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FRANCHISING UNDER DUTCH LAWS

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1. Introduction

The purpose of this Chapter is to provide a comprehensive summary of the main laws and regulations which are in general important when commencing with franchise in the Netherlands. As 'franchise' is an undefined term in the Dutch civil code, it is dependant on the facts of the matter and the circumstances what laws are in fact applicable. For example, in some franchise concepts the (vertical) competition laws are very important, while in other franchise concepts commercial agency laws may play a role or trademark issues may come up. Franchise can also be seen as a form of co-operation between two (or more) companies under the same brand. Even though this chapter provides an overview of the main legal aspects that are relevant to a franchise operation, this chapter does not provide an exhaustive overview of all legal aspects that may be relevant to such operation. This depends of the circumstances and more specifically of the franchise operation itself.

2. Franchise; a commercial contract

a. Definition of franchise under Dutch laws

Franchise has not been defined in the Dutch civil code, but the concept of franchising has – amongst others - been described in the EC Guidelines to the Commission Regulation (EU) No 330/2010 of 20 April 2010 on the applicability of Article 101 (3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices (the **Guidelines**), paragraph 189.

The description of franchise in the Guidelines is as follows:

Franchise agreements contain licences of intellectual property rights relating in particular to trade marks or signs and know-how for the use and distribution of goods or services. In addition to the licence of IPRs, the franchisor usually provides the franchisee during the life of the agreement with commercial or technical assistance. The licence and the assistance are integral components of the business method being franchised. The franchisor is in general paid a franchise fee by the franchisee for the use of the particular business method. Franchising may enable the franchisor to establish, with limited investments, a uniform network for

the distribution of its products. In addition to the provision of the business method, franchise agreements usually contain a combination of different vertical restraints concerning the products being distributed, in particular selective distribution and/or non-compete and/or exclusive distribution or weaker forms thereof.

To franchise, the general civil laws apply as well as Dutch court decisions. Book 6 of the Dutch Civil Code sets out the requirements relating to the formation of contracts. These provisions must be read together with the more general rules regarding juridical acts; that is, acts intended to invoke legal consequences provided in book 3 of the Dutch civil code. In Dutch literature and jurisprudence, certain rules of law in relation to franchise have been developed.

Besides the civil law and contractual aspects, competition laws play an important role in franchise relationships (as well as distribution and all other vertical agreements). The Commission Regulation (EU) No 330/2010 of 20 April 2010 on the applicability of Article 101 (3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices (the **Vertical EU Regulation**) is very important, as well as the Guidelines thereto. The Dutch Competition Authority (NMa) ensures compliance with European and Dutch competition laws (for more details see paragraph 4 below).

Franchise organisations that are a member of the Dutch Franchise Association (*Nederlandse Franchise Vereniging; NFV*) are bound by the rules in the European Code of Ethics for Franchising (Code) drawn up by the European Franchise Federation (www.eff-franchise.com).

b. Principle of reasonableness and fairness

As franchise is not specifically regulated in the Dutch civil code, franchise agreements are primarily governed by the freedom of contract principle; respective rights and obligations are defined by the will of the parties, as set out in the agreement.

In the Netherlands there is a general legal obligation on parties to deal with each other in good faith (*goede trouw*). General civil law is governed by the principle of reasonableness and fairness (*redelijkheid en billijkheid*). Franchise agreements are therefore also governed by the principle of reasonableness and fairness.

The principle of reasonableness and fairness may supplement an existing contract and relationship based on article 6:248 (1) of the Dutch civil code. It may also derogate from the contract that the parties agreed upon at an earlier stage, in the event such provision is unacceptable under the given circumstances according.

to the principle of reasonableness and fairness, based on article 6:248 (2) of the Dutch civil code. The standard to derogate from an agreed provision, is however high. Nevertheless, a large franchise organization should be aware that a provision in a franchise agreement that is very one-sided (for example: a provision that the franchise agreement may be terminated by the franchisor at any given moment, respecting a notice term of only 30 days), especially when dealing with a (very) small franchisee could be set aside by the principle of reasonableness and fairness, if such provision is unacceptable in the given circumstances. It is not possible to predict what kind of provisions may be set aside, if any, since a Dutch court will consider all relevant circumstances, including the economic power of each party, the dependency of the parties from each other, the duration of the contract, the investments made by either party, what each party could reasonably expect from the other party and all other relevant circumstances.

The above is especially relevant when a franchisee is a very small company, that may be comparable with a natural person or an employee. Dutch courts generally tend to protect such smaller and 'weaker' parties at the expense of economically stronger (larger) companies. However, this certainly does not mean that simply by being a weaker party, certain clauses will be set aside. This depends on all the circumstances in the matter.

When dealing with a (very) small franchisee, there is a possibility that general conditions - this could even include a (standard) franchise agreement, or part thereof - may be annulled by such franchisee because of reflex action of articles 6:236-238 of the Dutch Civil Code. Those articles deal with the so-called 'black' and 'grey' lists, listing prohibited clauses in general conditions for consumers. In certain situation, a small franchisee may claim it should benefit from reflex action of those articles.

c. Disclosure requirements

Pre-contractual disclosure requirements are a result from unwritten law and case law, which dictate the duty to inform (on the part of the franchisor) and the duty to investigate (on the part of the franchisee). Parties are entitled to rely on the accuracy of each other's information and must always bear in mind each other's reasonable expectations.

When a franchisor presents a prognosis regarding the expected success of a new franchise location to a franchisee, the franchisor is liable if at a later stage such prognosis turns out to be faulty, regardless of whether the franchisor prepared such prognosis itself or instructed a third (independent) party to do so. Therefore a franchisor should be very careful when submitting any prognosis to a (potential)

franchisee. It is not mandatory to provide a franchisee with a prognosis, but the franchisor will need to make available the terms of the licence and financial obligations under which the franchisee will operate. In the Netherlands, a franchisor will typically have a handbook containing know-how, instructions on the use of intellectual property, the look and feel of the franchise and other information relating to the franchise chain, which will be given to the franchisee before or upon conclusion of the contract.

During the franchise relationship, the franchisor has a duty of care, which means that if a franchisee does not reach the forecast turnover, the franchisor may have the continuing obligation to provide the franchisee with advice and assistance.

A misinformed franchisee can base a claim for nullification on error if the franchisee can prove that the franchise agreement has been entered into under the influence of an error and would not have been concluded had there been a correct understanding of the facts. Such a claim for nullification will only succeed where the misinformation is of a sufficiently serious nature.

An alternative would be to base a claim on deceit, but in this instance the franchisee would have to prove intent on the part of the franchisor, which is generally very difficult to prove. Nullification has a retroactive effect. If the actions or omissions of the franchisor also qualify as a civil tort, the franchisor is obliged to compensate all of the franchisee's damages. On the basis of error the franchise agreement may, upon request, be modified by a judge (for example, the franchisee's contract price may be reduced).

An alternative course of action is to base a claim for (partial) rescission or specific performance on breach of contract in the case that the franchisee can prove that the franchisor has failed in the performance of an obligation. In the case of rescission for breach of contract, the defaulting party may be required to compensate the damages which the other party suffers as a result, unless the failure is not attributable to the defaulting party. If the franchisee can prove that the franchisor, by misinforming the franchisee, has committed a breach of contract, it can claim either rescission, alternative compensation or specific performance, all combined with losses due to delay.

In the case of breach of contract or tort, the franchisor has an obligation to compensate all damages of the franchisee. These damages include both losses and lost profits. The main principle is that the breaching party should bring the other party into the position it would have been in had the civil tort or breach of contract not been committed. The burden of proof regarding damages is on the franchisee.

If damages cannot be assessed precisely, the Dutch court may estimate the amount of damages according to the general principles of reasonableness and fairness. In doing so, the Dutch courts have a large margin of discretion. The damages awarded will depend on the circumstances of the individual case.

d. Termination

Either party may terminate the franchise agreement for cause in the case of serious breach by the other party of its obligations. The criteria for what constitutes a serious breach should be carefully considered before actually terminating, since the Dutch courts will have the discretion to decide that a certain circumstance does not qualify as a sufficiently serious breach, notwithstanding the fact that this may have been agreed by the parties in the franchise agreement.

In case of termination of the franchise agreement by the franchisor without cause, a legal distinction should be made between contracts concluded for a definite and an indefinite duration. Contracts of definite duration can generally not be terminated before the end of the contract term unless the possibility to terminate early - without cause - has been specifically agreed upon. Early termination will in most situations result in liability of the terminating party. If a franchisor terminates a contract for a definite term prematurely (without cause), the franchisee can claim continued performance or damages. The damages could consist of lost profits calculated over the remaining term of the contract and costs and investments that the franchisee was not able to redeem due to the premature termination.

In case of a contract of indefinite duration, the contract may in principle be terminated by either party. This is the leading view, affirmed by the Dutch High Court. However, note that under certain circumstances a franchisor may have to come up with a 'good reason' to be able to terminate the agreement. Besides this, the franchisor will have to respect a reasonable notice period, the length of which depends on the circumstances of the matter. While until recently it was quite usual that courts granted termination periods of up to a maximum of six to 12 months, currently there are a couple of higher court decisions in which notice periods of 2-3 years have been granted, even when contractually the parties agreed to a shorter notice period.

In the event of termination of a franchise agreement, the franchisor may have to compensate the franchisee for investments or costs the franchisee may not be able to earn back as a result of the termination, as well as for over-stock (for instance taking back stock against a reasonable purchase price).

So far, no (higher) court has granted a franchisee payment of a goodwill or clientèle compensation, even though this has now and then been suggested in Dutch literature.

If the franchisor terminates a franchise agreement without cause or does not respect a reasonable notice period, the franchisee could claim continued performance during the period that should have been respected by the franchisor, or instead claim a financial compensation for damages.

e. General contract law aspects

Statutory interest

Under freedom of contract between professional parties, in principle the parties are free to agree on the interest rates to be applied. If the parties did not agree on any interest rate, Dutch statutory (trade) interest shall apply automatically in the event of late payment (if no payment term has been agreed, then automatically 30 days after having received the invoice). Per 16 March, 2013, a new Act entered into force, implementing EU regulation 2011/7/EU to prevent payment delays in commercial agreements (the **Payment Act**). The Payment Act gives the creditors more possibilities to recover their claims. Even though professional parties can agree upon payment terms, in the Payment Act has been laid down that only in exceptional circumstances, a payment term longer than 60 days can be agreed upon. When acting with governmental agencies, the maximum payment term should be 30 days and only in exceptional circumstances longer than this, however never exceeding 60 days. Based on the Payment Act, a creditor can claim as a minimum a compensation of euro 40 for the costs of recovery and the statutory trade interest is increased by 1 per cent. The Payment Act does not apply to transactions with consumers (private persons).

The Dutch legal interest rate in commercial matters as of 1 January 2014 amounts to an annual percentage of 8.25 per cent.

Transfer of contracts

A general provision regarding contract transfers is laid down in the Dutch civil code. A contracting party may, only with the consent of the other party, transfer its rights and obligations under the contract to a third party. Therefore, a franchisee may only transfer the franchise with the franchisor's consent. A franchisor will not normally refuse such a transfer where the third party meets the selection criteria. It can be contractually arranged that the franchisee should first offer the business to the franchisor on the same terms as those that the franchisee would offer to the third party.

order to receive protection and be able to invoke the sign (its trademark) against third parties. A registered trademark gives the owner the exclusive right to use that trademark for specific classes of goods or services in the designated territory. This means that the trademark owner can invoke the trademark against third parties who use a sign which is the same as or similar to the trademark and for identical or similar goods or services. As such, a trademark owner can protect its rights to avoid any confusion among the public as to where the goods/services originate from.

Under trademark law, the Benelux is considered as one territory. Therefore, any trademark registered in the Netherlands automatically applies to Belgium and Luxembourg as well (and vice versa). In the Benelux, trademarks are protected by the Benelux Treaty for Intellectual Property and should be registered with the public registry of the Benelux Office for Intellectual Property (BOIP).

In order to receive protection throughout the entire EU, a Community trademark (CTM) can be obtained through registration with the public registry of the Office for Harmonisation of the Internal Market (OHIM) of the European Union. A preliminary trademark search (for both the Benelux and the EU) can be conducted on the BOIP website <https://register.boip.int/bmbonline/intro/select.do?language=en>

A trademark is registered for an initial period of 10 years and can be renewed endlessly. However, in order to receive continued protection, the trademark owner should actually use the trademark. If it does not use the trademark for a period of 5 consecutive years, a third party may request cancellation of the trademark. On the other hand, such use-requirement does not apply during the first 5 years of registration. In those first 5 years, a trademark owner may still decide if and how it will be using the trademark, but it can nevertheless invoke the trademark against third parties.

Domain names

A domain name is not an intellectual property right as such, but is closely related as it often contains the same name as the trade name or trademark of a company. Most companies have one or more domain names for exploitation of their website(s). Domain names can be registered online or through local service providers in the designated territories, and can be renewed endlessly. Registration of a domain name as such does not give the registrant any further rights, such as trade name or trademark rights. The domain name merely serves as an address for your website, but trade names and/or trade marks must be obtained separately as described above.

Data protection

The Dutch Data Protection Act (**DPA**) lays down several requirements for processing of personal data. 'Personal data' is any data relating to an identified or identifiable person and 'processing' means almost anything that can be done with personal data, such as collecting, storing, erasing, using or retrieving. The DPA applies to both processing of personal data by automatic means and processing other than by automatic means. The DPA also contains restrictions relating to the transfer of personal data to other countries. Applied to a franchising context, the DPA would be relevant, for instance, where the franchisee or franchisor collects customer details pursuant to a customer loyalty programme. The DPA is the Dutch implementation of the EU Data Protection Directive.

Confidentiality

The franchisee typically commits itself, for the duration of the franchise agreement as well as following its termination, to keep all details of the franchisor's business operations confidential. This will typically extend to non-patented know-how materials. Franchise agreements in the Netherlands may include a financial penalty provision that can be invoked in the event of the other party violating the confidentiality clause. The courts shall have the right to mitigate such penalties. This mitigation right cannot be contractually excluded.

3. Intellectual property and licensing aspects

Trade name

A trade name serves to identify a company. Typically, a franchisee will trade under a certain name, its 'trade name'. This can be the same as the statutory name, but can also be one or more different names. The trade name(s) is/are the name(s) under which the company does business. Companies are required to register their statutory name with the Chamber of Commerce (CoC). It is recommended to also register any trade names used with the CoC, but the mere registration of a trade name does not give any rights/protection to such trade name. A company can only claim rights to a trade name if it actually uses the name. Rights to a trade name therefore come into existence by using the name, regardless of whether it has been registered with the CoC. In using a trade name, a company should ensure that the trade name is not confusingly similar to existing trade names of competitors or companies that offer related/complementary goods/services.

Trademarks

A trademark serves to identify certain goods or services as originating from a company. If a franchisee uses a certain sign to identify its goods or services (for example, Coca-Cola for soft drinks), it must register that sign as a trademark in

Copyrights, patents and designs

Depending on the type of goods a franchisee is going to distribute/sell, certain other intellectual property rights may be involved. In short, copyrights and design rights would protect the design or outer appearance of certain products (for example, the design of furniture, clothing, arts but also more functional products such as industrial products or appliances). Patents would protect any new inventions (such as machinery, chemicals etc). Copyrights cannot be registered in the Netherlands, but come into existence by creating a work. Patents and design rights must be registered in order to obtain protection. Design rights are valid for 5 years, and can be renewed up to 25 years. Patents are granted for 20 years. For registration of those rights, a trademark and design or patent agent should be consulted.

Know-how

In principle, know-how is not protected by any intellectual property right. However, know-how may be protected under the general provisions of Dutch unfair competition law (including civil tort). Know-how could be contractually protected by including confidentiality (non-disclosure) obligations in an agreement (for example, a franchise agreement). Such non-disclosure obligations could be strengthened by a penalty, which would apply if the recipient of the know-how violates the non-disclosure obligations.

Licensing

In a franchise situation, the franchisor often holds certain of the above mentioned rights and wishes to license those to franchisee for the duration of the franchise agreement. It is common to agree on terms through which the franchisee can exploit those rights and the products/services that are protected by those rights, but on certain specific conditions set by the franchisor in order to ensure the continued validity of those rights.

4. (Vertical) competition laws and regulations

Commission Regulation 330/2010 provides the relevant framework for the competition law assessment of all franchise agreements with an effect on trade between the member states within the European Union.

EU Commission Regulation 330/2010 of 20 April 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices: <http://eurlex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2010:102:0001:0007:EN:PDF>
This Regulation prohibits – amongst others - resale price maintenance as well as

certain restrictions regarding the territory or group of customers that can be served. It is also prohibited to limit so-called 'passive sales' by a franchisor, which includes sales via the internet and it furthermore restricts the duration of a contract in the case that it contains a non-compete clause. As regards purely domestic franchising agreements, the Commission Regulation equally applies by virtue of article 13a of the Dutch Competition Act (DCA). There are no additional Dutch competition laws relating to franchising agreements.

Franchise agreements that do not meet the criteria set forth in Regulation 330/2010 and to which no de minimis thresholds apply will be prohibited on the basis of article 6.1 of the DCA or article 10 of the Treaty on the Functioning of the European Union, unless the four criteria of the legal exception of article 6.3 DCA or article 101(3) TFEU apply.

Competition laws in the Netherlands are enforced both administratively and by means of civil litigation (private enforcement). The ACM (*Autoriteit Consument & Markt*) can impose fines if a franchise agreement would disregard what is set forth in Regulation 330/2010, in particular if the agreement would contain any hard-core restrictions (eg, resale price maintenance). The maximum statutory fine is 10 per cent of the undertaking's worldwide turnover.

A party to a franchise agreement claiming that the agreement infringes article 6.1 of the DCA or 101(1) TFEU can invoke the nullity of the agreement (in whole or in part) before a Dutch court. The court will have to decide on the applicability of Regulation 330/2010 or the legal exception of article 6.1 DCA or article 101(1) TFEU. If it decides in the affirmative, it will subsequently have to determine whether this leads to partial nullity (nullity of only the infringing clauses) or nullity of the agreement in its entirety. The latter will be the case if the court determines that without the infringing clause, the agreement would not (or would not on similar terms) have been concluded. In a few instances the court has nullified a franchising agreement in its entirety, notably because the franchisor engaged in resale price maintenance.

5. Corporate aspects

Franchise organisations may be subject to any form of business entity existing under Dutch law, in particular:

- ✓ private limited liability companies (so-called B.V.'s)
- ✓ public companies (so-called N.V.'s)
- ✓ sole proprietorships
- ✓ general partnerships
- ✓ limited partnerships

Private limited liability companies (B.V.'s) and public companies (N.V.'s) are legal entities. General partnerships, limited partnerships and sole proprietorships are non-legal entities. The question of whether a business entity is a legal entity or not affects the franchisor's liability.

All business entities must be duly registered in the Commercial Register of the Dutch Chamber of Commerce. Further information can be found at www.kvk.nl/english-kvk-sites/.

The requirements for forming and maintaining a business entity depend on what form of business entity is incorporated. In the event that a private limited liability form is used by the franchisor, the following requirements apply:

- ✓ a statement of no objection from the Dutch Ministry of Justice; and
- ✓ a notarial deed of incorporation including the articles of association.

On 1 October, 2012, the Act for simplification and flexibilisation of private company law (Wet vereenvoudiging en flexibilisering bv-recht) has entered into force, making important changes to Dutch law applicable to private companies with limited liability (besloten vennootschappen; B.V.'s). Per this date the laws with respect to B.V.'s became simpler and more flexible. As a result, it is now possible to deviate more from statutory rules in the articles of association of the company and a minimum capital of EUR 18,000 is no longer necessary. Furthermore the mandatory bank and accountants' statements with a contribution in kind have been abolished. A notarial deed of incorporation is still required. The Act has entered into force with immediate effect. This means that from 1 October, 2012, the Act immediately applies to all B.V.'s. The Act introduces a couple of possibilities to deviate from the provisions of the law in the articles of association, which offers foreign investors quite some freedom to incorporate or structure their B.V. as they deem appropriate.

Business entities that are incorporated under foreign law, but are active on the Dutch market rather than within their own country, are subject to the Companies Formally Registered Abroad Act (CFRA Act). The CFRA Act does not apply to members of the European Union (EU members) and countries that are members of the European Economic Area Agreement. All other entities will have to comply with certain requirements, which also apply to Dutch entities (registration in the Commercial Register, statutory minimum capital and the filing of annual accounts with the Commercial Register where the business entity is registered).

6. Employment law aspects

In principle, franchisees are deemed independent entrepreneurs. Hence, no labour and employment considerations apply. However, franchisees may qualify as 'employees' on the basis that the relationship between the franchisor and franchisee does not correspond with the franchise agreement as it is in fact an employment relationship. Case law shows that this is often the case with self-employed persons such as driving instructors and door-to-door salesmen.

If the agreement is considered an employment agreement, the franchisee is, inter alia, entitled to holiday allowance and payment during illness. Also, laws regarding termination of the employment agreement apply. According to tax law, the franchisor is required to withhold income tax and social security benefits in case the tax authorities deem the relationship between parties a (fictitious) employment relationship. Each 'cooperation agreement', such as a franchise agreement, is considered on its own merits. The name and wording of the contract between the parties is not decisive. The courts look at the intention of the parties when entering into the franchise contract, as well as the way in which the parties have given substance to their relationship.

If it is established that the franchisee is obliged to perform the agreed duties in person, the franchisor pays the franchisee, directly or indirectly, for these duties and a relationship of authority can be established which manifests itself in the right of the franchisor to give instructions which the franchisee must follow, an employment relationship can be assumed. Particularly in franchise relationships, the following criteria prove to be decisive: equivalence of the contracting parties, the ability of the franchisee to let someone else perform the duties (for example, third parties or employees of the franchisee), the franchisee bearing the business risk and economic independence of the franchisee.

As long as the franchisee is truly a franchisee, pursuant not only to the contract but also to its day-to-day activities, no employment relationship should be deemed to exist. Particularly if the franchisee is contracted via his or her Dutch limited liability company, the risk of an employment relationship is limited, at least from a civil law perspective. The tax authorities have a different view on this. However, to minimise the risk from a tax law perspective, the franchisor could ask the franchisee to submit a declaration of independent contractor status, which the franchisee can obtain through the Dutch tax authorities. Such a declaration is valid for one calendar year. If a franchisee can produce such a declaration, the tax authorities will in principle not assume a (fictitious) employment relationship for that year.

7. Dutch courts, arbitration and mediation

Franchise agreements will generally contain a dispute resolution clause, in which a competent court or a form of arbitration is explicitly chosen.

In the Netherlands, NAI arbitration (www.nai-nl.org) is well regarded and is in general less expensive than the more internationally well-known ICC arbitration.

The main advantages of arbitration are:

- ✓ arbitration offers a choice regarding the language of proceedings – the regular courts in the Netherlands only accept the Dutch language;
- ✓ it offers the possibility of agreeing on the country and area in which the proceedings will be conducted;
- ✓ it offers the possibility of choosing the number of arbitrators and the time limitations;
- ✓ it is, generally speaking, concluded more quickly than regular court procedures; it may be dealt with by appointed experts instead of or in addition to lawyers; and parties can agree to observe secrecy in arbitration. Regular court proceedings are public.

The main disadvantages of arbitration are:

- ✓ in general, it is much more expensive than regular court proceedings;
- ✓ regular court proceedings offer the possibility of appeal; and
- ✓ the quality of arbitration may not always be secured, depending on the actual arbitration forum, although NAI and ICC arbitration in general should be of good quality.

In cases where there is no valid arbitration provision, the sub-district court is competent in smaller claims (under the amount of EUR 25,000) and for particular issues, such as employment and rent-related disputes. Larger claims may be brought before the civil judge of the district court. The Dutch Franchise Association (NFV) can assist with mediation for parties seeking out-of-court remedies.