Disclosure requirements under Swedish franchise law

Anders Thylin
Advokatfirman Delphi & Co, Stockholm
anders.thylin@delphilaw.com

Franchising in Sweden

As many of the distinguished readers of this newsletter are well aware, franchising in Sweden is a growing and flourishing industry. A study[1] from 2004 sponsored by the Swedish Franchise Association determined that there are approximately 300 active franchise systems in Sweden (excluding gas stations, the postal services and car dealers). This includes 9,600 franchised units with a turnover of some 80 billion SEK, corresponding to almost five per cent of Sweden's GNP. Moreover, franchised businesses in Sweden employ about 100,000 people. The impact of franchising is very important for a small country like Sweden.

Swedish franchise systems can be traced back to the 1930s, when the pest control company Anticimex opened up for business. But the business format of franchising as a way of organising business did not really catch on in Sweden until the first McDonald's restaurant opened in Stockholm in 1973. Since 1973, franchising has grown rapidly every year.

Legal background

Even though we Swedes have seen substantial growth in franchising, the legislators have not (until now) seriously considered legislation on franchising. In the past, there have been several bills in Parliament 'meeting the dangers of franchising' and the need to protect franchisees, but none of the bills have been supported by more than a fraction of Parliament.

In 2002 however, things changed. The Swedish Franchise Association adopted a recommendation under which franchisors were obliged to disclose. This coincided with UNIDROIT's release of its model law on franchising later that year. Several new bills on franchisee protection were introduced and it soon became clear that the legislator contemplated legislation. Consequently, the Swedish Government Offices appointed an official investigator in 2003 to report whether there was any need for legislation with respect to:

- disclosure legislation similar to or resembling the UNIDROIT model law;
- the use of arbitration clauses in franchise contracts; and
- minimum notice requirements with respect to termination of franchise contracts.

The official investigator's report[2] was released in early 2005. It contained a thorough study of the conditions on the Swedish franchise market and concluded that:

- there was indeed a need for disclosure legislation (however not based on the model law);
- there was no need to legislate on the use of arbitration clauses; and
- there was no need to legislate with respect to minimum notice requirements.

In line with the findings, the official investigator proposed that an obligation to disclose should be incorporated into an existing Act that applied to marketing abuse. The proposed disclosure requirements were circulated by the Government for comments among several concerned bodies.

The Swedish Franchise Association, the Swedish Bar Association and others criticised the report, arguing that the conclusions were wrong and not based on the facts that were disclosed in the report. Some bodies were, however, positive and advocated not only legislation on disclosure, but also on the use of arbitration clauses and 'good cause' requirements to terminate franchise agreements.

Arguably, the critics were right, but to no avail. The Government acted swiftly, rewrote the proposal and introduced a bill to Parliament in 2006, introducing some changes with respect to the original proposal. The bill was passed on 17 May 2006, and a new Act on franchise disclosure came into force on 1 October 2006. The Act, freely translated into English, is named 'The Act on Franchisors' Obligations to Inform Franchisees' (the 'Act').[3]

Introduction to the Act

Under the Act, a franchisor is obliged to provide written information to a prospect franchisee on the meaning of the franchise agreement and other conditions that are necessary to understand the franchise, taking all circumstances into consideration. The information must be provided in due time prior to the franchisee entering into the franchise agreement. The information must be clear and understandable. Moreover, the Act introduces a new legal definition of a franchise agreement.

Disclosure requirements

Pursuant to the Act, the franchisor must provide the prospect franchisee with the following information:

- a description of the business that the franchisee will operate;

- information about other franchisees with whom the franchisor has entered into franchise agreements within the same franchise system and the scope of their businesses;
- information on the remuneration that the franchisee shall pay to the franchisor and other financial terms for the business;
- information on intellectual property rights that will be licensed to the franchisee;
- information on the products or services that the franchisee is obligated to purchase;
- information on all limitations on competition during and after termination of the franchise agreement;
- information on terms of the franchise agreement, terms for amendments and renewal of the franchise agreement as well as termination and the financial consequences for the franchisee upon termination; and
- information on how disputes are to be resolved and how dispute-related costs will be divided and other relevant information (such as other agreements required by the franchisor, etc).

These disclosure requirements also apply when a franchise agreement is transferred to a new franchisee, if the transfer is made with the franchisor's approval.

In the preparatory works,[4] it is noted that the disclosure requirements represent the minimum information that a franchisee should receive prior to entering a franchise agreement and that a franchisor's disclosure requirements for a particular franchisee must be assessed by applying general principles and industry practice, taking all relevant circumstances into consideration.

For closer guidance on the requirements, the preparatory works expressly refer the reader to the recommendation issued by the Swedish Franchise Association in 2002 and to UNIDROIT's model law. Incidentally, however, the Swedish Franchise Association has revoked its recommendation since the Act came into force, arguing that there is no need for a recommendation because the Act governs disclosure. It should also be noted that the preparatory works rejected adaptation of UNIDROIT's model law. Hence, the guidance in the preparatory works as to the detailed requirements is somewhat unclear.

When and in what way should disclosure be made?

Under the Act, the franchisor must provide the information in writing and in due time before the franchise agreement is signed. The concept of 'due time' should be determined on a case-by-case basis, considering the complexity of the franchise relationship. The 'due time' requirement is deemed less than 14 days only in exceptional cases. If the disclosed information is extensive and the franchisee's undertaking is great, 'due time' is at least three weeks.

The information must be clear and understandable. The preparatory works give no guidance if this means that the information must be made out in the Swedish language, but that is the general understanding among the lawyers I have talked to.

The franchisor must be ready to substantiate that the information has been received by the franchisee, hence making it a necessity to request a written acknowledgment of receipt from the franchisee. The franchisor is entitled to request a secrecy undertaking from the franchisee in connection with the franchisor's provision of information.

Applicability

The Act will apply to franchise agreements only (under the definition set forth below) and only to those franchise agreements that are entered into on or after 1 October 2006. Notwithstanding that, the preparatory works recommend that all franchisors examine what kind of information has been provided to existing franchisees.

The Act is not amenable to settlement; hence the franchisee cannot waive its rights under the Act.

In contrast to many other countries' laws, this law does not define a franchise. Instead, and as mentioned above, the Act introduces a legal definition of a franchise agreement into Swedish law.

The definition is as follows: a franchise agreement means an agreement whereby one business entity (franchisor), against remuneration, allows another business entity (franchisee), to use the franchisor's unique business concept regarding marketing and sales of products or services. Such agreement shall be construed a franchise agreement under the Act only if the franchisee is obliged to use the franchisor's trademark or other intellectual property rights and is obliged to participate in recurring checks of compliance of the agreement.

The new definition of a franchise agreement has given rise to some discussion. One of these is the difference between the previous definition of a franchise (derived from EU competition law) and the new definition. This gives plenty of room for arguing whether a business is a franchise or not. Up to this point, I have not encountered any real business or legal issues with respect to this. From a layman's perspective, the discrepancy between the definitions must, however, seem odd.

Another discussion concerns the fact that under the Act a franchise agreement must include an obligation to participate in recurring checks of compliance of the franchise agreement. Some lawyers have argued that a less serious franchise organisation could exclude the 'recurring checks' obligation. Since the Act is aimed at making it more difficult for such an organisation to sell franchises, these lawyers argue that the Act does not serve its purposes.

A point which is important because of the new definition is that some businesses that traditionally have not considered themselves franchise organisations now, by virtue of the Act, are considered franchises. Examples of such businesses are automotive manufacturers' chain of dealers, cooperating retail chains where the retailers have control over the coop organisation and gas station chains. All of these will most likely fall within the scope of the Act.

Remedies

A franchisor in breach of the Act may be subject to an injunction under penalty of a fine by the Swedish Market Court to disclose the required information. A franchisee, an association of business entities or any other association that has a justified interest of representing business entities may submit a petition. The Market Court has no powers to act if there is no petition from a legitimate claimant.

An injunction ordered pursuant to the Act is applicable to a franchisee who has not received the required information and to future franchisees with which the franchisor contemplates entering into franchise agreements. If a franchisor is in breach of an injunction, the original claimant may claim that the franchisor should pay the fine. The fine is payable to the Government, and not to the claimant.

Conclusion and some remarks

Whether it was necessary or not to implement disclosure legislation in the Swedish franchise market may be arguable. In my opinion, there were only a few franchise systems in the past that did not provide the franchisee with adequate information on the effects of becoming a franchisee. Nevertheless, the general sentiment in the market, as I perceive it, is that the Act was not so bad after all. It puts a reasonable amount of pressure on the franchise systems to compile their franchise sales information in writing and to make sure that the prospective franchisee not only signs a secrecy undertaking but also acknowledges receipt of the information. This has (again in my opinion) been a positive and rewarding exercise for many franchise systems, in that they have been forced to seriously reflect on what they are offering franchisees.

The legal construction of the Act is, however, not very well thought through and is possibly counterproductive to the purposes that the Act was intended to serve. In a hypothetical situation, a franchisee not receiving the required information may petition the Market Court to order the franchisor to disclose the relevant information. Provided that the franchisee is successful (and under Swedish law, the losing party is liable for the other party's costs in a trial) the franchisor may or may not comply with the injunction.

Should the franchisor choose not to comply, a possible fine (which is subject to the original claimant filing a second petition that the fine is payable, including the risks of paying the other party's costs) would be payable to the Government. From a commercial point of view, it seems unlikely (at best) that a franchisee would retain lawyers to submit not only one, but two petitions to force a non-complying franchisor to pay a fine, which would be paid to the Government.

Moreover, if the franchisor were to comply with an injunction and provide information to the franchisee, the disclosure would not constitute a binding offer (in general terms). This means that a franchisor which has been ordered by the court to disclose is not under any obligation to enter into a franchise agreement with the franchisee. One can assume that the franchisor would be less inclined to enter into a franchise agreement after having been sued by the franchisee.

Last but not least, let me point out that the Act has no direct effect on the relationship between the parties and cannot be directly pleaded to create a claim under Swedish law. However, the preparatory works clearly set forth that a franchisor's non-compliance with the disclosure requirements is a factor to be considered when assessing whether the franchise agreement should be mitigated or held unreasonable pursuant to §36 Swedish Act on Contracts.[5] Hence, the Act will have some impact on franchise relations in Sweden. The Act will possibly allow franchisees to base claims because of the franchisor's non-disclosure as well as earnings claims because of exaggerated disclosure in the future.

The Act has been in force for less than half a year and, to my knowledge, there are no pending cases involving the Act before the Market Court. Neither am I aware of any franchise litigation where the Act by analogy has been pleaded by a franchisee to substantiate a claim. I am, however, certain that such cases will be available for reporting in the future.

Notes

1 Franchising i Sverige – en företagsform på frammarsch, Svenska Franchiseföreningen och Svensk Handel, 2004.
2 Upplyst franchising, Ds 2004:55.
3 Lagen (2006:484) om franchisegivares informationsskyldighet.
4 Prop 2005/06:98 p 37.
5 36 § avtalslagen.