

**THE EFFECTS OF DEFECTIVE PRE-CONTRACTUAL INFORMATION IN THE FRANCHISE RELATIONSHIP. A DISRUPTIVE VIEW.**

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**1. INTRODUCTION. LEGAL BACKGROUND.**

The origin of the franchise contract, according to most experts, was in the United States in the decade from 1850 to 1860. The franchise was born as a novel product distribution system of the Sewig Machine Company, although it was not until the early 20th century that the Coca Cola, General Motors and Hertz Rent a Car companies began to popularise it, although at that time very focused on the distribution of product ("*distribution franchising*"). Subsequently, it would be extended to franchise services and mixed ("*business format franchising*").

Chronologically, the California in the United States was the first state that, in 1970, established a specific regulation on the information that had to be registered and documents to be delivered prior to the signing of a franchise contract. This was to protect potential "*unsophisticated*" franchisees from the proliferation of unfair practices and/or the appearance of misrepresentation.

Subsequently, on 21 December 1978, the Federal Trade Commission of the United States promulgated the so-called "*FTC Franchise Rule*" or "*Code of Federal Regulations. Title 16. Part 436. Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity*" at the federal level. This regulation was followed by specific regulations in several States and modified several times (the last in 2007).

The purpose of the rule was and is to protect potential franchisees from the untruthful statements made by franchisors at the time of selling the franchise, which caused not only serious damage to the franchisees concerned and the franchise system itself, but also to the economy. Consequently, the serious breach of the duties of pre-contractual information was sanctioned with contractual nullity and compensation of damages (including punitive damages).

At the European level, the first reference to pre-contractual information is found in the Code of Ethics of the Franchise approved in 1972 by the European Franchise Federation, a code that was reformed in 2003 and 2017. This code, which was approved by the Spanish Association of Franchisors (AEF) in 1994 (and recently in 2017), has a self-regulatory nature, so that all the members of the AEF assume the written commitment to apply it in their relations with the franchisees and third parties.

From a regulatory viewpoint, one of the first references to the concept of franchising at European level is found in the Judgment of the Court of Justice of the European Communities of 28 January 1986, the "*Pronuptia case*"<sup>1</sup>, which established the bases for the compatibility of the franchise system with the European regulations then in force, although at that time the question regarding pre-contractual information was not analysed. From this judgment came EEC Regulation 4087/88 of 30 November 1988, which regulated which contractual clauses of the franchise agreement were in accordance with European regulations and which were not.

One year later, on 31 December 1989, France published the *Loi Doubin* (developed by Decree of 4 April 1991) which for the first time regulated pre-contractual information in Europe.

The next country in Europe to establish a regulation was Spain and several years later other countries adopted similar rules (Italy, Belgium). The Netherlands recently opted for self-regulation and other countries in Europe have case law with similar effects.

In Spain the introduction of the obligation to deliver pre-contractual information came in the Retail Trade Law 7/1996<sup>2</sup>, of 15 January, article 62.3 of which, still in force, states:

*"Also, at least twenty days before the signing of any contract or franchise pre-contract or delivery by the future franchisee to the franchisor of any payment, the franchisor must have delivered the necessary information to the future franchisee in writing so that it can decide freely and with full knowledge on its incorporation into the franchise network and, in particular, the main identification data of the franchisor, description of the activity sector of the franchised business, content and characteristics of the franchise and its operation, structure and extension of the network and essential elements of the franchise agreement. The other basic conditions for the franchise concession activity will be established by regulation".*

This precept was later developed by Royal Decree 2485/1998, of 13 November, "*by which article 62 of the Retail Trade Law 7/1996, of 15 January, relating to the regulation of the franchise system, the Franchisor Registry is created,*" which was modified by Royal Decree 419/2006, of 7 April and Royal Decree 201/2010, of 26 February, currently in force.

None of the indicated Royal Decrees establish the civil consequences of non-compliance with regard to deficiencies in the delivery of pre-contractual information, but only establish administrative sanctions.

Referring to the effects, the only existing legal text (even as soft law) that deals with the possible consequences of the breach of the duties of pre-contractual information is the Model Law on the Disclosure of franchising information, approved by the International Institute for the Unification of Private Law (UNIDROIT)<sup>3</sup> of 25 September 2002 (in the drafting of which this author participated as a speaker representing the Kingdom of Spain), whose article 8 states:

*"If the information document or the notification of a significant modification: A) has not been delivered within the period set in article 3; B) Induces error over a significant event; or C) Omits a significant event, the franchisee can, by notifying the franchisor in writing 30 days in advance, terminate the franchise contract and/or ask the franchisor for compensation for the damages suffered as a result of the behaviours described in sections A, B and C, unless the franchisee had obtained the information that had to be disclosed by other means, has not been misled, or when terminating the contract constitutes a disproportionate measure in light of the circumstances."*

As can be seen, the franchise as a contractual system and the duties of delivery of pre-contractual information come from a legal system governed by common law, which sometimes hinders its location in our legal system based on the civil law.

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<sup>1</sup> In fact, three questions were raised concerning the interpretation of Article 85 of the EEC Treaty and of Regulation No. 67/67 of the Commission of 22 March 1967 on the application of Article 85 (3) to certain categories of exclusive agreements, in order to examine whether these provisions were applicable to franchise agreements.

<sup>2</sup> This article was introduced into the law through an amendment promoted by the Catalan Minority Group at the request of the Spanish Association of Franchisors, the author of this article having participated in the legislative process that then took place.

<sup>3</sup> It is not an international agreement but a simple model law (soft law) so that national legislators take it as a basis when drafting specific legislation on franchise contracts: Therefore, it is not directly mandatory, although it can serve as inspiration when interpreting other general precepts.

According to Spanish doctrine, as we will see in section 2.1, the obligation to provide pre-contractual information in the area of franchising is found in the duties derived from good faith prior to the formalisation of any contract.

Thus, while in transactions on tangible goods the general principle is "*caveat emptor*" (that is, that the responsibility for a purchase lies with the buyer, who must take the necessary measures to ensure the quality of the purchased good in advance, discarding possible future claims of the seller), in intangible transactions the contrary principle frequently emerges: it is the seller who must inform on the characteristics of what he sells. The reason is that in intangibles, either only the seller knows the characteristics of the right that is subject to transaction, or finds it easier to determine its characteristics.

From this point of view there is no doubt that the franchise consists of a set of intangibles, either because what the potential franchisee wishes to acquire is the right to use a successful business model, or because this business model is formalised through the right to use know-how, a brand licence and technical and/or commercial assistance.

Thus, the purpose of the pre-contractual information is none other than to ensure that the negotiating will of the contracting parties is properly formed in order to ensure that the consent given when signing the contract is made with full knowledge, and, in turn, avoid misrepresentation.

Therefore, when this regulation is addressed there are two main elements (the content of the pre-contractual information -to which we will only make a brief reference- and the legal consequences of non-delivery or delivery of poor pre-contractual information), on whose analysis we will focus this article. We will therefore focus on the current response of case law to the violation of the duties of delivery of the aforementioned information, to subsequently make a proposal for reconsideration of the current doctrine.

## **2. CONTENT OF THE PRE-CONTRACTUAL INFORMATION DOSSIER.**

The content of this information has remained unchanged since Royal Decree 2485/1998<sup>4</sup>. This author had the honour of participating in the work of drafting the regulations as a representative of the Spanish Association of Franchisors, which, as previously stated, was the one that from the beginning promoted the introduction of Article 62 of the Retail Trade Law<sup>5</sup>.

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<sup>4</sup> Currently, article 3 of Royal Decree 201/2010, of 26 February, which regulates the exercise of commercial activity under the franchise system and the communication of data to the registry of franchisors, establishes that at least 20 days in advance of the signing of the franchise contract or pre-contract or the payment by the future franchisee of any sums, the Franchisor must submit in writing the following truthful and non-misleading information:

*"a) Identification data of the franchisor: name or business name, address and registration data in the register of franchisors, as well as, in the case of a commercial company, capital stock included in the last balance sheet, with an expression of whether it is fully disbursed or in what proportion and registration data in the Commercial Register, when applicable.*

*In the case of foreign franchisors, in addition, the registration data in the registers of franchisors to which they are obliged, in accordance with the laws of their country or State of origin. In the case of being a principal franchisee, the above circumstances will also be included with respect to their own franchisor.*

*b) Proof of having granted for Spain, and maintaining in force, the title of ownership or licence to use the trademark and distinctive signs of the franchisor, and any possible judicial remedies that may affect the ownership or use of the mark, if any, with expression, in any case, of the duration of the licence.*

*c) General description of the sector of activity that is the object of the franchise business, covering the most important data thereof.*

*d) Experience of the franchising company, which will include, among other data, the date of creation of the company, the main stages of its evolution and the development of the franchised network.*

*e) Content and characteristics of the franchise and its operation, which will include a general explanation of the system of the business purpose of the franchise, the characteristics of the know-how and the permanent commercial or technical assistance that the franchisor will provide to its franchisees, as well as an estimate of the investments and expenses necessary for the start-up of a typical business. In the event that the franchisor gives the individual potential franchisee forecasts of sales figures or operating results of the business, these should be based on sufficiently substantiated experiences or studies.*

*f) Structure and extension of the network in Spain, which will include the form of organisation of the franchise network and the number of establishments in Spain, distinguishing those directly operated by the franchisor from those operating under the franchise assignment system, with an indication of the place where they are located and the number of franchisees that have ceased to belong to the network in Spain in the last two years, expressing whether the termination occurred due to expiry of the contractual term or other causes.*

*g) Essential elements of the franchise agreement, which will include the rights and obligations of the respective parties, the duration of the contract, conditions of resolution and, if applicable, renewal thereof, economic considerations, exclusivity agreements, and limitations on the free availability for the franchisee of the franchised business".*

<sup>5</sup> For the preparation of the content of the pre-contractual information, we started from the base of that which at that moment was required in all the states of the USA, omitting the requirements that were only requested in one particular state. For example, the

The Law obliges the Franchisor to inform the potential Franchisee, 20 days before the signing of the franchise contract and/or the delivery of any amount, of the main characteristics of the franchisor, the brand it has registered, its experience, the business system subject to franchising, the investments necessary for the start-up of the business, the structure of the network in Spain, the number of franchisees that have ceased to belong to the network in the previous two years and the essential elements of the franchise contract. What the law does not oblige is to provide forecasts of results (which, if delivered, must be sufficiently reasoned).

Part of the problem of the franchise arises from the fact that the law, logically, does not require disclosure of the content of know-how even though this is the essential benefit for the franchisor of the franchise contract. The reason is obvious: if the franchisor provided access to know-how, not only would the potential franchisee not have any incentive to sign the franchise contract and to pay a royalty for the use of said know-how, but it could hardly be avoided that the secrets of company in the know-how would be disclosed and lose all substantiality. On the other hand, it is precisely the concealment of the content of the franchisor's essential provision that makes the franchise system so prone to misrepresentation and therefore the obligation to deliver pre-contractual information (and the sanctioning of its infringement) so necessary.

Starting from the basis that at the time of signing the franchise agreement the Franchisee never knows the content of the know-how, what the law tries is to provide a set of information that allows the seriousness and reliability of the network to be joined to be determined with a certain degree of reasonableness.

## 2.1.- NATURE AND RELATED FIGURES.

There are numerous sectors in which the pre-contractual information that must be facilitated has been regulated so that the parties form their will in a free and conscious way, trying to avoid situations in which, once the contractual will is formed, indications of vices of consent could be appreciated that would invalidate the contract. Although the fact of not strictly complying with this regulation supposes *per se* that there has been a vice of consent that invalidates contractual will.

By way of example: bank contracting (MiFID directives<sup>6</sup>, the insurance sector<sup>7</sup> or electronic contracting<sup>8</sup>. In banking matters, there is extensive Supreme Court case law on the infringement of the duties of information (especially on risks) that deserves special mention for its possible future translation to the institution of the franchise.

Some authors<sup>9</sup> incardinate the origin of this duty of information in the principle of good faith of preliminary treatment or phase of contract formation<sup>10</sup> either as an expression of article 1258 of the Civil Code<sup>11</sup>, Article 7 of the Civil Code, or as a general principle of Law.

All this links with the correct formation of contractual consent closely linked to the good faith and reciprocal trust that preside over any franchise relationship. Contractual consent presupposes the conscience and will of the subjects so it will be missing if there is a vice of consent that is serious enough to make it invalidating<sup>12</sup>. As

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obligation to provide a copy of the last annual audit, the names of the directors or a copy of the franchise contract model was omitted. In the successive reforms of Royal Decree 2485/98, the convenience of modifying the content of pre-contractual information has arisen without being crystallised in any specific project.

<sup>6</sup> The MiFID is the European regulation that in Europe harmonises the regulation on the securities markets, the financial instruments that are negotiated in them, the organisation and relationship of the financial entities that provide investment services with their clients and the protection of the investor. It is called the Markets in Financial Instruments Directive.

<sup>7</sup> Insurance Contract Law 50/1980, in its Article 10 establishes: "*The policyholder has the duty, before the conclusion of the contract, to declare to the insurer, in the questionnaire that it submits, all the circumstances by known to it that can influence the risk assessment. It will be exempted from such duty if the insurer does not submit a questionnaire or when, even submitting it, they are circumstances that may influence the risk assessment and that are not included in it*".

<sup>8</sup> Law 34/2002, on services of the information society and electronic commerce.

<sup>9</sup> RONCERO SANCHEZ, ANTONIO. The reform of Commercial Distribution Contracts. The Law 2012, p. 144 and following.

<sup>10</sup> DIEZ PICAZO.L., Fundamentals of Civil Patrimonial Law I, p. 271

<sup>11</sup> Article 1.258 Civil Code: "*Contracts are perfected by mere consent, and obligate thereafter not only to the fulfillment of that expressly agreed, but also to all the consequences that, according to their nature, are in accordance with good faith, use and the law.*" Article 7 of the Civil Code: "*The rights must be exercised in accordance with the requirements of good faith...*".

<sup>12</sup> As O'Callaghan Muñoz indicates, in "Civil Code commented and with case law", Ed. La Ley. Ed. 8ª, p. 1329: "*The will is presumed conscious and free unless it is proven that a vice exists: presumption iuris tantum of validity of the contract. The vices that give rise to the nullity of the contract, are: error-vice (distinct from obstative error) developed in art. 1266; violence and intimidation, which are*

MARTÍ MIRAVALLS indicates<sup>13</sup>, "*uninformed consent after a period of pre-contractual negotiations, is a vitiated consent (...) it is understood, therefore, that the core of the duty of pre-contractual information to form an informed consent in master franchise headquarters should be about the data of the franchisor, the data of the network, the characteristics of the activity to be developed and the essential content of the contract...*".

In short, it is a protective regulation that is pre-contractual and seeks to balance the position of the parties.

### **3.- LACK OF VERACITY OF THE PRE-CONTRACTUAL INFORMATION.**

The regulations not only require the Franchisor to deliver the information indicated above to the potential franchisee about the franchise it intends to contract, but also article 3 of Royal Decree 201/2010, uses the terms "*truthful and non-deceptive information*".

Both words do not cease to be an expression of the good faith with which the parties negotiate the contract that will end up in the expression of a free and spontaneous consent of the parties, which requires it not to be flawed.

As we will see below, the consequences of the breach of this duty can be varied: there may be a vice when giving consent, in which case it could lead to the voiding of the contractual relationship and the restoration of the legal situation at the time prior to the signing of the contract; or, if the breach is of less intensity, it can give rise to damages.

Within the first category (vice of consent) there are two possibilities: if the information that the Franchisor transmits to the Franchisee is not truthful and/or turns out to be misleading, the will of the potential Franchisee has been formed on wrong or inaccurate beliefs about the franchise. There could be a vice of consent called error in consent. If in addition, insidious machinations or deception by the franchisor concur, there could be a vice of consent called misrepresentation.

We will now analyse the jurisprudential treatment of each of these assumptions.

#### **3.1.- ERROR IN THE CONSENT.**

Article 1265 of the Civil Code regulates the causes of nullity by indicating "*the nullity of the consent given by error, violence, intimidation and misrepresentation*". Likewise, article 1266 of the Civil Code provides: "*In order for the error to invalidate the consent, it must fall on the substance of the thing that is the object of the contract, or on those conditions of the same that had principally given reason to hold it.*"

In accordance with the jurisprudential doctrine on vices of simple consent, the fact of not delivering the pre-contractual documentation or not keeping the proof of delivery of the same sufficiently in advance does not in itself constitute cause of nullity of the franchise contract for vice of consent.

In order to produce a nullity due to an error in the consent, it must be excusable, that is to say, with average diligence, the franchisee candidate could not have known the characteristics of the intangible rights it acquired and the investments it was going to make.

In this sense, the Supreme Court, in Sentence no. 545/2009, of June 30, rejected the existence of that possible defect alleged by the Franchisee as it was sufficiently accredited that the Franchisee had sufficient knowledge of the sector in which it was willing to invest and before making such an investment had enough advice to not be able to appreciate that vice of consent<sup>14</sup>.

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*physical and moral violence, in fact the same, defined in arts. 1.267 and 1.268; and misrepresentation, provided in arts. 1.269 and 1.270.*"

<sup>13</sup> MARTÍ MIRAVALLS, J. "*The master franchise contract*", Ed. Aranzadi. Ed. 2009. Page 262 and 263. RUIZ PERIS pronounces in the same sense. J.I., other of the writers who have analyzed the franchise relationships in greater depth.

<sup>14</sup> In the same sense, Sentences 840/2013, of January 20, 2014, 385/2014, of 7 July 2014, 384/2014, of 7 July 2014 and 387/2014, of 8 July 2014, all indicate that the absence of information delivery does not necessarily lead to the nullity of the contract due to defects of consent, although they are sufficient evidence to be able to appreciate it. Thus, in the field of banking products, it is stated that to the

In order for the error of the consent to be invalidating, there must be three conditions required by case law: the essentiality of the error, its excusability and the causal link.

- a) Regarding essentiality, the error must be substantial, that is, it must affect elements that, had the franchisee known the information that it did not know, meant that it would not have signed the franchise agreement.
- b) Regarding excusability, this means that the potential franchisee, with average diligence, could not have known the information of which it was deprived. To be able to appreciate that the error is excusable, it is necessary to observe several factors including the knowledge of the sector, previous experience, and existence of advice from the potential franchisee.
- c) Finally, the existence of a causal link between the error suffered and the unlawful conduct of the Franchisor must be assessed.

In the field of franchising, the due diligence that can be required of the franchisee candidate, as an independent entrepreneur, is greater than that of a consumer and equals that of an orderly merchant, hence the application of the error in the consent is very restrictive.

Therefore, when the Judgments issued by the Provincial Courts in the last five years (2012-2016 period) are analysed, it is observed that the error of the consent has only been estimated in the Judgment of 8 May 2014, Sec. 16 of the Provincial Court of Barcelona, Judgment no. 61/15, of 8 February of the Provincial Court of Córdoba, Judgment no. 22/16, of 20 January of the Provincial Court of Barcelona and Judgment no. 288/16, of 11 June of the Provincial Court of Murcia.

The deficiencies in the delivery of pre-contractual information that are more relevant to be able to assess vices of consent are those that refer to that which constitutes the object of the franchise contract, such as: i) the content of the franchised business or; ii) the lack of transmission of know-how.

Furthermore, there are numerous judgments of Provincial Courts that dismiss the error in the consent, for example for lack of registration in the Franchisor Registry (Judgment of the Provincial Court of Zaragoza of 16 September 2003; Judgment of the Provincial Court of Madrid of 10 July 2007, Judgment of the Provincial Court of Barcelona of 26 March 2008 and Judgment of the Provincial Court of Madrid of 15 June 2009<sup>15</sup>) or because the breach of the duty to pre-contractual information is not essential, among others in the Judgment of the Provincial Court of Barcelona, 333/09, of 21 April, Supreme Court Decision 545/09 and 62/12 of 27 February, Judgment of the Provincial Court of Malaga 30/16 of 25 January, or Judgment of the Provincial Court of Madrid 142/16 of 5 April.

In this sense, the fact that the franchisor did not have great experience and did not expressly notice it in the pre-contractual information has not been considered relevant for the existence of error in the consent (see Judgment of the Provincial Court of Madrid no. 83/2010 of 30 December or Judgment no. 367/2016 of 19 October Section 19 of the Provincial Court of Madrid).

All this implies that the omissions of the pre-contractual information delivered and the personal conditions of the contracting parties must be examined on a case-by-case basis in order to determine if the vice of consent is appreciable. Not every omission and/or non-delivery of pre-contractual information leads to the concurrence of error-defect.

The consequences of the contractual nullity due to error will be the compensation of damages caused. And for this purpose Article 1303 of the Civil Code provides: "*Once the obligation has been declared null and void, the contracting parties must reciprocally return the things that were the subject of the contract, with their fruit, and*

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extent that the information duties fall on the financial institution, wrong knowledge on the part of the Client will be excusable since it is up to the financial institution to demonstrate that the information delivered was complete, truthful, adequate and understandable.

<sup>15</sup> "*In short, we must warn of the legal-private irrelevance of the failure to comply with the duty of administrative registration (lack of registration of the franchisor in the Franchisor Register) that may have the sanctioning consequences of a governmental order, but does not justify a nullity of the franchise contract*"

*the price the interest, except for what is provided in the following articles."* As the case law states, the purpose of the annulment is that the affected parties return to the personal and patrimonial situation prior to the invalidated event (Judgments of the Supreme Court of 22 September 1989, 30 December 1996, 26 July 2000), avoiding the unjust enrichment of one of them at the expense of the other.

### **3.2.- COMPENSATION FOR DAMAGES.**

We have already seen that case law is restrictive in terms of upholding the concurrence of error as vice of consent. Before analysing the figure of misrepresentation, whose nature is even more restrictive, we will now address the possibility of requesting compensation for damages for breach of contractual duties (which may or may not be coupled with termination of the contract depending on the degree and intensity of the infraction).

In fact Article 1.102 of the Civil Code establishes: "*Those who in the fulfilment of their obligations incur in misrepresentation, negligence or delinquency, and those who in any way contravene the wording of those obligations, are subject to compensation for damages and losses*"; and Article 1.124: "*The power to resolve obligations is implicit in the reciprocal, in the case that one of the obligated parties does not comply with what is incumbent on them. The injured party may choose between demanding compliance or the resolution of the obligation, with compensation for damages and payment of interest in both cases...*". And finally, Article 1.106 of the Civil Code establishes that compensation will include both loss of earnings and emerging damage.

From the analysis of the case law it is observed that the usual causes for claim of damages and termination of the contract derive from the non-delivery of know-how and/or defective commercial or technical assistance and that, in any case, to consider that breach resolving, it must be proven that it is due to causes attributable to the Franchisor and that there is no prior breach by the Franchisee.

In any case, in order to be able to require that compensation, not only the breaches of the Franchisor must be proven, but also the damage caused and the causal link between one and the other. Likewise, the loss of earnings<sup>16</sup> (that is, the profits that the Franchisee reasonably expected to obtain and which have been frustrated) and the consequential damage (such as the investments made and not amortized at the time of the resolution) must be subject to proof.

Much more debatable is an alleged compensation for clientele, since the provisions of article 28 of the Agency Contract Law would not apply by analogy<sup>17</sup>.

### **3.3.- DECEITFUL NATURE: CIVIL AND CRIMINAL MISREPRESENTATION.**

Misrepresentation is regulated in articles 1269 and 1270 of the Civil Code: "*There is misrepresentation when, with insidious words or machinations by one of the contracting parties, the other is induced to enter into a contract that, without them, they would not have done*".

Therefore, there is misrepresentation when the Franchisor consciously delivers untrue pre-contractual information, or with the intention of deceiving the other party in the formation of its will for the subscription of the franchise agreement. A different question would be criminal misrepresentation, which could lead to the appreciation of other criminal types such as the fraud.

For the misrepresentation to have annulment virtuality it must be serious, that is, concern the essential elements of the contract, given that if it relapsed on secondary elements one could speak of incidental misrepresentation and which therefore would not have that voiding virtuality. The essential elements are: i) the cession of the use of the brand and other distinctive signs to which the Franchisor was entitled; ii) the existence and transmission of know-how; iii) continued technical or commercial assistance by the Franchisor. Unlike civil error, here not only should it be accredited that the franchisee formed a wrong composition of the substance of what it was acquiring but it also must be proven that there was a scheme or deception made on a voluntary basis to induce such error in the franchisee.

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<sup>16</sup> The Supreme Court has repeatedly established that the so-called "dreams of profit" would be included in that concept and only future damages actually accredited can be granted (among other, Supreme Court Judgments of 11 February 2013).

<sup>17</sup> RUIZ DE VILLA, J., "The Franchise", Ed. Aranzadi Chapter 7, "*Consequences of breach of contract*", PAGE. 661-663, this author already analysed the questionable nature of said compensation.

As the doctrine of the authors has established, it would not be possible to appreciate misrepresentation if the advertising delivered by the Franchisor exaggerates some assertions which although they could literally be considered untrue, should be placed in context, in which they would be within the deception tolerated by uses and moral (the so-called *dolus bonus*). For example, if in the section on characteristics and structure of the network, growth forecasts and/or openings are established that ultimately will not be materialised.

#### **4.- SPECIAL REFERENCE TO FORECAST ACCOUNTS.**

Regarding the possible operation accounts that the Franchisor gives to the potential Franchisee, article 3.e of Royal Decree 201/2010, of February 26, provides "*If the franchisor delivers estimates of figures of sales or operating results of the business to the individual potential franchisee, these should be based on sufficiently substantiated experiences or studies*".

As you can see, the Law does not oblige the potential franchisee to be provided with a forecast of results. What it does establish is that if the Franchisor delivers one, this forecast must be based on real or sufficiently substantiated data.

The actual results of the operation of a franchise will be conditioned not only by the strength of the franchised business, but by a multiplicity of factors over which the franchisor has no control, starting with the franchisee's own qualities and dedication to the management of the franchised business, continuing with the reaction of competition in the area or its possible increase over time, or even the evolution of the economy itself.

Therefore, the Franchisee cannot claim against the franchisor for the simple fact that the operation of the franchised business has not obtained the results that were estimated. A claim is only possible if the forecast is not based on the experience of other open centres or is not sufficiently substantiated.

Case law usually dismisses the claims that try to protect the actions of resolution of the contract through the failure to obtain the results expected by the franchisee, because they understand that this type of forecasts are only forecasts and do not suppose a guarantee. Judgment 836/2008 of the Provincial Court of Madrid of 27 November 2008; Judgment of the Provincial Court of Barcelona of 28 February 2007, Judgment no. 618/2007 of 6 November of the Provincial Court of Madrid, Judgment of the Provincial Court of Barcelona of 21 April 2010, Judgment no. 197/2014 of 29 April of the Provincial Court of Malaga.

However, there is a slight change in the trend in the Judgment of 8 May 2014, rec. 781/2014, Section 16 of the Provincial Court of Barcelona and the Judgment of the Provincial Court of Ávila of 17 June 2015.

#### **5. A DISRUPTIVE FOCUS.**

Spain is a country in which the franchise system has allowed an extraordinary renovation of the commercial park (which today is called retail). Many of the small neighbourhood stores have joined organised networks (purchasing centres or franchises) to achieve synergies in purchases, R&D+i marketing and in this way compete with large stores. This success can be seen in the evolution of the number of franchise networks and number of franchisees in Spain over the years<sup>18</sup>.

Surely the success of the franchise in Spain has contributed to the promptness with which the regulations on pre-contractual information were approved, whose immediate effect, in our opinion, is the expulsion from the market of franchisors who fail to meet adequate pre-contractual information standards.

The question that could be asked is whether it is necessary to adopt some kind of change regarding this regulation.

It would seem that the current regulations are adequate and reasonable given the growth of the franchise in Spain and its level of litigation. In this sense, a recent report published by the committee of experts of the AEF

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<sup>18</sup> [www.franquiciadores.com](http://www.franquiciadores.com), "The Franchise in Spain. 2016 Report. National Statistics. Spanish Association of Franchisors". At the end of 2016 there were a total of 1,298 signs and a total of 70,541 premises operating in Spain. The registered turnover amounts to 26,991 million euros and generates employment of 268,986 jobs.

reveals that in recent years the number of litigations in Spanish provincial courts related to the franchise is 0.08% compared to the number of franchisees installed in Spain.

However, there is a phenomenon that is barely mentioned, which is the emergence of numerous networks in Spain that disappear after a few years. It is enough to make a comparison of the franchise networks published every year by the main consulting companies in the country to see that a remarkable percentage of networks disappear from the market after three years.

Hence the need to reinforce the consequences of non-compliance with the duty of pre-contractual information.

For this we believe that it should be possible to apply a Supreme Court Judgment published in 2013 but which has, in my opinion, drawn less attention than is due.

The Supreme Court Decision 638/2013 of 18 November establishes a new doctrine to resolve contracts, which can be of great help in the franchise: the doctrine of breach of service.

According to this doctrine, the essential breach lies not so much in the defective execution of the obligation, but in the dissatisfaction of the creditor's interest, which agrees with the substantial deprivation of "*everything that can be expected by virtue of the concluded contract*" or the frustration of the "*practical end of the contract*" or the "*intended purpose*" or "*legitimate expectations*" of the other party. This, in the words of the Supreme Court itself, allows the breach of service to refer to all contractual benefits without distinction, whether they are accessory or merely complementary, if it turns out that they were decisive for the conclusion or purpose of the concluded contract. In other words, the essential breach of the service is projected as an assessment or weighting of the suitability of the results, profits or utilities that logically could be expected from the nature and characteristics of the concluded contract and not on specific infringed obligations.

Projecting this doctrine on the obligation of pre-contractual information that is integrated into the franchise business relationship to formalise the contract, we would find that the legitimate expectation of the potential franchisee is to receive training and competitive advantages that are specified in a reasonably profitable business with an average management on its part and as long as there is no market event (increase in competition, economic crisis, etc.).

The frustration of this legitimate expectation could be given for example if the franchised business (in premises of similar characteristics of the franchised network) does not have the profitability that was reported to the franchisee, or if there are no competitive advantages promised in the pre-contractual information.

This would expand the power of the judge to penetrate the negotiating substrate of the franchised business to assess in a balanced way whether the information of the franchisor was adequate or whether, on the contrary, it generated exaggerated expectations, in which case they could decree the termination of the contract and compensation for damages.

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