THE PRE-CONTRACT OBLIGATIONS REGARDING THE FRANCHISING AGREEMENT

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Abstract
The current paper puts into context the Government Ordinance no. 52/1997 regarding franchising with the new concepts of the Civil Code. Thus, under the old Civil Code there were no specific regulations that could be applied to a pre-contractual obligation of the parties. During any negotiation, because the parties sent each other a series of offers, counter offers, and in the end decided whether to agree or not, some parts of a professional secret, know-how, or any other important information for one or both might be revealed to the other. Under international laws, such as the one in France, or by using internationally established unwritten law, such as the Franchising Model Contract by the International Chamber of Commerce and Arbitration in Paris, such a disclosure of important or secret information is protected from future unauthorized usage by any party or affiliate if the contract is not signed. In the view of the new Civil Code, this stage in the development of an agreement, not yet binding, is now regulated and protected.

Keywords: *franchising, franchisor, franchisee, business model, professional secret*

Introduction

The new civil code did not also include to its regulations the franchising agreement. Despite the same includes most of the civil and commercial agreements, the franchising agreement remains specifically regulated by the Govern Ordinance no. 52/1997 regarding the legal treatment of the franchising.

Under the law the franchising is a trading system based on continued collaboration between individuals or legal entities that are financially independent, by which a person named franchisor grants another person named beneficiary the right to operate or to develop a business, a product, a technology, or a service[1].

By encompassing the particularities set by the lawmaker the franchising may be comprehensively defined as the economic and legal operation by which a professional trader, the franchisor, being an individual or a legal entity, who is holding the title over tangible and/or intangible assets and the title over a successful business, allows another person or several persons, the franchisees (beneficiaries), to manufacture goods or trade them under their mark, using the know-how developed by the same, within a franchise network wherein the parties are independent from a legal perspective, but are operating the franchisable concept in a homogenous and collective manner.

As we stated in previous works[2] the conclusion of the franchising agreement involves going through three stages. The first of them, which also represents the subject matter of our study, is the pre-contract stage. The same is followed by the contract or proper stage, and after the expiry of the term set by the parties, or as result of a unilateral termination or of a cessation by fault of the agreement, respectively, for a period of maximum 5 years, the parties are bound by certain specific

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[1] The Govern Ordinance no. 52/1997 regarding the legal treatment of the franchising, published with the Official Journal of Romania (*"MonitorulOficial al României"*), part I, no. 224 of the 30/08/1997, approved as modified by the Law no. 79/1998 (O.J. part I no. 147 of the 13/04/1998) and republished, with the texts being given a new numbering, with the Official Journal, part I, no. 180 of the 14/05/1998.

[2] Dan-Alexandru Sitaru, *Contractul de franciză în dreptul intern şi comparat* (The Franchising Agreement within the Domestic and Compared Law), Ed. Lumina Lex, 2007, Bucharest.

obligations such as the non-competition one. Such period subsequent to the cessation of the effects of the agreement is the post-contract stage.

Contents

1. The contents of the pre-contract stage

Based on the franchisor's right to choose and select their beneficiaries, they need to first conduct a market survey, choose the franchising method and form they shall apply within the new territory, check the competence and the professionalism of the potential future partners, all in accordance with the already existing franchising network, or in order to create a new one. For such issues to be possible to apply the franchisor needs to know the economic, social, and legal situation within the contemplated geographical area according to their requirements and with their economic interest. However, quite often, the franchisor would approach a beneficiary precisely in order to be able to enter a market where, on their own and directly, they could not have access.

Broadly, the pre-contract period consists of determining such elements, which are of essence for developing a franchising network[3], and which confer the importance and the necessity for such period. Such period is one of high legal importance as regards the rights and the obligations of the parties, being the stage of essence the future franchising agreement shall be built upon. This is the period when the information exchange occurs that shall, on one hand, allow the franchisor choose the best partner to entrust with the secret of the franchisable concept, and on the other hand allow the potential beneficiary (we shall call them so as they only gain the legal status of a beneficiary at the time the agreement is signed) check the reliability, the profitability, and the accuracy of the franchise network they are going to join, assess whether they could materially and professionally meet the requirements imposed by the franchisor, etc.

Summarising, both parties need to examine the convenience of the business they wish to conclude, and following the negotiations become convinced that they are making a choice being fully aware, i.e. to lawfully form their consent[4].

2. The obligation to inform

The key element during this phase is the one of the mutual obligation to inform. It arises from the article 2 paragraph 1 in the G.O. no. 52/1997, wherein it is stated that the purpose of the pre-contract phase is to allow the parties to form a decision to collaborate. It is common for all the franchise types and methods set out, being an obligation with a general nature. We shall discuss such obligation, and we shall examine its legal nature, its contents, and its penalty, each in its turn.

2.1. The legal nature of the obligation

The New Civil Code sets within the article 1,183 paragraph 1 that the parties have the freedom to initiate, carry on, and break the negotiations, and they may not be held liable for the failure of the same. Therefore, any legal act is preceded by a negotiation wherein the elements of the offer are debated and may be agreed upon or not by the parties involved. A significant part of such

[3] For the definition of the franchising network please refer to Stanciu. D. Cărpenaru, *Tratat de drept comercial român* (Romanian Commercial Law Treaty), Ed. Universul Juridic, 2012, p. 584; Liviu Stănciulescu, VasileNemeş, *Dreptul contractelor civile şi comerciale în reglementarea noului Cod Civil* (The Civil and Commercial Contract Law as Regulated by the New Civil Code), Ed. Hamangiu, 2013, p. 593.

[4] Article 1,182 in the Civil Code, paragraph (1) The agreement is concluded by negotiation between the parties, or by the acceptance without reservations of an offer to contract. Paragraph (2) It is sufficient for the parties to agree upon the elements of essence of the agreement even though certain secondary elements are left to be agreed upon subsequently, or the determining of the same is entrusted to another person.

negotiation is represented by the mutual informing the parties are carrying on as regards their person, the object of the future act, and the incumbent rights and obligations, respectively.

The article 2 paragraph 2 and 3 in the G.O. no. 52/1997 sets the legal nature and the contents of the prior informing obligation that is especially incumbent on the franchisor. Unlike the Deontological Code of the French Franchise Federation, which was the inspiration source for the Romanian lawmaker, such article in the Romanian law did not also take over a final paragraph in the Code that expressly provided for that the list and the listing included by the paragraph 3 are not exhaustive. This is where the first issue arises from when determining the legal nature of the obligation to inform, namely to answer the question whether within the Romanian law such list is provided for in a limiting manner, or in a merely illustrative one.

In partial accordance with the doctrine, but in our opinion closer to the spirit of the law, the listing provided by the lawmaker, although expressly provided for, is however not limitative. Thus, it is consistent with the spirit of the law that certain clauses should be express, due to their importance, but we are not yet on the contract ground, but at the level of negotiations of nature to form the future contract consent. It is not an accident that the Romanian lawmaker chose to regulate such agreement as a mixed agreement, with clauses imposed by the law, but also with provisions expressly left at the discretion of the parties. In the case of the listing we are referring to, the lawmaker, being aware of the fact that within the Romanian law the mere obligation to inform may lead to penalties, has expressly regulated the contents of the obligation, but nothing prevents the parties from also debating and mutually communicating a series of other information. It is tempting to say that the law would be limitative in order to protect the franchisor, but this is not the case as they are expected to show a conduct that is specific for any professional trader, who should be able to cope with the competition, and adapt to the issues and the speed of the market activities.

An issue that arises when the laws in force are looked at appears to be the border, or the limit the obligation to inform should have.

To set a limit within the negotiations between the parties would be a serious interference by the lawmaker, which would be completely unjustified. It is also impossible for the lawmaker to quantify which information is, or is not, relevant and fundamental for the forming of the will of one of the parties. It is the duty of the franchisor, who is required to be an experienced trader, to best choose which partner they shall collaborate with, and as regards the beneficiary the same enjoys a series of legal provisions protecting them should they be a novice. Between the parties should exist, from the very beginning, within the spirit of the franchising agreement, a collaboration based on trust and good faith. Let us not forget that the future agreement shall have as a fundamental feature the fact it is concluded *intuit personae*, wherefrom arises the idea that both parties should act accordingly.

Another argument may also be brought for the idea that the list provided for by the law is not a limiting one, by construing it systematically. Thus, at the level of the whole law the obligations of the parties are the only ones provided for in a limiting manner, which is justified, while the other notions are defined with the mere purpose of clarifying a conceptual issue. The same is the case here, where the list within the paragraph 3 represents a clarification and at the same time a minimum of information that needs to be communicated by the franchisor, all for the purpose of protecting the beneficiary. Such fact however does not reduce the exigency of the fact that the failure to inform according to the paragraph 3 may entail penalties.

The paradox arising from such situation however devolves from the practice. On the theoretical level the things are clear, but when the two planes meet the following dilemma arises: how important is such information for the franchisor and whether the same are not subjecting themselves to a risk this way. Should they communicate more than the law provides for, they could transfer part of the secret of the franchisable concept. Let us assume that the beneficiary is acting in bad faith, and aims to fraud their good faith partner.

A limit may be set however, which is stated by the doctrine, which shows that the secrecy of the business, and the nature and the contents of the know-how, respectively, are limits for the extent of the obligation to inform. A certain "proportionality" of what is disclosed should be maintained in order to keep the secrecy of the fundamental elements.

While under the old legislation no legislative consecration existed as regards the good faith the parties are bound to show when negotiating an agreement, within the New Civil Code is regulated, for the first time, as a general rule, the requirement of good faith for the negotiations. Thus, according to the article 1,183 paragraph 2, the party entering a negotiation is bound to observe the good faith requirements. From this arises the legal obligation to negotiate upon the offer, the counteroffer, the refusal, or the possible acceptance, with firmness, seriousness, and within the spirit of the diligence of a good professional.

It is within the same law text, within the second thesis, that it is stated that the parties may not agree upon limiting or excluding such obligation. Therefore, the parties are free to conclude any additional agreement that would guarantee, for example, the confidentiality of the negotiations, namely to protect them from the situation described above when one party, as a rule the beneficiary, may only have the intention to obtain information, and not to conclude an agreement. They shall however never be able to derogate, by an express or tacit clause, from the requirement of good faith in conducting the discussions.

Within the paragraph 3 of the same article in the Civil Code the lawmaker states, generally, which the main deed or situation that would lead to a breaching of the obligation to observe the good faith negotiations is. Thus, it is against the good faith requirements, among other things, the conduct of the party that initiates or continues negotiations without the intention to conclude the agreement.

We feel that this law text comes to complete the previous paragraphs and perfectly fits the situation the old Civil Code was not covering. It was acknowledged the importance of the pre-contract phase, of the existence of the risk that by negotiations essential information may be disclosed without a possibility to hold liable the person taking advantage in bad faith by attending the negotiations without any intention to conclude the agreement.

It is also the New Civil Code that regulates, in order to avoid the situation previously described, the interdiction to disclose the confidential elements a person may become aware of during the negotiations. The obligation of confidentiality within the pre-contract negotiations is included to the article 1,184, which states that when information is communicated by a party during the negotiations the other party is bound not to disclose the same, and not to use the same for their own interest, notwithstanding that the agreement is concluded or not. The breaching of such obligation entails the liability of the party at fault.

Several important points result from this[5]. In the first place, the law does not require the parties to conclude a special agreement for the purpose of protecting the confidentiality of the information disclosed on the occasion of the negotiations. This, however, does not prevent the parties to, by their express will, conclude such an agreement. The Civil Code only covers the situation where no such agreement was concluded, by expressly stating that a confidentiality clause is presumed between the parties irrespective of their expressed will.

In the second place, for such presumption to operate the opposed party should be notified about the confidential nature of the information they received. We feel that in absence of such a notice the parties may apply the good faith principle, but the concerned party may not invoke, and may not impose the other party to be aware of the confidential nature. Even in the case of the franchising agreement, where arguments could be brought that both parties should have already been

[5] Please also refer to the comments on the article no. 1184 in the work: Flavius-Antoniu Baias, Eugen Chelaru, Rodica Constantinovici, Ioan Macovei, *Noul Cod Civil - Comentariu pe articole* (The New Civil Code – Comments by Articles), Ed. CH Beck, 2012.

aware that what involves the franchisable concept is confidential, we feel the presumption of confidentiality may not be held in absence of a clear, specific, and prior notice.

Finally, the New Civil Code specially regulates the situation where one party considers a certain element to be of essence for the conclusion of the agreement. Such element of essence may lead to refusing to reach a valid agreement. Thus, according to the article 1,185, when during the negotiations one party insists that an agreement is reached upon a certain element, or upon a certain form, the agreement shall not be concluded until an agreement upon the same is reached.

The law text perfectly applies as regards the franchising agreement. Often the elements of the franchisable concept are not negotiable, the franchise network is strictly controlled and regulated by the franchisor, and any transgression may entail the exclusion from the same and interest damages. This is precisely why the lawmaker allows from the very beginning that the elements of the future agreement on which in the opinion of one of the parties the formation of the same essentially depends should be clearly delimited, and in the event of one of the same being refused the continuation of the negotiations may become pointless.

The second issue regarding the legal nature of the obligation to inform is to determine whether it is an obligation of means (of caution and diligence) or one of result[6]. Following the majority line of the doctrine we state that this is an obligation of means, with all the consequences arising from this fact.

In keeping with the spirit of the law and of the future agreement, we state that the obligation to inform should go two ways, namely both from the franchisor towards the beneficiary, and, to a smaller extent, from the beneficiary towards the franchisor. Doubtlessly, the main obligation is on the side of the franchisor, and it consists of the provision of concrete data regarding the financial conditions, the exclusivity clauses, the term of the agreement, the termination, the renewal, etc. This however does not mean that the franchisor should make the future beneficiary also understand the information. They are bound to use all diligence for those listed by the law to reach the beneficiary in a clear and correct manner, but not also explained or detailed.

It may be construed that such a detailing or attempt to explain would lead to exceeding the protection limit of the secrecy of the franchisable concept mentioned above, meaning that it would be an exaggeration to construe the article 2 paragraph 3 in the Ordinance to the effect that the franchisor should guarantee the result, i.e. the debtor should understand the information. The information should be intelligible and concrete, and only an emphasis may be accepted for the purpose of drawing attention on certain major elements such as the duties, the volumes of goods to be sold, etc. On the other hand, a passive attitude from the beneficiary of the obligation to inform may not be excused later, as they also have the obligation to choose who they can and wish to enter a legal relation with.

By reference to the requirements the offer to contract imposes under the Civil Code, namely to be specific and complete, we feel that the same are not breached. The legal nature of the offer to join a franchise network is limited to stating the general elements of the franchisable concept, and not to actually teaching the concrete elements to the beneficiary. Such stage shall be completed in order to observe the franchisor's obligation to provide technical support and information after the contract was signed, therefore during the contract stage.

As regards the term the obligation to inform should be fulfilled within, unlike the French legislation that requires a document to include all the information to be prepared and submitted within 20 days after the agreement was signed, the Romanian law does not set a specific term. The mere submission of the contract offer to be read does not work instead of the obligation to inform, notwithstanding that the same may include or not the list provided for by the G.O. no. 52/1997 unless the submission manner is specific and complete.

[6] Article 1,481 in the Civil Code (1) In the case of the obligation of result the debtor is liable to procure for the creditor the promised result. (2) In the case of the obligations of means, the debtor is liable to use all the required means in order to achieve the promised result.

As regards the time the informing should take we feel that the same should be sufficient for the beneficiary to form their consent, being fully aware, as regards the conclusion of, and then the performance under the agreement.

2.2. The contents of the obligation

The contents of the information is expressly provided for within the paragraphs 2 and 3 of the article 2 in the G.O. no. 52/1997. Thus, the paragraph 2 provides for that the franchisor shall provide the future beneficiary with information to enable the same to participate, being fully aware, in the performance under the franchising agreement. Doubtlessly, the text once again shows the care of the lawmaker for the protection of the beneficiary. However, we feel that the same article may also be applied in order to protect the franchisor within the hypothesis that the same would have every interest to have the beneficiary join their network.

Concretely, the article 2 paragraph 2 sets the general requirement for the franchisor to provide all the information required for the formation of the future beneficiary's consent.

The article 2 paragraph 3 lists the categories of information the franchisor may discuss with the beneficiary[7]. We feel that the same, within the context of the old Civil Code, appeared to be the only information required and possible to be provided. The listing however is not limitative. Within the context of the New Civil Code, along with the regulation of the obligation of good faith during the negotiations, such listed elements are an orientation for the parties within the negotiations.

2.3. The penalty for breaching the obligation

As any legal obligation, the obligation to inform also needs to have a penalty attached.

The first issue we need to determine consists of determining whether the breaching of the obligation to inform may entail the civil contract liability, or the tort liability.

The agreement represents the manifestation of will arising from the offer to contract meeting the acceptance of the same. Or, in our case, since we are within the pre-contract period, it may not be stated that a legal act was validly concluded. The pre-contract stage represents a negotiation in order to conclude a franchising agreement. This is equivalent within the Romanian law with the franchisor submitting an offer to contract and the negotiations with the potential beneficiary in order to have the same enter the franchise network. As a conclusion we identify as applicable, in the event of breaching the obligation to inform, the civil tort liability.

The civil tort liability is regulated by the New Civil Code within the article 1,349. From the contents of the same also arise the elements of such form of liability. The illicit deed may consist either of entering a negotiation without observing the good faith requirements[8], or of providing inaccurate or false information. The damage is the result of the wrong fulfilment, or of the failure to fulfil the obligation to inform, and of the initiation or continuation of the negotiations without the intention to conclude the agreement, respectively, and needs to be proven. The damage should be the

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[7] The article 2 paragraph 3 provides for that: The franchisor undertakes to provide the beneficiary with information regarding:

- their acquired and transferable experience;
- the financial conditions of the agreement, namely the initial royalty or the network entry fee, the periodical royalties, the advertising royalties, the determining of the tariffs regarding the provision of services and of the tariffs regarding the products, the services and the technologies, in the case of the contract obligations to purchase;
- the elements enabling the beneficiary to calculate the forecasted result and to prepare their financial plan;
- the goals and the area of the granted exclusivity;
- the term of the agreement, the renewal, termination, assignment conditions.

For a detailed analysis please refer to Mihaela Mocanu, *Contractul de franciză* (The Franchising Agreement), Editura C.H. Beck, Bucharest, 2008; D.A. Sitaru, *the quoted work*, p. 47 and the following.

[8] Please also refer to the article 14 in the Civil Code, which provides for that: Any individual or legal entity should exercise their rights and fulfil their civil obligations in good faith in accordance with the public order and the good morals.

direct result of the illicit deed, and the absence of a causality relation between the two elements may lead to the inexistence of the tort liability. Not in the last place, the fault also needs to be proven.

The New Civil Code, within the article 1,183 paragraph 4, brings to attention a special case. In the case where the party that initiates, continues, or breaks the negotiations against the good faith, as we examined above, shall be liable for the damage caused to the other party.

In such case it is about the party that either attends the negotiations without the intention to become legally bound but possibly with an illicit purpose, namely it is about that unlawfully breaks the negotiations. Such a person might be the one that took a legal commitment towards another person and continues the negotiations being aware that they could not reach the conclusion of a new act since they would then be breaching their first commitment.

In such special case, in order to determine such damage shall be taken into account the expenses engaged in order to conduct the negotiations, the renouncing of the other party on other offers, and other such circumstances.

It is very possible for the franchisor to make a series of expenses in order to be able to concretely negotiate with a potential beneficiary, these including for example the transport expenses, those generated by the ceremonial, etc. The lawmaker's solution to allow the party that was harmed as result of the conduct exercised in bad faith by the other party to claim damages is equitable. The most serious case is when one party, being in good faith convinced by the immoral and illicit conduct of the other party, renounces on one or several other offers regarding the same object the same agreement. We feel that it is imperative that, as regards the renouncing on other offers made by third parties, as the law text states, the same should regard the same issue brought to negotiation, and the party acting in good faith should have renounced on them because they felt, or had all the elements to feel that they had reached an agreement with the other party, which would have initiated, or would be continuing the negotiations without the intention to conclude the agreement.

3. Conclusions

The pre-contract stage has taken shape in view of the legislation, but not sufficiently. The lawmaker has covered part of the previous gaps, but for similarity with the international legislations a stricter determining of the concept, and of the applicable penalty especially, would have been required.

We are seeing this stage more and more often on various agreement categories, such as the exclusive distribution agreement, the agency agreement, etc., but within any of them it does not have such an important weight as within the franchising agreement. It represents the birth of the agreement, the time the basis for a long-term collaboration is set, since as it is already known the franchising agreement is concluded for at least the period required for the beneficiary to cover their expenses.

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