FRIGNANI E ASSOCIATI

STUDIO LEGALE

PROF. AVV. ALDO FRIGNANI
ORDINARIO, UNIVERSITA' DI TORINO
AVV. PAOLO VIRANO

AVV. ANDREA PINI
AVV. EMANUELE WALZEL
AVV. ALESSANDRA SONNATI
AVV. MASSIMILIANO NOTARO

* * *

AVV. GERRIT WOLLMANN
RA FRANKFURT/M
DOTT. DARIO PASCHETTA

CONSULENTI:
PROF. ROBERTO CARANTA
ORDINARIO, UNIVERSITA' DI TORINO
PROF. AVV. PATRIZIA GROSSO FRIGNANI
ASSOCIATO, UNIVERSITA' DI TORINO
PROF. ELEONORA RAJNERI KARAGEORGEVITCH
ASSOCIATO, UNIVERSITA' PIEMONTE ORIENTALE

10133 **TORINO** - VIA ARGONNE, 1
TEL. (011) 6602302 R.A.
FAX (011) 6601884
info@studiofrignani.com
www. studiofrignani.com

IN COLLABORAZIONE CON
INZITARI & PARTNERS
*STUDIO LEGALE – **MILANO***
info@inzitariepartners.it
e
STUDIO LEGALE PROSPERETTI
*PROF. AVV. MARCO PROSPERETTI - **ROMA***
slp@proslaw.it

PROVVISIONAL TEXT CONCERNING THE ITALIAN PERSPECTIVE ONLY

IDI

NEW ISSUES IN INTERNATIONAL DISTRIBUTION

2010 Annual Meeting of the International Distribution Institute

Turin, 11-12 June 2010

Termination of Master Franchise Agreements and the consequences among the parties

PROF. AVV. ALDO FRIGNANI
Professor of Law, University of Turin

This article discusses the termination of Master franchise Agreements and its consequences among the parties in light of the Italian law.

1. Termination of Master Franchise Agreements

Since law 129 of 6 May 2004 (the Italian franchise law), also applying to master franchise agreements, does not foresee any specific provision on the termination of a franchise contract (except that, in case of fixed term franchise contract, the franchisor shall guarantee the franchisee a minimum term related to the period of amortization of the franchisee's investments, providing however that this term shall not be less than three years) this area of law is regulated by the general provisions of the Civil Code, interpreted through the few cases which have dealt with master franchise agreements.

Generally speaking, master franchise agreements may terminate[1]:

(a) in case of fixed term agreements, when the term of the agreements comes to the end;
(b) by mutal consent;
(c) by unilateral withdrawal;
(d) by breach;
(e) by other causes admitted by the law.

(a) Fixed Term Agreement

If the parties have signed a master franchise contract with a fixed term, at the expiration the agreement simply ceases to be in effect, without any procedure. In fact, the basic principle of freedom of contract (Article 1322 of the Civil Code), which includes freedom not to contract, implies from one hand that a sub-franchisee has no right to the renewal of the contract when it has come to an end (except what he may be able to negotiate) and from the other hand that there is no requirement for the franchisor, under Italian law, to declare the reasons for the non-renewal.

In order to avoid transactional costs, very often the parties stipulate that a fixed term contract may be automatically renewed, for an equal or shorter period, unless notice of termination is given by one of the party in advance (usually three, six or twelve months).

In the case *Soc. Avis Autonoleggio v. Soc. Mad* decided by the Taranto Tribunal in 2003[2] the Tribunal states that if the parties have agreed upon such a clause, the notice given by one of the party (in the case, by the franchisor) may not be considered as "unfair" termination of the contractual relationship since it corresponds to the exercise of a right contractually granted.

If the notice of termination is given without respecting the agreed delay, the contract runs for the whole period provided for and in case the franchisor fails to

[1] On the termination of franchise and distribution agreements in Italy see also A. Frignani on this *Journal* (1993), p- 66-70.
[2] Trib. Taranto, 22 December 2003, in (2004) *Foro it*., I, 262

fulfill his obligations (in brief, ceases his relationship with the franchisee) he is bound to pay damages equal to the loss of profits for the franchisee.

(b) Termination by mutual consent

Article 1372, paragraph 1, first part of the Civil Code states that "*A contract has force of law between the parties and that it cannot be terminated except by mutual consent"*. If termination occurs by mutual consent the effects take place as from the date agreed upon.

(c) Termination by unilateral withdrawal

In this case the party seeking to terminate the contract must give the other "adequate" advance notice.

The rule is found in Article 1569 of the Civil Code concerning the indefinite term agreement in supply contracts, which is commonly considered applicable to franchising. It states "*If the duration of supply is not established, each party may withdraw from the contract, by giving notice within the agreed period or the period established by the custom or in default with adequate period having regard to the nature of supplies*".

Furthermore, Article 1373 of the Civil Code provides that "*If the power to withdraw from the contract is attributed to one of the parties such power may be exercised until the contract has begun to be performed. In the contracts with continuing or periodical execution, such power may be exercised also later but withdrawal does not have effects on performances already executed or in course of execution*".

(d) Termination due to breach

The termination due to breach of the master franchise agreement is regulated, in the absence of specific provision, by Article 1453 of the Civil Code which provides "*In contracts providing for mutual counterperformance, when one of the parties fails to perform his obligations, the other party can choose to demand either performance or dissolution of the contract…*". In this respect it must be underlined that the Italian legal system envisages no exact equivalent to the English concept of 'fundamental breach'. However, the franchisor may terminate the contract whenever the breach of the contract by the master franchisee is important to him (Article 1455, Civil Code).

As a matter of fact, failure to pay for considerable lot of purchased goods (but the same question may rise, *mutatis mutandis*, in respect of any other sum or royalties that master franchisee is due to pay to the franchisor under a master franchise agreement) has been considered an important breach of the franchise

contract, as it has been reaffirmed in some recent summary decisions[3], while it is in our opinion doubtful if a single breach of one of the payment obligation cast on the master franchisee may be regarded as important to justify the termination of the agreement.

The same problem arises in respect of the other obligations on the parties. As a sample, they have been considered "important breaches" the violation by the franchisor of the obligation to transfer and update the know-how, since the know-how represents the typical element of a franchise agreement and allows the franchisee to render the client services identical to those devise by the franchisor[4] as well as the violations of the obligation not to sell competing products cast on a distributor, because of the damage to the commercial image of the supplier which arose from competing products being sold in premises carrying its trade signs[5].

On the other hand it is also necessary to take into account the case of reciprocal breaches by both parties. In such a event, according to the prevailing interpretation of the Italian Supreme Court it will be necessary to compare the behaviour of each party in order to establish, with reference to the respective interest and to the objective importance of the non-fulfilments, which is the more considerable breach and then which party may be held liable, bearing in mind that "*the breach must be exclusively charge upon that party to the agreement which, by his proper prevailing behaviour has impaired the relation between the reciprocal contractual obligation originating the justified non fulfilment of the other party*"[6].

However, the above interpretation does not consider the liability of the other party which is also himself guilty for the non-fulfilment. In our opinion the principle of cooperation between the parties (deriving from the more general good faith principle) may play an important role in order to adjuste the consequences of the reciprocal contractual breaches, also in term of related damages. A sample it is offered by a very recent decision of the Tribunal of Palermo[7].

In the case Winsport, the master franchisee, sued the franchisor A.F.M.E. before the Court of Palermo claiming for damages, asking the Tribunal to ascertain the termination of the Master Franchise Agreement due to breach of contract by the Franchisor.

According to the Master Franchisee, those breaches consisted mainly in the fact that Franchisor failed to:

1) arrange agreements with selected suppliers who offered more favorable purchase conditions than those offered to retailers outside the network;
2) supply materials for the training courses to be held before the opening of the stores;

---

[3] *Spesa Intelligente S.p.A. v. Ciesse S.r.l.*, Trib. Mantua, 7 September 2006, not yet published and *Cucina Italiana S.r.l. v. Nil Difficile Volenti S.r.l.*, Trib. Rome, 14 June 2004, not yet published.

[4] *Borrelli v. Soc. WDC*, Trib. Milan, 28 February 2002, in (2002) *Giur. Milanese*, 273

[5] *Unali v. SEM Spa*, App. Milan, 4 June 1996, in (1996) *Contratti*, 585 *et seq.*, with observations by L. di Liddo, *Violazione dell'obbligo di esclusiva e risoluzione*

[6] *Migliarotti v. Russo*; Cass. civ., Sez. II, 3 January 2002, n. 27, in *Giur. It.*, 2002.

[7] *Winsport S.r.l. v. A.F.M.E. S..A.*; 4 October 2006, not publised.

3) organize sales promotions and advertising campaigns and
4) supply the data processing system.

The franchisor counterclaimed that the contractual breach was to be attributed to the Master Franchisee because he failed to

1) negotiate and sign unit franchise contracts using the standard authorized contract;
2) attend the training courses;
3) provide training courses to sub-franchisees;
4) sign a sub-franchising agreement pending ruined commercial relationships and
5) pay several due sums.

Consequently, the Master Franchisee counterclaimed for damages. The Tribunal held that both parties failed to provide sufficient evidence of the claimed breaches, and that such breaches were not as fundamental as to jeopardize the contractual balance. Therefore, it rejected the claims for damages from both parties, pointing out that "*no intentional wrong-doing or negligence can be attributed to neither of the parties*".

It is worth drawing the attention to the excerpt of the decision where the Tribunal concluded that the franchisor did not fail to perform the obligation of arranging privileged commercial agreements with selected suppliers, mostly because the franchisor succeeded to prove his best efforts in gaining favorable conditions from the suppliers (although the rebates obtained were not as high as the franchisee hoped).

Also franchising agreements provide different kinds of obligations, some of which may be described as "best effort" obligations, others as "performance" or "good faith" obligations. As regards to "best efforts" obligations, a party may not claim that the obliged party failed to achieve the results, if the latter can prove to have used due diligence (i.e. doing anything reasonably possible to gain the results), had that conduct led to the expected outcome or not. As for "performance" obligations, they can be discharged by the obliged party only if it achieve the results agreed upon, or alternatively if it can prove that it was prevented from achieving the results for a fortuitous event.

The rule of Article 1455 of the Civil Code is applicable also when an express resolutive clause had been inserted. For this reason, quite often parties specify in the agreement those clauses which they deem of major importance, whose violation will give way to the termination of contract by the other party with immediate effect simply by notifying the other party (Article 1456).

If no such clause exists and there is a breach the innocent party must warn the party in default in writing, giving it an adequate delay to cure the breach. Such delay cannot be shorter than 15 days unless a shorter term was agreed upon by the parties or is deemed to be adequate according to the nature of the contract or trade custom (Article 1454). At the expiration of such term, if the breach has not been cured, the contract is terminated by operation of law.

(e) Termination by other causes admitted by the law

Article 1372, paragraph 1, part 2 of the Civil Code states that "*A contract has force of law between the parties and that it cannot be terminated except ... by causes admitted by the law*".

According to Article 1467 of the Civil Code "*In contracts for continuous or periodic performance or for deferred performance, if extraordinary and unforeseeable events make the performance of one of the parties excessively onerous, the party who owes such performance can demand dissolution of the contract, with the effects set forth in Article 1458*".

Dissolution cannot be demanded if the supervening onerousness is part of the normal risk of a contract. A party from whom dissolution is demanded can avoid it by offering to modify equitably the conditions of the contract.

The issue came up in the arbitral award *Midal v Toson,* decided in 1989[8], when it was declared: "*Economic difficulties which have occurred during the performance of a contract are not considered extraordinary and unforeseeable events which justify the discharge of such a contract for excessive onerousness*".

The facts of the case were the following. On 11 June 1979, Midal (franchisor) and Toson (franchisee) executed a sub-franchising contract which enabled the latter to use for his business in Latina a sales formula called 'discount' that had been granted to Midal under a franchising contract, within the network of a nationwide business association called VéGé. The contract was renewed by the parties by private deed, dated 28 September 1982.

The duration of the agreement was fixed for five years, extendable for periods of two years if not terminated by written notice sent to the other party at least 360 days prior to the date of expiration. According to this provision, the franchisee, by registered letter dated 24 March 1988, gave notice to terminate the contract on 28 September 1989. On 21 July 1988, prior to the expiration of the terms, the franchisee served a writ instituting a legal proceeding before the Latina District Court, claiming the rescission of the contract and alleging that the franchisor was in breach of contract — at the same time stating that it had become excessively onerous. The franchisor raised the objection that under the terms of the contract, disputes arising therefrom were subject to arbitration.

Afterwards, by telegram dated 29 July 1988 and letter dated 2 August 1988, the franchisor declared the contract rescinded and required the franchisee not to use further the distinctive signs, the licence of which was granted under the contract. On 20 October 1988, the franchisor served a paper introducing the arbitral proceeding. The franchisor demanded:

(a) the declaration of rescission of the contract due to the franchisee's fault;

(b) damages according to a clause of the contract which provides for a penalty equal to 3 per cent of the franchisee's turnover of the preceding year;

(c) ascertainment and prohibition of the illegitimate use of the distinctive signs, and claimed consequential damages.

---

[8] Reported by A. Frignani (1999) *Il contratto di franchis*ing, Milan.

The allegations of the parties were the following: the franchisor alleged that the franchisee did not manage its business according to good managerial rules following the instructions received and that this was in breach of contract. The defendant requested a declaration that its withdrawal from the franchising contract was justified due to excessive hardship and that the contract had been discharged on 21 July 1988.

The arbitrators then ascertained that the franchisee during the contractual relationship and particularly in the last period had not run his business in complete accordance with franchising provisions, since he did not always take part in the franchisor's promotional and advertising activities, he arbitrarily reduced the selection of the assortment and did not always pay attention to the proper rotation of such merchandise. Nevertheless, the arbitrators held that such defaults were not fundamental enough to justify the rescission of the contract, either in law or in equity. Furthermore, the arbitrators held that the illegitimate use of the distinctive signs made by the franchisee after the termination of the contract had been very limited in time so that consequential damages were negligible.

Afterwards, the arbitrators rejected the allegations of the defendant who had claimed the contract to be null due to certain clauses giving excessive supremacy to the franchisor. The arbitrators held that such clauses were only the expression of the need common to any contract which is made by enterprises to regulate business relationships in the most uniform and co-ordinated manner.

As far as the franchising contract is concerned, they stressed its nature as a distribution contract which had emerged in socio-economic practice and which had been recognised as full expression of contractual autonomy of the parties for some time. Finally, the arbitrators held that the franchisee's withdrawal by refusing merchandise and serving the above-mentioned writ was unlawful and not justified for the following reasons:

(a) it had not been ascertained that the franchisor's behaviour was against contractual good faith, nor that it was such as to influence negatively the franchisee's business;

(b) the economic difficulties experienced by the franchisee since 1987 were primarily due to increase of management costs and increase of competition;

(c) in the actual case the economic difficulties had not reached such a high level as to be qualified as extraordinary and unpredictable according to Article 1467 of the Civil Code.

Neither of the parties objected to their contract being considered a proper franchising agreement; the problem at stake concerned the risk, considered peculiar to the franchising contract.

The arbitrators applied Article 1467 of the Civil Code which introduced the hardship theory into the Italian legal system in contracts for continuous, periodic or deferred performance, giving the right to demand rescission of a contract to the party whose performance has become exclusively onerous, for unforeseeable and extraordinary events, which do not fall within the normal risk.

In the case in point, the arbitrators considered that the increase of management costs and competition which had created economic difficulties for the

franchisee fell within the normal risk, since they were neither unforeseeable nor extraordinary events. The statement conforms to the opinion of legal commentators and case law which point out that the parties to a franchising contract are necessarily independent undertakings. Such contract implies an area in which the franchisee takes upon himself the risk of the management of his own business and so the risk of profitability. In fact, if the risk should be borne by the franchisor who guarantees the profitability of the business, it would be possible to equate the franchisee to an employee.

Although independence is an essential element in franchising, the limitation of the franchisee's autonomy, in so far as it does not lead to its exclusion, is not considered a 'pathology' of the contract. The arbitrators stated that the control of the franchisor over the franchisee is a normal situation. They regarded such supremacy as the expression of the need for uniformity and co-ordination of behaviour of all franchisees, which is essential for keeping the unity of a franchising network image.

Finally, a master franchise agreement is terminated whenever *force majeure* circumstances prevent the sub-franchisee from exercising his business activity. The parties often lay down a non-exhaustive list of such circumstances, providing also for the cases in which the impossibility of carrying out business is only temporary.

2. Consequences of the termination of the master franchise agreement vis-à-vis sub-franchisees

When the master franchise relationship comes to the end, which is the fate of the sub-franchise agreement existing at the date of the termination?

It is principally the master franchise agreement that will govern what happens to the sub-franchise agreement existing at the date the master franchise agreement terminates.
Options are the following:

a) the sub-franchisee agreements would automatically terminate;
b) the sub-franchise agreements may be transferred to the franchisor;
c) the franchise network may be taken over by the franchisor or by another master franchisee appointed by the franchisor.

2.1 The contractual practice

a) Automatic termination

The master franchise agreement may provide for the automatic termination of the sub-franchise agreements in case of termination, due to whatever reason, of the master franchise agreement.

The automatic termination calls for a distinction: if there is in the sub-franchise agreements an explicit provision concerning the automatic termination of

the sub-franchise agreement at the termination of the master agreement, then the sub-franchise agreements simply terminate.

If no such clause exists in the sub-franchise agreements but only in the master franchise agreement, obviously the clause is not binding for the sub-franchisees and thus it should be ineffective towards them. Nonetheless there could be difference consequences, depending on the ground of the termination.

In case of termination due to breach of the master franchisee, since, according to Article 1218 of the civil code , the obligation is not discharged when its performance becomes impossible for a cause attributable to the debtor, the master franchise shall result in breach of the sub-franchise agreements with all the related consequences in terms of liability for damages (see para. 2.3 under). On the contrary in case of termination due to reason other than the master franchisee' breach, the obligation is discharge due to impossibility of the performance.

b) Assignment

In case of termination of master franchise agreement, it is in the interest of both the franchisor and the sub-franchisees to safeguard the sub-franchisees and to try to keep them in the system. Since the sub-franchisees will have no legal binding commitment with the franchisor, this could be achieved by inserting in the master franchise agreement a transfer clause providing for the automatic assignment to the franchisor of the sub-franchise agreements existing at the date the master franchise agreement terminates.

In this respect it must be noted that Article 1406 of the civil code provides that: "*Each party can substitute for himself a third person in the relationship arising from a contract for mutual counterperformances, if these have not yet taken place, provided that the other party consents thereto*". Very often the sub-franchise agreements contain a provision according to which the sub-franchisees gave their consent in advance to the assignment of the contract. While the validity of the advance consent to the assignment of the contract to the franchisor it is unquestioned, some doubts may arise whereby the relevant clause provides for the assignment to any third party. Although from one hand it can be argue that if the sub-franchisee agreed upon such a clause then the clause it is binding towards him, on the other hand it can be opposed that where the assignee is not expressly identified (at least by answering a particular description) the sub-franchisee, due to the personal nature of the franchise contract, is not obliged to accept the assignment.

If consent is not given in advance, then the assignment could constitute grounds for the sub-franchisees to terminate the contract.

If a transfer clause has been agreed between the parties, franchisor may propose that such a clause should specify that he has no obligation to accept the automatic assignment of all the existing sub-franchise agreements.

In fact it would be undesirable for the franchisor to step into sub-franchise agreements that are not profitable or that have a high degree of litigiousness.

Second he may not have a sufficient level of knowledge of the sub-franchisees or of the contracts performance to protect his interests.

Moreover it may be underlined that in international master franchise agreement the franchisor may not be able to assume the role of franchisor in a foreign country in which he doesn't have any organization or office to support his activities and to fulfill his obligations.

In consideration of the above issues, quite often master and sub-franchise agreements provide that, at the termination of the master franchise agreement, franchisor has an option (and not an obligation) to step into the existing sub-franchise agreements. When master franchise agreement terminate, then the franchisor would select which franchise agreement it would be convenient for him to accept.

If no transfer clause has been agreed between the parties, upon termination of the master franchise agreement, sub-franchisees will have no legally binding agreement with the franchisor. It ensues that the parties will have no further rights except what they might be able to negotiate.

c) Taking over

Last there is the possibility for the franchisor, at the termination of the master franchise agreement, to take over the master franchisee business and interest in the sub-franchise agreement in whole or in part or to appoint a new master franchisee which will take over the master franchisee business and interests in the sub-franchise agreement.

This could also be done in the form of a post termination option for the franchisor to purchase the business. In such a event, it should be recommendable to insert in the master agreement a provision dealing with the criteria to adopt to evaluate the business.

Worth to note, since the franchise contract are characterized by reciprocal consideration of the personal qualities and reliance on the other party, in the event of taking over of the master franchise business by a new master franchisee there is no obligation, for the sub-franchisees to continue their relationship with this latter. This would result in particular in the case whereby the new master franchisee materially alters the way the business is conduct. In such an event, the sub-franchisees may have sound reasons to withdraw.

2.2 The legal effect of the termination of the master franchise agreement

Finally it remains to be seen which are the legal effect of the termination of the master franchise relationship when the relevant agreements are silent on this issue.

Sub-contracts do not have a specific discipline in Italy except what provided for the sub-lease agreements by the 3rd paragraph of Article 1595, which states that "*Without affecting the rights of the sublessee against the lessee or hirer, the nullity*

or dissolution of the contract of lease and any judgment rendered in litigation between the lessor and the lessee are also effective against the sublessee".

Similarly, it would be possible to conclude that also the sub-franchise agreement would not survive to the termination of the master franchise agreement.

Such an outcome is confirmed by what follows.

First, we pint out that at the termination of the master franchise agreement, the master franchisee loses all rights and powers granted to him by the franchisor in execution of the contract and he will have to cease acting as master franchisee and to discontinue the use of any distinctive sign (and other industrial property rights) of the franchisor and of the franchisor's know-how and therefore he will not be further able to transfer to the sub-franchisees any elements of the franchise system.

The second argument is that the sub-franchise agreements may be considered as derivative contracts. In this light, although the sub-franchise agreements are independent contract they are not autonomous. We may therefore conclude that the termination of the "main" contract, the master franchise agreement, necessarily leads to the termination of the here derivates contracts (the sub-franchise agreements) on the basis of the principle "*resoluto iure dantis,resolvitur et ius accipientis"*[9].

Finally, the sub-franchise agreement may be seen as "linked" contracts that is to say contracts conceived as functionally and teleologically connected and in a position of reciprocal dependence[10]. This solution will enable the application of the rules of the "*simul stabunt simul cadent*"[11] since the vicissitudes of one of the contract (likes the one concerning its nullity and termination) have effects also on the other contracts.

On the other hand some authors argued that a master franchise agreement and the sub-franchise agreements are not automatically linked in respect of the termination of the master franchise agreement. The argument defending the thesis is that in some jurisdiction there is a provision which says that only if a party performance has become impossible because of circumstances for which the party is not responsible, the obligation is deemed to be extinguished, otherwise a party remains responsible. Although a similar provision exists also under Italian law, it does not exclude in our opinion the termination of the sub-franchise agreements for master franchisee's default, but it only impacts on the right of the (innocent) sub-franchisees to be indemnified by the (negligent) master franchisee.

2.3 The remedies against termination available to the innocent sub-franchisees

2.3.1 Against the master franchisee

As mentioned, the remedies available to the innocent sub-franchisees are in essence limited to a compensation for the damages suffered due to the contract

[9] The transferee's rights terminate with those of the transferor.
[10] Such a link may also lead in certain cases to franchisor vicarius liability.
[11] As they live together, together their fall.

termination, on the basis of Article 1218 of the Civil Code which provides that «*The debtor* (ndr. in the case, the master franchisee) *who does not exactly render due performance is liable for damages unless he proves that the non-performance or delay was due to impossibility for a cause not imputable to him*».

Assuming that the conditions necessary to claim for damages exist, a question of considerable importance is what damages are refundable. Given that the refundable damages include the actual damages as well as the loss of profit, it can be excluded that sub- franchisees are entitled to claim for the investment cost that have been already amortized or those, even if not amortized, that can be used for the conduction of a different business (such as, for example the rent of the point of sale).

Exemplary or punitive damages are instead unknown to Italian legal tradition while the non-patrimonial (i.e. non economically measurable) prejudice, is only restored when it is the effect of a crime.

2.3.2 Against the master franchisor

Even if the Italian legal system acknowledges the vicarious liability only under certain and codified circumstances, judges may be disposed to go beyond the provisions of law to protect the innocent sub-franchisees, who find themselves in the weaker position, and hold the franchisor liable for damages vis-à-vis sub-franchisees. Although there is no case law on the matter, Article 9 of Law No. 192 of 18 June 1998 governing subcontracting, which prohibits situations of abuse of economic dependence including "arbitrary" or "unfair" termination of the contractual relationship, if invoked by the franchisee, might play an important role in such a direction.

3. Conclusion

When negotiating a master franchise agreement and the related sub-franchise agreements parties should make particularly attention in drafting the relevant clauses.

The circumstances to be considered include the fact that the continuation of the franchise relationship with all or part of the existing sub-franchisees may be particularly valuable for the franchisor. When master franchise agreements terminate, the sub-franchisor will have to identify a new master, negotiate a new contract and take care of all the all the related start-up activities, incurring in the related sunk costs. At the same time he will lose the goodwill associate with the former network and he will not able, for a certain period of time, to receive royalties and other payment.

Since no franchisor will desire any damages being done to his existing franchise network, parties may find out alternative solutions to a complete termination of the master franchise agreement. It would therefore appear to be convenient for the franchisor to provide that, upon certain defaults of the master franchisee, a portion of the master franchise agreement should remain in force to continue servicing the existing sub-franchisees until expiration of the terms or to convert the right granted

under the master franchise agreement into a non exclusive basis. This would allow the franchisor to directly establish new agreements with franchisees or to find out another master for a portion of the territory.

To sum it up, a clear and accurate drafting of the master franchise agreement and of the related sub-franchise agreement is the first tasks of lawyers and counsels, who should never forget that an accurate writing of termination clauses is of paramount importance to protect both the franchisor and the sub-franchisees and it is essential to minimize or prevent irreversible (negative) effects.

(Prof. Avv. Aldo Frignani)