

**GOODWILL COMPENSATION IN FRANCHISING AND  
DISTRIBUTION CONTRACT IN EUROPEAN LAW AND BASES  
FOR AN ANALOGOUS APPLICATION OF THE COMPENSATION  
RULES APPLICABLE TO COMMERCIAL AGENTS**

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***Abstract***

Vertical agreements, such as commercial agency, franchise and distribution contracts are the legal backbone of modern distribution chains. Despite their fundamental economic importance in modern commerce, many laws do not provide a specific statutory regime for these contracts. This applies, particularly to franchise and distribution contract. The current state of franchise and distribution law and the related question of goodwill compensation after the termination of these contracts are still unexplored. In European law, there is no common attitude regarding this issue, not even among nations of similar cultures and legal systems, and judicial practice also proved to be inconsistent. There is no doubt that during franchising and distribution operation goodwill belongs to franchisor/supplier as the bearer of the system. However, having in mind that franchisee and distributor are an active party in the system who try to improve it, expand the clientele in the contracted area, and thus the business reputation of the overall system, doubts arise about the issue whether they are entitled to compensation for the increased goodwill, after the termination of the contract. This article reviews the treatment of goodwill upon the termination of franchise and distribution contracts in key European jurisdictions, as well as justification of the analogous application to these contracts of indemnity rules relating to a commercial agent.

**Keywords:** *goodwill, compensation, contract expiry, European law, European jurisdictions*

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## I. DEFINITION OF GOODWILL

What is goodwill? It is something easy to describe but difficult to define. Goodwill represents benefit or advantage from the famous brand, trademark, base of loyal clients, reputation and business relations in the business. It is the image of the company-attracting power which lures clients, gains and keeps their loyalty which is key to any successful business.

Goodwill is property of an intangible nature, commonly defined as „the expectation of continued public support. It means every positive advantage that has been acquired by a proprietor in carrying on his business, whether connected with the premises in which the business is conducted, or with the name under which it is managed, or with any other matter carrying with it the benefit of the business“.<sup>1</sup>

With the help of goodwill, the owner makes a profit above the usual rate due to a favourable reputation in the community and the identification of the business name with consumers. For accounting purposes, goodwill generally is the difference between the purchase price and the value of the assets acquired.<sup>2</sup> This surplus in the price of the acquired company or operating unit in relation to a market value of the net assets of the acquired unit, informally indicates some intangible values, such as: good customer relations, high employee morale, superior managerial skills, well-respected business name etc., which are expected to result in higher earnings than usual.<sup>3</sup> Therefore, goodwill is an economic advantage that stems from the reputation of the network, but also expectation that regular customers will keep supporting it and attract new clients.

Having in mind the above mentioned we can state that goodwill consists of two elements. The first one is reputation of the specific business that already exists, its favourable image in society, recognition of business brand by clients, superior market position etc. The second one represents expectation that such a reputation will continue to attract clients and gradually increase clients' base,<sup>4</sup> and that acquired reputation will continue to exist in the targeted area.

## II. GOODWILL OWNERSHIP DURING CONTRACT

There is no doubt that during franchising operation goodwill belongs to the franchisor as the bearer of the system. He is the initiator of the system and the main guardian of the entire network identity and reputation. Goodwill itself motivates franchisee to be involved in the system to convey it from the whole system to the newly established business unit, what is the economic purpose of franchising.<sup>5</sup> After getting a franchise and using franchisor trademark on that basis, a franchisee is identified with the reputation that trademark represents, what provides economic advantage since he starts with the business

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<sup>1</sup> Henry Campbell Black, M. A. et. al., *Black's Law Dictionary, Definitions of the Terms and Phrases of American and English Jurisprudence, Ancient and Modern*, (West Publishing CO, 6th ed., 1990), 694.

<sup>2</sup> Phillip A. Beutel & Bryan Ray, "Grasping the Value of Intangible Assets", 30(1) *International Tax Journal*, (Aspen Publishers, New York, 2004), 35-45. Available at: (Nov., 06, 2019) .  
<http://www.nera.com/content/dam/nera/publications/archive1/5907.pdf> .

<sup>3</sup> Black's Law Dictionary, *supra* note 2, 694.

<sup>4</sup> R. Dore, „Goodwill and the Spirit of Market Capitalism“, 34 (4) *The British Journal of Sociology*, (1983), 459-482.

<sup>5</sup> Deša Mlikotin-Tomić, *Franchising Contract (Ugovor o franchisingu)*, (Informer, Zagreb, 1986), 383.

which already has a high reputation and “client identification”. This enables franchisee not to begin from zero, but to have clients from the first day, whose number will increase in time. Developed model of business followed by well-known symbols is the main reason why the franchisee accesses the network. In other words, what sells franchise is its market recognition and success. Premises, trained staff, money etc. would have no value in franchising sense if there were no adequate franchise, ie business brand and trademark which clients recognize and require. Therefore, one of the main reasons why franchisee becomes involved in the network is franchisor’s developed business model followed by a well-known brand, in one word - goodwill. Goodwill renting, by which also a part of the winning market, is a *ratio* of franchising contract.

However, a franchisee is not a passive party in this story. On the contrary, a franchisee is the one who takes concrete steps in the market. His independent engagement could not be neglected. He invests effort and resources to win the market, attracts clients, increases reputation of the network etc., so it is indisputable that through his successful management, he can improve the business system in time, expand the clientele in the agreed market, increase the value of products and services, and thus the business reputation of the whole system and the value of the franchise itself. Therefore, while customers are initially attracted to a brand, they remain faithful to the brand precisely as a consequence of the personal merit of the franchisee.<sup>6</sup> Moreover, although the franchisor has a developed market and attracted clients whose exploitation he hands over to franchisee, that does not mean that franchisee will automatically have attracted clientele in his franchising area. The brand will certainly attract customers, but the franchise concept must be locally affirmed based on the consumer’s own experience.

This particularly applies to the early stages of a business when franchisor still has not attracted clientele in franchising area and when franchising concept only begins to be promoted locally and develops goodwill as the consequence of successful local concept implantation.

Therefore, it is not surprising that both contract parties have pretensions to the goodwill of the franchise system. Almost every dispute between franchisor and franchisee about goodwill arises from the simple fact that franchisor possesses goodwill which hands over, i.e. rents to a franchisee. Franchisee then considers that he owns goodwill which is given to him for further development and franchisor believes that all that the franchisee has received is a temporary use of something which is under his possession: goodwill connected with his trademark.

### **III. OWNERSHIP OVER THE INCREASED GOODWILL VALUE AFTER EXPIRY OF CONTRACT**

After expiry of franchise contact, goodwill remains in franchisor’s possession, who continues to seize effects from work of franchisee and acquire benefits from increased

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<sup>6</sup> Clay A. Tillack & Mark E. Ashton, “Who Takes What: The Parties' Rights to Franchise Materials at the Relationship's End”, 28(2) *Franchise Law Journal*, 88-128, (American Bar Association, 2008). Available at: (Nov. 22, 2019) [http://www.schiffhardin.com/Templates/Media/files/archive/binary/tillack-ashton\\_flf\\_fall2008.pdf](http://www.schiffhardin.com/Templates/Media/files/archive/binary/tillack-ashton_flf_fall2008.pdf).

clientele and popularity of franchising system, which is created partly due to the good franchisee management. Consequently, after the termination of the contract, some disputable issues may arise. Like in marriage, franchising "divorce" usually poses a question: "Who gets what?" Both contract parties put their time, resources, "tears and sweat" to develop business, and now each party claims their right to it. The core of this dispute is a relentless struggle for goodwill possession.

In principle, the stronger the goodwill of the franchisor, the less likely the franchisee will build his own goodwill and vice versa. As franchisor's goodwill is less developed that is greater franchisor's expectation that franchisee will develop its goodwill, which will at the same time strengthen the franchisor's as well. The problem arises when a franchisee innovates or otherwise acquires the customer's attention, including loyalty, and franchisor neglects the value of such contribution or attributes it to the system as a whole. Because, franchisor believes that he possesses system goodwill as well as every goodwill that comes as a result of franchise expansion, including local goodwill developed by individual franchisees. Therefore, a dispute usually arises regarding franchisee's request to compensate for the difference in the value of goodwill received at the beginning of the contractual relationship and the value of the increased goodwill at its end.

Similar „battle“ is fought on distribution field where distributor claims that he has fulfilled his obligations of introducing a new product on a new market, and enabled the possible placement of such product or service in the future. Therefore he also claims the fact that the customers will remain loyal to the branded products and the fact that he has had to report the customers' names and all the business with them continuingly to the supplier so that the supplier after the termination of the contract will have been put in a situation where he can seamlessly continue the business.

Generally, when the reason for contract expiry is prescribed to a franchisee/distributor, or it represents their free will, then rejection of compensation for increased goodwill is justified.<sup>7</sup> In this case, they should not be entitled to goodwill compensation, since no one can claim the benefits of their harmful actions. It may be fair the opposite, if the contractor who left a “mess” behind, such as poor system management and bad reputation, pays compensation to franchisor or supplier who took "clearing up the mess" upon himself, even though this situation is not accepted neither from the legal nor commercial side.

In the opposite situation, that is, if the contract terminates due to franchisor, ie supplier misconduct or is not renewed, even if the conditions for that have been fulfilled by the franchisee or distributor, rejection of goodwill compensation may create suspicion. In that case, the question is whether such circumstances give the right to the franchisee and distributor to seek compensation for the increased goodwill. Opinions regarding this issue in the countries of the European legal system are divided.

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<sup>7</sup> This solution is analogue to Article 89b (3) of the German Commercial Code regarding commercial agency.

The indemnity claim shall not arise if 1. the commercial agent has terminated the agency contract unless the conduct of the principal gave justified grounds for doing so, or the commercial agent cannot reasonably be expected to continue his activities on account of his age or of illness, or 2. the principal has terminated the agency contract and there was a compelling reason for such termination owing to culpable conduct on part of the commercial agent, or 3. a third party enters into the agency contract in place of the commercial agent based on an agreement between the principal and the commercial agent. Available at: (Sept. 20, 2019) [http://www.gesetze-im-internet.de/englisch\\_hgb/englisch\\_hgb.pdf](http://www.gesetze-im-internet.de/englisch_hgb/englisch_hgb.pdf)

Even though there are some similarities among countries, there is no international or transnational solution for this issue, not even among European countries of similar cultures and legal systems. Opinions vary from those that do not explicitly foresee the right to increased goodwill compensation, to those who support such an approach.

Some jurisdictions (Belgium, Estonia, Germany, Italy<sup>8</sup>, Ireland, Great Britain<sup>9</sup> and the Netherlands<sup>10</sup>), have no specific statutory regulation on (the termination of) franchise or distribution contracts, allowing a franchisee or distributor to claim compensation for the loss of clientele (goodwill) after the termination of the contract. Thus, it seems that in all of the studied jurisdictions, the legislator did not yet feel the need to create a special action allowing them to claim compensation for the loss of clientele, after the termination of these contracts.<sup>11</sup>

It is true that European point of view, when it comes to goodwill compensation, leans more towards franchisees and distributors, probably inspired by the protection of an economically weaker contracting party.<sup>12</sup> For example, the *Draft Common Frame of Reference (DCFR)* in Article IV.E.-2:305 provides for an indemnity for goodwill after the termination of all contracts falling within the scope of the Part on „Commercial agency, franchise and distributorship”. Such indemnity for goodwill is due when a party has significantly increased the other party’s volume of business and the other party continues to derive substantial benefits from that business.<sup>13</sup>

The general idea of DCFR is that irrespective of whether the contract was for an indefinite or a definite period and irrespective of how the contract ended (whether or not for fundamental non-performance), the mere fact that the contractual relationship comes to an end may lead to a transfer of goodwill. Indemnity for the clientele does not depend

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<sup>8</sup>Italian Law on Franchising Contracts 6 May 2004, n. 129 “Norme per la disciplina dell’affiliazione commerciale” does not provide for any provision concerning termination indemnity for the loss of customers. Alberto Venezia, *Termination of franchising and distribution agreements in EU*, COMMISSIONE RAPPORTI INTERNAZIONALI ORDINE DEGLI AVVOCATI DI MILANO, (Milano, 2018), 39.

Available at: (Oct. 31, 2019),

[https://www.ordineavvocatimilano.it/upload%2Ffile%2FAREA%20CRINT%2FEBOOK%20FRANCHISING%202018%2FEbook\\_franchising\\_2018\\_Crint.pdf](https://www.ordineavvocatimilano.it/upload%2Ffile%2FAREA%20CRINT%2FEBOOK%20FRANCHISING%202018%2FEbook_franchising_2018_Crint.pdf)

<sup>9</sup> In the UK „There is no comparable directive (Directive (EC/86/653)) which extends to distribution and franchise agreements“, *ibid.* at 172.

<sup>10</sup> In the Netherlands, a Dutch Franchise Code was introduced on 17 February 2017. The Dutch Franchise Code contains best practices on the conduct of the franchisor and the franchisee and does not entail any best practice in relation to the termination of the franchise agreement. *ibid.* at 141.

<sup>11</sup> T. Hartlief & J. Baeck, “Goodwill Compensation after Termination of a Franchise Contract: Comparative Perspectives on Cour de Cassation 23 October 2012 (No. 11 21.978)”, 6-2014 *European Review of Private Law*, (Kluwer Law International BV, 2014), 955–960, 958.

<sup>12</sup> The agreements themselves tend to reflect this gross bargaining power disparity. Usually, they are form contracts the franchisor has prepared and offered to franchisees on a take-it-or-leave-it basis...Indeed such contracts are sometimes so one-sided, with all the obligations on the franchisee and none on the franchisor, as not to make them legally enforceable. This view has also been used to justify “protective” legislation for franchisees. See James A. Brickley, Sanjog Misra and R. Lawrence Van Horn „Contract Duration: Evidence from Franchising”, *The Journal of Law and Economics*, (April 2006), 49(1):173-196 DOI: [10.1086/501081](https://doi.org/10.1086/501081), 173.

<sup>13</sup> Principles, Definitions and Model Rules of European Private Law Draft Common Frame of Reference (DCFR), PART E. COMMERCIAL AGENCY, FRANCHISE AND DISTRIBUTORSHIP, p. 2336. Available at: (Nov. 01, 2020) [http://www.transformacje.pl/wp-content/uploads/2012/12/european-private-law\\_en.pdf](http://www.transformacje.pl/wp-content/uploads/2012/12/european-private-law_en.pdf)

on any sort of fault. Thus, indemnity for the clientele does not depend on any sort of fault, and may even be cumulated with damages in the case of the premature termination of the relationship without adequate notice.<sup>14</sup>

Likewise, the Principles of the European Law on Commercial Agency, Franchise, and Distribution Contracts mainly reproduced in the DCFR, state that compensation shall be provided upon agreement termination, regardless of the termination cause (including the non-compliance by either of the parties) if: (a) the counterpart considerably increased the turnover of the other and the latter continues obtaining substantial profit from this activity, and (b) the payment of compensation seems reasonable taking into account all the circumstances.<sup>15</sup>

#### **IV. COMPENSATION FOR INCREASED GOODWILL– DESERVED OR NOT?**

The fact that franchisee and distributor put effort and resources in conquering the marketplace, strive to expand the clientele on the contracting market, increase business reputation of the entire system could refer to the justification of their claim for a goodwill compensation. However, as increased goodwill is not a product of their merit alone, it seems to us that there are stronger arguments in favour of not automatically and unreservedly recognizing the right to this compensation. This is not only because the main constituents of goodwill are intellectual rights, business system, relations with suppliers and customers and other assets for which there are no clear economic parameters that would help in calculating their accounting value, but primarily because goodwill is based on the branded product of the supplier and methods of its commercialization that was created by the franchisor. In terms of distribution, goods, its quality, its trademark, brand-related goodwill are decisive for the conclusion of the contract. All these aspects can only be attributed to the supplier. Also in franchising, the successful implementation of a business concept that leads to an increase in clientele as the ultimate goal of the entire operation belongs to the franchisor: he created it, edited it and ceded it to the franchisee. The purpose of handing over the product or business system is not its preservation, but its placement and improvement that also implies the expansion of the clientele.<sup>16</sup> As the customer base is created by the customers themselves, who are attracted by the product image, reputation and prestige of the brand, rather than by the efforts and actions of the franchisees/distributors, the distributor's and franchisee's goodwill is rarely their personal merit, at least not to the extent that they can call it their own, independent from the goodwill of the donor as the creator of the product and system.

True, there are cases where clients repose their trust in distributor/franchisee due to his specific individual characteristics. For example, the franchisor may have more franchising units in the same town which offer same products or services, but clients still

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<sup>14</sup> See Art. IV.E.–2:303 (Damages for termination with inadequate notice), DCFR.

<sup>15</sup> Principles of European Law on Commercial Agency, Franchise, and Distribution Contracts. (PEL CAFD), Art. 1: 305., Oxford University Press; 1 edition (August 10, 2006).

<sup>16</sup> Clients are usually considered as an essential part of goodwill and are even equalized with it, or, as noted by the renowned franchising lawyer Dominique Baschet, clients represent a consequence of that goodwill. Dominique Baschet, *La Franchise: Guide Juridique, Conseils Pratiques*, (2005).

respect one franchisee more than others because that one, for example, offers slightly better and more secure service, more experienced staff, or simply a nicer approach and relation with clients. The fact that such a successful franchisee is not entitled to compensation for the increased goodwill should not discourage him, because he is already benefiting during the term of the contract based on his success, in a sense of higher income from his competitors. In that way, the development of the client base for the benefit of the franchisor finds its “counterpart in the economic advantages that benefited the franchisee during the term of the agreement”<sup>17</sup> This can be significant encouragement and reward for his engagement and productivity. Therefore, a franchisee has already achieved benefits from the increased scope of business during the term of a contract, so it would not be fair to earn double on the same basis. Finally, if the franchisee takes all the credit for the increase in clients number, there is no guarantee that after contract expiry, these clients will stay loyal to the brand, and that the franchisor will continue to collect revenues on that basis. Hence, franchisee seeks compensation in consideration of the projections which may not even arrive. Therefore, it remains an open question as to what the franchisee intends when seeking compensation for increased goodwill?

In support of the view that the franchisee/distributor is not entitled to compensation for goodwill is the following fact. The supplier and the franchisor, who generally have the opportunity to exploit economic advantages without limit by creating their own branches in the targeted market, have decided to hand them over to the distributor and franchisee expecting some benefits from their activities that will encourage the development of system dynamics and improve his reputation. This is their guiding idea, the imperative of the whole concept. The franchisee contributes to the realization of this idea since the improvement of the system is his obligation to which he has agreed by signing the contract itself.

The improvement of the system should be the result of the joint action of the contractors, which imposes a mutual obligation of the contracting parties to present all improvements and enhancements of the system that occur during their business. In this way, the development dynamics of these systems is encouraged, which is necessary to meet the ever-changing market and demand in it. Finally, when it comes to a franchise agreement, the continuous assistance and control of the franchisor as the creator of the network over the franchisee's business as a member has a central role in creating, transferring and increasing goodwill, which supports the view that goodwill belongs to the provider.

The trend that is seen that goodwill compensation is granted to franchisees only encourages franchisors to contractually protect their rights to goodwill. For these reasons, there is an increasing number of contracts stipulating not only that goodwill belongs to

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<sup>17</sup> S. Willemart, *Analyse comparée des mécanismes et questions d'actualité posées par l'indemnité de clientèle en matière de concession de vente, per l'indemnité d'éviction en matière d'agence commerciale et par le droit commun en matière de franchise*, in *Regards croisés sur la distribution: concession, agence et franchise*, (Larcier,2015), 95.

the franchisor<sup>18</sup>, but all promotions, concepts and new ideas of franchisees belong exclusively to the franchisor,<sup>19</sup> which could also apply to a new clientele.

## V. GOODWILL COMPENSATION IN FRANCHISE AND DISTRIBUTION CONTRACTS IN SOME EUROPEAN COUNTRIES

Since distributorship and franchise contracts are mostly not regulated by statutory law, there is no statutory provision concerning goodwill compensation claims of distributors or franchisees either. The aforementioned regulations - DCFR and PEL CAFD – of the so-called "Soft law" and have no binding legal force, ie. they do not lay down special rules as a proposal for direct and automatic legislation in the Member States. The legislator can draw inspiration from them.

In the absence of mandatory provisions for franchising and distribution contracts relating to compensation for increased goodwill, an analogous application of the statutory provision concerning commercial agency is noticeable. The analogy is justified by the great similarity of these contracts, which is why many countries tend to apply it. In this sense it is of great importance the Council Directive 86/653/EEC of 18 December 1986 on the coordination of the laws of the Member States relating to self-employed commercial agents (hereafter: Directive 86/653/EEC)<sup>20</sup>. As there is no comparable directive relating to distribution and franchise contracts, many countries are prone to extend its application to these contracts by analogy.

Article 17 of this Directive prescribes a dual system of compensation in the event of termination of the agency agreement. Goodwill compensation shall be paid to the commercial agent or the agent's damages shall be indemnified, if and to the extent that he has brought the principal new customers or has significantly increased the volume of business with existing customers and the principal continues to derive substantial benefits from it.

The part of the Directive 86/653/EEC which refers to compensation claims for commercial agents was implemented in German regulation and stipulated in Article 89(b) of German Commercial Code in January 1990.<sup>21</sup> According to the current version of Art. 89 (b) (that is consistent with the judgment of the European Court of Justice<sup>22</sup>) the

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<sup>18</sup> „...All goodwill now or in the future associated with and/or identified by one or more of the Pizza Hut Marks belongs directly and exclusively to PHI“. Robert W. Emerson, „Thanks for the memories: Compensating franchisee goodwill after franchise termination“, *Univ. of Pennsylvania Journal of Business Law*, Volume 20, Issue 2, 286-339 (2017), 332.

<sup>19</sup> Robert W. Emerson, „Franchise goodwill: Take a sad song and make it better,“ Vol. 46:2 *University of Michigan Journal of Law Reform*, (2013), 357, fn 35.

<sup>20</sup> EUROPEAN COMMISSION, EVALUATION OF THE COUNCIL DIRECTIVE ON THE COORDINATION OF THE LAWS OF THE MEMBER STATES RELATING TO SELF-EMPLOYED COMMERCIAL AGENTS (Directive 86/653/EEC) / REFIT EVALUATION, Brussels, 16.7.2015. Available at: (May. 29,2020 ), [file:///C:/Users/pcc/Downloads/SWD-2015-146-final\\_en.pdf](file:///C:/Users/pcc/Downloads/SWD-2015-146-final_en.pdf)

<sup>21</sup> Michael Loerke & Rogge Clemens, *Germany: Compensatory Claim Of Commercial Agents Or Authorized Dealers For Loss Of Clientele*, Last Updated: 18 June 2008, Available at: (Nov. 20, 2019) <http://www.mondaq.com/germany/x/62084/Corporate+Commercial+Law/Compensatory+Claim+Of+Commercial+Agents+Or+Authorized+Dealers+For+Loss+Of+Clientele.com> .

<sup>22</sup> The most significant development and amendment in German law in this regard occurred as a result of the application filed by Hamburg Regional Court (*Landgericht Hamburg*) before European Court of Justice

commercial agent shall be entitled to demand a reasonable indemnity from the principal, after the termination of the agency contract, if and to the extent that: 1. the principal continues to derive substantial benefits, from business relations with new customers brought by the commercial agent, and 2. the payment of an indemnity is equitable having regard to all the circumstances and, in particular, the commission lost by the commercial agent on the business transacted with such customers. The cooperation between the commercial agent and the principal often lasts for many years. During that time the commercial agent usually puts a big effort into the development of a clientele which is of major importance for the principal. Once the agency agreement is terminated the commercial agent suffers a considerable loss of commission which a continuation of the agency agreement would have procured for him. On the other hand, the principal usually receives a considerable benefit from the developed clientele. Therefore, the underlying idea is to indemnify agents for benefits that the principal receives from the commercial agent's work after termination of the contract, and for which the agent has not been rewarded.

Although the judicial practice is not unique to this issue, most of the German courts have ruled that the mentioned provision of Art. 89 (b) of the Commercial Code applies analogously to certain forms of franchising agreements.<sup>23</sup> Concerning the distribution agreement, the analogous application of Article 89 (b) of the Commercial Code is largely acknowledged, as the Federal Court of Justice confirmed the possibility of analogous application at a very early stage. The Federal Court of Justice details that there is no impediment to analogous application of the § 89(b) of the Commercial Code to distributors “if the legal relationship between it [the distributor] and the manufacturer or supplier is not limited to a mere buyer-seller relationship, but the distributor was involved in the sales organisation of the manufacturer or supplier in such a way that it had to perform commercial duties comparable to those of a commercial agent to a considerable extent, and the dealer is furthermore obligated to transfer its customer base to the manufacturer or supplier“.<sup>24</sup> What is relevant in this regard is an overall assessment that makes the distributor appear similar to a commercial agent.

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in 2009 and as a result of this application, Article 89b(1) of German Commercial Code was re-drafted on July 31, 2009, to bring the German provision into line with a ruling of the European Court of Justice (ECJ) (Decision C348/07, March 26 2009). The amended Section 89b now better reflects the wording of Article 17(2)(a) of the Directive. Karl von Hase, *Provisions on Indemnity Payable to Commercial Agents Amended*, (07 December 2009). Available at: (Oct. 21, 2019)

<https://www.internationallawoffice.com/Newsletters/Company-Commercial/Germany/GSK-Stockmann-Kollegen/Provisions-on-Indemnity-Payable-to-Commercial-Agents-Amended#2>.

<sup>23</sup> The German Supreme Court (Bundesgerichtshof - BGH) has also joined the overwhelming opinion of German scholars, affirming in principle the appliance by the analogy of the right to indemnity of the commercial agent under Art. 89 b HGB to the franchisee [BGH NJW RR 2002,1554]. Also: LG Frankfurt am Main 10.12.1999, Az: 3/8 0 28/99 (not published); Giesler, *ibid*, Rn. 145; Köhler, NJW 1990, 1689-1697, 1689; Haager, NJW 2002, 1463-1475, 1471. However, some recent decisions by lower courts may be an indication of a change in this trend. The first of the lower courts that opposed the right to a franchise benefit to goodwill is the regional court in Mönchengladbach. This court rejected the franchisee's request for a goodwill fee because the contract did not explicitly request the transfer of a customer base. Chris Wormald, *Germany: Agency Compensation Denied*, FIELDFISHER (Jan. 27, 2012), Available at: (Oct. 25, 2018) <https://www.fieldfisher.com/publications/2012/01/franflash-compensation-upon-termination>

<sup>24</sup> Federal Court of Justice, judgment of 6 October 2010 - VIII ZR 209/07

In Austria, a country where the franchise agreement, as well as the distribution agreement, are not regulated by law, a commercial agent analogy is applicable only if the franchisee or distributor has the characteristics of an agent, which is supported by court decisions. Namely, according to the case-law of the Supreme Court (the OGH), Federal Law Concerning the Legal Relations of Self Employed Commercial Representatives [Agents] (*Handelsvertretergesetz* 1993, as amended by Federal Law Gazette I no 29/2016) is applied analogously, in particular with regard to the right to compensation under Section 24 of the Law.<sup>25</sup>

In Portugal, the Agency law also applies to franchise agreements in respect of termination and compensation.<sup>26</sup> „Where the performance of the franchisee is similar to that of an agent and the franchisor maintains the franchisees’ customers after the termination of the agreement, franchisees are entitled to compensation upon termination due to their loss of goodwill“. This view is endorsed by jurisprudence<sup>27</sup> and doctrine<sup>28</sup>.

Courts in France are inconsistent in dealing with goodwill issues. Until 2000, goodwill in the franchise agreement belonged to the franchisor.<sup>29</sup> Since then, there have been some changes in judicial practice. The turning point was the case of *Sarl Nicogli Le Gan Vie SA* in Paris in which the Court of Appeals ruled that goodwill belongs to the franchisee and is independent of the goodwill of the franchisor.<sup>30</sup> Two years later, that position was grounded on a decision known as the Trevisian Judgement, which recognizes the franchisee’s own goodwill that protects him from not renewing the contract for no good reason.<sup>31</sup> French law distinguishes between “national goodwill” belonging to the franchisor and “local goodwill” belonging to the franchisee.<sup>32</sup>

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<sup>25</sup> AUSTRIAN OGH: OGH 23 October 2000, 8 Ob 74/00s; OGH 15 December 1999 6 Ob 247/99p; OGH 30 March 1999 10 Ob 61/ 99i; OGH 24 November 1998 1 Ob 251/98p; OGH 17 December 1997 9 Ob 2065/96h; OGH in 1 Ob 359/99x mwN.

<sup>26</sup> Article 38 and 33 of Decree No. 178/86 of 3 July as modified by Decree No. 118/93 of 13 April.

<sup>27</sup> Supreme Court of Justice, proc. No. 06a4416, dated 9 January 2007.

<sup>28</sup> Antonio Pinto Monteiro, *Direito Comercial – Contratos de Distribuicao Comercial*, (Coimbra, 2002), 163-170 and L. Miguel Pestana Vasconcelos, *O Contrato de Franquia (Franchising)*, (Coimbra, 2000), 95-98.

<sup>29</sup> “all technology, know-how, and other industrial property rights remain the property of the franchisor after the termination of the contract...” Robin T. Tait, *Survey of foreign laws and regulations affecting international franchising*, (France 1990), (Philip F. Zeidman ed., 2d ed.), 11.

<sup>30</sup> Robert W. Emerson, „Thanks for the memories: Compensating franchisee goodwill after franchise termination“, VOL 20, 2017, *Pennsylvania Journal of Business Law*, (2017), 286-339, 302.

<sup>31</sup> *Ibid*, 350.

<sup>32</sup> French judicial practise in one case considers that even if franchisee uses franchisor's brand and applies his standards, he is engaged about his management, overtakes risks and has "right" to his own clients whose attracting and increasing represents the main basis of the franchising system. In that sense, French *Cour de Cassation* made a key decision known as The Trevisian Judgement from 2002, which prescribes that franchisee certainly owns his *goodwill* which protects him from contract non-renewal without founded reason. According to the above mentioned, French *Cour de Cassation* recognized that franchisors are owners of national clients, while franchisees are owners of local clients, what means that all franchisees are owners of goodwill at a local level. Therefore, having in mind the significance of local clients, franchisee as the owner of local goodwill can make a profit either from renewal of the contract or from the redemption claim due to non-renewal of the contract (to seek a goodwill compensation). See: Cour de Cassation, 3e civ., Mar. 27, 2002, Bull. civ. III, No. 00-20.732 (Fr.). See also: SA Andrey/SAS Vanica, Cour de Appel CA, Chambéry.com., Oct. 2, 2007, No. 06-1561 (Fr.).

A hesitant position on this issue also existed in Switzerland, where the Federal Supreme Court at first refused to apply the analogy. The turning point came in 2009 when the same Court changed its previous practice and awarded to a distributor a compensation for clientele upon the termination of the agreement, invoking Art. 418 of the Swiss Code of Obligations which regulates the goodwill fee of a commercial agent.<sup>33</sup> Namely, a distributor who is integrated into the supplier's distribution system like an agent shall be entitled to a claim for clientele compensation, under the same conditions as the agent.<sup>34</sup> The Directive 86/653/EEC is included in Spanish positive law through the Law 12/1992, of 27 May, on Agency Agreement Act (AAA). However, the doctrine and case law in Spain do not agree on how to address the problem which generates the analogical application of the AAA toward the termination of the franchise agreement. Those who advocate for the analogy usually resort, among others, to the argument that the agency and franchise agreements share a similar economic function and are integrated, along with the commercial distribution in the category of "distribution agreements" or "cooperation agreements". Such doctrinal sector concludes that in both agreements there is true commercial integration and that the customers shall be considered as a common asset that shall be settled between the parties when the integration is suppressed.<sup>35</sup> There is another doctrinal sector which opposes the analogical application of the AAA, mainly grounding their position on the differences presented by both contractual types. It is especially remarkable the acting independently in the name and on behalf of the franchisee, as well as the different compensation systems in each agreement.<sup>36</sup> Namely, although the franchisee is integrated in the franchisee's sales network and is limited by his instructions, he has much greater independence than a commercial agent, as he acts as an independent entrepreneur in his own name and for his account, and therefore has to bear a greater risk. There are differences and when it comes to compensation. Under the franchising agreement, the franchisee pays a fee to the franchisor to enter the franchise network, for the services and the franchise that he uses in this business. In the agency contract, the principal is the one who is obliged to pay the commission for contracts concluded by agent mediation.

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<sup>33</sup> ATF 134 III 497; Praxis 2/2009 no. 19.

<sup>34</sup> Available at: (Oct. 31.,2019., 11:37 AM) <https://www.idiproject.com/news/switzerland-developments-law-exclusive-distribution-0>

<sup>35</sup> The Supreme Court Ruling number 697/2007, of 22 June (RJ 2007, 5427) „the so-called compensation for clientele is not exclusive of the agency agreement and... may be appreciated in other agreements”. Likewise, Ruling number 357/2009, of 1 June, of the Supreme Court (RJ 2009/3191). Judgment of the Supreme Court of 22 October 2012 (RJ 2013, 1539).

<sup>36</sup> Despite there being a significant number of Rulings against, it is particularly noteworthy that the Provincial Court of Barcelona, of 10 June 2004 (AC 2004/1100), introduces important nuances when pointing out (in its legal basis number 7) that “the provision under article 28 of the agency agreement is not applicable, as it is necessary to take into account that the product covered by the franchise, given its reputation, exempts the franchisee, who has advertised thanks to the franchiser, from a great part of the dissemination and customer acquisition, so the profit that the defendant may have generated for the customer can only be regarded as derived in a small part from the activity of the franchisee”, which ultimately serves as a basis to moderate the compensation for customers. See also the Provincial Court of Alava Ruling of 10 April 2006 (AC 2006, 899), Provincial Court of Tarragona Ruling of 30 January 2008 (JUR 2008, 146713) and the Provincial Court of Burgos Ruling of 2 December 2011 (JUR 2011, 440702). See the Provincial Court of Valencia Ruling (6th Section) of 28 April 2000, the Provincial Court of Malaga Ruling of 30 November 2005, the Provincial Court of Tarragona Ruling (1st Section) of 30 January 2008.

Spanish judicial doctrine and case law have made an effort to make clear that the application of the AAA to the distribution agreement too, even by way of analogy is not and should not be automatic. This application must be done not only cautiously, but also analyzing every single case.<sup>37</sup>

Similar dilemmas are present in other countries whose authors and courts also disagree with the fact that the rules on commercial agency can be applied analogously to franchising or distribution.<sup>38</sup>

Thus, the Swedish Court of Appeal rejected the analogous application of the rules for indemnity claim of the Swedish Commercial Agency Act to the distributor because there was no valid basis for the analogous application of the rules. It was a prosecutor who claimed to have acted as a commercial agent and thus claimed damages for goodwill, but the Court stated that he had acted as an independent distributor and that there were no valid bases for an analogous application of the indemnity rules applicable to commercial agents. The Court also rejected the argument that the right to indemnity could be based on the rules set out in the Draft Common Frame of Reference (DCFR) - arguing that although these principles may provide guidelines for interpretation, they have not been implemented as Swedish law.<sup>39</sup>

The UK, as a European country with a common law legal system, has had no cases where franchisees have been entitled to a goodwill indemnity. But, in the case of distribution, „The English Court of Appeal (CoA) has held that Directive 86/653/EEC does not apply to distributors. English law does not permit Directive 86/653/EEC to be applied by analogy to justify awarding goodwill compensation to distributors...”<sup>40</sup>

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<sup>37</sup> See: Second legal reason for the decision, judgment of the Supreme Court No. 404/2015, of 9 July, point 4 of the Judgment being analyzed.

<sup>38</sup> See for ITALY: Aldo Frignani and John H. Pratt, “Termination and Non-Renewal of Franchise Agreements in the European Union: Italian Law in a Comparative Perspective with Other European Civil Law Systems and England and Wales”, Vol. 37, No. 1 *Franchise Law Journal*, (Summer 2017), 39; For SPAIN: Bogaert, Lohmann, *Commercial Agency and Distribution Agreements*, (3rd Edition, 2000). Also in PORTUGAL authors do not agree as to whether an indemnity is payable in the case of franchise contracts (pro: ISABEL ALEXANDRE, *O Contrato de Franquia (Franchising)*, (1991), 349; Ribeiro de Sousa, *Contrato de agencia* (2001), 143; Pestana de Vasconcelos, *O Contrato de Franquia*, Coimbra, (2000), 95-98, 94. Also LATVIA and SLOVAKIA. Article 45 of the Latvian Commercial Law. A franchise is considered an entrepreneur whose franchise is included in the franchisor's distribution network and who is obliged concerning the franchisor to sell the latter's goods on its own behalf and at its own expense. A similar position exists in Slovakia where the general view seems to be that provisions concerning commercial agents in the Commercial Code do not apply to franchise agreements because franchisees generally enter into contracts in their own names and on their own accounts. (Frolkovic. P and Biksadsky. L, “Franchising in Slovakia”, Volume 3, Issue 2, *International Journal of Franchising Law*, (2005), 3-11.

<sup>39</sup> In the case of the Court of Appeals T 4469-16, on April 6, 2017, after a 17-month contractual relationship, the supplier Veststar Sales AB terminated the oral cooperation agreement with Mion AB regarding sales of eatables with one-month prior notice. Arguing to had been acting as a commercial agent, Mion claimed an indemnity according to the provisions of the Swedish Act on Commercial Agency. Weststar Sales rejected the claim for an indemnity, primarily because Mion had acted as an independent distributor and that there were no valid bases for an analogous application of the indemnity rules applicable to commercial agents. Available at: (Oct.. 22, 2020)

<https://www.idiproject.com/news/sweden-court-appeal-rejects-analogous-application-swedish-act-commercial-agency-indemnity-claim>

<sup>40</sup> Robert W. Emerson, „Thanks for the memories: Compensating franchisee goodwill after franchise termination“, VOL 20, 2017, *Pennsylvania Journal of Business Law*, (2017), 286-339, 326.

On the other hand, Belgian Law one of the few which regulates distribution contract<sup>41</sup> grants the distributor, whose agreement has been terminated for a cause other than its serious fault, the right to compensation due to overtaking of goodwill and clients by a supplier.<sup>42</sup> When it comes to franchising, the Belgian doctrine considers that the franchisor benefits from the attractiveness of the franchise network — and consequently of the goodwill gained from the common efforts of franchisor and franchisee — throughout the term of the agreement to operate its business and to derive profits therefrom. Thusly, the contribution to and/or development of the client base for the benefit of the franchisor finds its “counterpart in the economic advantages that benefited the franchisee during the term of the agreement”<sup>43</sup>. In the absence of the conditions required to claim damages under a “pure” common law action for damages, a franchisee who considers itself entitled to a goodwill indemnity could attempt to recover same by requalifying its agreement as a distribution agreement, with, however, all the difficulties that this entails.<sup>44</sup>

A cursory look at some European countries tells us that there is no single position on goodwill compensation for franchisees and distributors, but in most surveyed jurisprudence it can be seen that legal experts and courts seem to be looking for an alternative way - by analogy with a commercial agent - to grant them, under certain conditions, compensation for goodwill after the termination of the contract. These conditions, under the influence of Directive 86/653 / EEC, are mainly related to the provision of a new clientele to the principal or an increased volume of business with the existing clientele, which will enable him to continue to derive significant business benefits. This increase in business must be the merit of the distributor or franchisee, which is determined in various ways such as: comparing turnover, number of customers or sales of licensed products at the beginning and end of the agreement, customer base, efforts made in advertising and promotion of licensed products, financial investment etc.

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<sup>41</sup> Book X “Commercial Agency Agreements, Commercial Cooperation Agreements and Distribution Agreements” of the Code of Economic Law (the “CEL”) by the Law of 2 April 2014 which incorporate the Law of 27 July 1961 relating to the unilateral termination of exclusive distribution agreements entered into for an indefinite period of time, as amended by the Law of 13 April 1971 (the '1961 Law'). Available at: (Nov.18,2020,08:55AM)

[https://www.ordineavvocatimilano.it/upload%2Ffile%2FAREA%20CRINT%2FEBOOK%20FRANCHISING%202018%2FEbook\\_franchising\\_2018\\_Crint.pdf](https://www.ordineavvocatimilano.it/upload%2Ffile%2FAREA%20CRINT%2FEBOOK%20FRANCHISING%202018%2FEbook_franchising_2018_Crint.pdf)

<sup>42</sup>Art. X.37 CEL: "If an agreement is terminated by the supplier for a cause other than the serious fault of the distributor, or if distributor terminates the agreement because of a serious fault of the supplier, the distributor may claim an additional equitable indemnity. This indemnity is calculated taking into consideration the following factors: 1° The considerable increase of client base brought by the distributor and that will remain with a supplier after the termination of the agreement;...". See also: Civil Code of the Republic of Serbia, Art. 1258, which grants the distributor the right to compensate the lost goodwill. Available at: (Oct.. 20, 2020, 11:09 AM) <https://www.mpravde.gov.rs/files/NACRT.pdf>.

<sup>43</sup> S. Willemart, *Analyse comparée des mécanismes et questions d'actualité posées par l'indemnité de clientèle en matière de concession de vente, per l'indemnité d'éviction en matière d'agence commerciale et par le droit commun en matière de franchise*, in *Regards croisés sur la distribution: concession, agence et franchise*, (Larcier,2015), 95.

<sup>44</sup> Alberto Venezia, *Termination of franchising and distribution agreements in EU*, COMMISSIONE RAPPORTI INTERNAZIONALI ORDINE DEGLI AVVOCATI DI MILANO, (Milano, 2018), 107.

Available at: (Oct.31, 2020), [https://www.ordineavvocatimilano.it/upload%2Ffile%2FAREA%20CRINT%2FEBOOK%20FRANCHISING%202018%2FEbook\\_franchising\\_2018\\_Crint.pdf](https://www.ordineavvocatimilano.it/upload%2Ffile%2FAREA%20CRINT%2FEBOOK%20FRANCHISING%202018%2FEbook_franchising_2018_Crint.pdf)

The distributor/franchisee must transfer data on clients (name, surname, contact), to the supplier or franchisor for him to be able to use this database after the termination of the contract. In most of the cases analyzed, the courts stated that the rules on goodwill compensation to a commercial agent could be applied analogously only if their position was comparable to that of a commercial agent. For the same reasons, in almost all goodwill compensation lawsuits, the distributor and the franchisee claim to have acted as commercial agents and therefore seek goodwill compensation by invoking the regulations governing the agent.<sup>45</sup> There are a minority of courts that have rejected the application of this analogy, citing the different legal positions of these entities and the different compensation system. Uneven resolution of this issue before the courts casts doubt on the justification of the automatic extension of the analogy to all vertical contracts, ie. to a franchise agreement and a distribution agreement when it comes to goodwill compensation.

## **VI. IS ANALOGOUS APPLICATION OF COMMERCIAL AGENCY RULES TO FRANCHISE AND DISTRIBUTION CONTRACTS JUSTIFIED?**

The positions of franchisees, distributors and agents in dealings with third parties are very similar. All of them protect the interests of their clients and are aimed at achieving the same goal: the best possible placement of the client's goods/services in the target market. Similarities between these agreements also exist internally. Namely, franchisees and distributors to a greater or lesser extent adhere to the instructions of their principals and periodically send them reports, which makes the degree of their independence less, and the similarity with the representatives greater. Therefore, identical motives - the promotion of sales through distribution by another entity, as well as a high degree of integration of the contracting parties, which, although operating independently, are similarly limited in their freedom, connects these contracts. When the *intuitu personae* character is added to these contracts as well as some identical post-contractual obligations: keeping business secrets, transferring the customer base, non-competition clauses, it seems that the similarity between them prevailed and that the analogy is justified. It is therefore not surprising that certain courts justified the application of the analogy in the proceedings before them.

On the other hand, in order to justify the application of the analogy, the contracts must have the same *ratio*. In principle, the reason for the commitment, ie the economic purpose that the parties want to achieve by concluding the contract is always the same in contracts of the same type and, consequently, different in relation to other, even related types of contracts.<sup>46</sup> The *ratio* of these contracts is not the same. The *ratio* of the distribution contract is the acquisition of goods from the supplier and their placement on

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<sup>45</sup> Court of Appeal Case T 4469-16, April 6, 2017, Following 17 months' contractual relationship, the supplier Weststar Sales AB terminated an oral cooperation agreement with Mion AB regarding sales of eatables with one-month prior notice. Arguing it had been acting as a commercial agent, Mion claimed an indemnity according to the provisions of the Swedish Act on Commercial Agency. <https://www.idiproject.com/news/sweden-court-appeal-rejects-analogous-application-swedish-act-commercial-agency-indemnity-claim> (Jan. 14.,2020).

<sup>46</sup> Slobodan Perović, *Zabranjeni ugovori*, (Prohibited contracts), Beograd, 1975, 85.

a new market with the realization of the difference in price. Although franchising in economic terms is one of the forms of distribution of goods and services, it has evolved through practices that have added to its specifics and moved further away from distribution, leaving it behind as a "cheaper way to enter new markets." Therefore, the *ratio* of franchising agreements is not only the turnover of standardized products and services but also the cloning of business identity, the rental of an elaborate business model followed by a well-known symbol. In the case of a commercial agency contract, the goal is to find new customers who will conclude a contract with his principal and this represents his *ratio*.

Furthermore, the subjects of these contracts do not have the same legal position. The franchisee and the distributor are legally independent. They enter the market as independent economic entities, on their own behalf and for their own account, exercising the ownership right over the goods they resell and the independent contractual obligation towards third parties. By acting on their own behalf and for their own account, they bear the entire commercial risk, which includes the risk of losing the clientele after the termination of the contract. This gives them greater independence and control over their venture, despite being broadly limited by the provider's instructions. A commercial agent, on the other hand, concludes transactions on behalf of someone else and for someone else's account, ie. for the account of his principal. Therefore, it's not the agent that enter into legal relations with third parties, but the principal, because the contract has been concluded in his name and for his account, so he is liable to third parties for non-performance or partial performance of contractual obligations. It follows from the above that the agent fully dedicates his work to the principal and his business interests, which he protects and promotes.

Differences also exist when it comes to compensation. In the case of a franchise agreement, the contractual fee is paid by the franchisee to the franchisor for entry into the franchise network (*Initial fee*) and for the services and the assigned franchise used in his business (*Royalty*). Under the distribution agreement, no special fees are payable. The distributor makes a profit on its own terms, based on the resale margin determined by him, and he is not obliged to receive instructions from the manufacturer or supplier. Unlike franchising and distribution contracts where relations with consumers are isolated from their relations with the franchisor/supplier, in a commercial agency the principal is the one who should pay a commission to the agent for the contracts concluded through his mediation.

## VII. CONCLUSION

The compensation for the *goodwill* in the field of the franchising and distribution agreements arise some important issues that have attracted the interest of case law and doctrine. As there are no imperative legal rules that would solve this problem, in the case-law of some European countries there has been a trend of analogous application of the rules on goodwill compensation of a commercial agent. Addressing the question of the justification of the application of that analogy, we have concluded that, despite some common elements, no sign of equality can be placed between these contracts. First of all, there isn't a sufficiently identical *ratio* between these contractual relations to justify the automatic application of the analogy. Then, unlike the agent, the distributor and the

franchisee are legally independent entities and have a greater degree of autonomy, which means that they have to bear a greater overall business risk, including the risk of losing the clientele after the termination of the contract.

The problem related to the real merits of franchisees/distributors for increasing the clientele has also deserved our attention. Here, we have taken the position that in distribution and franchising contracts, goodwill is based on the brand and the methods of its commercialization designed by the supplier or franchisor, which enabled franchisees or distributors to create their customer base. Thus, the customer base, when it comes to these contracts, is largely created by the customers themselves, who are attracted by the image, reputation and prestige of the brand, rather than the effort and commitment of franchisees and distributors. For example, clients in a franchising contract usually do not know that it is a franchise business because there is an external impression that it is a single entity and that each franchise unit is a branch in the chain of one owner, the franchisor. Due to the public impression of the existence of only one entity, there is frequent confusion among consumers between the franchisee - who runs the business, as a network member, and the franchisor - who owns the business, as the network creator. On the other hand, commercial agents strongly influence the attraction of clientele by determining how contract products will be sold in the market. They practically create a market for products and their own customer base. Upon termination of the contractual relationship, they are obliged to submit a list of business relationships, ie customer information, in order for the principal to continue doing business with them.

Although there is a slight trend in case law towards recognizing goodwill compensation to a franchisee and distributor, we are not of the opinion that such a trend should be supported, even in cases where the conditions for recognizing this compensation to a commercial agent are met. This is not only because we believe that they are not predominantly responsible for the won clientele, but also because the clientele compensation is not in line with the legal and economic structure of these contracts characterized by independence, legal autonomy, increased risk in relations with third parties, including the risk of losing the clientele after the termination of the contracts.

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