30 January 2019

Honorable Minister of “Rechtsbescherming” Mr. S. Dekker and the Honorable Secretary of State of Economic Affairs Mrs. Mona Keijzer

Dear Mr. Dekker and Mrs. Keijer,

I am the President & CEO of the International Franchise Association (IFA), the world's oldest and largest organization representing franchising worldwide. Celebrating nearly 60 years of excellence, education and advocacy, IFA works to promote, protect and strengthen franchising. IFA members in the United States and around the world include franchise companies in over 300 different business format categories, individual franchisees, and companies that support the industry in marketing, law and business development. Most of our members are already engaged in or are seriously considering engaging in international expansion. At least 40 of IFA’s franchisor members are already active in the Netherlands and we know first-hand that your market is appealing to additional franchisors considering international growth.

As you know, in the Netherlands as in much of the developed world, the franchise economy is a major contributor to employment and job creation. IFA has serious concerns that the proposed franchise legislation will deter many franchisors from expanding into the Netherlands and undermine existing franchise businesses in the Netherlands. Despite the legislation’s good intent, franchisees and franchisors would both be harmed. Given the important role of franchising in the creation of new businesses and jobs, this shift in the incentives of franchise businesses could produce a noticeable negative impact on economic growth, the delivery of outstanding services to Dutch consumers, and job creation.

The legislation undermines the ability of franchise networks to offer a consistent consumer experience from location to location. It would devalue the investment franchisors and franchisees have made in their franchised businesses and would subject franchisors to claims that they have failed to comply with unknowable pre-sale and ongoing disclosure obligations. The proposal would undercut franchisors in their right and responsibility to run franchise organizations and subject every decision they make of any significance to second guessing by even a small number of franchisees. Undermining franchisors in this way would hurt all franchisees who depend on the franchisor to tend and evolve the brand and business system in which franchisees have invested. Franchisors would, in effect, become guarantors to franchisees that the decisions and forecasts that they make will always positively affect the profitability of each franchisee. As in any business model, franchising, like every other business, is not immune to the risk of failure and neither the franchisor nor the franchisee is guaranteed success.

Review of a potential uniform approach to regulating franchising was conducted by UNIDROIT, the International Institute for the Unification of Private Law. A group of experienced franchisors, academics, and observers of draft legislation worked through a series of committees, subcommittees, meetings, and plenary sessions to produce a resulting report. Among the report’s key conclusions (quoted below) is that before any legislative action is taken, the following standards should be met:

1. whether it is clear that there is a problem, what its nature is, and what action, if any, is necessary;

2. whether prospective investors are more likely to protect themselves against fraud if they have access to truthful, important information in advance of their assent to any franchise agreement;
3. whether the nation's economic and social interests are best served by legally re-quiring a balance of information between the parties to a franchise agreement;
4. whether there is a pattern of abusive conduct, or whether this conduct is isolated or limited to particular industries;
5. the nature of the evidence of abuse;
6. whether existing laws address the concerns and whether they are adequately applied;
7. whether an effective system of self-regulation exists;
8. the financial burden the new legislation will place upon franchisors and investors as compared to the benefits of legally required disclosure; and
9. whether the proposed legislation inhibits or facilitates entry to franchisors, and its effect on job-creation and investment.

The proposed legislation is in many ways more extreme than existing franchise law in any other country.

If any type of disclosure regulation is to be adopted, it should be specific, unambiguous, designed to present information that typically would affect the decision of a reasonable prospective franchisee to buy or not buy a franchise. It should be flexible enough to account for the over 300 different lines of business in which franchising is active and considerate of the fact that the dozens, if not hundreds of brands competing in a single arena almost always have very different ways to deliver the outstanding goods or services their consumers expect. It should be concise so that it is likely to be read, and not burdensome to prepare. Any franchise disclosure legislation should clarify which transactions and which persons are subject to the law.

For example, the U.S. Federal Trade Commission Rule now applies only when a franchise will be granted for a location within the United States or its territories. Whether the proposed law would apply to the sale of master franchises should be addressed, and if it is contemplated that both franchisors and their master franchisees must make disclosures to prospective and existing subfranchisees of master franchisees, how those duties are to be fulfilled should be described. Any such regulation should also explain the remedies that are available to franchisees and franchisors under the law, and what any applicable statute of limitations may be.

The Most Problematic Provisions Include:

1. The proposal would retroactively impose:
   a. An obligation of franchisors to obtain the consent of individual franchisees or franchisee associations before implementing any material changes to their franchise programs, even when such changes are expressly permitted in their franchise agreements.

   b. A duty on franchisors and franchisees to make ongoing disclosures to franchisees about all information “that they know or can reasonably suspect to be relevant or become relevant for the other party…[relating] to the performance of the agreement…” Unlike franchise disclosure rules in other countries, this is an ongoing, undefined and unlimited obligation.

2. Franchisors also would be required to provide undefined “financial information regarding the intended location” of each franchisee’s business, even though franchisees residing in a location or who have negotiated leases for a location for their franchised businesses would likely know much

more about the financial information than franchisors from different areas.

3. Franchisors would be required to provide "substantiation of decisions [they make] that may have considerable financial consequences for the Franchisee." A duty to explain and substantiate every decision to do or not to do something is extremely burdensome, and it sets up franchisors for lawsuits for making the wrong guesses about what the possible consequences of events may be in a given scenario, in every instance.

4. The legislation establishes a presumption that franchisees will have a right to goodwill compensation when their agreements are terminated. Franchise agreements are typically terminated under three circumstances:
   a. When the franchisee fails to make payments to the franchisor or fails to comply with the requirements of the franchise agreement;
   b. When the franchisee decides to abandon the franchise, usually because of its failure to operate profitably, or because it hopes to pursue a similar business under a different brand; or
   c. When the franchise is sold or otherwise transferred by the franchisee to a third party, and the transferee signs a new franchise agreement directly with the franchisor.

   Under scenario a. the franchisee is likely to have damaged the brand. Under scenario b. the franchisee abandons the franchise because it is not generating adequate patronage or operating in a manner that generates profits, each of which is an indication of damage to the reputation of the brand. Under scenario c. the selling franchisee should have realized the fair market value of the business from the buyer.

   When acquiring a franchise, a franchisee acquires a license to use the brand and to participate in the goodwill developed by the franchisor. The goodwill derives from the business system developed and tended by the franchisor and the execution of this business system by the franchisor and franchisees. The franchisees act as formula entrepreneurs in executing the business system of the franchisor. If the franchisee succeeds and thereby contributes to the goodwill, then they benefit from the franchise's profits and potentially through sale of their franchise. As described above, in the circumstances where a franchisee would be terminated or abandon their franchise, they would not have contributed to the goodwill. Not having contributed to the goodwill, they should have no claim on it.

5. The legislation is premised upon erroneous assumptions.

   a. Franchisors do not know the future and cannot predict which changes to their franchise programs may adversely affect each franchisee. Franchisors who cannot provide such disclosures should not been seen as bad franchisors.

      The overwhelming majority of franchisors are small businesses which lack the personnel and financial strength to provide this level of detailed information. Although larger international brands do business in the Netherlands, often they grant master franchises to local businesses, each of which would presumably be subject to the compliance burdens of this legislation vis a vis their subfranchisees.

   b. Franchisees commonly see franchisors that lead a franchise network and develop, and implement new programs, offer new products and new ways of doing business as

preferable to those that do not. As formula entrepreneurs, franchisees depend on their franchisor to tend and evolve the business system. Franchise agreements and reasonable franchise disclosure requirements explain to prospective franchisees that franchisors will implement changes to their programs from time to time, and that the franchisees may be required to adopt those changes in their businesses, often at their own expense. Those who do not wish to agree to those terms should not become franchisees. Franchisees invest in franchise programs because of their franchisors' track record of successful operation and adaptation of their franchise programs. Those who want to invest in programs, such as cooperatives, where each participant owns an equity interest in the enterprise, and voting rights exist for the members can seek out and participate in those types of businesses.

c. The success of franchising is built upon consistency from one outlet to the next. If each franchisee can accept or reject every new aspect of a franchise program, then consumers will not know which products, services, standards, warranties, etc. apply whenever they go from one franchised outlet to another of the same brand. A law that undercuts the ability of franchisors to provide consistency to consumers will undoubtedly drive consumers away from franchised small businesses, harming franchisees. The beneficiaries would be the outlets of large, corporate-owned chains that are not hindered by the rules applicable to franchising.

d. The cost and risk of complying with the unlimited, undefined, ongoing disclosure requirement cannot be warranted. The scope of disclosures described in the proposals far exceed anything required in any existing laws. In an attempt to protect itself against claims of violations of the disclosure requirements, a franchisor might look to the disclosure requirements of every country in the world, try to integrate them and to explain conflicting requirements. The legal costs of such a document would be hard to imagine, and the length would be amazing. It is highly doubtful that franchisees would ever read and understand such a document. It is therefore questionable what value such a document might have. The value of a disclosure document to prospective franchisees is proportional to their ability to digest it. The United States has one of the most comprehensive disclosure requirements for franchisors in the world. U.S. Franchise Disclosure Documents (FDDs) tend to range in length from 100-1000+ pages. The proposal would require documents far exceeding the length of U.S. FDDs.

e. It is the responsibility of each prospective franchisee to conduct a thorough due diligence of the franchise system, to retain competent legal and other advisors, and to fully understand the terms contained in any disclosure from the franchisor before signing any franchise agreement. Drawing, again, on recent U.S. surveys of franchising sales activities, in the U.S. only 1-2% of those who complete a preliminary application to acquire a franchise actually end up buying a franchise. Prospective franchisees have the prerogative, at the start of the franchise relationship, whether or not to enter into any particular franchise relationship. Prospective franchisees may also choose to not become franchisees of any franchise system.

6. The requirement that franchisors and franchisees be "good" (Article 912) is so subjective, that courts could be clogged with claims that franchisors and franchisees violated the law because they weren't "good." If that standard had been workable, legislators and regulators would be unnecessary.

7. Article 914 only permits one-sided negotiation during the four weeks following delivery of disclosures. A franchisor which makes a concession to a franchisee cannot obtain a concession in return. Why not?

8. The duty to make ongoing disclosures to existing franchisees is irrelevant to the basic impetus for franchise disclosure laws. The aim of franchise disclosure laws is to give prospective franchisees information they need to know to make an informed franchise investment decision. Once a person has executed a franchise agreement, the decision has been made, ongoing disclosures do not provide clear benefit to the franchisee.

IFA's comments have focused on the disclosure aspects of the law. In the absence of strong proof of necessity, the elements that seek to govern that relationship between franchisees and franchisors are strongly inadvisable. The experts that met as part of the UNIDROIT review concluded that only disclosure legislation makes sense for franchising. The areas that relationship laws seek to address were found to be already sufficiently covered by the underlying laws of each country.

Effective pre-investment disclosure can benefit both prospective franchisees and franchisors by enhancing the competition among franchisors for qualified franchisee candidates. If the terms contained in a franchise offering are clearly communicated, prospective franchisees will be better able to evaluate and make investment choices among the range of franchise opportunities available to them and to choose from those that meet their goals, ambitions, financial and, other requirements. As drafted, this legislation will not only fail to produce these benefits but will negatively impact economic growth and job creation through harm inflicted on the franchise economy. This harm would be felt by franchisors and franchisees alike. A more effectively drafted disclosure law could benefit prospective franchisees while minimizing unintended harms.

IFA is glad to have this opportunity to express our concerns, and we would be grateful for the opportunity to advise or further discuss this in a manner or venue convenient for you.

Sincerely,

Robert Cresanti

Robert C. Cresanti, CFE President & CEO
International Franchise Association