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Franchising in Norway: balancing complexity in a contractual  
relationship

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# Franchising in Norway – Balancing Complexity in a Contractual Relationship<sup>1</sup>

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## 1. Introduction

### 1.1 Background and context

The first known organized chain in Norway operating as a franchise is said to be a textile wholesale chain, established in 1966.<sup>2</sup> The term “franchise” was not used, but the system matched the description of a franchise system. Franchising can be described as a commercial development strategy based on an interdependent partnership between independent commercial entities: the franchisor and franchisees.<sup>3</sup> This partnership is typically based on the transfer of a package of intellectual property rights relating to trademarks, trade names, shop signs, utility models, designs, copyrights, know-how or patents, to be exploited for the resale of goods or the provision of services to end users.<sup>4</sup>

The number of franchise systems, as organisational forms, increased in Norway during the 1970’s, with 183 systems operating as franchises by 1998.<sup>5</sup> The number is still increasing, with an estimated 242 franchise systems in 2004 and 300 systems in 2016.<sup>6</sup> Within the retail industry one third of local units are owned or hired by a franchisee.<sup>7</sup> As a result of this growth,

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<sup>1</sup> The author wishes to thank Petra Sund-Norrgård, Stojan Arnerstål and René Franz Henschel for their valuable feedback and comments.

<sup>2</sup> Børge Nilssen, *Franchising i Norge* Oslo 1998 p. 4 and Lars G. Norheim, *Franchising, avgangsvederlag og agentur*, Oslo 2003 p. 54.

<sup>3</sup> See for example The World Franchise Council (WFC): “Principles of Ethics for Franchising”, adopted May 5, 2002. See also Børge Nilssen, *Franchise – Verdiøkende samarbeid mellom selvstendige parter*, Oslo 2009 p. 9-10.

<sup>4</sup> See the definition article 1 (3) a) of Commission Regulation (EEC) No 4087/88 of 30 November 1988 on the application of Article 85 (3) of the Treaty to categories of franchise agreements (now repealed). See also Lars G. Norheim «Franchising – begrepsforklaring og oversikt over noen rettslige problemstillinger» *Tidsskrift for forretningsjus* 1995 p. 8-31.

<sup>5</sup> The information is based on a franchise survey conducted in 1998 by Norges Franchise Institutt in cooperation with Effectum Franchise Consulting and AC Nielsen Norge.

<sup>6</sup> The information is based on a franchise survey conducted in 2004 by Effectum Franchise Consulting in cooperation with Arild Andhøy AS (Franchise Survey 2004). See also Norwegian Franchise Forum, a member organization for franchise in Norway; <http://norskfranchise.no/om-nff>.

<sup>7</sup> NOU 2011: 4 Mat, makt og avmakt, Rapport til Matkjedeutvalget, Dokument 13 «Konkurransforhold ved detaljsalg av dagligvarer» p. 93 and Knut Erik Rekdal, Franchisekonferansen 2. mars 2016, «Status franchise i Norge» Result analysis from Virke Retail Database (Virke is the Enterprise Federation of Norway); <http://www.virkepluss.no/FRANCHISEKONFERANSEN/Documents/Franchisekonferansen%202016%2002%20mars%202016.pdf>

franchise systems have become an important part of the industry. In Norway, 15-20 % of all business entities are based on franchise systems.<sup>8</sup> Despite this, limited research addresses the legal implications of Norwegian franchise systems.<sup>9</sup>

The relationship between franchisor and franchisee is based on and governed by special agreements, not the principles applicable to employment arrangements or the co-ownership of entities. Thus, franchising is a contractual relationship, which imposes obligations on the franchisor and his franchisee, in a contract-based manner of doing business.<sup>10</sup> As a consequence, when analysing the legal implications of this relationship the point of departure should be contract law and its principles. Furthermore, contractual rights and obligations may be modified, supplemented or completely supplanted, by the unwritten norms of the ongoing relationship.<sup>11</sup>

The main characteristic of a franchise system is the concept of uniformity, approaching the market as one unit.<sup>12</sup> The outward appearance of a franchise, i.e. how the market receives the concept and the expectations of the end user, is decisive for the reputation of the franchise concept.<sup>13</sup> The internal relationship between franchisor and franchisee is supposed to reflect the outward appearance.<sup>14</sup> Consequently, uniformity and reputation are of common interest to the parties.

One must also take into account the fact that franchisors and franchisees are independent entities and may have divergent interests.<sup>15</sup> The incentives of the transacting parties do not always coincide.<sup>16</sup> Based on data from empirical studies of Norwegian franchisee dealers in a

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<sup>8</sup> Franchise Survey 2004 and <http://norskfranchise.no/hva-er-franchise>

<sup>9</sup> Examples of Nordic literature addressing legal consequences are Karen Dyekjær-Hansen, «Franchising», *Det 32. Nordiske Juristmøde*, 1990 p. 388-412, Norheim 1995 p. 8-31, Lars G Norheim «Franchising og konkurranseretten» *Tidsskrift for forretningsjus*, 1996 p. 12-44, Morten Wegener, «Ophør af franchiseaftaler», *Juristen*, 1997 p. 264-287, Norheim 2003, Ellen Eftestøl-Wilhelmsson «Eneforhandlerens, franchisetagerens og tjenesteagentens rett til et økonomisk sluttoppgjør», *Tidsskrift for Rettsvitenskap*, 2005 p. 608 – 627, Carl Martin Gölstam, “DCFR och franchising”, *Svensk Juristtidning*, 2012 p. 1013-1033 and Petra Sund-Norrgård, *Tolkning av franchisavtal*, Helsingfors 2014.

<sup>10</sup> Norheim 2003 p. 27.

<sup>11</sup> In particular discussions concerning US franchise relationships, see for example Gillian K. Hadfield, “Problematic Relations: Franchising and The Law of Incomplete Contracts”, *Stanford Law Review*, 1990 p. 927-992 (p. 929).

<sup>12</sup> Norheim 2003 p. 27 and 89. See also the decision in CJEU, C-161/84 (Pronuptia), assigning a jurisprudential definition of franchising by highlighting, among other things, that franchising implies the “application of uniform business methods”.

<sup>13</sup> Protection of a business concept, e.g. a franchise concept, is discussed in Knud Wallberg, “Beskyttelse af forretningsconceper”, *U.1999B.55* and Are Stenvik, “Rettsbeskyttelse av forretningskonsepter og -metoder” *Tidsskrift for forretningsjus*, 2002 p. 483-523. See also Norheim 2003 p. 89.

<sup>14</sup> Norheim 2003 p. 83.

<sup>15</sup> Hadfield 1990 p. 950.

<sup>16</sup> Benjamin Klein, “The Economics of Franchise Contracts”, *Journal of Corporate Finance*, 1995 p. 9-37 (p. 12).

multinational gasoline distributor network, it has been argued that the franchise relationship presents a potential for conflict between franchisor and franchisee when franchisees are opportunistic.<sup>17</sup> It is argued that the franchisor seeks standardisation and control over franchisees to maintain the reputation of the concept, whereas franchisees strive for autonomy in operating their own business.<sup>18</sup> Franchisees may be tempted to increase their short-term profitability by free riding on the brand name.<sup>19</sup> This problem of free riding provides the background for analysis and discussions in this article.

Three out of four franchise systems in Norway are of Norwegian origin.<sup>20</sup> A study of these contractual relationships in Norwegian franchise systems is useful in order to understand the national regulation of franchise relationships.

In this article, I will focus on the ongoing relationship between franchisor and franchisee, their rights and obligations, and analyse certain elements in their long-term relationship.

## 1.2 Topic and research questions

The principal objective of this article is to analyse the contractual relationship between franchisor and franchisees in Norwegian franchise systems. Divergent and mutual interests, a wide range of rights and obligations and a focus on uniformity make the franchise agreement rather distinct from other contractual relationships.<sup>21</sup> Balancing the complexity of the arrangement with the parties' adaptability and allowing enough flexibility in the system to maintain uniformity and the reputation of the concept could be decisive for the success of the system.<sup>22</sup>

A study of franchise agreements may reveal whether the parties' rights and obligations are sufficiently balanced to ensure best practice and the quality of the franchise system.<sup>23</sup> Thus, I

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<sup>17</sup> Roland E. Kidwell, Arne Nygaard & Ragnhild Silkoset, "Antecedents and Effects of Free Riding in the Franchisor-Franchisee Relationship", *Journal of Business Venturing*, 2007 p. 522-544 (p. 523).

<sup>18</sup> Kidwell et. al. 2007 p. 523.

<sup>19</sup> Jérôme Barthélemy, "Agency and institutional influences on franchising decisions", *Journal of Business Venturing*, 2011 p. 93-103 (p. 93).

<sup>20</sup> Franchise survey 2004 p. 3 and p. 8. See also Norheim 2003 p. 55 and Norway Business Law Handbook, Strategic Information and Laws International Business Publications, USA 2013 p. 83.

<sup>21</sup> Dyekjær-Hansen 1990 p. 395 and Norheim 2003 p. 83.

<sup>22</sup> In US franchise systems this complexity is discussed to a great extent, see for example Nabil I Al-Najjar, "Incomplete Contracts and the Governance of Complex Contractual Relationships" *The American Economic Review*, 1995 p. 432-436 (p. 435).

<sup>23</sup> On this aspect, see Norheim 2003 p. 82 ff. and p. 90.

will investigate the franchisor's obligation to support franchisees and their right to instruct and control them. I will then discuss whether this is balanced towards the principles of independence in franchise systems. Based on my findings, I will discuss to what extent the balance between uniformity and independence is fairly reflected in the contractual relationship.

As a starting point, I will give a short overview of how the contractual relationship is interpreted under Norwegian contract law and identify the complexity in a franchise agreement.<sup>24</sup> In this context, I will discuss whether the principles applying to the interpretation of franchise agreements differ from the principles used to interpret other types of contracts.<sup>25</sup>

To illustrate the contractual regulation of support services, I have chosen to investigate to what extent franchisors are obliged to offer franchisees training as a part of the ongoing arrangement. Training may also be a part of a support package purchased by a franchisee and paid for with the franchise fee. My conclusion may serve as a basis for discussing whether an obligation to offer training is required in each arrangement. Due to the facts that the scope and type of support may differ, I will investigate to what extent a franchisor can choose between different elements of support in a flexible manner or whether they are regulated in detail.

Furthermore, I will analyse to what extent the franchisor has a contractual right as part of the franchisor's monitoring role to control franchisees' performance, in order to ensure the uniformity and reputation of the franchise system. In theory, the franchisor's strong contractual position and the monitoring role is supposed to prevent the opportunistic free riding of franchisees.<sup>26</sup> It can be discussed whether a system with a strong focus on the franchisor's monitoring role leads to the assumption that franchisees have less independence and flexibility. As a consequence, I will investigate to what extent the franchisors' right to control franchisees are balanced against franchisees' independence in the ongoing relationship.

The franchisee's role in a franchise system is to a considerable extent dependent on provisions in the contractual relationship. It can thus be discussed whether franchisees have, or should have, a right to participate in the decision making in ongoing arrangements. In order to highlight this issue, I will investigate the existence of a contractual collaboration obligation between the franchisor and franchisees, which balances both parties' interests.

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<sup>24</sup> The complexity in Norwegian franchise agreements is also discussed in Norheim 2003 p. 106 ff.

<sup>25</sup> See discussions in Sund-Norrgård 2014 p. 97–124.

<sup>26</sup> Norheim 2003 p. 163.

The contractual bond between franchisor and franchisee may have unwanted effects. Is it, for example, possible that franchisors who place strict controls on their franchisees also have to answer for their franchisee's missteps? I will therefore debate the consequences of a strong focus on franchisors' support and monitoring in a franchise relationship.

### 1.3 Methodological approach

Analysis and discussions in this article will be based on traditional legal research methods, investigating Norwegian legal sources.<sup>27</sup>

Legal argumentation and the interpretation of legal sources may require information about actual practice from empirical studies.<sup>28</sup> Studying franchise contracts makes it possible to have an insight into the nature of the relationship between franchisor and franchisee.<sup>29</sup> Investigating genuine contractual provisions can also shed light on the content of the law concerning franchise systems in Norway.<sup>30</sup> Thus, research questions in this article will be studied through a combination of legal and empirical research, integrating legal sources and empirical material.<sup>31</sup>

No Norwegian statutory law regulates the franchise system as a contractual means of doing business. However, other legal sources cover legal issues connected to franchising.<sup>32</sup> First of all, the Contract Act governs contractual relationships.<sup>33</sup> In addition, the Marketing Control Act could be relevant to business relationships.<sup>34</sup> Another aspect of the legal framework likely to

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<sup>27</sup> See for example Jan E Helgesen og Torstein Eckhoff, *Rettskildelære*, Oslo 2001. See also Hans Petter Graver, «Vanlig juridisk metode? Om rettsdogmatikken som juridisk sjanger», *Tidsskrift for Rettsvitenskap*, 2008 p. 149-178 (p. 173).

<sup>28</sup> Hans Petter Graver, *Den juristskapte virkelighet*, Oslo 1986 p. 141. See also Kristian Andenæs, «Rettsvitenskap og empiri» i *Regulering og styring III: Et bidrag til den juridiske forskeruddannelse*, København 1992 p. 107-120 and Graver 2008 p. 173, Brian Leiter, «Explaining Theoretical Disagreement», *The University of Chicago Law Review*, 2009 p. 1215-1250 (p. 1216) and Synne Sæthre Mæhle, «Rettsvitenskapelig forskningsmetodikk – i lys av grunnleggende forskningsverdier», *Tidsskrift for Rettsvitenskap*, 2015 p. 125-157 (p. 143).

<sup>29</sup> Klein 1995 p. 36.

<sup>30</sup> Claes Sandgren, "On Empirical Legal Science" *Scandinavian studies in law*, 2000 p. 445-479 (p. 465). On contracts as a legal source, see Viggo Hagstrøm, *Obligasjonsrett*, 2013 p. 42-43.

<sup>31</sup> Combinations of empirical and legal research methods are also discussed in Dalberg-Larsen, *Rettsvitenskapen som samfunnsvidenskap*, 1977 p. 536 ff. and Dahlberg-Larsen *Hvorfor interessere sig for andre samfunnsvidenskaper?* *Regulering og styring III: Et bidrag til den juridiske forskeruddannelse* 1992 p. 57-73 (p. 65).

<sup>32</sup> See for example Swedish disclosure law on franchise (Lag 2006:484 om franchisegivares informationsskyldighet). See also Dyekjær-Hansen p. 411 and preparatory works: NOU 2011: 4 Mat, makt og avmakt and NOU 2012: 6 God handelsskikk i dagligvarekjeden. The increasing use of franchises as a system for organising real estate firms is emphasized in NOU 2006: 1 p. 19.

<sup>33</sup> The Contract Act 31. May 1918 n. 4 (Avtaleloven).

<sup>34</sup> The Marketing Control Act 9. January 2009 n. 2 (Markedsføringsloven). Also, the Competition Act 5. March 2004 n. 12) (Konkurranseloven) and Working Environment Act 17. June 2005 n. 62 (Arbeidsmiljøloven) may influence franchise relationships but will not be discussed in this article.

affect contractual decisions is the efficacy of acts relating to intellectual property, e.g. under the Trademark Act and the Company Name Act.<sup>35</sup>

Court decisions will be useful when investigating contractual franchise relationships. However, the most relevant court decisions come from lower courts. Conflicts between franchisor and franchisee are to a great extent solved by arbitration, and are therefore not public.<sup>36</sup> Consequently, a study of court decisions may not reveal the whole picture of franchise relationships. The legal value of decisions from District Courts is also low.<sup>37</sup> Due to this, court decisions on franchises will serve as illustrations and examples.

The Norwegian Franchise Forum's (NFF) code of ethics may provide guidance on franchise relationships.<sup>38</sup> The code is intended to create a framework for the members of NFF based on self-regulation according to the principal standards of "faith, truth and honesty". The codes are not intended to provide solutions in specific cases or serve as guidance in court cases. Consequently, the legal value of these codes will be low. The NFF is inspired by an international code of ethics, The European Code of Ethics developed by European Franchise Federation (EFF) and ethical codes of the International Franchise Association (IFA).<sup>39</sup> In addition, Principles of Ethics for Franchising from the World Franchise Council (WFC) also provide guidance. The European Code of Ethics and Principles of Ethics for Franchising will be mentioned in this article where appropriate.

Different model rules, e.g. the Principles of European Contract Law (PECL) and the Draft Common Frame of Reference (DCFR) regarding franchises will serve as illustrations of rights and obligations where appropriate.<sup>40</sup> The Model Franchise Disclosure Law produced by UNIDROIT is also worth mentioning as model rules.<sup>41</sup> It has inspired several countries to

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<sup>35</sup> Trademark Act 26. March 2010 n. 8 (Varemerkeloven) and Company Name Act 21. June 1985 n. 79 (Foretaksnavneloven). Trademarks are further discussed in Stojan Arnerstål, "Protection of Franchise Concepts in Trademark Law and Contract Law", *Tidsskrift utgiven av Juridiska föreningen i Finland* 2016 p. 366-390.

<sup>36</sup> A great deal of the court decisions are from lower courts. Court decisions are to some extent published in Lovdata; [www.lovdato.no](http://www.lovdato.no). This includes all Supreme Court Decisions and Court of Appeal but only a selection of District Courts' judgments. Unpublished District Court judgments are found *ad hoc* by asking attorneys and researchers

<sup>37</sup> See also Ole Hansen, «Om de længerevarende kontraktforholds forankring i den almindelige kontraktret - længerevarende kontrakter som forskningsfelt», *Tidsskrift for Rettsvitenskap*, 2011 p. 443-477 (p. 460) and Jacob Juul and Peter Fauerholdt Thommesen, *Voldgiftsret*, 2008 p. 22.

<sup>38</sup> <http://norskfranchise.no/etiske-regler>

<sup>39</sup> See Sund-Norrgård 2014 p. 66.

<sup>40</sup> In respect of the influence of Model Law regarding franchise in Nordic countries, see Sund-Norrgård 2014 p. 68-91 and Hagstrøm 2013 p. 61-70. DCFR IV.E Chapter 4 on Franchise is of importance. See Draft Common Frame of Reference (DCFR) Full Edition Volume 3, Christian von Bar and Eric Clive (ed.), Munich 2009 p. 2382 ff.

<sup>41</sup> On the influence of Model Franchise Disclosure Law in Nordic countries, see Sund-Norrgård 2014 p. 86-88.

introduce binding regulations that grant the franchisee a high level of protection, including a duty of pre-contractual disclosure on the part of franchisor. However, Norway has not adopted legislation based on the UNIDROIT model.

Empirical research on real-life franchise systems and contractual relationships may consist of a collection of written contracts and operations manuals or handbooks in each system. In short, the written contract serves as the main document, imposing rights and obligations between the parties. The operations manuals function as the franchisees' handbook for operating in the correct manner. Empirical research on franchise systems will benefit from access to contracts and manuals from all relevant areas of business.

The franchise system is an organisational form used across various businesses, e.g. retail, hotels, restaurants, travel agencies, training centres, car related activities, personal services and business-to-business services. In Norway, franchises have traditionally focused on business-to-consumer activities, e.g. the retail industry.<sup>42</sup> However, there seems to be a shift from retail as a dominant franchise system to services, especially in business-to-business services.<sup>43</sup> As a minimum, empirical research should comprise both goods and services and both business-to-consumer and business-to-business activities.

Furthermore, the feasibility of collecting franchise contracts largely depends on the willingness of franchisors to provide model contracts and operations manuals.<sup>44</sup> Business interests are at stake. The transparency which research facilitates may not be in the interests of the franchisors. Thus, the collection of contracts and manuals may meet obstacles.

For my research, access to real-life written contracts and operations manuals was decisive. In order to collect information, I contacted the Norwegian Franchise Forum.<sup>45</sup> They supported my research project and provided general information and insight on franchise systems in Norway. Following an initial approach from the Norwegian Franchise Forum and Effectum Consulting AS, a sample of 40 franchise systems were asked to be a part of the research project.<sup>46</sup> They were all informed that the sensitive data gathered would be handled with full

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<sup>42</sup> The well-known retail chain Rema 1000 is based on franchise systems. Norgesgruppen also uses franchise systems as organizational form to some extent.

<sup>43</sup> Franchise Survey 2004 p. 8.

<sup>44</sup> Norheim 2003 p. 35-39 and Mads Bryde Andersen, *Enkelte transaksjoner Aftaleretten III*, Gjellerup 2011 p. 450.

<sup>45</sup> Norwegian Franchise Forum was established in 2014, to a great extent emerging from Norwegian Franchise Association established in 1973, cf. Norheim 2003 s. 54 and <http://norskfranchise.no/historikk>

<sup>46</sup> E-mails and letters were sent 21<sup>th</sup> September 2015.



confidentiality so that no names which could facilitate the identification of the parties or franchise system would be mentioned in the research. As a condition for access to relevant documents, all information would be received in exchange of a non-disclosure agreement. In addition, the project was mentioned at a Franchise Conference, where participants were invited to take part in the research project.<sup>47</sup>

The collection of contracts and manuals was to some extent dictated by circumstances. Following this approach, I gained access to 12 franchise contracts and four operations manuals. This sample of written contracts and manuals comes from industries within personal services, sale of goods in consumer markets and business-to-business services. Thus, more or less through luck, the data gathered represented an acceptable cross-section of the franchise industry in Norway.

It was not possible in the time available to collect a sufficient number of contracts to fulfil the requirements for a statistically representative sample.<sup>48</sup> It can be argued, however, that the purpose for which this empirical material is being used (e.g. a sample of contracts and manuals), can be achieved even if the formal requirements for the collection of materials are not fulfilled.<sup>49</sup>

As for the numbers of contracts and manuals collected, since the sample is not statistically significant and might be biased due to the way it was collected, it is suitable to be used for qualitative studies. The contracts and manuals will be interpreted as *illustrations and examples*, rather than as generalizable evidence of provisions in franchise agreements.

## 2. The contractual relationship between franchisor and franchisee

The franchise agreement provides starting points and boundaries for the parties.<sup>50</sup> It is intended to regulate rights and obligations and reflect the strategy of the franchise network.<sup>51</sup> As a starting point I will investigate to what extent franchise agreements are interpreted in a specific way, compared to other contractual relationships.<sup>52</sup>

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<sup>47</sup> Norwegian Franchise Forum arranged The Franchise Conference 15<sup>th</sup> October 2015.

<sup>48</sup> This challenge is also discussed in Norheim 2003 p. 39 ff, Geir Woxholt, *Idrettens sponsoravtaler*, Oslo 1993 p. 19-20 and Erik Røsæg, *Garantier eller fattigmannstrøst*, Oslo 1992 p. 31-37.

<sup>49</sup> Claes Sandgren, "On Empirical Legal Science", *Scandinavian studies in law*, 2000 p. 445-482 (p. 467).

<sup>50</sup> Pre-contractual conditions in franchise systems are further analysed in a case study in Finland, se Petra Sund-Norrgård "Franchising in Finland - Lessons learned from a Multiple Case Study" *Tidskrift utgiven av Juridiska föreningen i Finland* 2016 p. 261-304.

<sup>51</sup> See for example Gölstam 2012 p. 1019-1020.

<sup>52</sup> According to DCFR Volume 3 p. 2383 franchise contracts should for example be distinguished from ordinary distribution contracts.

The franchise agreement is often standardized for everyone in the franchise system.<sup>53</sup> A standard form contract has the advantage of signalling aspects of the relationship that every franchisee can expect.<sup>54</sup> Since franchise agreements vary from one system to another, it is debatable whether they are actually based on elements typical of standard contracts.<sup>55</sup>

Whether or not franchise agreements can be defined as standard contracts, there is no doubt that rights, obligations, and responsibilities are established by one party, the franchisor. Consequently, franchise agreements are concluded through the form of *adhesion contracts*, pre-written by the dominant party.<sup>56</sup> For the franchisee, the choice is whether or not to be a part of the franchise system, on a “take-it-or-leave-it” basis.<sup>57</sup>

Furthermore, the arrangement between franchisor and franchisee is often seen as a principal-agent relationship.<sup>58</sup> If the agent is naive and unsophisticated compared to the principal, there could be an imbalance in the franchise relationship.<sup>59</sup> To ensure best *possible* balance of rights and obligations it could be necessary to interpret franchise contracts in a way that will reduce or remove an *unwanted* imbalance.<sup>60</sup>

Provisions in the franchise agreement, in the form of an adhesion contract, may therefore be interpreted according to reasonableness in the Contract Act § 36. The Contract Act § 36 provides provisions which may invalidate certain clauses or the entire agreement.<sup>61</sup> If franchise systems are built on imbalance, it can be debated whether the contract should be interpreted in a way that ensures the rights of a *weaker* franchisee.<sup>62</sup>

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<sup>53</sup> Norheim 2003 p. 84.

<sup>54</sup> Hadfield 1990 p. 961.

<sup>55</sup> See the discussion in Sund-Norrgård 2014 p. 55 and 59. Variation of franchise contracts is also pointed out in Norwegian preparatory works, see NOU 2011: 4 Mat, makt og avmakt p. 26.

<sup>56</sup> Norheim 2003 p. 84, Mads Henry Andenæs, *Kontraktsvilkår*, Oslo 1989 p. 6-7 and 108-109. Sund-Norrgård 2014 p. 56 and 230. The topic is also discussed in foreign literature, see for example Rosa Lapiedra, Felipe Palau and Isabel Reig, “Managing asymmetry in franchise contracts: transparency as the overriding rule” *Management Decision*, 2012 p. 1488-1499 (p. 1489).

<sup>57</sup> Johan Giertsen, *Avtaler*, Bergen 2014 p. 83, Andenæs 1989 p. 108-110, Jens Schovsbo, *Immaterialretsaftaler*, København 2001 p. 29-30 and Sund-Norrgård 2014 p. 56.

<sup>58</sup> Sund-Norrgård 2014 p. 57.

<sup>59</sup> In this direction James A. Brickley, Sanjog Misra and R. Lawrence Van Horn, “Contract duration: evidence from franchising”, *Journal of Law and Economics*, 2006 p. 173–196.

<sup>60</sup> Giertsen 2014 p. 81. A need for special regulation protecting franchisees is discussed in René Franz Henschel, “Contract law aspects of Business Format Franchising in Denmark – a need for special regulation protecting franchisees?”, *Tidskrift utgiven av Juridiska föreningen i Finland* 2016 p.

<sup>61</sup> For an overview of Norwegian legislation, see for example Viggo Hagstrøm, «Urimelige avtalevilkår», *Lov og rett*, 1994 p. 131-168 and Giertsen 2014 p. 203 ff.

<sup>62</sup> Sund Norrgård 2014 p. 100-103, Norheim 2003 p. 163-164 and the Swedish Supreme Court decision in NJA 1992 p. 290.

The Norwegian Supreme Court has held that contracts between two professional parties should not be interpreted in a way that overrides the written word unless justified by clear circumstances.<sup>63</sup> Consequences of a relationship between one stronger and one weaker party in a franchise system could be such a *circumstance*. For example, in one case from the District Court, the judge pointed out a disparity and awarded the franchisee compensation for the franchisor's breach of an economic obligation.<sup>64</sup> In other cases, it was pointed out that both parties in franchise relationships are professionals and the contracts must be interpreted in that regard.<sup>65</sup> The franchise system was, in these decisions, said to be a balanced relationship between two professional parties, so a high threshold for breach of contract was imposed based on the Contract Act § 36.

Based on economic theory, it can be argued that the efficiency in the strong position of the franchisor is necessary and should not be questioned by contractual regulations or statutory law.<sup>66</sup> In addition, franchisees in each system may vary from professional and experienced traders to inexperienced, naive newcomers.

Consequently, it cannot be stated as a *general* norm that franchise contracts must be interpreted in a way that will reduce or remove an unwanted imbalance. On the other hand, discussions on balance related to *specific* provisions in this article, support and monitoring, may shed light on whether best practice is achieved by emphasising the interests of the so-called weaker party.

When interpreting franchise agreements, one must take into account the fact that they are long term contracts with significant uncertainty.<sup>67</sup> It is not possible to foresee all future circumstances that could arise. Thus, detailed requirements may not be the best solution, or even possible to set out as standard provisions. Considerations arising from the need for dynamic elements and future developments in the relationship may call for flexible provisions.<sup>68</sup> On the other hand, flexible regulations might open up uncertainty for the franchisee. The choice between detailed or flexible regulations could also be a question of balance, reviewing whether

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<sup>63</sup> See for example Norwegian Supreme Court decisions in Rt. 1994 p. 581, Rt. 1998 p. 1584, Rt. 2000 p. 806 and Rt. 2002 p. 1155.

<sup>64</sup> TSTRO-2010-104324 Sør-Trøndelag District Court (Big Bite decision) p. 7 (premiss 50).

<sup>65</sup> Case number 14-121579TVI-AUAG Aust-Agder District Court (Brun og blid decision) p. 11 and Case number 14-143059TVI-OTIR/07 Oslo District Court (McDonald's decision – appealed) p. 8.

<sup>66</sup> Norheim 2003 p. 161 and 164.

<sup>67</sup> Hadfield 1990 p. 947.

<sup>68</sup> Erlend Haaskjold, *Kontraktsforpliktelser*, Oslo 2013 p. 100.

franchise contracts tend to treat the obligations of the franchisors and the franchisees differently.<sup>69</sup>

The need for precise regulations could depend on how well rights and obligations are covered in statutory law and the importance of the contract itself.<sup>70</sup> Since there is no statutory law regulating franchise relationships in Norway, the contract itself will have great value in determining the parties' rights and obligations. The overall principle in contract law is the freedom of contract expressed in NL 5-1-1 and NL 5-1-2.<sup>71</sup> Various other statutory or non-statutory norms may serve as supplements to the contract or place limitations on the contractual relationship. Nonetheless, the starting point will be an interpretation of the contractual terms.<sup>72</sup>

Written contracts may be interpreted in a relational way in order to satisfy a need for flexibility.<sup>73</sup> It is possible to look beyond the written contract and examine the ongoing relationship in which the franchise agreement is embedded.<sup>74</sup> This can be seen from the use of the operations manual as the dynamic element in franchise agreements.<sup>75</sup>

The operations manual consists of detailed guidelines, which require careful and extensive reading. It may describe the goal of the system, the franchise concept (including trademarks and know-how), strategy, profile, facilities, human resources, employment, product, services, security and detailed instructions on franchisees' obligations.<sup>76</sup> The operations manual may also set out communication systems between franchisor and franchisee, using a two-way intranet.

Whether the operations manual forms part of the legally binding contract between franchisor and franchisee is discussed in legal literature.<sup>77</sup> In Norwegian franchise systems, it seems to be concluded that the manual is legally a part of the franchise agreement.<sup>78</sup>

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<sup>69</sup> This is discussed in Al-Najjar 1995 p. 436.

<sup>70</sup> In this direction, Haaskjold 2013 p. 99.

<sup>71</sup> Kong Christian Den Femtis Norske Lov av 1687, femte bog, andet kapitel.

<sup>72</sup> See for example RG 2009 p. 19 Borgarting Court of Appeal (7-eleven) and LF-2009-45922 Frostating Court of Appeal (Grong Minipris).

<sup>73</sup> Hadfield 1990 p. 979. The relational theory of contracting is based on Macneil, Ian R., "Economic analysis of contractual relations: Its shortfalls and the need for a rich classificatory apparatus", *Northwestern University Law Review* 1981 p. 1018-1063 and Macneil, Ian R., *The relational theory of contract – selected works of Ian Macneil* by David Cambell (ed) London 2001. The relational theory of contract is also discussed in Sund-Norrgård 2011 p. 45-54.

<sup>74</sup> Hadfield 1990 p. 985.

<sup>75</sup> Norheim 2003 p. 100.

<sup>76</sup> Norheim 2003 p. 101.

<sup>77</sup> See Sund Norrgård 2014 p. 58 concluding that the manual is a part of the contract.

<sup>78</sup> Norheim 2003 p. 100.

Consequently, the scope of the franchisor's control is extended as the franchisor writes both the manuals and the contract.<sup>79</sup>

Uncertainty regarding the content and requirements for completing franchise agreements leads to an increased focus on non-statutory norms which also acquire greater legal weight.<sup>80</sup> Based on the wide range of industries and entities where franchise systems are present, these relationships differ from one system to another. The question is whether it is possible to state a general norm for behaviour in franchise relationships.

One possible norm is often expressed as an obligation to exercise power in accordance with good faith and fair dealing.<sup>81</sup> A principle of good faith and fair dealing aligns the parties' performance and intentions with a requirement to use due care.<sup>82</sup> Breach of good faith in pre-contractual circumstances could also be governed by the Contract Act § 33.<sup>83</sup> In addition, there could be an overlap between the principle of good faith and the regulations in the Contract Act § 36.<sup>84</sup> In short, one could say the Contract Act becomes relevant when *the content* of the provisions is unreasonable in a way that may render the provisions null and void, while the principle of good faith and fair dealing is about the parties' *performance and behaviour*. In addition, The Marketing Control Act § 25 states that no act shall be performed in the course of trade which "conflicts with good business practice among traders".<sup>85</sup> Good business practice can thus be described as a form of good faith and fair dealing.<sup>86</sup> In business relationships, the core of the principle of good faith is to impute certain considerations to the contracting parties.<sup>87</sup>

In my sample of franchise contracts, only three have provisions explicitly stating loyalty as a common obligation of the parties. Another four refer to ethical codes in general, while the

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<sup>79</sup> Hadfield 1990 p. 945.

<sup>80</sup> Jori Munukka *Kontraktuell lojalitetsplikt*, Stockholm 2007, p. 491.

<sup>81</sup> The principle of good faith and fair dealing is discussed to a great extent in Nordic legal literature, see for example Nils Nygaard, *Rettsgrunnlag og standpunkt*, Bergen 2004 p. 279 ff, Anders Holm, *Den avtalsgrundade lojalitetsplikten*, Linköping 2004, Munukka 2007, Henriette Nazarian, *Lojalitetsplikt i kontraktsforhold*, Oslo 2007, Erika P. Björkdal, *Lojalitet och kontraktsliknande förhållanden*, Uppsala 2007, Camilla Dalbak, "Lojalitetsplikt som grunnlag for å begrense og utvide fleksibilitet i avtaleforhold", *Lov og rett*, 2007 p. 598-612, Christina Ramberg "Lojalitet i engelsk och svensk avtalsrätt", *Tidsskrift for Rettsvitenskap*, 2013 p. 521-530 and Margrethe Buskerud Christoffersen, "Lojalitetspliktens utvikling i nyere norsk rettspraksis" in *Ugyldighet i privatretten - minnebok for Viggo Hagstrøm*, 2016 p. 153-182. The term "good faith and fair dealing" is used to translate the Norwegian term "lojalitetsplikt", see Nazarian p. 104.

<sup>82</sup> Haaskjold 2013 p. 82. See also Dalbak 2007 p. 611 and Sund-Norrgård 2014 p. 121.

<sup>83</sup> Buskerud Christoffersen 2016 p. 154.

<sup>84</sup> Dalbak 2007 p. 611.

<sup>85</sup> Tore Lunde, *God forretningsskikk næringsdrivende imellom*, Bergen 2001 p. 191 and Haaskjold 2013 p. 85

<sup>86</sup> Dalbak 2007 p. 605.

<sup>87</sup> Lunde 2001 p. 191 and Haaskjold 2013 p. 85.

rest do not mention loyalty or good faith and fair dealing. The empirical study of a sample of contracts can illustrate provisions in the written contract and indicate relationship norms, but cannot document the actual circumstances in each case. Lack of provisions for loyalty as a contractual obligation may indicate that this is perceived as a general non-statutory principle, based on ethical codes or other legal sources, which is therefore unnecessary to expressly include in the agreement. Given that franchise agreements are long-term relationships, a non-statutory principle of good faith and fair dealing could be imputed into such agreements.<sup>88</sup>

The Norwegian Supreme Court has held that when a long-term relationship is established, it creates a situation which demands continuing active and loyal mutual cooperation to both parties' advantage.<sup>89</sup> If the contractual relationship implies special faith or cooperation between the parties, the principle of good faith and fair dealing should be strengthened.<sup>90</sup> As franchises are long-term relationships, it is logical to emphasise the principle of good faith and fair dealing when interpreting these agreements. Good faith and fair dealing may be stronger in long-term relationships, because of the parties' interdependencies.<sup>91</sup> Thus, breach of good faith and fair dealing has been pleaded as a ground for termination of the franchise agreement, by both franchisor and franchisee, in several Norwegian court cases.<sup>92</sup> However, the complexity of franchise agreements demands special consideration of the parties' interdependency and need for flexibility.

Four of the contracts in my sample, while not having provisions addressing loyalty, do have explicit provisions stating the franchisor's right to terminate the contract if the franchisee acts in conflict with the franchise system, decreasing the reputation of the system or damaging the uniform concept.<sup>93</sup> These contracts do not have specific provisions stating a *franchisee's* right to termination if a *franchisor* somehow decrease the reputation of the system or damages the uniform concept. However, there are some examples from District courts, going quite far in the direction of awarding the franchisee compensation for loss arising from breach of the

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<sup>88</sup> Norheim 2003 p. 98

<sup>89</sup> Norwegian Supreme Court in Rt 1982 p. 1294.

<sup>90</sup> Haaskjold 2013 p. 77. See also Dalbak 2007 p. 607.

<sup>91</sup> See for example Nazarian 2007 p. 305 ff.

<sup>92</sup> See for examples LB-2000-2573 Borgarting Court of Appeal (ACE), LB-2002-1867 Borgarting Court of Appeal (Elisenberg), LB-2006-109376 Borgarting Court of Appeal (RE/MAX I), LA-2007-35455 Agder Court of Appeal (RE/MAX II), Case number 11-108374TVI-BBYR/01 Bergen District Court (Bon Invest decision), Case number 12-155782TVI-AUTE Aust-Telemark District Court (Rett og rimelig decision) and Case number 14-143059TVI-OTIR/07 Oslo District Court (McDonald's decision – appealed)

<sup>93</sup> In Norwegian «systemskadelig opptreden».

franchisor's obligation to use best efforts.<sup>94</sup> However, these decisions could be criticized as going too far in placing extensive obligations on the franchisor to ensure there is a connection between the franchisees' work effort and profit.

Ethical Codes developed by the Norwegian Franchise Forum emphasize the importance of "mutual respect and joint care".<sup>95</sup> The franchise agreement must be based on truth, faith and honesty. According to the European Code of Ethics; "Parties shall exercise fairness in their dealings with each other".<sup>96</sup> The World Franchise Council's "Principles of Ethics for Franchising" states that: "franchisor and franchisee co-operate in all loyalty and in respect of their mutual obligations and commitments".

Good faith and fair dealing, as a general principle forming part of the interpretation of a contractual relationship, is mentioned in model laws. The PECL states that when interpreting the contract, regard shall be given to "good faith and fair dealing".<sup>97</sup> According to the DCFR the parties must "collaborate actively and loyally".<sup>98</sup> In this, a party must do more than merely refrain from obstructing the other party's performance, and make an effort to achieve the objectives of the franchise agreement.<sup>99</sup> Furthermore, the DCFR holds that the "franchisee must take reasonable care not to harm the franchise network".<sup>100</sup> Provisions like this stress the importance of avoiding misbehaviour on the part of the franchisee, which may result in damaging the reputation of the franchise network.<sup>101</sup> As mentioned above, much the same is found in four of the contracts in my sample.

The franchise contractual relationship is complex and includes rights and obligations based on the written contract, operations manual, applicable statutory law and non-statutory norms. Regard may be given to the imbalance between the parties, but in this assessment one must remember that franchisees within each system will differ, ranging from experienced professionals to absolute newcomers. Although the franchisor is the dominant party, there is no obviously imbalanced relationship. Thus, it is difficult to state a general norm for all franchise

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<sup>94</sup> See for example the Big Bite decision, the Bon Invest decision and the Rett og Rimelig decision.

<sup>95</sup> <http://norskfranchise.no/etiske-regler>

<sup>96</sup> European Code of Ethics art 2.4.

<sup>97</sup> See PECL art 1.106 (1) and PECL art. 5:102 (g). See also Sund-Norrgård, *Lojalitetsplikt i licensavtal*, Helsingfors 2011 p. 72-74 and Sund-Norrgård 2014 p. 70.

<sup>98</sup> DCFR IV. E - 2.201 and DCFR Volume 3 p. 2290-2291. See also Sund-Norrgård 2014 p. 70.

<sup>99</sup> DCFR Volume 3 p. 2291.

<sup>100</sup> DCFR IV. E - 4.303 (3).

<sup>101</sup> DCFR Volume 3 p. 2420.

relationships. Both parties have to some extent a duty of good faith, benchmarked differently within each system. A study of the specific elements in the franchise agreements might shed light on the best possible balance in this relationship.

### 3. An overview of franchisors' support services

Protection of the stability and effectiveness of the uniform network and maintenance of the reputation of the franchise concept is dependent on both the franchisor and franchisee.<sup>102</sup> One way in which the franchisor can ensure this uniformity is by putting emphasis on providing support services to franchisees.

Start-up and ongoing support from the franchisor are also important for the franchisee. They purchase support services as a part of the package of corporate services, paid for by the franchise fee.<sup>103</sup>

Support services can also be means of strengthening the mutual interests and interdependency between the franchisor and the franchisee and between the franchisees. The parties may have a mutual interest in support services, in achieving the goal of a successful franchise system and the fulfilment of contractual obligations.

Ongoing support given to franchisees may take various forms, such as auditing, training, individual guidance, marketing assistance and management of trademark and know-how. Professional assistance might generally be of a technical or commercial character, such as management consulting related to cost savings, finance, marketing, employment etc.<sup>104</sup>

Each of my sample of written contracts states that the franchisor has an obligation to support the franchisee when establishing the local unit and to then assist the franchisee with ongoing advice and control. The importance of assistance at the beginning is emphasized. Furthermore, words such as *ongoing assistance* and *ongoing guidance and advice*, refer to the obligation of the franchisor to provide the franchisee with assistance on a regular basis. The contract provisions are less specific as to the content of the assistance, and the question could be raised whether there are requirements for the specific quantity and quality of this assistance.<sup>105</sup>

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<sup>102</sup> See Arnerstål 2016 p. 371 ff. on the franchise concept from the point of view of trademarks.

<sup>103</sup> Hadfield 1990 p. 962.

<sup>104</sup> Norheim 2003 p. 96.

<sup>105</sup> Hagstrøm 2013 p. 166.



According to a decision of the Court of Appeal, lack of guidance and assistance in the ongoing relationship is relevant when determining whether a contractual provision is nullified, based on the Contract Act § 36.<sup>106</sup> The District Courts have also discussed the Contract Act § 36 in relation to whether the franchisor fulfilled the obligation to provide assistance and advice.<sup>107</sup> One court stated that the contract is of a kind that is normal for a franchise and pointed out that breach of a duty of individual guidance could amount to breach of the Contract Act § 36.<sup>108</sup> In another case, it was held that the franchisor cannot be expected to effectively give every franchisee spontaneous individual guidance.<sup>109</sup> It was also stated in this case that if franchisees do not attend courses and meetings offered by the franchisor they cannot expect any further assistance. The franchisee was, according to the judge, required to participate in offered training.

In the DCFR, franchisors' assistance is divided into "necessary assistance" and "further assistance".<sup>110</sup> Necessary assistance should be a part of the package which the franchisor transfers to franchisee in exchange for financial remuneration.<sup>111</sup> Demands for specific further assistance, which is not necessary in general terms, could lead to additional costs for the franchisee. To what extent the franchisor should effectively give the franchisee spontaneous assistance is not regulated.

To illustrate the regulation of support services, I will investigate to what extent franchisors are obliged to offer training to franchisees.<sup>112</sup> I will investigate to what extent training is regulated in the contract, and whether it is an obligation based on a quality norm arising from general contract law or a non-statutory principle of good faith and fair dealing. In other words, what can a franchisee expect from a franchisor in terms of training as a support service?

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<sup>106</sup> LB-2006-109376 Borgarting Court of Appeal (RE/MAX I).

<sup>107</sup> TOSLO-2001-4297 Oslo District Court (CoMak decision) and Rett og rimelig decision. See also Hagstrøm 1994 p. 155.

<sup>108</sup> CoMak decision.

<sup>109</sup> Brun og blid decision p. 9.

<sup>110</sup> DCFR IV. E. – 4:203 (1) and (2).

<sup>111</sup> DCFR Volume 3 p. 2402.

<sup>112</sup> Previous foreign studies suggest that ongoing support is normally not standardized in the franchising system since they are costly to maintain and the profit status of the franchisor may vary from year to year, see Tarique Hossain and Sijun Wang, "Franchisor's Cumulative Franchising Experience and Its Impact on Franchising Management Strategies", *Journal of Marketing Channels*, 2008 p. 43-69 (p. 51).

#### 4. Training as a support service

As part of support services, the franchisor may be obliged to arrange training in which all franchisees in the system are meant to participate.

From the franchisor's perspective, training will ensure franchisees' understanding of the concept and underlying mutual goal. This is an important step in building uniformity. A more generalized objective for the franchisor might be to establish an internal institutional culture, creating a feeling of belonging to "one family". From the franchisees' perspective, start-up training could provide a major advantage in comparison with starting one's own business.

According to the 2004 franchise survey, 15% of franchisors did not have any planned training arrangements for their franchisees.<sup>113</sup> The extent that these systems offer other services to support the franchisees is not revealed. The situation may have changed in the 12 years since this survey was conducted. Nonetheless, the survey revealed that 85 % of the responding franchise systems do have some kind of planned training to offer franchisees. It is therefore interesting to investigate how training and courses are regulated in each system.

In my sample of written contracts, each contract mentions planned training to some degree. Four of the contracts explicitly state franchisors' obligations to arrange training, without any costs for the franchisees. Six of the contracts describe the franchisor's obligations more vaguely, stating an obligation to *develop* training activities.<sup>114</sup> One contract states that franchisors are obliged to *take steps* to organise training and courses.<sup>115</sup> Finally, one contract even states that the franchisor *might arrange* training if deemed necessary due to quality requirements, economy of scale or considerations of efficiency. Consequently, for the majority of the contracts the obligation to actually arrange training seems to be flexible for the franchisor. Another observation is that these provisions do not say anything about when or how these actions are supposed to be carried out.

The wording in the provisions in my sample of contracts shows that training is regulated, but to some extent, it is regulated as a flexible obligation for the franchisor. Very similar wording regarding the obligation to *develop* training actions indicates that this is a quite common, if not standardized, means of regulating training. Nonetheless, the regulation of planned training does

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<sup>113</sup> Franchise Survey 2004 p. 11.

<sup>114</sup> One example in Norwegian is «utvikle tiltak for opplæring og løpende kompetanseutvikling».

<sup>115</sup> In Norwegian; «tilrettelegge».

not seem to be specifically described in the written contract, and therefore provides limited information about the *content* of training to be offered to the franchisee.

The operations manuals may include detailed requirements on how the training is supposed to be carried out. In my sample of manuals, my first observation is that the training programs are not formulated as an obligation for the franchisor to arrange, but that there is mandatory participation for the franchisee. This can be explained as arising from the goal of the operations manual; it functions as the franchisees' handbook for operating in the correct manner. One could say that if franchisees are supposed to participate in these courses, then the franchisor should be required to develop them. Nonetheless, there could be a psychological rationale for stating that participation is obligatory for the franchisee.

As a general rule, the manuals state that franchisees are obliged to participate in start-up training. This could be programs arranged over a few weeks. Typically, there are several start-up courses during the first year, with most of them occurring at the beginning of the contract. A common element of these programs is that they are regulated quite specifically in the manual. There might, for example, be a detailed activity plan with courses and training during the first year after the franchisee has joined the system. Initial training seems to be mandatory for all new employees and franchisees.

In most of the franchise systems, start-up courses are followed by general courses or courses in specific areas: e.g. marketing, management, IT-systems, sales etc. In some of the manuals in my sample, training is combined with a yearly conference event with all franchisees invited. In other cases, particularly if the franchise system is extensive, these courses are organized in each region throughout the year. These courses seem to be more ad hoc, based on the need for mutual knowledge and overall competence.

My analysis revealed that the franchisees are obliged to take part in training courses when these are arranged. I have not found any statement of sanctions if a franchisee does not participate in courses, but non-appearance could imply a franchisee's breach of contract.

A specific form of training can be found in worldwide franchise concepts with extended training and mandatory courses, where there is subsequent *approval*.<sup>116</sup> Trainees must for example complete a range of learning objectives, during a training program that can take

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<sup>116</sup> See for example McDonald's homepage about the franchise in Norway.  
<http://www.mcdonalds.no/no/Franchise/Prosessen.html>

between 9 and 24 months, before they can qualify to own a franchise.<sup>117</sup> In Norway, there are examples of franchise systems offering a program where talented individuals are recruited, either internally within each system or from external applicants.<sup>118</sup> Some have special courses, talent programs, for selected employees who want to be franchisees in the future. Employees have to apply for participation in these talent programs.

It may also be questioned whether training, as a support service offered by the franchisor, is required in order to fulfil the franchisor's support obligations within the franchise system or whether it could be stated as a flexible obligation.<sup>119</sup>

A quality norm for the franchisor's support obligation could be interpreted as being a part of the ongoing relationship within each system. Compared to statutory rules regarding sales of goods, the requirement for conformity in relation to nature, quantity and quality is decisive in fulfilling the contractual obligation.<sup>120</sup> Furthermore, these rules state that goods *do not* conform with the contract, unless they are fit for "the purposes for which goods of the same description would ordinarily be used".<sup>121</sup> In practice, it is an established non-statutory norm to deliver goods of merchantable quality (in Norwegian; "pliktil til å levere vanlig god handelsvare").<sup>122</sup> **It can thus be discussed whether an analogy to these rules could be applied to a franchisor's performance regarding support services. If so, training could be required to fulfill franchisors' obligations to support franchisees due to an abstract analogy to "merchantable" quality.**<sup>123</sup> The answer to this may differ, based on the complexity in each system and franchisees' experiences.

The importance of actually having a training program is emphasized by the District Courts.<sup>124</sup> In one case, the franchisees had withheld the franchise fee, alleging breach of contract because the franchisor had not fulfilled his contractual obligation to provide support services.<sup>125</sup> As a result, the franchisor terminated the contract due to the franchisees' non-payment of the fee.

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<sup>117</sup> <http://smallbusiness.chron.com/need-open-mcdonalds-10513.html>

<sup>118</sup> See one example <http://www.rema.no/talent/>

<sup>119</sup> The franchisor might have a contractual obligation to develop the concept and ensure uniformity and reputation of the concept as a part of the franchise system.

<sup>120</sup> See for example Sales of Goods Act 13. May 1988 n. 27 (Kjøpsloven) § 17 (1) and United Nations Convention on Contracts for the International Sale of Goods (CISG) art. 35 (1). See Hagstrøm 2013 p. 166-173.

<sup>121</sup> Sales of Goods Act § 17 (2) a) and United Nations Convention on Contracts for the International Sale of Goods (CISG) art. 35 (2) a).

<sup>122</sup> Hagstrøm 2013 p. 167, Haaskjold 2013 p. 485 and Norwegian Supreme Court Rt. 1974 p. 269, Rt. 1998 p. 774 and Rt. 2007 p. 1274.

<sup>123</sup> Hagstrøm 2013 p. 169.

<sup>124</sup> Brun og blid decision, Rett og rimelig decision and BigBite decision.

<sup>125</sup> Rett og rimelig decision p. 22.

The question which arose was whether the termination was legally binding for the franchisees. The court held that lack of support in general was a breach of contract, giving the franchisees a right to withhold the fee and that the termination by the franchisor was invalid.

As for ethical codes, the Norwegian Franchise Forum emphasizes effective communication and the members are obliged to establish programs to ensure communication and dialogue.<sup>126</sup> Training is not specifically mentioned, but a translated version of the European Code of Ethics appears as a part of these codes. According to the European Code of Ethics for Franchising, the franchisor “shall provide the individual franchisee with initial training [...] during the entire life of the agreement”.<sup>127</sup> Thus, ethical codes place an emphasis on training as an obligation for the franchisor.

The DCFR states that the franchisor “must provide the franchisee with assistance in the form of training courses, guidance and advice, in so far as necessary for the operation of the franchise business, without additional charge for the franchisee.”<sup>128</sup> The general idea is that franchisees need assistance (e.g. training) to successfully manage the business and use intellectual property rights and know-how in practice.<sup>129</sup> As for training, franchisors are obliged to offer training courses if necessary. Training seems to be a flexible obligation for the franchisor.

Another observation is that when training *is* arranged, it seems to be the preferred support service to offer franchisees. Thus, the question arises of whether training can replace individual assistance as the main support service offered by the franchisor. If so, a consequence could be that if a franchisee does not attend training courses offered by the franchisor, the franchisee could then be prevented from pleading lack of support as grounds for terminating the contract.<sup>130</sup> As an illustration, a decision by the District Court seems to lead in this direction.<sup>131</sup> One of the questions examined was whether the franchisors’ overly strict instructions and lack of support provided grounds for the franchisee to terminate the contract. The judge held that since the franchisee had an opportunity to participate in training courses, but had not attended, this was at

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<sup>126</sup> <http://norskfranchise.no/etiske-regler>

<sup>127</sup> European Code of Ethics for Franchising art. 2.2.

<sup>128</sup> DCFR IV. E. – 4:203 (1).

<sup>129</sup> DCFR Volume 3 p. 2400.

<sup>130</sup> In this direction Brun og blid decision.

<sup>131</sup> Brun og blid decision.

his own risk.<sup>132</sup> According to the judge, the franchisor had not breached his obligation to support the franchisee. A statement saying that franchisees who do not attend offered training do so at their own risk may be too categorical. Franchisees' needs for support will differ throughout the contractual period. Individual guidance may be the best solution for inexperienced franchisees.

Nonetheless, a shift from individual assistance to providing training, as a general rule, could be in conflict with a principle of good faith and fair dealing. There should be a balance in the range of support services offered to franchisees in order to ensure that all franchisees in the system, from the experienced to newcomers, receive support.

A franchisor's obligation to organise training is not regulated in detail in the contract, but in the operations manual it is stipulated as an obligation on the franchisee. To what extent the franchisor should arrange training must be considered based on the need in each system, experienced and inexperienced franchisees and a balance against other support services. Flexible regulations regarding content, quality and quantity of training allow for a relational interpretation of this obligation, considering the complexity of franchise agreements.

##### 5. The franchisor's monitoring role

An important component of franchise systems is the connection between investment in the reputation of the trademark and the delegation of rights to represent them in the market. These trademarks can become vulnerable to free riding activities which then undermine the reputation and value of franchise networks.<sup>133</sup> Given the evidence that most people tend to free ride whenever possible, franchisors must safeguard this value by managing the internal relationship.<sup>134</sup> The franchisor's strong position and monitoring role is thus intended to prevent opportunism and free riding by franchisees.<sup>135</sup> The contractual regulation of this monitoring role may be important when investigating a balance in franchise relationships.

According to agency theory, the franchisor's monitoring role might resolve the conflict of interest between the principal (franchisor) and agent (franchisee).<sup>136</sup> However, monitoring may

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<sup>132</sup> Brun og blid decision p. 9.

<sup>133</sup> Kidwell et.al p. 536.

<sup>134</sup> Williamson, Oliver E. "Comparative Economic Organisation: The Analysis of Discrete Structural Alternatives," *Administrative Science Quarterly*, 1991 p. 269-296.

<sup>135</sup> Norheim 2003 p. 163 and Gölstam 2012 p. 1020.

<sup>136</sup> Eugene F. Fama and Michale C. Jensen, "Separation of Ownership and Control", *The Journal of Law and Economics*, 1983 p.301 ff. See also Oliver Williamson, *The Economic Institutions of Capitalism*, 1985 p. 33-34.

also be useful to prevent non-performance that is simply accidental or caused by the insufficient skills of inexperienced franchisees. Franchisors should therefore use contracts as a means to control franchisees' behaviour.<sup>137</sup>

All of the contracts in my sample regulate monitoring and control. None of them has provisions explicitly stating a franchisor's *right* to monitor, but one is implied. For example, in four of the contracts it is stated that the franchisor has a contractual obligation to *measure and communicate* results within the system. This transparency implies a right for the franchisor to monitor and control each franchisee in the system.

As a consequence of the franchisor's right to monitor and control, franchisees are obliged to keep the franchisor informed. Thus, both the written contract and the manual state that the franchisees must give the franchisor access to the local unit, documents, activities, information on customers, facilities, products, accounts etc.<sup>138</sup> The franchisees' overall obligation to hand in reports and cooperate is regulated in detail in the manual.

The principle of good faith and fair dealing could also ensure that franchisors have the right to monitor and control the franchisees. Thus, some form of control and monitoring is important for all franchisees in the system, due to the free riding problem and the mutual interest in maintaining the uniformity and reputation of the concept. To ensure best practice, franchisees' opportunistic behaviour should be regulated in the agreement. As mentioned above, four of the contracts in my sample have explicit provisions allowing for termination if the franchisee operates in conflict with the franchise system. Even without explicit provision, opportunistic behaviour can be regarded as a fundamental breach of contract which allows termination.

Franchisors' instructions and control are emphasized by the District Courts. In one decision, the court found that a franchisor had full authority for imposing specific requirements on the franchisees in order to ensure a well-functioning franchise concept.<sup>139</sup> The court seems to accept that the franchisor's dominant role provides grounds for placing strict controls on the franchisees and implies a right to monitor. In another case, a failure to thoroughly control the budgets suggested by the franchisees was said to be relevant when considering the franchisor's obligation to deliver a *prudent franchise concept* (in Norwegian "et vanlig godt

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<sup>137</sup> Klein 1995 p. 12.

<sup>138</sup> In the same direction, see Norheim 2003 p. 98.

<sup>139</sup> Brun og blid decision.

franchisekonsept”).<sup>140</sup> However, the question of whether the franchisor actually has an obligation to deliver a prudent franchise concept is in itself a topic for discussion. An obligation to control the budget, directly connected to an obligation to deliver a prudent franchise concept, demands careful application and may not be stated as a general norm. In any case, in both decisions the franchisors’ monitoring role seems to be interpreted as a part of the ongoing relationship.

According to the Ethical Codes of the Norwegian Franchise Forum, *both parties* are obliged to share information with each other.<sup>141</sup> The European Code of Ethics for Franchising states that the individual franchisee shall supply the franchisor with operating data and allow the franchisor to have access to premises and records at reasonable times.<sup>142</sup> Consequently, control and monitoring are listed in ethical codes.

Provisions in the DCFR impose on the franchisee an obligation to allow the franchisor to enter premises and to grant access to the accounts of the franchisee.<sup>143</sup> The franchisor’s inspection is thus said to be an effective method to check whether the franchise business is operated in accordance with the guidelines and maintaining the uniformity and reputation of the concept.<sup>144</sup> My sample of contracts and manuals seems to be in line with the DCFR on this point.

Another observation in my sample of agreements is that the level of *support* is emphasized at the beginning of the relationship, while the level of *monitoring* seems to be stable throughout. Thus, a balance between the support offered and the level of monitoring is worth discussing.

The focus on start-up training indicates that franchisees need support at the beginning, but as time passes, they can operate more on their own and become more independent. Franchise literature points out that they reach the “free” stage characterized by the franchisee’s need to demonstrate competence and assert independence, thus testing the franchise system’s boundaries.<sup>145</sup> At this stage, when franchisees do not need support, the franchisor’s need for control and monitoring could increase to ensure that the franchisees still follow the concept. It may be necessary to impose strict controls to avoid free riding and opportunistic behaviour. The

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<sup>140</sup> Bon Invest decision p. 13.

<sup>141</sup> <http://norskfranchise.no/etiske-regler>

<sup>142</sup> European Code of Ethics for Franchising art. 2.3.

<sup>143</sup> DCFR IV.E – 4.304.

<sup>144</sup> DCFR Volume 3 p. 2422.

<sup>145</sup> Greg Nathan, *The Franchise E-Factor*, 2015. See also Nilssen 2009 p. 140-141.



flexibility in the written contract and the dynamic element of the manuals allow franchisors to use their own judgement as to the best balance between support and monitoring.

As to the franchisors' monitoring and control, the contracts and manuals have detailed regulations on the franchisees' obligation to cooperate through the provision of access to documents and reports. The franchisor's role is regulated in a more flexible manner, but a principle of good faith and fair dealing might be imputed in order to ensure that the quality of the system is maintained.

#### 6. Balancing complexity in franchise relationships

The franchisees' role in a franchise relationship is complex, with focus on both independence and interdependency. In each agreement, the franchisees gain a contractual *right* to use the franchise concept and the *obligation* to use the franchisor's uniform business model.<sup>146</sup> However, subject to the previously analysed obligations and the controls put in place to preserve uniformity of the network, the franchisee must remain legally and financially independent from the franchisor.<sup>147</sup>

Based on the above, it can be debated whether a strong focus on support and monitoring increases the franchisor's dominance and decreases the franchisees' independence in a way that does not serve best practice. Management theory has, for example, stipulated that imposing too many constraints in order to maintain uniformity could jeopardise franchisee independence, whereas too much independence might jeopardise the uniformity of the franchise network.<sup>148</sup>

The complexity in a franchise relationship will typically be revealed when analysing the balance between uniformity and independence. Best practice in franchise systems may be ensured if there is a balance between uniformity and independence as a part of the contractual relationship. It is thus important to emphasise that the topic discussed here is not equality between the parties, but the best possible balance between certain elements in a franchise relationship.

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<sup>146</sup> Norheim 2003 p. 104.

<sup>147</sup> Norheim 2003 p. 86-87. This is also stipulated in European Code of Ethics for Franchising art. 1.

<sup>148</sup> See for example Rozenn Perrigot, Guy Basset, Danièle Briand and Gérard Cliquet, "Network uniformity and risk of reclassification of the franchise contract", *International Journal of Retail & Distribution Management*, 2014 p. 884-901 (p. 887).

As a basis for this discussion, I have investigated the franchisors' support services which are focused on training and the franchisor's monitoring role. To ensure uniformity, both training and monitoring are to a great extent regulated as constraints placed on the franchisee. This may cause franchisees' independence and flexibility to decrease.

In Norwegian preparatory works regarding the retail industry, it has been claimed that the franchisee does not have sufficient power in specific areas and should be able to have more impact on decisions made by the franchisor.<sup>149</sup> The question arises to what extent franchisees have, or should have, any influence within the system in order to ensure balance and best practice.

As illustration of this, one decision from the District Court revealed that the court was surprised by the lack of transparency in the franchise system.<sup>150</sup> It was pointed out that decisions of great importance for the franchisees were made by the franchisor alone, without requiring any statement of grounds or explanation.<sup>151</sup> The court seems to call for transparency and some kind of input on decisions. Much the same was pointed out in a decision where the court stated that the franchisor did not fulfil his support obligation and did not make himself available for dialogue.<sup>152</sup>

Due to the franchisor's dominant role, the franchisees' ability to influence decisions is dependent on the franchisor inviting them to participate in dialogue and establishing opportunities for communication.

It is a general provision in my sample of written contracts that franchisors are obliged to have systems for efficient information and communication. Thus, the franchisor has a contractual obligation of *ongoing cooperation* with the franchisee in order to reach the goal set for each local unit.

Communications are regulated in more detail in the operations manuals. There are examples where the franchisor has an obligation to arrange one or two meetings per year, with both the franchisor and all franchisees being present. The purpose of these meetings is to give the franchisees an opportunity to discuss topics of interest and exchange experiences with other

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<sup>149</sup> NOU 2011: 4 p. 15. A suggested solution to this disparity is to pass a statutory law on franchise in Norway.

<sup>150</sup> McDonald's decision (appealed).

<sup>151</sup> McDonald's decision p. 13.

<sup>152</sup> Rett og rimelig decision p. 21.

franchisees and the franchisor. In larger systems, these meetings seem to be combined with celebrations of franchisees' results, training courses and get-together events.

There is also one example where the franchisor is obliged to create a more formal forum for discussion, to be arranged four times a year. This forum consists of a panel with three elected representatives from the franchisee and two or more from the franchisor. Another example is quite similar, but in this case, the panel consists of franchisees *chosen by* the franchisor. To what extent franchisor avoid choosing "yes-men" as members of the panel can obviously be debated. In any case, it is common to all these panels where both franchisees and franchisor are present that they do not have decision-making authority, but instead function solely as *guidance* panels.<sup>153</sup>

Three of the manuals stipulate panels where only franchisees meet during the year. These franchisee panels have meetings with the franchisor two or three times a year. In Norwegian franchise literature the establishment of panels like these, which enable franchisees to meet and discuss more freely, is suggested as an obligation of the franchisor in each system.<sup>154</sup>

In larger franchise systems, the franchisor arranges meetings in each region 5-6 times a year. Every franchisee is supposed to attend these meetings. This is stated as an obligation in the manual. In addition, these large systems arrange two meetings a year on a one-to-one basis between a regional manager and each franchisee in which ad hoc topics and follow-up issues are discussed.

Overall, an opportunity for communication and dialogue seems to be stipulated throughout my sample of contracts. In some contracts it is stated that the franchise network is based on collaboration, welcoming franchisee competence and experience in developing the system.

It can also be discussed whether cooperation and communication is part of an overall principle of good faith and fair dealing. The Ethical Codes of the Norwegian Franchise Forum state, for example, that members of the NFF are obliged to establish a program for effective communication within the franchise system.<sup>155</sup> Furthermore, the European Code of Ethics for Franchising states that a franchise is based on "ongoing collaboration" between franchisor and

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<sup>153</sup> See also Norheim 2003 p. 88.

<sup>154</sup> Nilssen 2009 p. 136-137.

<sup>155</sup> <http://norskfranchise.no/etiske-regler>

franchisee.<sup>156</sup> According to the Principles of Ethics for Franchising from the World Franchise Council, franchisors are supposed to favour “a permanent and structured dialogue with the franchisees to aid the protection and development of the franchisor’s know-how” and the franchisor and franchisee must “co-operate in all loyalty and in respect of their mutual obligations and commitments”.<sup>157</sup> Thus, the ethical codes seem to focus on both parties, with cooperation as a common commitment. In the DCFR the obligation to collaborate actively and loyally is stated in the common rules for commercial agency, franchise and distributorship.<sup>158</sup>

Collaboration accords both with contractual provisions and the principles of good faith and fair dealing, but franchisees’ actual influence cannot be claimed as a general rule. The extent to which a franchisee will gain any influence through these forums will vary from one system to another.

Increasing the level of bonding between franchisor and franchisees, with a focus on transparency and communication, might also have unwanted effects. Franchisors’ support and monitoring may increase involvement in a way that leads to the franchisor becoming responsible for the franchisees’ performance.<sup>159</sup> Franchisors who place strict controls on their franchisees may have to answer for their franchisees’ practices.

It can be queried to what extent providing guidance to franchisees and their employees will increase joint employment liability risks.<sup>160</sup> As a starting point, it could be argued that the franchisee’s position as an independent party should lead to the assumption that an employee of a franchisee cannot be considered an employee of a franchisor. However, looking to the US, a decision from the National Labour Relations Board dramatically changed the joint employment standard, potentially with a major impact on the franchise world.<sup>161</sup> One consequence of the

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<sup>156</sup> European Code of Ethics for Franchising, see definition in art 1 and about good faith in art. 2.4.

<sup>157</sup> Principles of Ethics for Franchising art IV.

<sup>158</sup> DCFR IV.E – 2.201 and DCFR Volume 3 p. 2290-2291.

<sup>159</sup> In July 2014, The National Labor Relations Board (NLRB) issued a press release indicating that it would pursue unfair labour practices cases against McDonald’s, USA, LLC, as a joint employer. The case is much discussed in US, see for example Hann, Jeremy *Is the price of a consistent cup of coffee shared human rights liability?* Nov 2015, <http://www.labourandemploymentlaw.com/2015/11/is-the-price-of-a-consistent-cup-of-coffee-shared-human-rights-liability/#page=1>

<sup>160</sup> Erik B. Wulff and Nicole A. Smith, “The next labour threat to franchisors: manager overtime pay – next steps for employers”, *FranCast Series 13* November 2015. <https://www.dlapiper.com/en/global/insights/publications/2015/11/francast-nov-2015/the-next-labor-threat-to-franchisors/>

<sup>161</sup> In August 2015, NLRB issued a decision in the Browning-Ferris matter, Browning-Ferris Industries of California, Inc. (362 NLRB No. 186). The decision dramatically changed the joint employment standard that had existed for over 30 years in the US. See for example <https://www.nlr.gov/news-outreach/news-story/board-issues->

decision was that an employee of a franchisee could be considered an employee of a franchisor through joint employment. The decision has met with massive criticism and has resulted in several states in the US enacting legislation which specifically provides that an employee of a franchisee *will not* be considered an employee of a franchisor.

In Norway, lack of influence by employees within the franchisees' unit has been discussed in preparatory works.<sup>162</sup> There is no doubt that the increasing numbers of franchise systems may have an impact on employment, increasing the distance between the employee (within the franchisees' unit) and decision maker (franchisor).<sup>163</sup> It is thus argued that franchise systems may have negative consequences for the employees in each franchisee's unit. To increase the influence of the franchisee unit on the franchisor, a consultation paper suggested the establishment of joint employment panels addressing the working environment.<sup>164</sup> These panels were supposed to ensure protection of the employees' status in the system. When the government invited comments on the consultation paper, these pointed out negative consequences for the contractual relationship between franchisor and franchisee and strongly criticized the suggestions of the joint panels.<sup>165</sup>

Franchising is based on an interdependent partnership between independent commercial entities. Due to this fact establishing a strong bond between the franchisor and the franchisee's employees could have a major impact on the franchise system. Joint employment and other means of joint responsibility could be in conflict with the whole idea behind the franchise concept and the contractual relationships between independent parties.

When support services form part of the package purchased by the franchisee, the imbalance between the parties might be seen as both appropriate and valuable.<sup>166</sup> Nonetheless, to ensure both uniformity and independence, collaboration between the parties may serve best

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decision-browning-ferris-industries. The new joint employment standard had also impact in B.C. Human Rights Tribunal's decision in *United Steelworkers obo others v. Tim Hortons and others*.

<sup>162</sup> NOU 2010: 01 Medvirkning og medbestemmelse i arbeidslivet.

<sup>163</sup> In 2010, approximately 25 000 local franchisees were employing 70 000 – 100 000 people in Norway; see NOU 2010: 01 point 3.3.1.6.

<sup>164</sup> NOU 2010: 01 point 10.4.7.4.

<sup>165</sup> See for example comments on the consultation paper from Hovedorganisasjonen for handel og tjenester in Norway (HSH), Arbeidsgiverforening for samvirkeforetak SAMFO and Coop Norge Handel. These documents can be found: [https://www.regjeringen.no/contentassets/a1244e0adf274058b8c23076f978da4b/hsh\\_merknader.pdf](https://www.regjeringen.no/contentassets/a1244e0adf274058b8c23076f978da4b/hsh_merknader.pdf), [https://www.regjeringen.no/contentassets/a1244e0adf274058b8c23076f978da4b/samfo\\_merknader.pdf](https://www.regjeringen.no/contentassets/a1244e0adf274058b8c23076f978da4b/samfo_merknader.pdf) [https://www.regjeringen.no/contentassets/a1244e0adf274058b8c23076f978da4b/coop\\_norge\\_handel\\_merknader.pdf](https://www.regjeringen.no/contentassets/a1244e0adf274058b8c23076f978da4b/coop_norge_handel_merknader.pdf)

<sup>166</sup> Hadfield 1990 p. 962.

practice in the ongoing franchise relationship. A balance may be reached by arranging meetings and panel discussions, bearing in mind the independence of both the franchisors and the franchisees. One must take into account the risk of unwanted effects, in particular of joint responsibility.

#### 7. Concluding remarks

The contractual relationship between franchisor and franchisee is complex and not possible to fully regulate through a written contract. To ensure flexibility, contracts are incomplete, leaving detailed regulations to the operations manual as a dynamic element. Given the overall aim of the manual, franchisees' obligations are spelled out in greater detail than those of the franchisor. The actions of the franchisors are thus regulated more flexibly in the ongoing relationship.

Taking into account the form of adhesion contracts, the franchisor's dominant role will have a decisive impact in the ongoing relationship. Once again, imbalance is a consequence of the very nature of what is being exchanged in a franchise agreement.<sup>167</sup> The franchisor's strong position and monitoring role is intended to control franchisees at all stages of the relationship, from naïve to experienced franchisees and from interdependent to more independent franchisees. In my sample of contracts and manuals, the monitoring role was implicitly expressed through franchisees obligation to keep franchisor informed.

In terms of training, the psychological issue as to whether training is formulated as an obligation for the franchisor to arrange or as an obligation where the franchisee must participate, should be considered. With training as the preferred support service, a decrease in individual guidance might also have an impact on the balance and transparency in the relationship. The key here seems to be the establishment of collaboration through formal meetings or panel discussions. To what extent franchisees actually gain influence can be debated. Nonetheless, dialogue is important in ensuring transparency.

A balance between support and control throughout the contractual period may ensure best practice. In this article, I have chosen to investigate training and monitoring and to use them as illustrations of rights and obligations. A discussion of balance could also be based on an investigation of marketing assistance, individual guidance, auditing etc. Nonetheless, the backdrop would be the complexity of balancing uniformity and independence in a franchise

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<sup>167</sup> Hadfield 1990 p. 962.

relationship. Both the franchisor's support and the franchisees' performance, with franchisors' monitoring as a safeguard, are crucial for the success of the franchise system. The parties have a mutual interest in best efforts. Both parties have an obligation to collaborate loyally towards the success of the network.

A challenge, as pointed out in the above discussion on joint employment, is that increased bonds between parties may also increase joint responsibility. In relation to this, the franchisor must be aware of the consequences of imposing strict controls on the franchisee.

In the end, it is a question of best practice for the protection of the franchise system, for both the franchisor and all of the franchisees. Uniformity of the network must be balanced with franchisees' independence, not placing too many constraints on the franchisees but still sufficient to ensure uniformity. In this regard, the complexity of the contractual relationship must be taken into account.