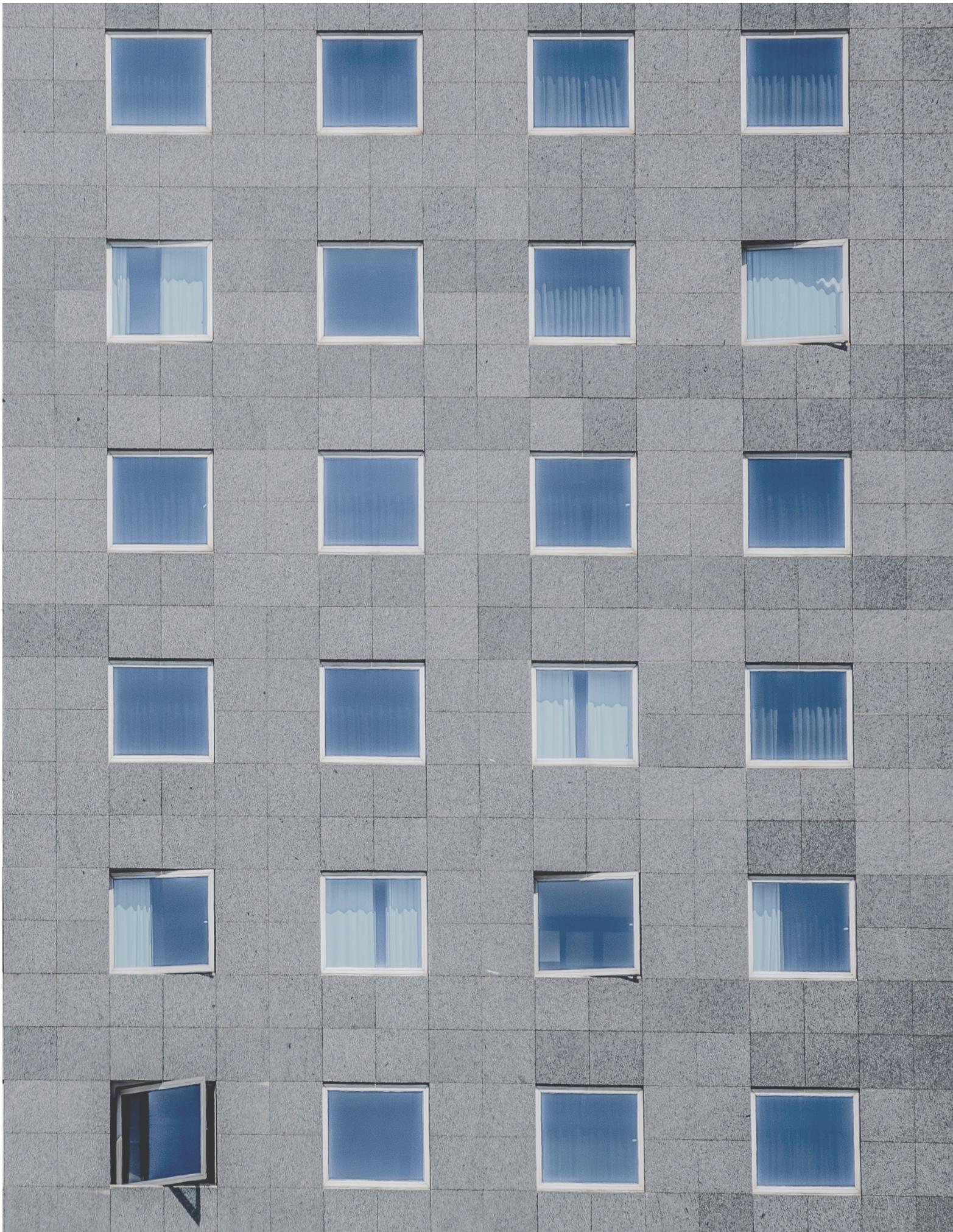




**FRANCHISE
CASE LAW
OBSERVATORY**

Years 2014 - 2016



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LETTER OF PRESENTATION

The Committee of Experts of the Spanish Association of Franchisors (AEF) was created in 2004. Its members are lawyers appointed by the board of the AEF and chosen on criteria of excellence for their knowledge and practice in the franchise sector.

Throughout its history, the Committee of Experts has developed numerous activities, including the preparation of reports on legislative projects that affect the franchise and lobbying activities with the authorities that processed the so said regulations, the adaptation of the European Code of Franchising Ethics to Spain, mediation in conflicts affecting members of the AEF, as well as participation in numerous events that contribute to the promoting of the franchise. The members of the committee are also specialised franchise arbiters recognised by the World Intellectual Property Organisation, among other national courts of arbitration.

Among the informative tasks of the committee are the writing of a periodic newsletter and the preparation and updating of a case law database that is available on the web www.abogadosdefranquicia.com.

On this occasion, I am pleased to present the “Franchise Case Law Observatory”, which was created as a further tool at the service of the franchise sector. The Observatory consists of a statistical study that offers a quantitative and qualitative x-ray of litigation in the field of franchises in Spain. It therefore not only statistically analyses the number of judicial and arbitration decisions related to the franchise and their impact in relation to the size of the sector, but also makes a qualitative analysis to determine the state of opinion of case law on the most important issues. This study was created to be ongoing and will therefore be updated each year with the new resolutions.

Jordi Ruiz de Villa
Chairman of the Committee of Experts of the AEF
JASAS Franchises area member

2. METHODOLOGY

Several databases were consulted in preparing this report, mainly the Westlaw (Aranzadi) and CENDOJ, related to judgments of Provincial Courts and of the Supreme Court (First Civil Chamber).

In the case of arbitration awards, the information has been obtained directly from the main Spanish Courts of Arbitration, that is to say, the Court of Arbitration of Madrid, the Court of Arbitration of Barcelona and the Spanish Court of Arbitration of the Chamber of Commerce of Spain. Logically, for reasons of confidentiality, only the statistical data has been accessed and not the content of the awards or the identity of the parties.

Judgments issued by the Examining Magistrates' Courts have not been taken into account given that there is no reliable database that publishes all judgments handed down in Spain. Both Westlaw (Aranzadi) and other databases consulted make a subjective selection of those judgments that they consider most relevant, so statistical data cannot be obtained.

Both the Judgments and the Arbitral Awards have been ordered according to the bodies that have passed them, and the years (2014 to 2016). A classification has also been made depending on whether the party that initiated the process was the Franchisor or the Franchisee.

Finally, the litigious amount and the sector of activity were analysed in order to bring them into line with the main economic figures of the franchise.

This analysis gives us greater knowledge of the degree of litigiousness of an activity that in 2016 grouped 50,994 franchisees with a turnover of 16,349.3 million euros, and the main conflicts that arise between franchisor and franchisees.

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3. INTRODUCTION

Between 2014 and 2016, a total of 126 Judgments¹ were passed. In 2014, a total of 47 judgments were passed as compared with 39 in 2015 and 40 in 2016, which represents a decrease of between 17% and 15% with respect to 2014.

As you can see, the numerical decrease in resolutions is not very significant since it is about 8 and 7 resolutions less respectively.

The total number of judgments shows that, against all odds, the Franchise is a conflictive sector with little litigation.

There are probably more controversies than cases, but the fact that they do not resort to judicial help to resolve their differences shows that the systems of mediation, negotiation and conciliation are successful and allow differences between the parties to be resolved in a reasonable way.

Of the seven cases that tried to access the Supreme Court, only one produced a judgment and six were left unaddressed, which is consistent with the fact that the franchise is an institution with known legal roots, and therefore of relatively low cassational interest.

In arbitration, from the information obtained from the different Courts of Arbitration it is seen that from 2014 to 2016 only two arbitration proceedings were processed that were filed by the Franchisor claiming amounts owed and termination of the franchise agreement and in which the Franchisee did not appear.

Below, we will break down these figures according to the body that issued the resolution.

1 / They include the Judgments of the Supreme Court, Higher Courts of Justice and Provincial Courts.

4. PROVINCIAL COURT JUDGMENTS

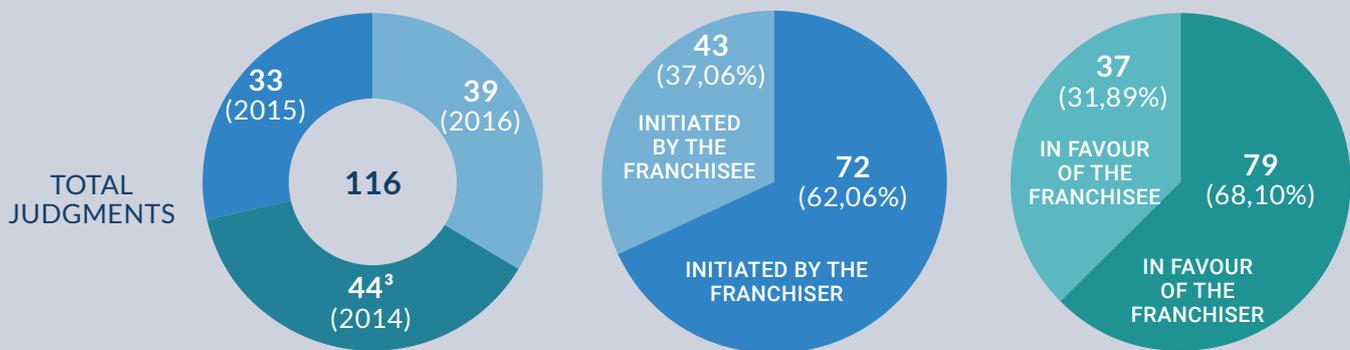
The number of judgments reflects a lack of litigation regardless of the prism with which they are analysed. If we analyse the global number of resolutions, from 2014 to 2016, the Provincial Courts ruled 116 times on aspects related to the franchise agreements: 44 in 2014, 33 in 2015 and 39 in 2016.

	TOTAL
TOTAL JUDGMENTS	116
2014	44 ²
2015	33
2016	39

2/ Only one resolution is requested by a third party outside the contractual relationship. Judgment no. 192/2014 of 9 May 2014 of the Provincial Court of Granada dismisses a claim by a consumer against a franchisee and its franchisor for damages suffered in the transport of goods.

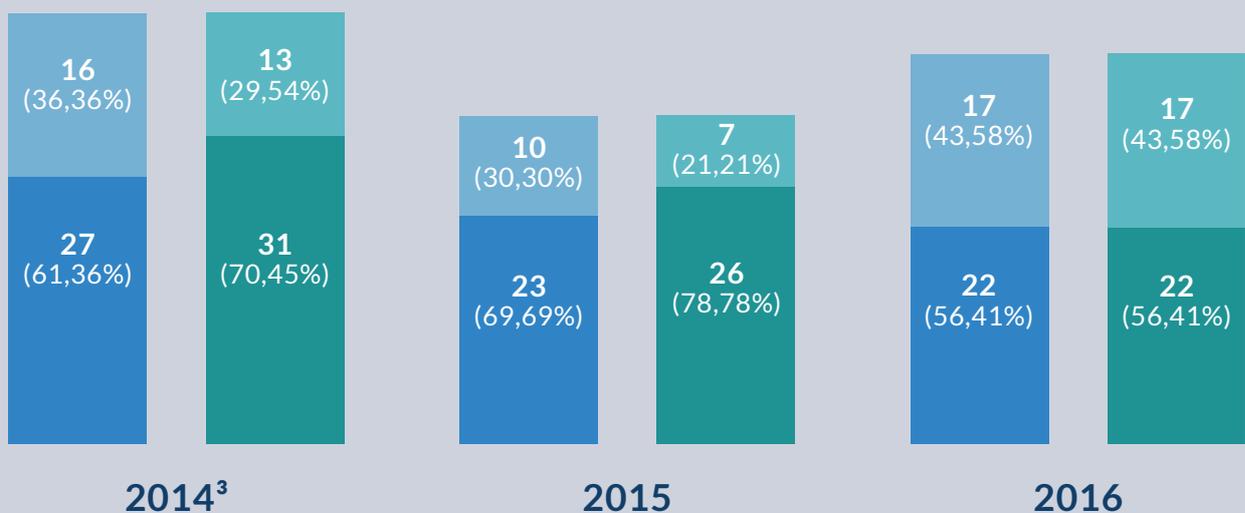
The analysis by years shows that the number of judgments issued by the Public Administrations remained stable from 2014 to 2016. Therefore, although it is true that in 2016 there was an upturn with respect to 2015, it is not higher than in 2014 and in numerical terms the variations are not significant.

Regarding the analysis of the judgments depending on who initiates the procedure - the franchisor or the franchisee - the following table shows us: Below, we will analyse several perspectives:



■ INITIATED BY THE FRANCHISEE
 ■ INITIATED BY THE FRANCHISER

■ IN FAVOUR OF THE FRANCHISEE
 ■ IN FAVOUR OF THE FRANCHISER



3/ Only one judgment comes from a claim of a third party outside the contractual relationship. Judgment no. 192/2014 of 9 May 2014 of the Provincial Court of Granada dismisses a claim from a consumer against a franchisee and its franchisor for the damages suffered in the transport of goods

As it can be seen, 62.06% of the procedures have been requested by the Franchisor and this percentage hardly changes during the years 2014 and 2015. Only in 2016 there is a noticeable decrease in the number of procedures requested by the Franchisor, which falls to 56.4%, so the franchisor maintains the initiative in the judicial proceedings.

Regarding the result of the resolutions issued, in 2014 and 2015 a high percentage (around 70-80 %) are favourable to the Franchisor, while in 2016 there was a sharp decline to 56.4%.

Likewise, in 2014 and 2015 the number of judgments in favour of the franchisor is 10% higher than the number of procedures initiated by franchisors, which means that franchisors have obtained numerous favourable judgments from procedures initiated by franchisees. On the other hand, in 2016 the number of judgments in favour of the franchisor coincides with the number of procedures initiated by franchisors.

Now a comparison will be made between the number of resolutions issued in the years under analysis and the number of franchisees and an analysis of the sectors with the highest degree of litigation.

	TOTAL	NUMBER OF FRANCHISEES ⁴ / DEGREE OF LITIGATION
TOTAL JUDGMENTS	116	141.738 0.08%
2014	44	44.619 0.09%
2015	33	46.125 0.07%
2016	39	50.994 0.07%

4/ Data obtained from the Annual Reports of "La Franquicia en España. Estadísticas Nacionales" published by the Spanish Association of Franchisors <http://www.franquiciadores.com/la-franquicia-espana/>

The degree of litigiousness during the years 2014 to 2016 remains stable on an average of 0.08% in relation to the number of establishments open to the public under the franchise system in Spain.

The sectors of activity that present a greater litigiousness are the Hospitality and Catering and Fashion with a total of 11 procedures in the 3 years analysed, and Financial Services with 10 procedures.

While the Hospitality, Catering and Fashion sectors constitute the sectors with the greatest number of brands and franchises, Financial Services presents an unusual degree of litigiousness.

According to the AEF Report “The Franchise in Spain 2017”, of the 1,298 existing brands in Spain in 2016, 229 belonged to the Fashion sector and had 5,001 franchisees. The Hospitality and Catering sector had a total of 187 chains and 7,139 franchisees, while the Financial Services sector only had 8 franchise brands and 130 franchisees.

The conclusion is that approximately 8.6% of litigation comes from a very specific sector, so that abstraction made of this specific situation is that the franchise system in Spain is even less conflictive than the statistics show.

5. SUPREME COURT JUDGMENTS

As it can be seen in the graph, the Supreme Court (Civil Chamber) resolutions in 2014 to 2016 show that the majority of cases were not even admitted for processing, since of the 7 cases that were filed, only one produced a judgment, the content of which is not particularly important since it is a claim by a consumer against a franchisee.

	2014	2015	2016
TOTAL JUDGMENTS	2	4	1
INADMISSION	1	4	1
BACKGROUND JUDGMENTS	1	0	0

It can therefore be affirmed that the Supreme Court has not created case law regarding franchises during the period under analysis.

6. ARBITRAL DECISIONS

Given the confidentiality of the arbitration awards, the main Courts of Arbitration consulted only provided information regarding the number of arbitral awards, whether they were in favour or against the Franchisor, the object of the claim and its amount, and the average term of resolution of the arbitration procedure.

The Spanish Court of Arbitration of the Chamber of Commerce of Spain and the Court of Arbitration of Madrid confirmed that from 2014 to 2016, out of a total of 182 cases processed and 86 awards handed down none was related to franchise agreements.

The Court of Arbitration of Barcelona, on the other hand, confirms that from 2014 to 2016 a total of 2 awards related to franchise agreements were issued, both initiated by the Franchisor, for an overall €126,957.47.

Finally, in 2014 to 2016, a total of 3 judgments were issued by the Higher Courts of Justice in relation to annulment of the Arbitral Award; all were dismissed because no reason can be seen for their cancellation and declaring the validity of the arbitration clauses.

As it can be seen from the limited number of awards issued in relation to the number of procedures submitted to ordinary jurisdiction, this is a means little used in the franchise system in solving conflicts, probably due to the costs of an arbitration process.

7. QUALITATIVE ASSESSMENT OF CASE LAW

The analysis of the Case Law related to conflicts arising from the Franchisee-Franchisor relationship allows six main issues of prosecution to be segmented. It is irrelevant, for these purposes, that the procedure has been initiated by the Franchisor or by the Franchisee since, in most cases, the defendant rejects and, in practically all of the analysed background, the Franchisor is finally forced to accredit correct and proper compliance with its three main rights: (1) concession of the peaceful use of the brand; (2) transmission of know-how, and; (3) initial and continued assistance adequate to the concept of a Franchisee business. Another of the recurring issues is the profitability of the franchise business. We now turn to the main issues that are the subject of prosecution in the most recent resolutions:

(I) NULLITY OF THE FRANCHISE AGREEMENT DUE TO FAULTS IN THE CONSENT OF THE FRANCHISEE.

In some of the resolutions under analysis, the Franchisees filed legal actions based on the alleged nullity of the franchise agreement for faults in the consent, taking into account the rationale that we summarise below:

-The nullity of the agreement is requested because there are faults in the consent given by the Franchisee.

-The absence or insufficiency is argued of the pre-contractual information provided by the Franchisor as the cause of error in the consent granted by the Franchisee who, if they had received such information or received it completely, would not have given their consent to the agreement.

-The difference between the economic results obtained by the Franchisee in the operation of the business and the amounts suggested by the Franchisor prior to the agreement was also alleged in different procedures.

The Case Law is unanimous in the sense that the franchise agreement does not grant a promise of a result to the franchisee, who assumes the risk of the business activity.

(II) NULLITY OF THE AGREEMENT DUE TO LACK OF OBJECT.

The non-existence of know-how is argued both as a cause of nullity of the agreement and sometimes as a cause of resolution of the same, alleging the breach by the Franchisor of the obligation to provide the Franchisee with the aforementioned know-how. The resolutions tend to assess the accreditation of the transmission of know-how by means not only of the delivery of the Franchise Manuals to the Franchisee, but also through the existence of training programmes, operational or functional elements and assistance and/or supervision tasks deployed by the Franchisor.

(III) FRANCHISEE BREACHES DUE TO NON-PAYMENT OF ROYALTIES.

This is possibly the most common cause of litigation between franchisor and franchisee. It is a breach that is usually counteracted by the Franchisee alleging the existence of previous breaches attributable to the Franchisor, such as the lack of transmission of know-how and the absence of training and commercial and/or technical assistance. With this, the procedure, as we have said before, becomes an examination of the degree of compliance by the Franchisor of its own contractual obligations. Only the existence of a previous breach attributable to the Franchisor allows the Franchisee to evade its obligation to pay Royalties. The resolutions analysed mostly resolve as to the non-existence of previous breaches by the Franchisor and consequently declare the existence of the breach of the Franchisee supposing non-payment of the Royalties.

(IV) BREACH BY THE FRANCHISEE DUE TO VULNERATION OF THE POST-CONTRACTUAL NON-COMPETITION CLAUSE.

The reported breach occurs in two different circumstances:

- The first is that the Franchisee, after the end of the term of the agreement, continues to develop an activity in competition with franchisor (this being prohibited in the agreement).

-The second is that, when the agreement is terminated in advance as a result of a contractual breach of the Franchisee, it continues to develop an activity in competition with franchisor (this also being prohibited in the agreement).

Resolutions require there to be no prior breach by the Franchisor so that he can claim fulfilment by the Franchisee of its obligation of post-contractual non-competition. Resolutions admit the application of the prohibition on post-contractual competition, as well as the possibility of establishing penalty clauses for the case of breach of this obligation by the Franchisee, although the amount of said clause can be moderated by the judge if they consider it disproportionate. There are no resolutions that oblige the franchisee to cease activity for breach of its obligation of post-contractual non-competition.

(V) BREACH OF THE FRANCHISEE DUE TO MARKETING OF PRODUCTS OR UNAUTHORISED SUPPLIERS.

The imposition by the Franchisor of the suppliers from which the Franchisee can (and must) acquire the materials that will be used in the operation of the franchise is sometimes questioned by the Franchisee. The resolutions consider that such an imposition, and the consequent prohibition on purchasing products from other suppliers, is a logical consequence of the nature of the franchise agreement and of the faculty of control by the Franchisor of the know-how that is transmitted to the Franchisee.

The power of control over the products that the Franchisee has to acquire, either from the Franchisor or from third parties with the prior authorisation and verification of the Franchisor, is but a consequence of the transmission of the know-how to the franchisee, that is to say, the technical knowledge that is not of public domain and that is necessary for the manufacture or commercialisation of a product or the provision of the service; so they provide an advantage to those who master it over competitors, which passes through avoiding disclosure.

The obligations of the Franchisee to be supplied the raw material and any other merchandise related to the operation through the Franchisor, and to acquire them from third parties with the prior authorisation of the Franchisor, must be understood as being in accordance with the nature of the agreement and essential for the maintenance of the good name and the image of the franchised network.

(VI) NON-COMPLIANCE BY THE FRANCHISER BY FAILING TO PROVIDE TECHNICAL ASSISTANCE.

The provision by the Franchisor to the Franchisee of commercial and/or technical assistance during the term of the agreement is an essential obligation of the Franchisor within the framework of a franchise relationship. This is established in the regulations and the Case Law has been peacefully accepted. Therefore, the absence or deficiency (understanding this as its uselessness in providing the Franchisee with advice regarding the actual activity to be developed by the franchisee in the operation of the franchise activity) is considered a breach of sufficient entity to motivate the termination of the agreement for causes attributable to the Franchisor.

Judicial decisions consider a variety of instruments as valid means for the provision of assistance, such as commercial training, technical training, advice on marketing and/or advertising and supervisory tasks deployed in the establishment of the franchisee.

8. SOME IMPORTANT JUDGMENTS

- **Balearic Islands Provincial Court ruling of 17.10.2014:** As a consequence of the collapse of the real estate system it was agreed to apply the clause *rebus sic stantibus* and reduce the fees of the franchise agreement.
- **Valencia Provincial Court ruling of 19.01.2015:** As it is a dispute in which consumers did not intervene but rather companies, these should be the ones who submitted the community norms that were allegedly infringed in relation to the discussed facts to the debate and discussion of the process. As the defendant is limited in its counterclaim to request the non-application of the non-competition clause, not because of its illegality, but due to its inapplicability, the second instance could not declare anything in that regard.
- **Castellón Provincial Court ruling of 22.07.2015:** A claim by a Franchisee was dismissed stating that certain behaviours having been declared encroachment in the United States were valid and fair according to Spanish legislation. The Provincial Court accepted that the white book allows franchisees to know the requirements they must meet to opt for a new franchise agreement, but also recognised that even if a franchisee meets all the requirements, the franchisor is not obliged to grant a new franchise agreement because this is part of its freedom to contract. This ruling is the first and most complete precedent in Spain and probably in Europe in relation to encroachment and the non-linking of the franchisor's internal policies. [Defended by one of the members of the Committee]
- **Madrid Provincial Court ruling of 12.02.2016:** Within the framework of a unilateral termination of the agreement, the franchisee could not prove that the franchisor would impose a damaging price policy on it. The bargaining would only have been considered unfulfilled if the prices imposed were abnormal in all competing establishments offering low prices, which was not accredited.

- **Las Palmas Provincial Court ruling of 14.05.2016:** Professional negligence occurred on the part of a doctor who did not provide the due information to the patient about the consequences of the treatment he received. The civil liability of the franchisor was upheld in this case before the franchisee, given that it acted under its premises in using the material and techniques
- **Judgment of the Provincial Court of Madrid of 19.10.2016:** The nullity of the franchise agreement was claimed due to the inexistence of know-how, but it was considered inappropriate because the fact that the business was not the subject of a prolonged experience could not be equivalent to the lack of know-how or the existence of error or deception, just as there was no claim of fault because no accounting data were available to prove a certain success in the business when this was also unknown to the franchisor because of the incipient activity. The franchisee had access to this information before the signing of the agreement, so it was not possible to admit these reasons as valid for the termination of the agreement.

CONCLUSIONS

- 1

From a quantitative point of view it is observed that the degree of litigation in terms of franchising is very low in relation to the percentage of establishments under franchise, maintaining an average litigiousness of 0.08%.
- 2

The largest number of procedures are initiated by the Franchisor with an average of 62.06%, the main action being that of termination of the franchise agreement for non-compliance and claim of amounts owed.
- 3

A tendency of resolutions favourable to the Franchisor is maintained, with an average of 68.10%, although in 2016 there was a notable rise of resolutions in favour of the Franchisee with 56.41%.
- 4

Unlike what happens in other countries, arbitration is not widely used in the franchising sector yet.

Madrid - Barcelona, November 2017

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