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FRANCHISING AS AN 'ATYPICAL CONTRACT': ENGLISH AND ITALIAN MODEL

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Franchising as an 'Atypical Contract': English and Italian Model*

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Abstract.

Franchising contract is one method to distribute goods and service. By making a franchising contract the franchisor allows the franchisee to open a shop under his trademarks, trade name, signs, etc. The shop will be his own and the business will be his business, through subject to the discipline of the franchise. The franchisor imposes on franchisee certain qualitative standards; moreover franchisor grants franchisee the use of his trademarks. The franchisee will pay royalties on the clothes sold, but he has the assurance that he is going to sell a product well known by consumers. Franchising is a relatively new form of contract. It is atypical in that it cannot be fitted into the traditional list of nominate contracts. This paper will show that it is not a sub-form of any member of that list. It is also atypical in being a mode of wealth creation which lies between hierarchy and market. That is to say, a franchisor does not trust his product directly to the market and does not set up a strong hierarchy under his control as does an entrepreneur who sets up a corporation. This characteristic of being between hierarchy and market will also be a theme of this article. This paper will concern the franchise distribution contract, and in particular the so called business format franchising.

The paper will therefore be to define the franchising contract and describe the several ways in which this contract can assume a juridical form. The aspect on which the article concentrates is differentiation. A franchising contract is a distribution contract which cannot classified as a dealership, as a partnership, as an employment contract, as a commercial agency contract, but it is an "atypical contract". This understanding the contract has to be achieved by making the effort to distinguish the franchising contract from the other similar contracts. The useful features of the franchising contract are one of the main reasons why European legislation is especially concerned with franchising.

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Franchising as an 'Atypical Contract': English and Italian Model

1 Introduction.

McDonald's or Marks and Spencer, or the next door BMW car shop are, if observed from the outside, large business activities aimed at mass distribution of commodities. Business activities obey a single economic logic, that of profit. No one who is not a lawyer would understand that this very same logic is nursed in the three examples by different legal forms. Business chose their legal form to minimize their organisational costs. The legal system nevertheless pursues different tasks to obtain the mere facilitation of business activity. By differentiation's the legal form, beyond the mere desire of the parties the law attemnts to nurse its balance between its facilitative function and its function of control.

A franchising contract is a distribution contract which cannot classified as a dealership, as a partnership, as an employment contract, as a commercial agency contract, but it is an "atypical contract". This understanding the contract has to be achieved by distinguishing the franchising contract from the other similar contracts. This feature could be considered only as classification and in a certain sense only a formalistic problem. However this is not this is not the case. In fact, if a contract is classified as a certain type there will be many rules applicable to this only because it belongs to that type of contract and not to another one. Many mandatory rules, particularly in EC law can be applied only to named contracts. Thus the practical importance of taxonomy in this domain. First, these rules are the statute rules which regulate that specific contract, secondly the implied terms developed with regard to that specific contract.

This article has the presumption to be an original contribution to the academic legal debate in Europe about the edification of a European contract law. After years of discussion about the general part of the contract or general principles, it is time to look

at the specific contracts[1]. One of the first question that involves the specific contracts is to understand if the differentiation between a typical contract and an atypical one is only a nominal problem or it has relevant consequences in the discipline of the contract itself. In this article it is my intention to mind this question referring my thinking at the franchising contract in two different system, the Italian and the English one. In have chosen the Italian system because there is a different discipline between a typical contract and an atypical one; instead, in the English system the distinction between typical and atypical contracts is not a matter of the legal debate at all.

[1] O Lando *Principles of European Contract Law*; parts I and II / prepared by the Commission on European Contract Law, edited by O Lando and H Beale, (Kluwer law International The Hague, London, Boston, 2000).

2. Definition of Franchising Contract.

The modern franchising contract is relatively young.

The ECC Regulation No 4087/88 30 November 1988 on the application of art 85(3) of the Treaty says:

> [F]ranchise means a package of industrial or intellectual property rights relating to trade marks, 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".

We can say that through a franchising contract the franchisor grants a licence within a certain area to sell goods or services using his trademark and shop signs, utility models, designs, copyrights, know-how. On the other hand, the franchisee pledges himself to use trademark and shop signs, utility models, designs, copyrights, know-how of franchisor, to maintain certain qualitative standards, and to pay the franchisor a percentage of annual income such as royalties and an initial fee.

The contract of franchising could be defined as a system of collaboration between a producer of goods or an offerer of services, called franchisor, and a distributor, called franchisee, who are independent from each other, but bound by a contract.[2] Under this agreement, the franchisor offers the franchisee the possibility of being part of his structure of distribution, with the right of exploit trademarks and shop signs, utility models, designs, copyrights, know-how; in consideration of this right the franchisee has to pay royalties. Moreover the franchisor is bound to provide franchisee with goods and services, while franchisee is bound to conform to any commercial behaviour imposed by the franchisor.[3]

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[2] The independence between franchisor and franchisee is pretty important because it permits to distinguish franchising by employment and commercial agency contract, J Pratt *Franchising Law and practice* (Thomson Sweet & Maxwell London 2003) 1026

[3] In this meaning: A Frignani *Il franchising* (Utet Torino 1990).

3 Franchising as an 'Atypical Contract': English and Italian Model.

A franchising contract has many features in common for example with an employment contract, or with an independent contractor, or with a commercial agency relationship or with a dealership or with a partnership but it is a contract in its nature unique and different from each one of this examples.

From a theoretical point of view in the English contractual system there is no difference between a specific or typical contract and an atypical or not a specific contract. In contrast, the Italian contractual system distinguishes between typical and atypical contract. A typical contract is a contract whose content is regulated directly by a statute, such as sale of goods, carriage, mortgage, and so on. An atypical contract is not regulated by a statute and to be considered valid the system must evaluate it as "directed to the realisation of interests worthy of protection according to the legal order" (art 1322 of the Italian civil code). There is a tendency of the Courts to apply to the atypical contracts the rules of the most similar typical contract with the result sometimes to impede to the atypical contract to arise according to his nature.

The main reason of this great difference between the English contractual system and the Italian one is historical. The English contractual system has been developed by the *action of assumpsit*. The *action of assumpsit* was a general action through which any promise with a valid *consideration* could be defended before the Court. It did not matter that the promise would be related with a typical action or contract[4]. In this meaning the English judge did not have the necessity to classify an action or a contract because this was irrelevant for the protection of the party.

In contrast, the Italian system is related with the Roman contractual system. The Roman contractual system was based on typical actions. Only if there was a specific action it was possible to defend the right before the Court. The Roman contractual system never recognised the "*nuda pacta*", atypical agreements based on the consent of

[4] AWB Simpson *A History of the Common Law of Contract, The Rise of the Action of Assumpsit* (Oxford University Press Oxford 1975); DJ Ibbetson *A Historical Introduction to the law of obligations* (Oxford University Press Oxford 1999) 126-151; R Zimmermann *The Law of Obligations: Roman Foundations of the Civilian Tradition* (Juta & Co Cape Town 1990).

the parties[5]. Nevertheless, also in the Roman law the parties had a particular degree of freedom to conclude contract over the forms, as Professor Ibbetson explains:

> [W]hile the verbal contract was defined by its form, the consensual contract were defined by their substance. They were divided into four heads, covering the most significant economic transactions: *emptio venditio*, or sale; *locatio conductio*, which covered a range of transactions from hire of goods to employment, held together rather loosely by the common feature that one person put property or services at the disposal of another in exchange for money; *societas*, or partnership; and mandate, where one person agreed to do something for another gratuitously. Legal rules determined which category any particular transaction fell into, and the parties had no power to designate it as something else. On the other hand they did have considerable freedom to fix their own terms; the law provided only a standard set of rights and duties, which applied in the absence of the parties agreement to the contrary.[6]

Moreover according to Professor David the common law "*ne connait pas en principe des contrats nommés: c'est un droit du contrat, non des contrats"*[7]. So, in conclusion we could say that according to the English contractual system is not relevant if an agreement belongs to a specific contract or to an atypical contract. Instead, according to the Italian contractual system only an atypical contract is "directed to the realisation of interests worthy of protection" according to the legal order because the system presumes that the specific contracts are already worthy of protection. The Court must consider an atypical contract worthy of protection.

Deeper examination shows that the conventional picture of the common law as lacking 'typical' contract has been exaggerated. In their legal education it is true that common lawyers learn only the general law of contract, but, as in the civil law such contracts as sale, partnership, agency, employment all have been own names and their

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[5] G Gorla *Il contratto. Problemi fondamentali trattati con il metodo comparativo e casistico. Lineamenti generali* (Giuffrè Milano 1955) vol 1, 352.

[6] DJ Ibbetson *A Historical Introduction to the law of obligations* (Oxford University Press Oxford 1999) 8.

[7] R David *Les contrats en droit anglais* (2nd edn Pugsley Paris 1985) 316: "The English *common law* does not know a general principle of typical contracts; there is only a law of contracts and not a law of the contracts."

own regimes.[8] We can in any case denote that the factual approach of the English law allows the atypical contracts to be accepted according to their nature more easily that in the Italian system. In fact, in the Italian system the atypical contract is usually referred to the more similar specific contract and the Court will try to use the legal discipline of this latter also to regulate the atypical one. This operation happens applying the criteria of analogy and extensive interpretation of the norms that are usually general and abstracts[9]. The Italian judge tends to subsume the atypical contract under the rules of the specific contract already disciplined by the legislator. The Italian judge does not only interpret the contract but he has to qualify it to apply a legal discipline. Because the system tends to treat the atypical contract as a specific one is the main reason of the different treatment between an atypical and a specific contract.

The consequence of this behaviour is that the atypical contracts have more obstacles to receive a discipline by the Courts in accordance with their economic nature. The factual approach of the common law and its general rules are enable to discipline better the atypical contracts. From this point of view we can say that the English contractual system is more flexible to regulate the new contracts that the Italian one.

The franchising contract is not a specific listed contract, it is not a typical contract[10]. We might say that franchising contract either is so similar to another specific contract that can be classified as twin of this or it is so particular that it cannot be confused with other specific contracts. Following through this inquiry will see that it cannot confused with the employment contract, with an agency relationship, with a partnership relation or with a dealership contract and so on. In this meaning, we can say that the franchising contract is particular or atypical contract. The franchising contract cannot be confused with similar schemes because its function and nature is different from the others.

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[8] *Chitty on Contracts* HG Beale (ed) (28th edn Sweet & Maxwell London 1999); *English Private Law* P Birks (ed) (Oxford University Press 2000) vol 2.
[9] G De Nova *Il tipo contrattuale* (Giuffrè Milano 1974).
[10] In Italy, the Law 6 may 2004 n. 129 now provides a definition and it regulates some aspects of the franchising contract, such as the form, that must be written; the duty of disclosure of the franchisor, the duration of the contract, etc..

4 Franchising and Employment.

In this paragraph we will distinguish franchising contracts from other similar contracts such as employment, commercial agency and partnership. This task is essential also to understand when the franchisor is liable for the act of the franchisee and when not. Pursuing this inquiry, we will appreciate how franchising has an internal structure which is largely invisible. The consumer does not perceive distinction between franchisor and franchisee. More accurately, he does not perceive the separate existence of the franchisee. The main consequence of this perception is that in many cases the franchisor, in virtue of the power of control that he exercises over the franchisee is liable for the act of the latter to the third party.

Undoubtedly, franchising is a private contract, but what is the relevance of the fact that the franchisee becomes part of the commercial structure of the franchisor? Which juridical relation is applicable in this case? The point is crucial especially to establish: a) the degree of liability of the franchisor to the third party for the torts of the franchisees and: b) to understand which legal discipline is applicable to the contract in the case of a lack of regulation in the contract signed between the franchisor and the franchisee.

Also the employment contract is characterised by the power of control of the employer over his employees. Thus, it is necessary to define the employment contract and to analyse to what extent the franchising contract can and cannot be compared with it.

5 Contract of Employment or Contract of Service and the Difference from a Contract for Services in the English System.

The traditional English model of the contract of employment perceives that the central obligation of the parties is the exchange of work for wages[11]. More specifically, a contract of employment[12] or a contract of service arises in English law when a subject (employee) does something for the interests of, and under the instructions and the control of, another subject (employer), without being independent of him. The employer selects his employee; the employee can usually work only for his employer and always has a fiduciary duty. The employer pays a regular salary; the employee has a paid holiday, insurance contracts, and so on. The employee works at a fixed place and to a fixed timetable. The termination of the contract is subject to certain mandatory rules according to which the employer cannot send off the employees without a good reason. A contract of employment or of service is generally contrasted with a contract in which an independent contractor is engaged to perform a particular task, often known as a "contract for services"[13].

The distinction between an employment contract and other juridical relationships (such as a contract for services or commercial agency), is very important as there is a huge body of rules applicable only to the employment contract and not to the other contracts[14]. The discipline of the employment contract is also constituted by an articulated set of implied terms[15]. These terms are presumed to form part of every contract of employment, unless there is an express contrary agreement between the parties[16]. Moreover, in the law of tort, the contract of employment is used to fix the

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[11] H Collins and others *Labour Law. Text and Materials* (Hart Publishing Oxford 2001) 66.
[12] Once, the contract of employment was named also as a contract of master and servant.
[13] M Freedland 'Employment' *Chitty On Contracts. Specific Contracts* HG Beale (ed) (28th edn (Sweet & Maxwell London 1999) 788; *Ferguson v John Dawson & Partners (Contractors) Ltd* [1978] 3 AER 817; *Massey v Crown Life Insurance Co* [1978] 1CA WLR 676; *President of Methodist Conference v Parfitt* [1984] QB 368; *O'Kelly v Trusthouse Forte PLC* [1984] QB 90. We only note that once the employment relation was indicated using the name master-servant. Nowadays, this expression is not longer used.
[14] For example the Equal Pay Act 1970 (UK), the Trade Union and Labour Relations Act 1974 (UK), the Sex Discrimination Act 1975 (UK), the Employment Protection Act 1975 (UK), and so on.
[15] *Scally v Southern Health and Social Services Board* [1992] 1 AC 294.
[16] Collins and Others (n 11) 66. See also *Hivac Ltd v Park Royal Scientific Instruments Ltd* [1946] Ch 169.

scope of the vicarious liability of employers for the negligence of agents who cause loss to third party[17].

As we have seen, also in the franchising contract the franchisor can exercise a strong power of control over the activity of the franchisee and the franchisee is integrated in the distribution structure of the franchisor. So we need to define the employment contract and the contract for service because we want to distinguish it from the franchising contract and to avoid confusions among them; we can say that also "the relationship between the franchisor and the franchisee might be characterised as that of master and servant." That would be a mistake, as we shall see. [18]

In this meaning, coming back at the employment contract, Professor Freedland emphasises eight identifying features of a contract of employment:[19]

[1]) the degree of control exercised by the employer; 2) whether the worker's interest in the relationship involved any prospect of profit or risk of loss; 3) whether the worker was properly regarded as part of the employer's organization; 4) whether the worker was carrying on business on his own account or carrying on the business of the employer; 5) the provision of equipment; 6) the incidence of tax and national insurance; 7) the parties' own view of their relationship; 8) the traditional structure of the trade or profession concerned and the arrangements within in.[20]

The main obligation of the employment contract is the exchange of work for pay.[21] Another main feature of the employment contract is the degree of control power exercised by the employer over the performances of the employees[22]. It has been said that:

> [T]he traditional distinction is that whereas the employer can merely direct *what* work is to be done by the independent contractor, he may also direct *how* the work is to be done by the employee."[23]

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[17] Collins and Others (n 11).
[18] JN Adams and KV Prichard Jones *Franchising. Practice and Precedents in Business Format Franchising* (Butterworths 4th edn London 1997) 47.
[19] M Freedland 'Employment*' Chitty On Contracts. Specific Contracts* HG Beale (ed) (28th edn Sweet & Maxwell London 1999) 791.
[20] PS Atiyah *Vicarious Liability in the Law of Torts* (Butterworths London 1967).
[21] *Miles v Wakefield MDC* [1987] AC 539.
[22] M Freedland 'Employment' *Chitty On Contracts. Specific Contracts* HG Beale (ed) (28th edn Sweet & Maxwell London 1999) 793; *Performing Right Society Ltd v Mitchell and Booker (Palais de Danse) Ltd* [1924] 1 KB 762.
[23] M Freedland 'Employment' *Chitty On Contracts. Specific Contracts* HG Beale (ed) (28th edn Sweet & Maxwell London 1999) 790.

Whittaker v *Minister of Pensions and National Insurance*[24] says that the greater the degree of control exercisable by the employer, the more likely it is that the contract is one of service. In this case, the plaintiff was a trapeze artist who was engaged by a circus company to perform her act. By the agreement the claimant undertook, in addition to performing her act, to help in moving the circus from place to place and to carry out usherette duties during performances. One day Miss Whittaker fell and broke her wrist. She made a claim to industrial injury benefit under the National Insurance Act 1946 (UK). So the juridical question was to establish if Miss Whittaker at the moment of the accident was an employee because the Minister of Pension denied to pay the insurance assuming that Miss Whittaker was only an independent contractor for service.

The Court declared Miss Whittaker to be an employee of the circus because of the strong power of control of her labour. Mocatta LJ, with the consent of the Court, says that the question is not only the amount of control but the nature of control and the direction in which is exercised[25]. He concludes:

> [M]iss Whittaker had no real independence and had to carry out her contractual duties as an integral part of the business of the company during her engagement."[26]

The power of control can be exercised in several ways. In fact, sometimes the performance of the employee is so highly specified that the employer cannot exercise in a concrete sense his power of control, because he must leave the employee free to act and this latter is able to control only the result of the work. In this meaning there is, at the same time, an employment contract if the employer regularly pays the employee or if he is able to give general instructions about the job; if the employer uses a structure, tools or instruments provided by the employer[27].

The method of exercising the power of control is different in the case of an employment contract than in the case of a contract for services. In fact, in the case of an

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[24] *Whittaker v Minister of Pensions and National Insurance* [1967] 1 QB 156.
[25] *Whittaker* sub n (24) 167.
[26] *Whittaker* sub n (24) 168.
[27] *Mersey Docks v Coggins & Griffith (Liverpool) Ltd* [1946] AC 1.

employment contract the control power can be exercised in each moment of the contractual relation; for example the employer can control if the employee is working during the scheduled time or not. The employer can fix a timetable, vacation time, and so on. In a contract for services the contract regulates the using of the control power and usually it is exercised from time to time or at the end of the task.

Generally speaking, we could say that in the case of an employment contract the power of control extends to *how* the performance is made; as opposed to the case of a contract for services in which the control can usually be exercised only as to the *final result* of the performance, while *how* this result is obtained is out of the control. So the power of control means that the employer can easy down the *way* in which the employee has to perform his duties and usually this power does not exist in case of a contract for services.

Another important test for our discourse is the relevance of the "organization test". Usually, an employee is a regular part in the organization of the employer, while an independent contractor has to complete his task, but the degree of integration with the structure of the employer is low. The employee is part of the regular structure of the employer, while in the case of a contract for service the debtor can be engaged for a temporary work. Moreover, an independent contractor usually uses his own tools to perform his contractual duties, while the employee uses the tools that the employer provides[28].

In *Ready Mixed Concrete (South East) Ltd.* v *Minister of Pensions and National Insurance*[29] the question was to decide whether Mr. Thomas Henry Latimer was by virtue of a contract between himself and the plaintiff an employee or a self-employed person for the purposes of the National Insurance Act 1965. The Minister considered Mr Latimer to be an employee and required the contributions from Ready Mixed. The Court instead declared Mr Latimer as an independent contractor.

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[28] *Global Plant v Secretary of State for Social Services* [1972] 1 QB 139; *Market Investigations Ltd v Minister of Social Security* [1969] 2 QB 173.
[29] *Ready Mixed Concrete (South East) Ltd v Minister of Pensions and National Insurance* [1968] 2 QB 497.

Mr Latimer was a lorry driver who worked for many years for Ready Mixed. In particular, Mr Latimer signed three contracts with Mixed group: the first as employee, then he resigned; the second as owner – driver, with his own lorry that after two years he sold; the third again as owner-driver, but he signed also a hire purchase contract relating to a new lorry. The hire-purchase company was Ready Mixed Finance Ltd; it was one of the Companies of the business group of the plaintiff.

Ready Mixed introduced a scheme of delivery by drivers working under contracts. It always had been the intention both of Ready Mixed Group and of the owner-drivers that the latter should be treated as independent contractors, and not as employees of member companies of the Ready Mixed Group. Owner-drivers did not work set hours, and there were no fixed meal breaks. No instructions were given on behalf of the company to owner - drivers concerning the method of driving trucks from the plant to the place of delivery, and in particular owner-drivers were not instructed as to the routes that they were to follow:

> [I]f any person acting on behalf of the company had sought to instruct Mr Latimer how to deliver concrete or how to drive his truck, Mr Latimer would have told that person to mind his own business. No such person so instructed Mr. Latimer."[30]

The Minister stressed the idea that, despite the name of the contract, Mr Latimer was entirely integrated in the organizational structure of the Mixed Company and therefore he was an employee and thus the Mixed Company had to pay the contributions and taxes. In fact Mr Latimer, according to the contract, "shall at all times of the day or night during the term of this agreement make available the truck to the company". He had to wear the company's uniform, complying with all the companies rules, regulations or requirements, carry out all reasonable orders from any competent employees of the company as if he were "an employee of the company", and by his conduct and appearance "including the speed and manner in which he operates the truck" use his best endeavours to further the good name of the company.

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[30] Ready 500.

MacKenna LJ, with the consent of the Court, says that the differences between a contract of service and a contract for services is in the intensity of the control power; for example 1) when a contract obliges one party to build for the other, providing at his own expense the necessary plant and materials, this is not a contract of service, even though the builder may be obliged to use his own labour only and to accept a high degree of control: it is a building contract. It is not a contract to serve another for a wage, but a contract to produce a thing (or a result) for a price; 2) when a contract obliges one party to carry another's goods, providing at his own expense everything needed for performance, this is not a contract of service; 3) when a contract obliges a labourer to work for a builder, providing some simple tools, and to accept the builder's control, the contract is one of service; 4) when a contract obliges one party to work for other, accepting his control, and to provide his own transport, this is still a contract of service.

So according to MacKenna LJ, with the consent of the Court, the contract between Mixed Group and Mr. Latimer was a contract for services, and in particular a contract for carriage because, although he worked only in the organization of Mixed Group and although Mixed Group had the power to give him many instructions, nevertheless he had a high degree of autonomy. In fact Mr Latimer was free to decide whether he would maintain the vehicle by his own labour or that of another; he was free to use another's services to drive the vehicle when he was away; he was free to choose where he will buy his fuel or any other of his requirements, etc.

Ready Mixed is very important also if we refer it at the franchising contract and we can adopt the mind of the Court to describe the differences between an employment and a franchising contract. In a franchising contract there is also a strong control power and the franchisee works in the organization of the franchisor. But despite these elements of similarity it does not follow that the contract is necessarily an employment one.

One of the main features of the franchising contract is the power of control that the franchisor can exercise to check the activity of the franchisees. These control powers

mean that the franchisee has the duty to sell the goods or offer the services only through the method sutipulated by the franchisor; that the franchisees must ensure that their commercial behaviour conforms with the instructions of the franchisor, and so on. The aim of the franchisor is to have the highest possible degree of uniformity among his selling commercial points.

If these are the main features of the employment contract, we shall have to ask whether a franchising agreement can be considered to be an employment relationship. The second question will be whether or under what circumstances the franchisor is liable for the negligent acts of the franchisee that create a tort to the third party? In other words, is the franchisor vicariously liable for the act of the franchisee? To answer the first question we will have to compare the main features of a franchising contract with the employment contract and with a contract for services.

6 Contract of Employment or Contract of Service and the Difference from a Contract for Services in the Italian System.

The employment contract in the Italian legal system is usually defined as a "contratto di lavoro subordinato". The concept of subordination means that in a relationship one party has a hierarchical power over the activity of the other party which has to conform his activity to the instructions of the superior. Art 2094 of the Italian civil code says that:

> [A] subordinate employee is a person who binds himself for a remuneration, to cooperate in the enterprise by contributing his intellectual or manual work, in the employment and under the management of the enterprise."

There is a "subordination contract" or a subordination employment contract when the employee performs his duties using the structure applied by the employer and for the interest of the employer who binds himself to pay a remuneration. These are the essential elements of an employment agreement[31]. The substantial similarity with the English law, which has just been discussed, will be apparent.

The subordination of the employee to the employer means also that the employer has a disciplinary or control power over the employee[32]. The disciplinary power or control power means that the employer can give instructions to the employee who must regulate his behaviour and perform the contractual duties according to these instructions. The Supreme Court in the case *Sapio* v *Casa Cura Lara*[33] pointed out that the essential feature of the employment contract is the subjection of the employee to the organizational, directional and disciplinary powers of the employer. At the same time, this means that the employee can have a space of autonomy within the performance of his duties. There is a balance between subordination and autonomy, in which the employee must always act subordinate to the structure applied by the employer, and the risk of the activity in general is on the employer and never on the employee.

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[31] *Alleanza Assicurazioni v Ungari* Cass 4 April 1989 no 1635; *Gebrekidan v Rai Tv* Cass 13 November 1984 no 5748; *Del Sasso v Inpdai* Cass 10 December 1982 no 6770 Giur It 1984 I 1 148.
[32] *Società Bellisario Fitness Center v I.n.p.s.* Cass 18 December 1996 no 11329.

The disciplinary powers can be exercised through orders given at the beginning of the relations or sometimes or through instructions given day by day. For example in the case *Soc. Fisiokinesiterapia* v *Pascucci*[34] the Supreme Court pointed out that a physiotherapist who works in the structure of the employer and who receives day by day instructions concerning how to do his job can be considered a subordinate employee and not an independent contractor.

[33] *Sapio v Casa di Cura Lara* Cass civ, 14 April 1987 no 3716 Mass Giur It 1987.
[34] *Soc Fisiokinesiterapia v Pascucci* Cass civ sez lav 24 November 1998 no 11924 Mass Giur It 1998.

7 Differences between the Franchising Contract and the Employment Contract.

We have seen that in the franchising contract the franchisor exercises a high degree of control over the franchisee. This control power extends not only to checking the contractual task, but it allows the franchisor to impose the modality of the performance of the franchisee, granting trademarks and know-how. The franchisor has the power to lay down the price at which the goods should be sold, in which way the shop must be structured; to which qualitative standards the performance must be offered to the consumers; which promotional activities the franchisee can make and in which way; in which territorial area the franchisee can sell the goods or offer the services; the franchisee must conform himself to the changing request by the franchisor in the commercial offer of the goods to the consumer; the franchisor can change the price of the goods. In other words the franchisor has the power to impose detailed instructions that the franchisee must follow. The control of the franchisor is exercised day by day and not only on the result of the performance.

The second feature in common with the employment contract is the degree of integration between the franchisor / employer and the franchisee / employee. Through a commercial contract the franchisee is integrated in the structure of the franchisor and there is no distinction in the commercial chain between the franchisee and the branches, if any, which are owned directly by the franchisor. The integration in the structure of the franchisor means that the franchisee become part of the network an office branch directly dependent by the organization of the franchisor. For example, the franchisor will apply the furniture of the shop, as will as the instruments and tools to produce, sell and offer the goods and the services. The franchisee cannot build up his own know-how, but he has to follow the instructions of the franchisor who establishes the way in which the goods must be distributed. The organization test gives the result that franchisee is stable integrated into the structure of franchisor. We can say that the franchisee is an essential part of the commercial structure of the franchisor. For example Mark and Spencer is not a franchise. A manager who is beyond doubt an employee runs its local branches. A franchise looks no different, and, so far, it would appear what the

franchisee must have the same status and position as the manager of a Mark and Spencer manager store.

What are the differences between franchising and employment contract? The first difference is that franchisee does not receive a salary or wages for his commercial activities, but he has to pay fees to join the structure of the franchisor, and royalties on goods and services sold. We have seen before that the model of the contract of employment perceived that the central obligation of the parties is the exchange of work for wages. The franchisee is in a sense remunerated, but the money he makes could not easily be described as wages paid by an employer.

Secondly, although it is true that the franchisor exercises a strong control power over the franchisee, nevertheless the franchisee remains an independent undertaking related through a distribution contract to the franchisor[35]. The independence of the franchisee is manifested in the fact that he is the employer of his employees; that he is an entrepreneur who risks his capital and usually he is the owner of the assets of his outlets [36].

Thirdly, the legal nature of franchising is different from the nature of the employment contract. Through the franchising contract the entrepreneur seeks a more flexible form based in part on the *hierarchy* (power of control) and in part on the *market* (autonomy of franchisee, economic risk of the franchisee, transfer of the know-how and trademarks); instead, through a employment contract the entrepreneur looks for a structure entirely based on the hierarchy[37].

Also according to the Italian system, the franchising contract cannot be considered like an employment contract because, despite the control power of the

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[35] J O'Connell Davidson '*What do Franchisors Do? Control and Commercialisation in Milk Distribution*' (1994) 8 Work, Employment & Society 23.

[36] JN Adams and KV Prichard Jones *Franchising. Practice and Precedents in Business Format Franchising* (Butterworths 4th edn London 1997) 48.

[37] S Sciarra *Franchising and Contract of Employment: Notes on a Still Impossible Assimilation, in Franchising and the Law Theoretical and Comparative Approaches in Europe and in the United States* C Joerges (ed) (Nomos Verlogsegesellschaft Baden Baden 1991) 239-266; A. Dnes, *The Economic Analysis of Franchise Contracts,* in Journal Institutional &Theoretical Econ., 1996, 152, 297-324.

franchisor, the franchisee has always a too high degree of independence and autonomy. In *Bratti v Ges.Com srl & Cipac SpA*[38] the controversy arose from a contract of franchising to manage a supermarket. Mrs Bratti signed a contract of franchising in relation to her supermarket and according to the contract she had to work from the 8 a.m. to the 1 p.m. and from the 3 p.m. and the 8 p.m. for six days per week. Secondly she had to pay 93 % of the income earned to the franchisor. Mrs Bratti brought an action against Ges.Com and Cipac and she maintained that she had no autonomy and thus the contract had to be qualified as an employment contract. The Court emphasises that the strict clauses of the franchising contract are not sufficient to consider the franchising as an employment contract. Moreover the Court observed that in the supermarket used to work also the two sisters of Mrs Bratti and this circumstance was incompatible with an employment contract, while it was perfectly compatible with a franchising relation.

By contrast, in *Ottenio v Istituto Sociopsicologico l'Ideale*[39], the plaintiff, after a training course provided by the defendant concerning the activity of a marriage agency, received the proposal to join the defendant structure through a franchising contract. He paid the initial fee and he started the commercial activity. After few months he realised that the franchisor did not transmit to him any kind of know-how, that he was performing almost all the activity of the franchisor and yet that he could not exercise his activity with autonomy. He claimed in Court that in reality the contract signed was an employment contract. The Court decided that in this case the contract was an employment relation, because the organization was provided by the *Istituto Sociopsicologico l'Ideale* and therefore Mr *Ottenio* was continuously and systematically employed in the organization of the franchisor; Mr *Ottenio* could not choose his collaborators, the time of opening and closing of the agencies were decided by the "franchisor". So, according to the Court of Florence, when there is no autonomy at all between franchisor and franchisee, there is a contract of employment and not a franchising contract.

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[38] *Bratti v GES.COM srl & CIPAC spa* Pretura di Palestrina 14 February 1987 Resp Civ e Prev 1988 240.
[39] *Ottenio v Istituto Sociopsicologico L'Ideale* Pretura di Firenze 9 November 1984 Mass Giur It 1984.

It is clear that according to the Italian system a franchising contract cannot be confused with an employment contract if the franchisee maintains a degree of autonomy from the franchisor. Nevertheless there is a risk of an abuse of the franchising contract to avoid the mandatory rules that regulate the employment contract. In this case the Court will not be influenced by the name of the contract. The rules concerning employment contracts will automatically be applied to the false franchising contract. Another solution could be to the contract void if it is apparent that it has been designed only to bypass the mandatory rules. In this case the Court can apply art 1344 of the Italian civil code which says:

> [T]he *causa* is also considered unlawful when the contract constitutes the means for evading the application of a mandatory rule."

In conclusion, although the franchisor exercises a deep power of control over the activity of the franchisee, although the franchisee becomes part of the organization of the franchisor, nevertheless there are substantial differences between franchising contract and employment contract, especially in the internal contractual relation.

8 Franchising and Commercial Agency.

Different is the case of commercial agency. Commercial agency is a contract very well known in the continental systems, while until 1986 it was almost unknown in the English system. This contract scheme has been brought in the English system by an EC directive. According to the art 1,2 of the EC directive 86/653 and to Regulation 1993/3173 and Regulation 1998/2868[40] commercial agency can be defined as:

> [A] self-employed intermediary who has continuing authority to negotiate the sale or the purchase of goods on behalf of another person, hereinafter called the principal, or to negotiate and conclude such transactions on behalf of and in the name of the principal."[41]

However, the agency regulations do not apply to all agency relationship and do not regulate the whole contents of the commercial agency contracts[42].

In Italy the contract was already regulated in the civil code as one of the listed contract by the art 1742 which gives this following definition of it:

> [B]y the contract of agency one party permanently undertakes, for a remuneration, to promote the making of contracts for the account of another person within a specified territory."

By contrast, the commercial agency, until the EC legislation, was unknown in the common law system. Basically the EC law, through this legislation on commercial agency, intends to protect more deeply the commercial agent against the illegal behaviours of the principal. Truly speaking the common law developed many rules which give protection to the agent against the principal when it happens a breach of the fiduciary relationships. Professor Reynolds emphasised[43]:

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[40] Directive 86/653: [1986] OJ L328/17; Regulation 1993 SI 1993 No 3173; Regulation 1998 No 2868; see also, J Davey and F Randolph *Guide to the Commercial Agents Regulations* (CCH Editions Ltd Bicester 1994); FMB Reynolds (ed) Bowstead and Reynolds *On Agency* (17th edn Sweet & Maxwell London 2001) 581-627.

[41] FMB Reynolds 'Agency' *Chitty On Contracts* HG Beale (ed) (28th edn Sweet and Maxwell London 1999) vol 2, 4 observes that this new contract has a limited extension in the Common Law because his rules are not applicable to the agents acting in respect of sales of goods and does not cover agents acting in regard to land, nor to those arranging services. It applies only to agents acting in sales of goods.

[42] S Saintier *Commercial Agency Law. A Comparative Analysis* (Ashgate Aldershot 2002) 48.

[43] FMB Reynolds (ed) Bowstead and Reynolds *On Agency* (17th edn Sweet & Maxwell London 2001) 582.

> [T]he common law rules as to the relationship between any principal and any agent are based on the assumption that freedom of contract prevails. In so far as any protection has been perceived as necessary, it was protection of the principal against misuse of his powers by agent, as by taking a bribe, making a secret profit and in general assuming a position in which is own interests or those of others for whom he acts are adverse to those of his principal. It was against the context of such perceived dangers that the fiduciary duties of the agent have developed. Their potential breadth is related to the breadth of the common law of agency itself, which does not in general utilise categories, and applies to many types of representative, some of which (e.g. solicitors) would not be regarded in other countries as within the law of agency at all."

There are some important differences between franchising and commercial agency: 1) the first difference is the degree of integration with the infrastructure of the franchisor or the principal. In fact through the franchising contract the franchisee becomes part of the distribution chain of the franchisor; whereas with a commercial agency contract the agent is not integrated in the structure, but independently promotes the business to consumers of the goods or service supplied by the principal. 2) The commercial agent acts under his own commercial name, but he sells or purchases the goods acting on behalf of the principal. The franchisee, by contrast, has to act under the trademark of the franchisor, but he cannot act on behalf on the franchisor. The franchisee does not represent the manufacturers since he acts for his own account. 3) The franchisee must pay an initial fees to start using the trademark which the franchisor has granted to him, while the commercial agent not[44]. 4) The franchisor earns royalties in percentage of the goods sold out by the franchisee and the rest of the sum is for the franchisee, while in the commercial agency the agent earns a commission on the goods sold and the rest of the sum is for the principal.

There are also common features; for example, both franchisee and commercial agent are under the authority of the franchisor and the principal; their commercial activity is usually not occasional, but continuing. So in conclusion the franchisee

[44] Case 161/84 *Pronuptia de Paris v Irmgard Schilligalis* [1986] ECR 353.

becomes really part of the distribution chain of franchisor, while the commercial agent sells or purchases the goods of the principal, but his degree of autonomy from the principal is higher than the autonomy of the franchisee. We can say that in a certain way the control of the franchisor is also on the way to distribute his goods, while the control of the principal on the commercial agent is only on the result of the distribution.

9 Franchising and Partnership.

The franchisor and the franchisee are two independent undertakings. There are situations where the franchising agreement could be considered a partnership and the franchisor could be considered liable for the acts and the debts of the franchisee. The question is this: if one subject externally acts as part of another economic subject using his trademarks, his commercial name, his insignia, such that there is no apparent distinction between them, do these subjects form a partnership? Are these features sufficient to consider the grantor always liable for the acts, the contracts and the debts of the grantee?

According to the Partnership Act 1890 (UK) there is a partnership when there subsists a relation between persons carrying on a business in common with a view of profit. The section 5 specifies that:

> [E]very partner is an agent of the firm and his other partners for the purpose of the business of the partnership; and the acts of every partner who does any act for carrying on in the usual way business of the kind carried on by the firm of which he is a member bind the firm and his partners, unless the partner so acting has in fact no authority to act for the firm in the particular matter, and the person with whom he is dealing either knows that he has no authority, or does not know or believe him to be a partner."

The Limited Partnership Act 1907 (UK) introduced into English law the innovation that a person might be a partner in a firm but liable only to the extent of the capital he has invested[45]. The definition of a partnership excludes the limited liability partnerships formed under the Limited Liability Partnership Act 2000 (UK).[46] The partnership is a relationship; it is not as such an organization in its own right with a separate legal personality.[47] A partnership does not by nature confer any limited liability on the partners. It is possible that a partnership arises also between two independent

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[45] M Blackett-Ord *Partnership* (2nd edn Butterworths London 2002) 4.
[46] D Armour *Limited Liability Partnership* (Tolley Croydon Surrey 2001); W Beck *Protecting Partnership Capital* (Business Books Ltd London 1969). More precisely, we have to note that the Limited Liability Act 1907 (UK) disciplines the limited partnerships that must not be confused with limited liability partnerships which are a species of corporation and creatures of the Limited Liability Partnership Act 2000 (UK).
[47] G Morse *Partnership Law* (5th edn Blackstone Press London 2001) 1.

undertakings or between two companies.[48] The core of the partnership is carrying on a business in common with a view of profit.[49] One of the main consequence of the partnership is that each partner becomes liable without limit for the debts incurred by the others partners in the course of partnership[50]. The question, which arises, is could a franchising contract be considered as a partnership between franchisor and franchisee?

The key to distinguish franchising and partnership is the interpretation of the concept of the business "carried on common with a view of profit". In *Walker West Developments Ltd* v *F J Emmett Ltd*[51] Walker had purchased from Emmett a piece of land. Land was being developed and houses were being built; the houses were being built for sale. Both the plaintiffs and the defendant were involved. The plaintiffs were property developers and the defendants were builders. The court had to decide what was the nature of the agreement, a partnership or something else. The plaintiffs said that they were partners. The defendants said that the plaintiffs were building owners and that the defendants were builders and employed as such.[52] Goff LJ, with the consent of the Court, pointed out that the question was to establish if there was a common business or there were two businesses. Goff LJ did not consider relevant the fact that the agreement did not contain provisions rendering Ermett liable for losses. In fact according to Goff LJ in this case there was a partnership agreement because the business was only one and because there was a sharing of profits.

To be a business carried in common it is necessary that part of the business is really common. For example a creation of a joint bank account, the joint engagement of a consultant, the joint application for permissions, and so on[53]. Moreover, all the partners must have a control on the common business. If only one of the partner has a power of control on the other partner and on the way to exercise the business there is no a partnership[54]. To be partnership is necessary a sharing of the profits, but at the same

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[48] *Newstead (Inspector of Taxes) v Frost* [1980] 1 WLR 135.
[49] M Blackett-Ord *Partnership* (2nd edn Butterworths London 2002).
[50] G Morse (n 47) 1.
[51] *Walker West Developments Ltd v FJ Emmett Ltd* [1978] CA 252 EG 1171.
[52] Walker 1171.
[53] *Kriziac v Ravinder Rohini Pty Ltd* [1990] 102 FLR 8.
[54] *Mann v D'Arcy* [1968] 1 WLR 893.

time not each sharing of profits arises a partnership. In fact from the same common activity two independent undertakings can get profits, but for this only reason they are not partners. It is necessary not only sharing net profits, but also sharing the expenses and net looses[55]. As Blackett-Ord pointed out:

> [O]ften a business is conducted under a franchise agreement. No partnership is likely between the owner of a business and its operator because the standard franchise agreement will give the franchisor a share in the gross returns of the franchisee business but not in its net profits."[56]

In conclusion we can say that through a franchising agreement the franchisee shares part of the business of the franchisor and in particular the distribution or production of the goods, but generally, although the control power exercised by the franchisor and the royalties paid by the franchisee, franchisor and franchisee remain two independent undertakings. The control is not reciprocal, but is a hierarchical control. Moreover, there is not a sharing of the losses and of the profits between franchisor and franchisee, but only a share in the gross returns.

[55] *Cox v Coulson* [1916] 2 KB 177 CA.
[56] M Blackett-Ord *Partnership* (2nd edn Butterworths London 2002) 37.

10 Franchising and Dealership[57].

The dealership is another contract which allows an entrepreneur to distribute his goods[58]. Adopting a contract of dealership, the entrepreneur grants to a dealer the exclusive right to sell his goods in an exclusive territory. The dealer normally will sell only the goods of the entrepreneur, but he will act under his commercial name, while he will sell the goods of the entrepreneur under his trademark. The dealer becomes part of the distributive chain of the entrepreneur, but the he acts under his commercial name and the consumers perceive this distinction. The dealer buys from the producer the goods and sells them on his behalf and not on behalf and in name of the entrepreneur; in this meaning the dealership is different also from the commercial agency.

In the Italian system, the dealership is regarded as one of the innominate contract. It means that the civil code or other special laws do not have a written regulation for it. The rules are created by the judgements which try to apply the rules regarding the sale of goods, or the contract of supply, or the commercial agency, or the contract of commission, using the method of the analogy[59].

Franchising is different from dealership, because the franchisee acts under the commercial name of the franchisor, he has to pay an initial fees and royalties on the goods sold, while the dealer usually has not to pay an initial fees and he does not pay royalties, but he earns on the goods sold his commission. Both the dealer and the franchisee do not act on behalf of the "principal", but they act on their own name. The main difference is that the franchisee from an external point of view is part of the organisation of the franchisor, while the dealer acts with his own commercial name and the consumers perceive the distinction between him and the supplier of the goods and services.

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[57] In the Italian legal system the dealership contract can be translated as "contratto di concessione di vendita".
[58] The contract of dealership is very common in the market of the cars.
[59] O Cagnasso and M Irrera *Concessione di vendita, Merchandising, Catering* (Giuffrè Milano 1993).

In the case *Ford Italiana s.p.a. v Campopiano*, Ford signed a contract of dealership with Crema Motori, the car dealer. Mrs Campopiano bought a new Ford car from the Crema Motori. After few days, Mrs Campopiano asked for Crema Motori the original documents of the car to control the immatriculation of the car in the public register. Crema Motori answered that it could not deliver the documents because, there was a contractual clause between them and Ford by which the car until the immatriculation was of property of Ford. Mrs Campopiano brought an action against Ford to obtain the immatriculation of the car and the original documents. Ford replied that Mrs Campopiano had to claim an action against Crema Motori because this was a contract of dealership, therefore Crema Motori was an independent undertaking who does not act on his behalf. Moreover the degree of integration between Ford and Crema Motori was not so high to justify an action against Ford. Nevertheless, the Court of Crema stated that this distribution agreement may be qualified as a franchising contract if the degree of co-ordination and integration between the undertakings of retailer and wholesale distributor is so high that their contractual relationship fulfils the requirements of art 1 No 3 lett b of Regulation 4077/88[60].

A franchising contract entails advantages and disadvantages for the franchisor and the franchisee. In particular for the franchisor, the main advantage is that franchising confers the possibility of expanding a business without a big investment of money and very rapidly. The franchising contract allows the franchisor to earn money in the expansion of his business because the franchisee will pay an initial fee to open an outlet and royalties for the goods and services supplied. Through the franchising contract, the franchisor is able to build up an integrated commercial structure without employing people, but at the same time he is able to direct and control the franchisees.

The disadvantages for the franchisor arise because the franchisee is an independent businessman and the franchisor has not a complete control power over him and over his economic activity. The good name of the trademark of the franchisor could be affected by the unfair conduct of the franchisees. The relation between franchisor and franchisee is regulated through a contract which does confer only a partial hierarchical

[60] *Ford Italiana Spa v Campopiano* Trib Crema 23 November 1994 Contratti 1996 52.

power. This means that the breach of contract of the franchisee have direct effects on the franchisor's commercial name and trademarks and the franchisor can defend his rights only with contractual tools.

From the point of view of the franchisee the advantages which arise are the possibility to open an outlet in a market under a more or less well known trademark, with the consequence that he can immediately occupy a good position in the market, without having to build up goodwill and reputation himself. The franchisee receives all the benefits of a trademark of the franchisor who has the duty to defend and improve the marketing of his trademarks. The franchisee is the owner of his own business and the risks of it are substantially reduced[61].

At the same time the franchisee is not an independent entrepreneur[62]. His risks are reduced at the cost of turning himself into little more than a manager. This feature can be considered as a disadvantage for the franchisee because he is not free to develop his business in according to his willingness, but in according to the instructions of the franchisor. Then he has to pay royalties and initial fees.

[61] J Pratt *Franchising Law and practice* (Thomson Sweet & Maxwell London 2003) 2006.
[62] PC Millet *The Enciclopedya of Forms and Precedents* (5th edn Buttherworths London 2003) vol 16, 10.

11 The Peculiar Structure of a Franchising Contract: Ways to Structure a Commercial Chain.

The question which arises now is why McDonald's, say, or Pizza Hut chooses a form of organization based on franchising contract, while Barclays Bank or Mark and Spencer does not. In fact, the branches of Barclay's Bank and the shops of Mark and Spencer, for example, are part of the one organization. Every Mark and Spencer shop is owned by Mark and Spencer, while if the network were a franchise, all would be independent business owned by their own proprietor but all looking alike. Again people who work in the branches of Barclays Bank are employed by the bank; by contrast, people who work for McDonald's in Paris or Rome are not employed by McDonald's but by the local franchisees. Every single McDonald's outlet is private business employing his own staff but conforming to McDonald's rules.

A commercial chain can be structured in several ways. What are the real reasons why entrepreneurs prefer a hierarchical form than an organizational structure based on the franchising contract? The choice of an organizational form entirely based on hierarchy allows the entrepreneurs to use an almost total control on all the phases of the production and sale of the goods or services. The entrepreneurs can exercise hierarchical powers over employees and the commercial branches will automatically apply the instructions and directives. Those who run monolithic hierarchy have to devise sticks and carrots, incentives and deterrents, to realize their right control in such a way as to maximize the motivation and industry of the workers.

On this point of view there are no juridical division and barriers inside the organization of the seller of goods or services. The main feature of this kind of organization is the possibility to exercise hierarchical powers. So, usually the advantages are in a major control on the way of selling goods or offering services to the consumers and the possibility to control the qualitative standard of the products. Such

forms of organization have the advantage that no agreement between independent undertakings is subject to the prohibition of art 81 EC Treaty[63].

Secondly, the choice to organize the structure of a company can be imposed by the nature of the service offered to the consumers. For example a bank cannot imagine to use a structure for its branches based on several franchising contracts. In fact, a bank usually can operate only by a public concession and this concession cannot be delegated to other subject through a contract such as a franchising contract. Moreover, a bank has duties of total privacy about all the information of its clients and it is inconceivable that it allows other subjects out of the bank, but related by a contract, to use these information. The nature of the services offered to the consumer is not compatible with the use of a franchising contract to build a commercial chain of a bank. Thirdly, in the opinion of many researchers the main reason for a firm to adopt a franchising structure or not, is determined by the transaction costs[64].

The theorem of Coase assumes that when there are no transaction costs, the general efficiency could be obtained just through the private transactions. But the costs exist and the firm exists in order to save the costs of the contract[65]. In Coase's vision the firm is simply an institution as is the market, another basic institution. In fact, the distribution of products using a contract means that transaction costs arise from the contract itself. In particular, there are costs in concluding a contract, in maintaining control of the contract, in avoiding opportunistic behaviours by the other contractual party and the risk of breach of the contract. The cost of administering an internal structure, such as are involved in the management of employees, and investment of capital required to open new shops can clearly be eliminated by engaging in simple commercial contracts to sell goods or services.

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[63] V Korah and WA Rothnie *Exclusive Distribution and the EEC Competition Rules* (2th edn Sweet & Maxwell London 1992) 4.
[64] RH Coase 'The Nature of the Firm' (1937) 4 Economica NS 386-405; Id. 'The Problem of Social Costs' (1960) 3 Journal of Law and Economics 1-44.
[65] RH Coase 'The Problem of Social Costs' (1960) 3 Journal of Law and Economics 1-44.

The modern discipline on transaction costs agrees in saying that the hierarchical integration is able to reduce costs more than the recourse to the market, when the costs of outsourcing the activity are higher than those in maintaining production within the hierarchical structure of the franchisor.[66]. On the other hand many economists believe that, as a firm becomes bigger, diseconomies of scale in management begin to outweigh any economies of scale in production. In a very large firm, it is difficult for the people making decision to know what is actually happening throughout the whole organization or even in the parts directly involved[67]. In this meaning, the franchising is a good compromise between the use of contract and the use of integration.

Under a franchise contract, the franchisor has considerable measure of control over the behaviour of the franchisee. The relationship is almost that of a firm and an employee[68]. This can suggest that the definition of the franchisee as a separate firm, rather than as a part of the franchisor, is a legal and not economic distinction[69]. The hierarchical integration reduces the transaction costs; so the idea is that adopting a contract of franchising to organise the distribution, the franchisor intends to come back from the market to integration and not *vice versa* from the integration to the market. The most relevant reasons for choosing a hierarchical form of distribution or a form of distributors based on contract and more particularly on the franchising contract are the level and convenience of transactions costs. So the firm will adopt a contract to build a vertical integration of its distribution when the transaction costs will be less that the costs necessary to manage a hierarchical structure and *vice versa*.

Finally, another reason to choose the franchising structure is the lower initial investment needed that the undertaking has to put in the distribution structure to trade the goods or services under its trade-mark. The initial investment is lower than the investment necessary to open a branch office. This is a good reason that can attract the

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[66] O Williamson *The Economic Institutions of Capitalism, Firms, markets, relational Contracting,* (The Free Press, New York US 1986) 178.
[67] V Korah and WA Rothnie *Exclusive Distribution and the EEC Competition Rules* (2nd edn Sweet & Maxwell London 1992) 4; Williamson (n 66) throughout.
[68] PH Rubin 'The Theory of The Firm and The structure of The Franchise Contrac*t'* (1978) 21 Journal of Law and Economics 223-233.
[69] Rubin (n 68) 225.

little and middle undertakings to use franchising contract to develop their distribution chain. The necessary capital is found at every point of the franchising network.

12 Conclusion.

We have compared franchising with employment, commercial agency and dealership. Evidently, the lines that can be drawn are elusive. We have argued, however, that in both English and Italian law franchising must be differentiated from all the better–known contracts. The law therefore has to accept that in franchising it has what in Italy is called an atypical contract, standing outside the list of nominate contracts. Stable atypical contracts inevitably, as their name and nature become understood, add themselves to the nominate list.

We have observed that a franchisor does not trust his product directly to the market and does not set up a strong hierarchy under his control as does an entrepreneur who sets up a corporation. This characteristic of being between hierarchy and market is the successful key of a franchising contract. We can say that franchising contract is atypical from an economical point of view and form a legal one, because it cannot be classified as an employment or a commercial agency or a dealership and at the same time it reflects the tension between intention and control power and it allows the entrepreneur to build up a commercial structure that lies between market and hierarchy.