

# FRANCHISING

## How to Not Land your Franchise in a Mess

Hubertus Thum, Dr. iur, LL.M.

Neustiftgasse 3/5, 1070 Vienna, Austria | Tel: 0043 1 361 2222 | Email: office@thum-law.at | Web: www.thum-law.at

Franchising is complex and there are ways in which franchisors could easily find themselves in legal disputes by not being attentive enough. Dr Hubertus Thum speaks to Lawyer Monthly about how foreign investors are often unaware about good will indemnity and investment compensation, and common issues franchisors may fall into under Austrian regulations.

**Franchising is a complex cross-sectional area. What are the common issues that foreign franchisors fall into, due to being uninformed about Austrian regulations?**

Issues often arise in case of franchise agreements based on a different jurisdiction being just translated but not properly adapted to Austrian laws or the Austrian market situation. What works in one country does not necessarily work in another country too.

There is quite a high standard regarding pre-contractual information. Many disputes arise due to false or missing information the franchisee is (not) provided with before signing the franchise agreement. Besides checking the documents and information in regard to correctness and completeness, it is highly recommendable to include proper disclaimers.

In addition, foreign franchisors should be aware of possible franchisee's post-contractual claims as described below.

**Are there other topics that could lead to disputes, despite Austrian regulations?**

As in the other EU member states, the respective cartel laws apply. Minimum or fixed sale prices are strongly forbidden, irrespective of the market shares.

Often the franchisor wants the franchisee to conduct his own marketing activities within his region. Depending on the type of business, the franchisor should consider that he might be held liable for the franchisee's activities (e.g. if an advertisement states an infringement of competition law).

Thus, it is highly recommendable to have guidelines on how to conduct any marketing activity and possible reimbursements between the franchisor and the franchisee.

**What are the consequences of terminating franchise agreements in Austria? Does the franchisee have any claims that foreign investors are often unaware of?**

In case of termination of the franchise agreement, franchisors may face several claims by the franchisee depending on the reasons for terminating the contract. Besides claims for outstanding fees or damages due to wrongful termination, there are especially two possible claims that foreign franchisors are often not aware of: a so called good will indemnity, and an investment compensation.

**What are the good will indemnity and the investment compensation about?**

The good will indemnity derives from an analogous application of rules regarding commercial agents: the commercial agent directive (86/653/EEC) introduced compulsory indemnity/compensation in favour of the commercial agent under certain circumstances if the contract is terminated. The agent shall be entitled to an indemnity if he has brought new costumers to the principal or significantly increased the volume of business with existing costumers and the principal continues to derive substantial benefits from the business with such costumers. The payment of this indemnity has to be equitable in regard to all the circumstances.

The analogous application was first picked up by the German Federal Court (BGH) in regard to authorized

car dealer agreements and later more or less copied by the Austrian Civil Supreme Court (OGH), which has also applied it to the termination of (subordination) franchise agreements. According to the OGH, the main criterion for justifying the analogy is an "integration in the franchisor's distribution processes comparable to that of the commercial agent".

The OGH developed a list of contract clauses which can indicate such an integration. The most decisive factor is still a general perspective. The good will indemnity can amount up to a franchisee's annual margin.

On the other hand, franchisors may be faced with an (additional) investment compensation in case of termination of the contract. Distributors that are part of a 'vertical distribution system' (including franchising) are entitled to claim non-amortized or non-adequately utilisable investments they were obliged to make according to their distribution agreement with regard to a uniform distribution system. A possible (good will) indemnity remains unaffected.

Both claims do not exist if the franchisee has terminated the contract, unless the franchisor has given the reason for it. Nevertheless, the claims also exist in case of termination by mutual agreement and expiration.

**What are the possibilities for a franchisor to avoid a franchisee's claim for a good will indemnification? Can they be excluded by agreement or by choosing another governing law?**

Under Austrian law the above



### About Hubertus Thum

Starting and running a business is enough of a challenge in a competitive and short-lived world. Dr Hubertus Thum's clients – including SMEs, distributors, manufacturers and commercial agents – benefit from his years of experience and his sense of the times.

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mentioned good will indemnity and the investment compensation are obligatory and cannot be excluded by agreement. In case of a commercial agent operating within the EU, agreeing on a governing non-EU law does not help the principal. The commercial agent's claims still remain.

Nevertheless, in regard to franchise agreements the situation can be different depending on the franchisor's origin, the franchisee's registered office and the actual place of activity.

In some specific constellations it might be possible to exclude the above-mentioned claims by choosing a jurisdiction and governing law that does not provide the franchisee with such claims. Additionally, it might be possible to exclude them by contract.

Considering the international circumstances an arbitration clause might be a good solution too. **LM**