



International Distribution Institute

Is Agency becoming an Alternative to Franchising?

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Agency versus Franchising

- From a business viewpoint

- Advantages

- Franchisor's major control of the operation of the business: preservation of the Franchise System and service quality
- Inventory control
- Price control
- Provides business intelligence to franchisor
- Control of business risks, insolvency situations

- Disadvantages

- Franchisor's larger involvement in the operation of the business
- Availability of franchisor's local resources for operating in foreign jurisdictions
- Bigger costs for franchisor

Agency versus Franchising

- From a legal viewpoint
 - Advantages
 - Non applicability of competition law (only genuine agency)
 - Non applicability of franchising regulations (?)
 - Disadvantages
 - Applicability of compensation for goodwill
 - Applicability of a framework of statutory rights very protective to the agent
 - Employment law related risks regarding franchisee and franchisee's employees (joint employer)
 - Other liability leaks: versus the shop lessor, local suppliers and customers

The Traditional Distinction: Agency vs. Distribution

- Definition of commercial agency
 - Promotion or promotion and completion of sales on behalf or on behalf and in the name of supplier
 - An Agent will be considered as a “Commercial Agent”, when he is independent, i.e., he is free to organise his activity and timetables according to his own criteria, with his own personnel and premises and his own administration.
 - Other commercial intermediaries figures are available in Spain: mandate, commission and dependant agent.

The Traditional Distinction: Agency vs. Distribution

- **China:** 商业特许经营管理条例 2007 (Commercial Franchise Administration Regulation) 第三条 (Article 3)
 - the right to use its business operating resources, including registered trademarks,
 - franchisee conducts business under a uniform mode of operation
 - franchisee pay franchise fees

Problems with the Traditional Distinction

1. Competitive marketing requires better coordination and control
2. Franchises have pre-contractual disclosure obligations, which can be a barrier to entry
3. The internet has broken up the sales process – customers search and select online, and go to a store to pick-up
4. Financing the cost of uniform presentation – signs, inventory etc.
5. Goodwill payments on termination in commercial agency

Non applicability of competition law

Impact of the New EU Commission Guidelines regarding the *Genuine Agent*:

- Para 33 a): seems to capture consignment agreements
 - Para 33 (f): seems to capture franchise advertising funds, excludes as well any other contributions to brand promotion by franchisee
 - Para 33 (d): seems to capture clients' default in payments, does it require that the PoS belongs to the franchisor?
 - Para 33 (g): requires franchisor to own the lease contract for the premises or only to bear the cost ?
 - Para 33 (g): the cost of any equipment – including software and shop refurbishment – to be born by franchisor
 - Para 33 (g): Store staff: seems to allow franchisee to remain as the employer, only excludes franchisee's payment for employee's training
 - Para 33 (h): allows delivery of online sales provided that costs are paid/reimbursed by franchisor
- From a business view point, would it be feasible for franchisors to structure franchise agreements as genuine agency agreements?



Non applicability of competition law

Impact of the New EU Commission Guidelines regarding the Genuine Agent:

EU COMMISSION GUIDELINES ON VERTICAL RESTRAINTS

(33) In light of the above, an agreement will generally be categorised as an agency agreement that falls outside the scope of Article 101(1) of the Treaty where all of the following conditions apply:

*(a) the agent does not acquire the property in the goods bought or sold under the agency agreement and does not itself supply the services bought or sold under the agency agreement. **The fact that the agent may temporarily, for a very brief period of time, acquire the property in the contract goods while selling them on behalf of the principal, does not preclude the existence of an agency agreement that falls outside the scope of Article 101(1) of the Treaty, provided that the agent does not incur any costs or risks in relation to the transfer of property;***

(b) the agent does not contribute to the costs relating to the supply or purchase of the contract goods or services, including the costs of transporting the goods. This does not preclude the agent from carrying out the transport service, provided that the costs are covered by the principal;

(c) the agent does not maintain at its own cost or risk stocks of the contract goods, including the cost of financing the stock and the cost of lost stock. The agent should be able to return unsold goods to the principal without charge, unless the agent is at fault, for example, because it fails to comply with reasonable security or anti-theft measures to avoid stock losses;

(d) the agent does not take responsibility for the customers' non-performance of the contract, with the exception of the loss of the agent's commission, unless the agent is at fault (for example, failing to comply with reasonable security or anti-theft measures or failing to comply with reasonable measures to report theft to the principal or the police or to communicate to the principal all necessary information available to it on the customer's financial reliability);

(e) the agent does not assume responsibility towards customers or other third parties for loss or damage resulting from the supply of the contract goods or services, unless the agent is at fault;

*(f) **the agent is not, directly or indirectly, obliged to invest in sales promotion, including through contributions to the advertising budget of the principal or to advertising or promotional activities specifically relating to the contract goods or services, unless such costs are fully reimbursed by the principal;***

*(g) the agent **does not make market-specific investments in equipment, premises, training of personnel or advertising**, such as the petrol storage tank in the case of petrol retailing, specific software to sell insurance policies in the case of insurance agents, or advertising relating to routes or destinations in the case of travel agents selling flights or hotel accommodation, unless such costs are fully reimbursed by the principal;*

(h) the agent does not undertake other activities within the same product market required by the principal under the agency relationship (for example, the delivery of the goods), unless those activities are fully reimbursed by the principal.

Hybrid Models

Commission-Affiliation

Developed in Europe

Criticism: franchise relationship must still have certain fundamental characteristics, one of which is that a franchisee operates a real business that it owns.

Yes or Not?



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Hybrid Models - Commission-Affiliation

An Example from China:

Italian Franchisor – everyday clothing

Wanted to better control:

- quality
- price
- return and refund policy

Hybrid Models - Commission-Affiliation

Issues:

- controlling the price is resale price maintenance
- controlling the quality means inventory controls
- franchisee may not have the financing
- controlling returns and refunds means control of the sale

Hybrid Models - Commission-Affiliation

Solutions:

中华人民共和国民法典 (Civil Code of the PRC) 2021-01-01

Chapter 25 – Commission Agency Contracts

Article 955 Where the commission agent sells at a lower price lower than the price set by the principal or buys at a price higher than the price set by the principal, it shall obtain consent from the principal.

Overcomes Article 14 of the PRC Anti-Monopoly Law on vertical price fixing

Hybrid Models - Commission-Affiliation

- so the franchisor would own the inventory – could it ‘consign’ to a franchisee?

If it did, would the relationship still be a franchise relationship?

Hybrid Models - Commission-Affiliation

- In *Fujian Kuaiyipai E-commerce Ltd. v Xiamen Tianlingyuan E-commerce Ltd.* 《福建快易拍电子商务有限公司与厦门天邻缘电子商务有限公司特许经营合同纠纷》 and *Yan Wang v Mianyang Meile Cosmetics Ltd.* 《王彦与绵阳市美乐化妆品有限责任公司特许经营合同纠纷》, the courts confirmed that it is legitimate to have a consignment arrangement regarding the sale of goods in a franchise relationship.

福建快易拍电子商务有限公司 (Fujian Kuaiyipai E-commerce Ltd.) v 厦门天邻缘电子商务有限公司 (Xiamen Tianlingyuan E-commerce Ltd.) Fujian High People's Court (2017) 闽民终563号, dated January 23, 2018.

王彦(WANG, Yan) v 绵阳市美乐化妆品有限责任公司 (Mianyang Meile Cosmetics Ltd.) Sichuan High People's Court (2017) 川民终1260号.

Hybrid Models - Commission-Affiliation

- Because it was a consignment arrangement the franchisor would own the inventory in the store,
- but the franchisor had better access to financing than the franchisees, so this benefitted both.
- Still the franchisor was required to prepare and deliver a disclosure document
- Point of Sale System – optional as to whether the digital payment would go the franchisor’s bank account or that of the franchisee.

Hybrid Models - Commission-Affiliation

- Privacy compliance:
 - August 2021 China adopted 中华人民共和国个人信息保护法 (**PRC** Personal Information Protection Law)
 - the privacy policy will need to be appropriate for the ownership of the point-of-sale system chosen
 - Ownership of the customers' data - adds complexity to the data recollection process and data flows

Would hybrid models qualify as franchise agreements?

- Under Spanish law franchising is the assignment of a right to exploit a business system under:
 - a common name, signs and IP rights and a uniform presentation
 - Proprietary, substantial and unique or know-how, and
 - Continuous assistance
- Nothing in Spanish law (governed by the principle of freedom to contract) would prevent to structure a franchise arrangement as an agency agreement but agency law is most likely to apply to such arrangement
- However, it is not clear whether the contract could still be defined as a franchise if the arrangement would not allow the franchisee to handle the business as an independent entrepreneur - franchising regulations might not apply to a contractual arrangement where the franchisee does not have a right to exploit the business with independence

Thoughts under Spanish law

- ✓ Franchising contractual structures providing for the supply of goods under **consignment** seem to be feasible for business and legal purposes: both, competition law and franchising regulations would still apply.

- ✓ Structuring franchising agreements as **genuine agency agreements** would seem to be less feasible for business purposes and:
 - competition law would not apply,
 - agency regulations would apply
 - it is unclear whether franchising regulations would apply.