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## **500 YEARS AFTER COLUMBUS DISCOVERED AMERICA, AMERICAN FRANCHISORS MAY DISCOVER EUROPE**

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## **500 YEARS AFTER COLUMBUS DISCOVERED AMERICA, AMERICAN FRANCHISORS MAY DISCOVER EUROPE**

In 1992, the 12 European countries comprising the European Common Market (Belgium, Denmark, England, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal and Spain) will become a single economic market through the elimination of trade barriers. These barriers relate to physical barriers, such as product specifications and professional qualifications, and fiscal barriers such as harmonization of tax rates and a common currency. This Single European Market, having a population of approximately 325,000,000, greater than the United States or Japan, will be a significant economic force in the global economy. With much being written about Europe in 1992, U.S. franchisors are increasingly focusing their attention towards Europe for international master franchise opportunities. The great changes being experienced in Eastern Europe during the last few years are further intensifying this interest. For the post-1992 Single European Market franchising may be one of the best marketing formats to take advantage of the removal of these barriers.

This is a far cry from the unsettling events in the mid-80s, when a West German franchisee, Mrs. Schillgalis, shook the very fabric of franchising in Europe. Here's what has happened.

In 1958, the European Economic Community ("EEC") was created pursuant to the Treaty of Rome. In the Treaty are provisions declaring as unlawful and anti-competitive certain business activities. Franchising was not specifically mentioned. During the 1970s when franchising really took hold in the United States for numerous types of products and services, U.S. franchising companies looked elsewhere, including Europe, for franchise opportunities.

Unlike the United States where there existed federal and state antitrust and franchise laws, no laws existed in any of the European countries regarding franchising. U.S. franchisors assumed and analogized that the U.S. antitrust laws, particularly the Rule of Reason for vertical restraints, would be similar to any European competition laws and structured European franchise agreements in a fashion

similar to their U.S. counterpart. It was not until 1986 that a European court was asked to decide on the validity of a franchise agreement.

Pornuptia de Paris is a French franchisor of wedding gowns and accessories. Through its West German subsidiary, it entered into a franchise agreement with Mrs. Schillgalis for franchises in Hamburg, Oldenburg and Hanover, Germany. When Mrs. Schillgalis failed to pay royalties on time, Pornuptia filed suit in a West German court, seeking to recover the unpaid royalties. Mrs. Schillgalis counterclaimed alleging that Pornuptia failed to supply promised commercial and technical assistance and that certain provisions of the franchise agreement were in violation of the competition law provisions of the Treaty of Rome. The West German trial court ruled in favor of Pornuptia. On appeal, the West German Appeals Court agreed with Mrs. Schillgalis and ruled that certain provisions in the franchise agreement were anti-competitive. This sent tremors throughout the franchise industry as certain restrictions on franchisees, deemed reasonable and customary in the U.S., possibly rendered European franchise agreements void and unenforceable.

Pornuptia then appealed to the German Supreme Court. Recognizing the gravity of the situation, the case was further referred to the European Court of Justice. Fortunately, the European Court of Justice adopted a more liberal and practical approach concluding that the restrictions were reasonable and necessary to protect the franchisor's trademark and method of doing business, although certain provisions had to be refined. In the months that followed, the European Court of Justice was asked to review several other franchising concepts - Yves Rocher, Computerland and ServiceMaster. Armed with these decisions of the European Court of Justice, the EEC Commission had sufficient experience to adopt an exemption from the competition laws of the Treaty of Rome through the enactment in December, 1988 of the Franchising Block Exemption.

The Franchising Block Exemption makes franchising in Europe more similar to, but not identical to, franchising in the United States. Most of the restrictions customarily imposed on franchisees, such as

a location clause limiting to a specific location from where the franchisee can operate, limiting the types of products or services a franchisee can sell or from whom he or she can purchase, granting to a franchisee of an exclusive territory and prohibiting a franchisee to engage in a competing business are now permissible. There are some instances where the Franchising Block Exemption is more restrictive than what is permitted in the United States. One relates to the franchisees' development of new ideas. Under most U.S. franchise agreements, new ideas of a franchisee become the property of the franchisor that has the sole decision in permitting the franchisee and other franchisees to incorporate the idea into the franchise system. In the EEC, the idea remains the property of the franchisee but the franchisee is obligated to grant a perpetual, non-exclusive license to the franchisor and other franchisees to utilize the idea. Furthermore, while covenants not to compete in the United States are generally permissible, subject to being reasonable in scope, geography and duration, the Franchising Block Exemption specifically provides that a covenant not to compete cannot last for more than one year beyond the expiration or termination of the franchise relationship and only in the previous exclusive territory, if any.

The Franchising Block Exemption has brought greater certainty and uniformity to franchising in the EEC. Consideration must still be given as to the target member country's competition and special franchising laws and other laws which could impact upon franchising and franchise operations. In addition, certain changes to the franchise system must be made on a country-by-country basis to address language differences, cultural and lifestyle differences, individual tastes and habits and national characteristics. This exemption, the developments culminating in 1992, and the immense changes in Eastern Europe will likely attract more U.S. franchisors as part of the burgeoning global economy. It also means new opportunities for U.S. citizens experienced in franchising, such as franchise executives, franchise salesmen, franchise consultants and franchise lawyers, as foreign companies can obtain the benefit of the many years of experience in franchising these experts have had in the United States.

Franchising is a universal marketing concept subject to refinement based on country laws, culture and consumer tastes. The elimination of trade barriers in 1992 will only further fuel the franchising fires. Five hundred years after Columbus discovered America, perhaps Columbo Yogurt or some other American franchising company will discover Europe.

*Keith J. Kanouse, Esq*