

MAKING THINGS SAFER



MARCIN WNUKOWSKI, ATTORNEY-AT-LAW, PARTNER AT SQUIRE PATTON BOGGS, WRITES ABOUT THE BEST WAY TO MAKE FRANCHISE CONTRACTS BETTER FOR ALL SIDES CONCERNED.

Franchise contracts have played a pivotal part in shaping the Polish economy, even more so since the country's transition into a free-market economy. In 2020, before the COVID-19 pandemic, there were more than 1,300 franchise chains in Poland, from small diners and repair shops to such giants as McDonald's.

Yet, unlike elsewhere across the European Union, including Italy, Holland, Latvia, and Romania (let alone in the franchise's birthplace—the US) Polish franchise contracts, surprisingly, given their economic significance, are scarcely regulated, and qualify as the so-called innominate contracts. This means that neither the language of the contract nor the obligations of the parties are specifically regulated by statute. The existence and functioning of franchise contracts are based on the freedom of contract principle emanating from the Polish Civil Code. This, in turn, means that the parties are free to structure the franchise contract as they please, so long as it does not infringe on the appropriate legal relationship, or contradict the law and the community life rules.

CONTRACTS GOING ASTRAY

A certain consensus has evolved over more than 30 years of the Polish free-market economy as to such contract's mandatory terms. Under the franchise contract, the chain organizer (the franchisor) allows the other party (the franchisee) to use its trade name, style, symbols, trademarks, specific business knowhow, concepts, and operating techniques, all that in exchange for the franchise fee outlined in the contract. The fran-

chisor should assist the franchisee with the operating techniques, while the franchisee ought to operate using the provided know-how and intellectual property rights, as well as in line with the franchisor's guidelines. In the franchise model, the franchisee may run its business using a foolproof setup and a recognizable brand. Despite no statutory regulations, the Polish system had been developing fairly uninterruptedly for many years. Yet, between 2018 and 2020, irregularities in the franchise market began to surface. Among others, concerns were raised about abusing the chain organizers' market position (e.g. franchisees were forced to purchase products and services from preferred partners, often overpaying and overstocking), as well as charging excessive chain entry and contract termination fees. Also, allegedly, under the popular standard franchise contracts, the franchisee would bear nearly all of the business risk. Other reported issues included promoting business models with questionable efficiency and misrepresenting anticipated earnings to future franchisees so that they were unable to fully appreciate the future operation's business risk.

REGULATOR'S ACTION

These issues have prompted the legislator to attempt to regulate the franchise contract parties' rights and obligations. The need for and the extent of such regulations have been debated since 2020 up to now. On 27 July 2022, the Justice Ministry announced a Civil Code (and other laws) amendment regulating the fran-

chise contracts. It is not clear when the new Parliament will vote on the new law.

PRACTICAL APPROACH

The pace of the legislative work aside, one should pose the question of whether it is necessary to regulate the franchise contract language by statute. Whether putting it in strict legislative confines will not result in "overregulation", which may slow down or even set back this market's development, because the franchise contract will be overly expensive and regulated. I believe such regulation seems advisable. Perhaps it is not an urgent matter as the existing regulations seem sufficient to thwart any material market irregularities. However, some frameworks may prove useful. I tend to lean toward civil-law style regulation which includes the franchise contract within the Civil Code. With this, regulating the franchise contract would result in a more stable legal environment for the market to function. In addition, better legal protection for franchisees would facilitate their business decision-making and be conducive to more potential entrepreneurs deciding to operate like that.

PROTECTING CONTRACT PARTIES

Such regulation should, first, define the franchise contract and set out its basic terms. It would also be advisable to enact provisions protecting the weaker party as in most cases, franchisees are natural persons

lacking the knowledge and skills to fully appreciate the proposed contract and its ramifications. To a certain extent, such protection might be effected by obliging the franchisor to provide a detailed document describing the proposed contract, its language, and the franchise chain's operations, including the financial information for the past 2-3 years (if the franchise has been operating this long). Such a document should be drafted in simple and understandable language. This would enable the franchisee to more objectively assess its contemplated enterprise. Such obligation applies under the US law. When protecting the franchisee, we should not forget about protecting the franchisor. What may be beneficial, if regulated, is a no-competition requirement to be met by the franchisee leaving the chain and a franchisor's intellectual property protection clause, as well as certain contract termination rules.

OTHER SAFEGUARDS

The 27 July 2022 Justice Ministry draft does regulate the above matters. The draft is relatively short and covers only the rudiments of the franchise contract. It seems that the legislator need not further interfere with freedom of contract. The existing regulations, such as the Unfair Competition Act or the Civil Code (concerning contractual penalties) appear a sufficient basis to combat any irregularities.

Aligning the franchise contract with civil law will offer a more stable legal framework for the market.