



International Distribution Institute

Encroachment, breach of exclusivity and reservation of rights in franchise agreements

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Framework

Analysis of judgements of our respective jurisdictions (Canada, France, Italy and USA) on encroachment and exclusivity/reservation of rights.

In all our jurisdictions, territorial exclusivity is not a necessary element of the contract: parties are free not to provide (or to explicitly exclude) the franchisee's exclusivity.

However, if an exclusivity is provided, possible rules on pre-contractual disclosure and/or requiring specific indications to be provided in the franchise agreement, shall be considered.

Contractual clauses

1. No exclusivity clause provided for in the contract
2. Explicit provision that the franchisee is not granted any exclusivity
3. Typical franchise exclusivity clause:
«franchisor's obligation not to open direct outlets, nor to allow the opening of franchise outlets in the franchisee's exclusive territory»
4. Additional reservation of rights to the franchisor (e.g. the franchisor remains free to sell through other parallel channels)
5. Full territorial exclusivity (quite exceptional: mainly in the real estate sector):
«The franchisor grants/warrants the franchisee the exclusive exploitation of the franchise in the agreed territorial area»

Encroachment

Franchisor directly acting in competition with its franchisee:

Possible franchisor's conducts:

- opening direct points of sales
- offering other franchise outlets
- selling through other channels (e.g. supermarkets, online sales etc.)

in the exclusive area granted to the franchisee or, in any case, close to the franchise outlet

Indirect liability of the franchisor for encroachment among its franchisees

The approach followed by Courts (1)

Interpretation of the contract:

- «Unconscionability» (common law)
- Ambiguity (common law/civil law)
- Contract of adhesion (common law/civil law)
- Good faith interpretation (civil law)
- Role of pre-contractual disclosure (common law/civil law)

«Significant imbalance» (civil law)

The approach followed by Courts (2)

Performance and enforcement of the agreement

- «Implied terms» (common law)
- Good faith and fair dealing (common law/civil law)

General principles on breach of contract are always applicable

Conclusions (1)

CANADA: The parties are free to include or not include territorial exclusivity as well as any specific reservation of rights. In the absence of any specific provisions, the wording of the specific grant will determine territorial and any exclusive rights. The contract will first be interpreted using interpretation principles particular to franchise agreements. In the case of ambiguity, it is possible for the court to consider the language in the disclosure document. The contract will then need to be performed (including by statute, where applicable) in accordance with principles of good faith and fair dealing. Good and clear drafting is critical. But the court will always assess performance against the contractual language and based on good faith and fair dealing principles.

FRANCE: While there is no legal provision requiring a territorial exclusivity to be included in franchising contracts, the provisions of the French commercial code prohibiting the “significant imbalance” unfair trade practice has been used by Courts to rule that clauses excluding explicitly territorial exclusivity could be considered as significantly imbalanced if the contract does not provide for a pre-emptive right in case of an appointment of another franchisee in the same area. Courts also take into consideration the behavior of the parties and the information communicated in the pre-contractual disclosure documents to assess a possible breach of good faith/loyalty obligation by the franchisor.

Conclusions (2)

ITALY: The contract must provide: «the scope of the territorial exclusivity, if any, with respect to other franchisees or to channels and sales units directly managed by the franchisor» (Art. 3.4(c), Law 129/2004). Courts often apply the principle of good faith both with the aim of re-interpreting the contractual clauses and for assessing the franchisor's conduct during performance.

USA: The contract may permit the franchisor to compete with the franchisee anywhere and through any distribution method. The parties' course of dealing, the franchisee's reasonable expectations at the time of contracting, the implied covenant of good faith and fair dealing, and applicable state statutes may augment the contract and effect the outcome.



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Thanks for your kind attention!

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