

J A U S A S

FRANCHISE IN SPAIN

I.- Definition of Franchise

In Spain there is no specific legislation that regulates franchises. Its legal description can be found in article 2 of Real Decreto (Royal Decree, "RD") 2485/1998, of 13th November, which develops article 62 of Law 7/1996, of 15th January, on Retail Commerce.

Article 2 defines the essential elements which shape the usual types of activity within this kind of commerce which are as follows:

1. An agreement between companies (Franchiser and Franchisee).
2. The transfer of rights for the marketing of products and/or services.
3. A payment of any mean for the transfer of the right to market the franchise.
4. The right transferred by the franchiser to the franchisee should include at least:
 - The use of a common denomination or similar sign.
 - Uniform presentation
 - Know-how.
 - The provision of commercial and technical assistance throughout the duration of the contract.

It is not necessary to record the contract in writing, although the existence of documentary proof is the usual.

Apart of some specific aspects as the pre-contractual disclosure, there is no statutory regulation for this type of contract, and the parties may insert such clauses into the contract as they deem necessary.

II.- Relevant Legislation.

There is no specific regulation for this type of contract in Spain, although there are several enactments which refer to it:

- a) EU Regulation 2790/1999, (in substitution of EU Regulation 4087/1988), regarding the applicability of exemptions to vertical agreements and collusive practices.
- b) Article 62 of Law 7/1996, of 15th January, on Retail Commerce.
- c) Real Decreto 2485/1998, of 13th of November, on franchises, and by virtue of which the Franchise Registry was created and disclosure requirements were set out.

J A U S A S

- d) Real Decreto 378/2003, of 28th of February, which develops Law 16/1989, of 17th July, on Competition Law, regarding exemptions.
- e) Decrees of different Autonomous Governments, regulating registration in their Regional Franchise Registries.
- f) Some articles of the Spanish Mercantile Code and the Spanish Civil Code.
- g) Some articles of specific laws applicable to the franchise, such as:
 - Law 11/86, 20th March on Patents.
 - Law 32/98, 10th November, on Trademarks.
 - Law on Intellectual Property.
 - Law on Civil Responsibility for Product Liability.
 - Law 3/1991, 10th January, on Unfair Competition.
- h) Deontological Codes.

In Europe, owing to the lack of specific legislation on franchise, a number of Deontological Codes have been developed. These Codes define franchises and lay down basic rules regulating these contracts.

Of these documents, the most important one is the European Deontological Code for Franchises.

III.- Disclosure requirements.

Article 62 of the Law on Retail Commerce has introduced a duty of transparency whereby the franchiser, other than registering in the appropriate Registry, must supply the potential franchisee with a host of information.

This disclosure, which is imposed by Art. 3 of Real Decreto 2485/1998, must be truthful and given in writing at least 20 days prior to the signing of any contract or preliminary contract or prior to the payment of any sum on the part of the potential franchisee.

The information that the franchisee will have to supply is:

- 1) Information regarding the characteristics of the franchiser:
 - a) Name, address and the Franchisers' ID number, given by the Central Franchisers' Registry;
 - b) Data of inscription at the Companies Register;
 - c) Last balance sheet approved with description of the paid up and subscribed capital. In case of foreign Franchises the data from their country's Franchiser's Registry if it exists;
 - d) If it is a master franchise they will have to provide also the data above mentioned from the Franchiser itself;

J A U S A S

- 2) Evidence of property of trade marks for Spain the title of property of the trade marks under which the franchise is being ruled, and information about any claim against them;
- 3) A general overview of the business sector to which the franchise belongs and an estimated investment and expenditure plan to be carried out by the franchisee for the setting up of a standard establishment;
- 4) An explanation about the Franchiser's experience, including:
 - a) Date when the franchise was created.
 - b) Main phases of its evolution.
 - c) Development of the franchise network.
- 5) A general description of the franchise includes, an explanation of its know-how and technical and commercial assistance that will be parted by the Franchiser;
- 6) Structure and size of the net in Spain, including:
 - a) An explanation about how the net is organized in Spain
 - b) Number of establishments that form part of the franchise in Spain, divided in how many are being ruled directly by the Franchiser itself, and how many by independent franchisees.
- 7) A list of franchisees who have terminated their franchise contracts in the two previous years, as well as the cause of termination;
- 8) A statement of the franchise contract, with an specific mention to:
 - a) Rights and duties which it grants and imposes.
 - b) Termination and renovation clauses.
 - c) Economic terms and conditions.
 - d) Exclusivity requirements.
 - e) Any limitation to the Franchiser when developing the business.

IV.- Term.

The duration of the franchise can be freely determined by the parties. Statistically it has been shown that the majority of franchises are agreed for a period of between 5 and 10 years.

V.- Trademark License or Distinguishing Marks.

The franchiser must be in possession of the trademark register which he is licensing to the franchisees. Furthermore, the license must not have been revoked.

J A U S A S

It should be pointed out that it is possible to license trademarks which are in the process of being transferred. The vulnerability of such transactions is evident, since the trademark may be rejected thereby causing the loss of the exclusivity rights granted by the license.

The contract must impose upon the franchisee a duty to co-operate with the franchisor in any prosecution or claim against any action contrary to the trademarks' exclusivity rights.

VI.- Know-How

EU Regulation defines know-how as "the combination of unpatented practical knowledge that is the result of the franchisor's experience and has been conformed by him, is secret, substantial, and has been identified".

Therefore, for the franchisor to be in a position to transfer the know-how:

- 1) He must have conformed it himself: this involves the prior existence of his own or standard establishments through which the franchisor will have acquired the relevant practical knowledge or methods which he intends to franchise.
- 2) It must be secret: It cannot be publicly known or easily accessible, even if some of its components are not secret.
- 3) It must be substantial: in the sense that it can confer technical or competitive benefits on the franchisee, and afford him access to new markets.
- 4) It must have been identified: this means its detailed description, be it in the franchise contract or in the Franchise Manual.

VII.- CONFIDENTIALITY.

It is advisable to establish a duty of confidentiality, not only on the franchisee as such, but also on his directors and employees, whose contracts with the franchisee (employer) shall necessarily include confidentiality clauses and their corresponding penalty clauses in the event of a breach.

VIII.- Non competition clause

For the duration of the contract the franchisee may not be authorised to carry out such activities as may be in direct competition with those present or future activities of the franchise business.

As regards the duration of this duty after the end of the contract, the Law imposes a limit of one year.

J A U S A S

It is advisable to include on the agreement a purchase clause, by virtue of which upon the termination of the contract, should he be “utilising part of the franchise method”, he will be forced to pay the agreed price for the purchase of such knowledge as he may have acquired through use.

IX.- Territorial exclusivity

Franchises not necessarily involve territorial exclusivity for the franchisee.

Likewise, it is convenient not to establish a rigid territorial system. It is best to provide for its modification by virtue of changes in population, the attainment of certain sales figures or other such random variables, which cannot be seen as impositions, but rather as unpredictable variations in contract conditions.

It is always convenient to reserve, within exclusive zones, the possibility of establishing franchises in certain places, notwithstanding the possible need to grant a franchisee already in the zone an option to acquire the franchise first.

X.- Goodwill

It is necessary to clearly spell out in the contract who is entitled to the goodwill. Upon termination of the contract, especially when it has come about as the result of a breach, there is the possibility of damages claims by the former franchisee, against the franchiser or the new franchisee, as regards the clientele.

XI.- Royalties

The existence of a franchise contract necessarily involves the existence of a payment for the transfer by the franchiser in favour of the franchisee.

There is a variety of types of payment and calculations, ranging from the fixed fee to fees linked to turnover, profits, targets, or a combination of these.

It is even legally permissible for no fee at all to be fixed, as long as the fee lies implicitly included in the price paid for the supplies that the franchisee is under a duty to purchase from the franchiser.

XII.- Advertising

Advertising is an inherent part of the promotion of any trademark or franchise method.

The design and management of general advertisement campaigns must always be reserved to the franchiser. Any local or specific campaigns for each franchise establishment ought preferably to be designed by the local establishment, although with the franchiser’s consent.

J A U S A S

XII.- Signs and Advertisements

One of the most usual problem when terminating a franchise contract in a non friendly way is the refusal to remove signs or other advertisement items.

In this case it is necessary to have recourse to the Courts and, although a number of precautionary measures may be adopted, it is highly likely that the resolution of the conflict will be a lengthy affair.

Thus, it is recommended to ask for banking guarantees covering contractual franchisee's obligations the recovery of which may dissuade the franchisee from objecting to the removal of the chain's distinguishing signs.

Another option is to establish a deposit on the signs and other distinguishing features in favour of the franchisee, so that title to the signs remains with the franchiser, who can claim dishonest appropriation if, upon termination of the contract, the franchisee refuses to return them.

XIII.- Supply

In the case of franchises where there is a fixed standard of product quality, franchisees are normally supplied by the franchiser or by the latter's designated suppliers.

This requirement may be relaxed for commonly available products, especially if the price at which the franchiser is supplying the products is not competitive, in which case the duty of exclusive supply may be declared null and void for not being based on objective requirements in terms of product quality or specifications, according to UE legislation.

XIV.- Prices

Although the different franchisees usually charge the same prices, the franchiser cannot legally impose uniform prices on the franchisees. He may merely recommend prices and prevent the application of low or loss-making prices.

XV.- Franchise Registry

The Franchise Registry is a public Register and was created by Art. 5 of RD 2485/1998. It is allocated in the "*Dirección General de Comercio Interior del Ministerio de Economía*" (General Directory of Interior Commerce of the Spanish Treasury Ministry), and it registers the details of any franchiser listed in Art. 7, whose activities will be carried out on Spanish territory, provided that such activities will be carried out in more than one autonomous region.

J A U S A S

Therefore, a local franchiser who only acts within the confines of a single autonomous region, is not under the duty to figure in the Central Registry, but only at the Register of the Autonomous Region where he carries the business.

At present all the Spanish Regions have their own Registries, (see Annex 1) who are responsible to supply the main Registry with the franchisers' details, as well as any changes in those franchisers domiciled in their territory. Foreign franchisers domiciled outside Spain, and without an Spanish branch, must register directly with the Central Registry.

Registration is compulsory and must be completed prior to the start of any activity. The application for registration and supply of documentation will be carried out at the relevant bodies of the autonomous regions. Once registered, each franchisee will be given a Registration ID (N.I.F.R.A.) by the Central Register that will be valid throughout Spain.

Also in this case, the abovementioned RD 2485/1998 does not specify the consequences of non-registration or the registration of erroneous information, but is also applicable what stated about the infringement of Article 62 of the Law on Retail Commerce.

The franchiser information that must be supplied to the Registry is:

- a) Name, address, Franchiser information: Tax ID and Company Register Information.
- b) A list of its Patent and Intellectual Property rights subject to the franchise, as well as any claims on them
- c) A memorandum describing the business carried out indicating the number of Franchisees with indication of how many are managed by the franchiser and how many by independent franchisees , and a list of all those who have ceased to carry out the business in the past two years.
- d) In the case of a main franchiser (master franchise), details of its franchiser and of the duration of the contract.

Franchisers are under a duty to inform the relevant authorities in their Autonomous Region within three months since any change in circumstances. Each January, the franchisers must update any information regarding new and closed establishments, both their own and those franchised, throughout the preceding year.

The Franchise Registry is merely declarative, since registration does not mean that the Administration is recognising or validating in any way the information entered and any penalty is set in case of non inscription.

According to the above mentioned regulation, three types of situation may occur when a Franchiser starts its activity in Spain:

- a) The business is being developed in the territory of only one Autonomous Region:
The Franchiser must register to the Autonomous Region Register and no

J A U S A S

notification has to be send by the Autonomous government to the Central Registry, and no Franchiser ID will be given to it from the Central Registry.

- b) The business is being developed in more than two Regions. The Franchiser must register to the Autonomous Region Registry where is located its seat and the Autonomous Register is the responsible for sending to the Central Register the data of the Franchiser. The Central Registry will notify to the Autonomous Registry the Franchiser ID number.
- c) The Franchiser has no seat in Spain. In this case, it has to apply directly for inscription at the Central Registry who will give him directly the Franchiser ID number.

Neither Royal Decree 2485/1998, nor any other enactment applicable in Spain, sets out an standard registration procedure and the criteria by means of which a company has or can ask for inscription. This situation is very confusing for Franchisers, since in Spain there are 17 Autonomous Governments, and each of them has fixed its own inscription criteria, which implies that the same business may be admitted for registration in a certain Registry, while rejected in a different one (i.e. in the Catalan Registry rejected the inscription of Burger King, while in Madrid's Registry this type of franchise is being inscribed).

Furthermore, since the different Autonomous Registries are the ones in charge of filing within the Central Registry (and not the Franchiser itself), the bureaucratic procedure may turn to a lack of accuracy in the information existing at the Central Registry, what makes in many occasions the information contained into it useless, and forces those interested in getting an accurate information to ask for it at the different Autonomous Registries.

XVI.- Violation of the disclosure or inscription requirements.

As it has already been mentioned, the Royal Decree 2485/1998 does not envisage a sanction in case of violation of the disclosure requirements, nor in case of non inscription to the assigned Registry, nor in case they are not notified the different changes that may happen to the franchise and that have to be notified to the Autonomous and Central Registry. It is the Autonomous Government Legislation which regulates it. Therefore, in case of a proved infringement, the fines will be paid to the Autonomous Government.

Furthermore, one of the most important points to be analysed is the effects that those infringements may have between parties. The rules to be applied would be the ones stated in the Code of Commerce and in the Civil Code, following the interpretation given by the Courts, taking into consideration whether this misinformation would have affected, the franchisee's decision to enter into a the agreement with the franchiser, or not. No need to say that this feature will specially affect the breach of the disclosure requirements, more then the fact of providing inaccurate data to the Registry.

J A U S A S

XVII.- Main aspects to be regulated in a franchise agreement.

The majority of franchise contracts are based on standard form contracts which were adopted by the EEC Commission in order to avoid breaching Competition laws.

The fundamental contents of these contracts might be as follows:

- ✓ Date and place.
- ✓ Identity of the parties.
- ✓ Recitals.
- ✓ Object of the franchise (description of the franchise business).
- ✓ Territorial exclusivity (which does not necessarily have to be granted).
- ✓ Use of trademark(s) (normally an unregistered license is granted).
- ✓ Technical assistance (specification of form and regularity).
- ✓ Transfer of know-how (specification thereof, property rights over it, regime regarding improvements).
- ✓ Advertising (will establish who controls it and the fees to be paid by the franchisee).
- ✓ Transfer of Contract (generally, being an intuitus personae contract it is not possible to transfer the contract without the franchiser's permission).
- ✓ Economic matters (royalties, exclusive supply contracts, prices).
- ✓ Term of Contract.
- ✓ Termination of Contract (non-exhaustive list of causes of termination).
- ✓ Law and language of the contract.
- ✓ Jurisdiction or Arbitration clause (preferably arbitration in the case of international contracts).

XVIII.- Tax implications of franchising contracts.

Spanish fiscal legislation does not regulate franchising contracts in a specific manner. Therefore, each tax will be determined according to the general norms applicable to each type of income.

In this respect, the main services rendered in connection with franchising contracts are:

- ✓ Use of the brand name and patents.
- ✓ Transfer of know-how.
- ✓ Technical assistance.
- ✓ Other services: advertising, etc.

The fiscal implications stemming from franchising contracts affect the following fields:

- ✓ Transactions between related parties.
- ✓ Non-resident Income Tax: Withholding on the payments to non-residents.
- ✓ Value Added Tax: Payments to non-residents are subject to Spanish VAT.
- ✓ Corporation Income Tax: Deduction of expenses.
- ✓ Payment of dividends.

1. Transactions between related parties.

From a fiscal point of view, it is important whether that the parties participating in a transaction have dependent or connecting relationships, because in this case transfers of profits between them may be generated if transactions are not at arm's length.

In order to avoid related parties carrying out transactions at values that are greater or less than market value in such a way that, a lower taxation in Spain or a deferral of the same takes place, an assessment at market value is established in the Spanish fiscal regime regulations.

In any event, in the Spanish fiscal regime, the Tax Administration undertakes the correction of value. This can only take place when an economic harm results to the Spanish Tax Administration from the agreed prices, whether this is because of a reduction in the tax burden or a deferral of the same.

The principle of applying normal market conditions to the transactions made between related parties also governs Double Taxation Treaties, where it is established the power to tax said transactions at the normal market price.

2. Non-resident Income Tax: Withholding on the payments to non-residents.

In applying the corresponding regime to each component (royalties, rendering of services) in accordance with the Double Taxation Treaty, the compensation for each one has to be separated. Nevertheless, it will be necessary to analyse the relative importance of each and every category of services rendered, because if one of these constitutes the main purpose of the contract, it will be possible to treat the total consideration as it corresponds to this category (DGT 3/8/92, AEAT 2/12/99).

In each case it will have to be studied the different double taxation treaties that may be applicable.

3. Value Added Tax: Payments to non-residents are subject to Spanish VAT.

Article 70. One. 5. of the Value Added Tax Act: there are a range of services that are considered to be rendered in Spain and so are consequently subject to VAT. The recipient of said services shall account for Spanish VAT on acquisition using the reverse charge mechanism. It will apply the 16% general rate.

This category of services includes, among others:

- ✓ The assignments and concession of copyright, patents, licenses, manufacturing or commercial brand names and other intellectual or industrial property rights.
- ✓ The assignment or concession of goodwill, of exclusive sale or purchase rights or the right to undertake a professional activity.
- ✓ Services rendered by virtue of contracts of advertising, creation, distribution or advertising sponsorship.

J A U S A S

- ✓ Professional consultancy services.
- ✓ Data treatment for computing procedures, including the supply of specific computer products.
- ✓ The provision of information, including the procedures and experience of a commercial nature.
- ✓ The leasing of corporate real estate, with the exception of means of transportation and containers.

4. Corporation Income Tax: deduction of expenses.

The Tax Administration is able to refuse the deduction for Corporate Income Tax purposes of the expenses arising from transactions between related parties, to the extent to which the agreed price does not correspond to the market value and a reduction or deferral of taxation in Spain takes place for the parties concerned.

5. Payment of dividends.

The Non-resident Income Tax Act establishes that the profits distributed by subsidiary companies in Spain to their parent companies resident in other member states of the European Union will be exempt from taxation in Spain and therefore not subject to withholding. This shall apply provided that the parent company holds a direct stake of at least 25% and this stake has been held on an uninterrupted basis during the year prior to the day in which the dividends are payable, or failing that, this holding remains for the time that is necessary to complete a year.

XX.- Jurisprudence.

It must first of all be pointed out that. The number of cases regarding to the breach of this type of contract dealt with by the Spanish courts has been very small, especially at Courts of appeal or Supreme Court .

The most relevant resolutions are:

EU Supreme Court Judgement “Pronuptia Case”, 28th January 1986, which represents the jurisprudential version of the franchise contract. This judgement predates the coming into force of Regulation 4087/1988, and outlines its differences with supply contracts, namely:

- a) The franchiser must transfer his know-how or assistance or work methods, applying his business methods.
- b) The franchiser is under a duty to design, direct and finance the advertisement campaigns needed to publicise the franchiser’s trademark.

Spanish Supreme Court Judgement (STS) of 15th may 1985, which defines franchise contracts as “the authorisation given by the grantor to the grantee to use his trademark, usually of international dimensions, thereby including the grantee in his

J A U S A S

marketing chain”. The judge was referring to the franchise chains which were beginning to make their way into the national market.

STS of 27th September 1996, which, several years after the inception of EU Regulation 4087/1998, defines franchise agreements at length, and lists its essential components.

STS of 27th September 1996, points out that *“Franchise are peculiar to and characteristic of new market tactics aimed at avoiding the monopolistic pressure exerted by the large multinationals, whose tendency to control the economy can only be halted by means of commercial agreements and alliances between small traders, who are then in a position to form supply centres and can therefore carry out continuous and homogenous economic campaigns”*.

Further on the judgement indicates: *“for one thing is the equivalence of franchise agreements and mercantile sale of goods contracts – which is impossible – and another is to apply the principles of mercantile sale of goods laws to franchise contracts, which is what has been done by the Judge a quo”*.

The present document contains general information about franchise in Spain at the date when it was issued, and cannot be considered as a legal opinion applicable to any specific and individual situation and its conclusions may be modified by new legislative changes or by the Court resolutions. In consequence thereof, and in order to avoid misuse of the information, the conclusions detailed in the present report cannot be used to support any decision that shall need specific legal advice. The total or partial distribution of this report to third parties, as well as the use of the content of the report for other purposes than originally intended, is prohibited without our previous authorization.

J A U S A S

ANNEX 1

REGIONAL FRANCHISER'S REGISTRIES	
COMUNIDAD DE MADRID: Angel Luis Martín Martín Consejería de Economía y Comercio. Tfno: 91 580 22 49 E-mail: purificacion.sanchez@comadrid.es	JUNTA DE ANDALUCIA: Ana Isabel Moreno Muela Consejería de Trabajo e Industria Tfno: 95-5066108 E-mail:comercio@cti.junta-andalucia.es
GENERALITAT DE CATALUÑA: Fco. Javier Sobrino Suárez Dpto. de Industria, Comercio y Turismo Generalitat de Catalunya Tfno: 93 415.16.17 E-mail: fjsobrino@correu.gencat.es	COMUNIDAD DE CANARIAS: Emiliano Santana Ruiz Consejería de Industria y Comercio Gobierno de Canarias Tfno: 928 30.60.00 Ext 0256 E-mail: Esantana@CISTIA.es
COMUNIDAD VALENCIANA: Gregorio Lleó Alama Dirección General de Comercio y Consumo Tfno: 96 386 96 08 E-mail: gregorio.lleo@industria.m400.gva.es	COMUNIDAD DE NAVARRA : Joaquín Labiano Servicio de Comercio y Consumo Gobierno de Navarra Tfno: 948 427 734
COMUNIDAD DE GALICIA: Jose Manuel Fernández Núñez Dirección General de Comercio y Consumo Tfno: 981 54.45.30 / 981 54.55.92	COMUNIDAD DE PAIS VASCO: Jaione Aberasturi Erezuma Depto. de Industria Comercio y Turismo Tfno: 945 01.99.65 E-mail: j-aberasturi@ej-gv.es
COMUNIDAD ARAGÓN: Sr. Pedro Bueso Dirección General de Industria y Comercio. Servicio de Comercio y Artesanía. Diputación General de Aragón. Tfno: 976 714 732	COMUNIDAD DE CANTABRIA : Manuel Revuelta Palacio Consejería de Economía y Hacienda Gobierno de Cantabria Tfno: 942 207.51.87
COMUNIDAD DE LA RIOJA: Persona: Servicio de Comercio Tfno: 941 291 230	COMUNIDAD PRINCIPADO ASTURIAS : Jose Luis Carús Servicio de Comercio Dirección General de Comercio y Turismo Principado de Asturias Tfno: 985 10.66.70
COMUNIDAD CASTILLA Y LEON: M ^a Antonia Ruiz Calado Dirección General de Comercio y Consumo Junta de Castilla y León Tfno: 983 -41.14.47	COMUNIDAD CASTILLA LA MANCHA : Guillermo Gómez García Dirección General de Turismo, Comercio y Artesanía Junta de Comunidades de Castilla-La Mancha Tfno: 925 26.78.00
COMUNIDAD ISLAS BALEARES: Carlos Mena Ginovés Consejería de Economía, Agricultura, Comercio e Industria. Gobierno de las Islas Baleares Tfno: 971 17.66.04 / 07	COMUNIDAD DE EXTREMADURA: José Sereno Martínez Dirección General de Comercio. Consejería de Economía, Industria y Comercio. Tfno: 924 38.66.37 E-mail: jsereno@eic.juntaex.es
COMUNIDAD DE MURCIA: Rosario Castaño Collado Dirección General de Comercio, Consumo y Artesanía. Tfno: 968- 28.46.03 E.mail: Mrosario.Castano@Carm.es	