the franchisor's conduct. Thus, I propose that comprehensive franchise law adopts this common approach and makes available the remedy of damages that allows an aggrieved franchisee to recover money for the loss or damages sustained as a result of the franchisor's contravention of the franchise sale rules. As underlying principles for recovering damages, I suggest that comprehensive franchise law embraces a compensatory characteristic of damages, which is also widely accepted by the selected legal systems. Thus, the function of damages under comprehensive franchise law should focus on compensating for the loss or damage suffered by the franchisees.

From a theoretical perspective, the compensatory character of damages serves the idea of corrective justice, which focuses on what is morally required

³³³ See subsections 3.4.3.3 and 3.4.4.3.

³³⁴ See subsections 3.4.3.3 and 3.4.4.3.

³³⁵ Hawaii: HI ST, § 482E-9(c); South Dakota: SD ST § 37-5B-49; Washington: WA ST 19.100.190(3).

concerning wrongful conduct and harm caused thereby.³³⁶ Inspired by the Aristotelian concept of justice, some scholars, such as Coleman, claim that compensation is a form of justice that eliminates unjustifiable gains and losses.³³⁷ Suppose a franchisee suffers any loss or damage due to the franchisor's wrongful conduct. In that case, the franchisor should compensate the franchisee in order to remedy the loss or damage suffered. Therefore, compensating for loss or damage should be a primary goal of the remedial system under comprehensive franchise law.

One may raise a further question of whether an award of punitive or exemplary damages should be introduced under the remedial regime of comprehensive franchise law. Can deterrence be the secondary character of the remedy of damages under the law? In my view, this question may not be answered from a theoretical standpoint as it is frequently a matter of legal policy. As a policy, some legal systems may introduce this deterrent-based monetary compensation. In this case, courts may be able to award damages up to hundreds of millions of dollars or euros under the circumstances of the case.³³⁸ Awarding a huge amount of damages would discourage any person from deciding to engage in any opportunistic conduct. In particular, franchisors would be forced to think carefully before behaving opportunistically towards franchisees, as punitive damages would make the franchisors insolvent. Thus, the deterrent function of punitive damages would be argued to support the goal of preventing a franchisor from behaving opportunistically.

One might argue that an award of compensatory damages could play a preventive role, as do punitive damages. In practice, courts in some jurisdictions seemingly adopt this idea. For example, in *Royal Bank of Canada v W Got Associates Electric Ltd*, the Supreme Court of Canada held that the award of compensatory damages could be used as a deterrence.³³⁹ Franchise-specific regulations typically impose administrative penalties or criminal offenses for a violation of provisions of the laws. These sanctions could be argued to be much more effective than the imposition of punitive damages. In these cases, the availability of punitive damages might not be very demanding insofar as other remedial mechanisms can play a prohibitive or preventive role. Regarding this punishment issue, I am inclined to believe that punishing opportunistic

336 According to Weinrib, the concept of corrective justice, introduced by Aristotle, underpins private law relationships. See Ernest J Weinrib, 'Corrective Justice' (1992) 77 *Iowa Law Review* 403, 425. Thus, this moral concept of corrective justice could provide a foundation for establishing the compensatory system of damages.

337 Richard A Posner, 'The Concept of Corrective Justice in Recent Theories of Tort Law' (1981) 10 *The Journal of Legal Studies* 187, 197.

338 Tina Bellon, 'Missouri judge affirm \$4.69 billion talc verdict, J&J vows to appeal' (REUTERS, 22 August 2018) <<https://reut.rs/3yHiDgU>> accessed 21 January 2022; Holly Yan, 'Jurors give \$289 million to a man they say got cancer from Monsanto's Roundup weedkiller' (CNN, 12 August 2018) <<https://cnn.it/3A1vu4e>> accessed 21 January 2022.

339 *Royal Bank of Canada v W Got Associates Electric Ltd*, [1999] 3 SCR 408 [28].

franchisors should rely on public law sanctions such as imposing penalties for violating conduct. In my view, these sanctions are typically supervised by public authorities who could employ them more readily and effectively. Thus, I suggest that, from a private law perspective, comprehensive franchise law does not permit the recovery of punitive damages.

– *Cancellation of a contract*

(1) *Similarity*

The DCFR, the USA, and Australia similarly offer some contract law mechanisms that permit an aggrieved franchisee to revoke a franchise relationship in the case of the franchisor's non-performance of the disclosure duty or the duty to provide complete, current and accurate information. Under the DCFR, a franchisee may resort to contract law provisions concerning vitiated consent or intention. Under the rules, the franchisee may avoid a franchise contract for mistake or fraud, upon the satisfaction of the pre-requisites for the avoidance. Likewise, in the USA and Australia, the franchisee may avoid or rescind a franchise agreement based on the theory of misrepresentation. As can be seen, a ground for avoiding or rescinding a franchise contract is, though not identical, much the same. The franchisee is allowed to avoid the franchise agreement if it concluded the agreement based on a misapprehension caused by the franchisor.

In addition, the DCFR, the USA, and Australia are similar in terms of partial avoidance or rescission and the effects of the avoidance or rescission. Under the selected legal systems, a franchise contract can be avoided or rescinded partially. In some exceptional cases, the franchisee may avoid or rescind particular terms of a franchise contract if the terms of the agreement are severable, and the affected terms can be separated from the rest. Besides, the avoidance or rescission will annul a franchise contract at its inception or *ab initio*. In other words, a franchise contract will be annulled as if it never existed. Furthermore, the avoidance or rescission of a franchise agreement will take a retrospective effect. The valid avoidance or rescission will follow the restoration of the parties to their initial status. In principle, both parties will be obliged to return the properties and benefits received under the agreement to the other party.

(2) *Difference*

The USA and Australia differ from the DCFR in two aspects as follows.

First, the US and Australian legal systems make an action for rescission for a violation of disclosure rules available for an aggrieved franchisee. In the USA, most state franchise sale laws provide that a franchisee may bring an action to rescind a franchise contract because of the franchisor's violation of disclosure provisions under the statutes. In Australia, the franchisor's contravention of disclosure rules under the Franchising Code of Conduct lays the

ground for an action for private remedies under the CCA. Among other things, an aggrieved franchisee may ask the court to declare a franchise contract void. The franchisee may apply for a declaration of avoidance of a franchise agreement under the ACL by satisfying a court that the franchisor engaged in misleading or deceptive conduct in violation of the ACL. In contrast, the DCFR does not provide a specific right to avoid a franchise contract based on a violation of the franchise-specific rules. In this case, the franchisee needs to resort to general rules of contract law that would entitle the franchisee to invalidate the agreement.

Australia differs from the USA in terms of the requirement of actual or anticipated loss under statutory laws. In Australia, the competition and consumer statutes require that an applicant franchisee must suffer, or is likely to suffer, the loss or damage when applying for a declaratory order. In contrast, the US franchise sale laws do not require this element. The imposition of this requirement implies that Australia regards a declaration of avoidance as a remedial order to redress the actual and anticipated damage. Thus, it would be more challenging to rescind a franchise contract in Australia than in the USA, as the US state sale laws do not embrace this equivalent concept. In any case, rescinding a franchise contract under the US franchise sale statutes may not be effortless because some franchise sale statutes require the franchisor's violation of the laws to be material. In other words, the franchisor's marginal violation of the laws would not provide a basis for the franchisee to bring an action for rescission.

Second, an aggrieved franchisee needs a court order when rescinding a franchise contract under the US and Australian statutory laws. In other words, the franchisee cannot effectively rescind a franchise contract by notice of rescission. Instead, the franchisee must sue the franchisor in court for an award of rescission of a franchise agreement. In contrast, the franchisee may avoid a franchise contract for mistake and fraud under the DCFR merely by giving the franchisor the notice of avoidance. The main reason underlying this difference could be that the rescission in the USA and Australia is regarded as an equitable remedy. In principle, the court will play a significant role in determining whether it is fair under the circumstances of the case to order a contract to be rescinded. On the other hand, the avoidance of a contract under the DCFR is a matter of right. The franchisee would enjoy this right without having recourse to judicial intervention.

(3) *Discussion*

From the comparison, the chosen legal systems commonly allow an aggrieved franchisee to escape a franchise relationship if a franchisor failed to comply with the duty of disclosure and the duty to provide complete, current and accurate information. In doing so, the franchisee may resort to the general contract law rules or sector-specific law rules, such as the rules of the franchise sale law. Rescinding or avoiding a franchise contract under general contract

laws and statutory laws may be based on different concepts. In contract law, a franchisee usually has to prove its vitiated consent. That is, the franchisor must demonstrate that it concluded a franchise contract because of a mistake induced by the franchisor. Conversely, a common ground for rescinding a franchise agreement under the statutes is the franchisor's violation of the disclosure rules. In sum, rescission in contract law focuses on an internal element of defective consent, while statutory rescission pays attention to an external element of the violation of the laws.

In this case, I propose that comprehensive franchise law provides mechanisms that allow a franchisee to cancel a franchise contract if the franchisor violates the rules regulating the disclosure duty and the duty to provide complete, current and accurate information. The establishment of the statutory mechanism would be useful for an aggrieved franchisee as it will ease the burden of proof of some subjective requirements that usually is required in contract law systems. For example, under the DCFR, suppose a franchisee seeks to avoid a franchise contract for a mistake. In this case, the franchisee must prove that the franchisor caused the franchisee to make a material mistake, and the franchisor knew or could reasonably be expected to have known that fact. Likewise, suppose the franchisee will rescind a franchise contract for fraudulent misrepresentation in the USA and Australia. The franchisee must prove that the franchisor knowingly or recklessly misrepresented facts intending to induce the franchisee's reliance. In some cases, demonstrating the franchisor's internal mind would be cumbersome for a plaintiff franchisee. In contrast, in Australia, the franchisee does not have to prove the franchisor's intention if the franchisee brings a statutory action to avoid a franchise agreement under the CCA.

Conversely, comprehensive franchisee law could surmount the difficulty by not requiring proof of that subjective element. In other words, comprehensive franchisee law may require the demonstration of the objective components. For instance, in the case of non-compliance with the duty of disclosure, the franchisee may be required to show that the franchisor failed to comply with one or all of the disclosure requirements before entering into a franchise agreement. In this case, the franchisee will only have to prove the fact that the franchisor did not comply with the disclosure requirements; the franchisee may have to demonstrate that the franchisor omitted disclosing information on certain required disclosures in a disclosure document. Alternatively, the franchisee may provide evidence indicating that some information in the disclosure document is inaccurate or out-of-date.³⁴⁰ As can be seen, no proof of the franchisor's intent to defraud is demanded.

340 Utilizing this approach would be more effective if it is reinforced by other approaches, such as enabling a franchisee to verify the provided information from public records or other fellow franchisees in the franchise system by public law. However, discussing these approaches is beyond the scope of this thesis and would be useful for future research.

There may be cases where a franchisee alleges a franchisor of failing to comply with insignificant requirements. In these cases, I suggest that comprehensive franchise law requires the element of materiality as some US state franchise sale laws do. In this case, the franchisee may have to show that the franchisee's violation of the disclosure requirements materially affected the franchisee's decision to conclude a franchise contract. To put it another way, the franchisee may have to prove that it would not have concluded the agreement had the franchisor correctly performed the disclosure duty or the duty to provide complete, current and accurate information. For example, the franchisee may rescind a franchise contract if the franchisee can demonstrate that it would not have entered into a franchise contract with the franchisor if the franchisor had disclosed accurate and current information about the franchisor's financial performance in the course of the COVID-19 pandemic.³⁴¹

3.4.5.3 Conclusions

– Concluding remarks

The DCFR, the USA, and Australia provide an aggrieved franchisee with a set of three private law remedies – enforcement of performance, damages, and rescission or avoidance – in the event of the franchisor's non-performance of the pre-contractual duties of information. The DCFR, the USA, and Australia are similar in that they provide the remedies of damages and rescission or avoidance. These civil remedies are *ex-post* sanctions in the sense that they can be resorted to after a franchise contract was concluded. In terms of the enforcement remedy, only the DCFR and Australia provide legal mechanisms that would allow the franchisee to compel the franchisor's performance before the conclusion of a franchise contract.

– Key recommendations

(1) Remedial regime

For the purpose of protecting the franchisee's rights to the franchisor's performance of pre-contractual obligations, comprehensive franchise law should introduce a remedial system that enables an aggrieved franchisee to seek three private law remedies as follows: enforcement of the franchisor's performance

³⁴¹ During the pandemic of the COVID-19 in some countries, many franchisee businesses may have adversely been affected by the outbreak of the disease. In this case, a disclosure document may not contain accurate data on the franchisor's financial status at the time of disclosure. Thus, in some countries such as the USA, an accurate account of the franchisor's financial performance representations is considered important in the time of the pandemic. See The NASAA Franchise Project Group, 'Disclosing Financial Performance Representations in the Time of COVID-19' <<https://bit.ly/3xAbeQf>> accessed 21 January 2022.

of pre-contractual information duties, recovery of damages, and cancellation of a franchise contract.

(2) *Enforcement of performance in kind*

The first private law remedy should facilitate the actual acquisition and utilization of the pre-contractual information. This remedial function would enable a prospective franchisee to make a reasonably informed decision whether or not to buy a franchise. The franchisee's ability to resort to the enforcement of performance would help avoid any dispute arising after a franchise contract is concluded.

(3) *Recovery of damages*

The second remedial mechanism aims to redress the franchisee's loss or damage caused by the franchisor's non-performance of the pre-contractual information obligations in money form. Under the remedial regime, comprehensive franchise law should allow the recovery of damages that serve a compensatory purpose. That is, an award of damages should primarily aim to redress the franchisee's actual loss or damage.

(4) *Cancellation of a contract*

The third private law remedy intends to provide a franchisee with a chance to escape an undesirable franchise relationship because of the franchisor's non-compliance with the information duties. Comprehensive franchise law should constitute a legal mechanism that allows the franchisee to cancel a franchise contract. Comprehensive franchise law should insert the element of materiality by requiring that the franchisor's non-performance of the obligations be material to the franchisee. That is, the franchisee would not have concluded a franchise contract if the franchisor had performed the duties duly.

3.5 CONCLUSIONS

Chapter three has examined the franchise legal framework of the DCFR, the USA, and Australia regulating a pre-contractual franchise relationship and found that the disclosure rules of the franchise legal frameworks similarly establish the franchisor's pre-contractual disclosure duty requiring a franchisor to provide a prospective franchisee with material information about a franchise business before the conclusion of a franchise contract. Nevertheless, the selected legal systems' disclosure rules vary in detail. The third chapter has explored that the franchise legal framework of the DCFR, the USA, and Australia does not constitute the franchisor's duty to provide complete, current and accurate information as an independent obligation. Despite the absence of this obligation, the legal frameworks contain several rules requiring the franchisor to ensure that a prospective franchisee acquires qualified information that would

enable the franchisee to make an informed decision before concluding a franchise contract.

In the context of private law remedies, chapter three has discovered that an aggrieved franchisee may seek the three private law remedies in the case of the franchisor's failure to comply with the franchise disclosure rules. First, the franchise legal framework of the DCFR, the USA, and Australia similarly permits an aggrieved franchisee to recover damages and discharge a franchise relationship. However, the source of remedial rules may differ from legal system to legal system. In addition, the franchise legal framework of the DCFR and Australia seems to enable the franchisee to enforce the franchisor's performance of pre-contractual duties. Despite this similarity, the DCFR differs from Australia in that the enforcement of specific performance is a contract law remedy. In contrast, the enforcement remedy is a statutory, discretionary remedy under the Australian competition and consumer legislation.

