

**KNOW-HOW IN FRANCHISE CHAINS:
A LITERATURE REVIEW
AND IN-DEPTH INTERVIEWS WITH LAWYERS**

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1. INTRODUCTION

Know-how is widely acknowledged as one of the cornerstones of franchising. However, despite its importance, both in the successful management, but also the regulation of the franchise agreement, it remains a somewhat elusive construct. Within this paper, by drawing on both the *ex ante* literature and the views of 27 expert lawyers from France, Italy, Spain and the United Kingdom, we seek to gain new insights into the concept of know-how, by addressing the following questions: How are know-how requirements understood and interpreted by doctrine and jurisprudence? And, is there consensus in the interpretation of the characteristics of know-how?

In this paper, we try to answer these questions. We believe the findings allow us to better understand the concept of know-how, and provide a critical insight of the various characteristics of the know-how imposed by the European regulation. The findings further highlight the importance of evaluating the effectiveness of know-how.

1.1. Know-how and franchising

The term “know-how”, an abbreviation of the US expression “know-how to do it”, was first used in Europe fifty years ago. Over the last half century, know-how has become a more generic term, including not only industrial and production secrets but also commercial secrets and knowledge derived from experience¹. According to the International Association for the Protection of Intellectual Property (AIPPI), “know-how” is constituted by “knowledge and experience of a technical, commercial, administrative, financial or other nature, which is practically applicable in the operation of an enterprise or the practice of a profession”. Know-how is now integrated into intellectual property rights as well as industrial property rights

¹ Binctin N. (2018), *Savoir-faire*, Répertoire de droit commercial, Dalloz.

(patents, trademarks and models), copyrights and neighbouring rights². However, whilst know-how is a valuable intangible resource, it does not benefit from a specific legal protection.

For franchise systems, in addition to system identifiers and the technical and commercial assistance provided to chain members, the transmission of know-how is one of the three main pillars of the franchise contract³. Know-how is even considered to be the “cornerstone” of franchising⁴. It is this element that distinguishes franchising from other distribution contracts (concession, partnership...)⁵. If know-how does not exist, the franchise contract is reclassified into a collaboration contract, a supply contract or a brand licensing contract⁶.

The interviewed lawyers confirmed the fact that know-how is usually considered to be the most important criterion that contributes to the duplication of the franchisor success.

“It is a qualifying criterion for the existence of a franchise contract because it requires know-how, a brand and assistance. So without know-how, there is no franchise, we are in something else, we can be in a dealership, license, whatever you want, but not a franchise.” (Interviewee 11)

“In fact, the know-how is THE determining criterion of the franchise contract in relation to all the other contracts of cooperative trade, so it's THE criterion.” (Interviewee 8)

“Franchising has a specificity, it is the duplication of the know-how.”
(Interviewee 4)

² Commission Regulation 330/2010, Article 1 (f).

³ Baschet D. (2005), *La franchise : Guide juridique – conseils pratiques*, Gualino.

⁴ Baschet D. (2005), *La franchise : Guide juridique – conseils pratiques*, Gualino.

⁵ Mainguy D. (2018), *Contrats spéciaux*, Dalloz, 11th edition.

⁶ Malaurie-Vignal M. (2017), *Droit de la distribution*, Sirey, 4th edition.

Interviewees explained that know-how is composed of different elements that are not necessarily innovative but which, through their unique combination, create originality and efficiency.

“The know-how, by my definition, is a cooking recipe. That is to say that there are known elements, elements that you find everywhere and that you mix with your sauce. So, it's a mix of known elements which means you having something like a concept. You do not have 36 ways to make a ham-butter sandwich. On the other hand, what you do have, is how to select your suppliers, how to present your sales area, your brand, how to sell your sandwich, to welcome your customers, to give this little extra, all that leads to a specific know-how, so the know-how is a cooking recipe.” (Interviewee 4)

“What is know-how? It is a set of resources and skills that the franchisor has conceptualized to operate in an efficient and profitable manner. And from there, by having [...], a finished product which has an efficiency, he is able to sell it to franchisees who come to him, not to buy the know-how, but to buy the right to use the know-how.” (Interviewee 12)

According to the interviewees, by providing franchisees with a competitive advantage, the know-how puts them on the path of commercial success.

“The main characteristic of know-how is that it is a way of doing a thing that gives you some kind of difference in comparison with your competitor. This is the main characteristic of know-how and it is as simple as that.” (Interviewee 22)

“What's important to me is that it brings me a competitive advantage, saving me time and money in setting up my business.” (Interviewee 3)

“Its scope is to be effective, to bring a competitive advantage. [...] It must enable the person who buys the rights, paying the entry fee, the royalties, etc., to profitably exploit his/her business.” (Interviewee 12)

The interviewees explained that know-how enables franchisee candidates who are unfamiliar and inexperienced of the sector, to become very good professionals.

“The know-how is all the crap created by the franchisor when he started his pilot stores and that the franchisees will not know about, the mistakes they will not make, because they pay an entry fee, royalties and so on. Thus, it is the opportunity for a candidate, who is new to the business, to use the practical experience of the franchisor through the establishment of its pilot stores.” (Interviewee 3)

“Know-how is something that will allow someone unfamiliar with the trade to become an expert. So it's a definition that is personal, but it's developed on the basis of experience. [...] The franchisee will sign the franchise contract because he wants to buy a job he does not know how to do. [...] The know-how is what will allow a guy who has never baked to become a baker. In 15 days, without any baking qualification, it will allow someone who is not a baker to run a bakery. Maybe not to be a baker, but to run a bakery. [...] So that's it, the know-how. So actually, the good idea, the concept, the sign, the graphic charter... All that is not enough, it does not encompass know-how, knowing that franchising [...], it's not only the know-how but also the transmission of the know-how.” (Interviewee 8)

The interviewees also specified that know-how is not a fixed, standardized concept. It has different contents and limits depending on the countries concerned, and the sectors of activity.

“The problem [...] is that the know-how that franchisors make available to their franchisees varies from business to business.” (Interviewee 14)

“[Know-how] has different forms according to the industry and the country [...]. It is not easy to define a franchisor’s know-how. It depends, for example, on whether you sell services or you sell products. If you sell services, it is probably easier to define know-how because what you are selling is basically based on a particular know-how. If you sell products, it is more difficult to identify the franchisor know-how, but in that case, it is the capability of the franchisor to have a particular marketing activity or a particular presentation of the products.” (Interviewee 25)

The interviewees mentioned that even within the same country, and the same sector, there are different types of know-how: technical know-how and commercial know-how, back office know-how, front office know-how, the transferred know-how and non-transferred know-how...

“I believe that there has been a very important evolution in the interpretation of what ‘know-how’ is by the Courts. In the beginning, know-how was mainly associated with industrial knowledge, which was associated with industrial property rights like patents, but subsequently the definition of what could be considered ‘know-how’ has been greatly expanded and now includes commercial or business knowledge, and is now more commercial than industrial. This trend is relevant in franchising because franchising is more about the transmission of commercial knowledge rather than industrial

knowledge. So I consider this evolution of the concept of know-how to be correct.” (Interviewee 24)

“I have the feeling that the most important thing is the commercial know-how. Compared to technical know-how, for me, it's the most distinctive, and can be the most distinctive in the relationship between the franchisee and his customers. So, for me, this is the one that the franchisee will look for, from a franchisor, more than a technical know-how. Maybe another approach is possible, but for me, that's what will make a nice franchise chain, it's still a chain in which there is an added value from the franchisor-franchisee relationship.” (Interviewee 6)

“From my point of view, the true know-how is a very operational know-how, which consists of two aspects in the most developed systems. That is to say, there is the know-how that I use with the [...] terms front office and back office. The know-how is the combination of these two types [...]. Back-office know-how is how we will manufacture the product, [...] the right package... good technology, good logistics, good supply chain. And so, that's the back-office know-how.” (Interviewee 10)

“I would like to distinguish between two levels of know-how, the fact that there is a know-how that is transferred to the franchisee and another know-how that is not transferred to the franchisee. For me, the distinction is important because if I take the example of ready-to-wear, a franchisor will not transfer its know-how on the creation of a collection, on the management of the logistics and so on.” (Interviewee 3)

1.2. Know-how defined

In the last Regulation on vertical agreements (n°330/2010), the Commission of the European Union highlights that the know-how is a package of “non-patented practical information, resulting from experience and testing by the supplier, which is secret, substantial and identified” (Article 1 (g)). The Commission provides some details on these characteristics. “Secret” means that the know-how is not generally known or easily accessible. “Substantial” refers to know-how that is significant and useful to the buyer for the use, sale or resale of goods or services. “Identified” means that the know-how is described in a manner sufficiently complete to enable verification of whether it meets the conditions of secrecy and substantiality⁷.

It was clear that all the lawyers interviewed were familiar with the 2010 regulation on vertical agreements and what it demands in terms of know-how.

“The know-how is defined in the 330-2010 regulation as a set of secret, substantial, identified non-patented practical information, resulting from the experience of the supplier and tested by him in this context.” (Interviewee 11)

However, some of them were perplexed by the qualifiers used to identify the know-how. These adjectives were considered irrelevant and out of touch with the economic reality.

“Substantial, secret, identified, it is not very clear and so at the level of so-called jurisprudence, [...] that is, the application of these texts by the Judges, it is unclear [...] each Judge will shape the definition. [...] And you have franchise chains for which you have judges who say, somewhere in France: ‘Yes, there is a know-how’ and in another place in France, at the same time on the same chain, ‘no, there is no know-how’. You have experts who are

⁷ Commission Regulation 330/2010, Article 1 (g).

appointed by the Judges, judicial experts, one will say, 'there is a know-how', the other will say, 'no there is no know-how'." (Interviewee 8)

"Secret, substantial and identified, I challenge a franchisor to define the terms. If you want me to say that [i.e., the know-how] is secret, substantial and identified, I would not tell you, even if these are the terms that are used. Because I was going to say, these are terms of lawyers, pedantic lawyers, magistrates disconnected from the economic reality." (Interviewee 4)

Some of the interviewees explained these views by the fact that the criteria used were qualitative rather than quantitative and involve subjective evaluations.

"We are on a subjective assessment, what we call a subjective judgment in law and not an objective assessment. Objective is 30% of market share, it is 1 million turnover. There, we are objective. We know if we are below or above. But here, we are subjective." (Interviewee 1)

"As long as we are using qualitative and not quantitative criteria, we will remain in a position which is inevitably subject to interpretation. Then, we can restrict the interpretations in dominant case law, in constant jurisprudence by saying: 'Judge, you have no right to say that', because the judges above do not say it or say different things. But it will always be subject to interpretation. And so, there will always be this legal uncertainty. [...] This is the huge problem of the franchise contract. For the franchise contract to become something big, powerful, capitalized, there must be legal certainty." (Interviewee 8)

It can be seen from the perspectives offered above, that despite the critical role of know-how in both the franchise concept and franchise regulation, its central characteristics, are still open to interpretation. We therefore explore the three characteristics of know-how, i.e., identified, substantial and secret, in more detail in the following sections, before providing some concluding remarks.

2. THE ‘IDENTIFIED’ CHARACTERISTIC

In order to be clearly identified, know-how must first be tested. Once properly identified, it will be more easily transmittable and will be ready to be exploited in compliance with the standards of the franchisor.

2.1. Tested know-how

The franchisor know-how must have been tested and experienced to prove its effectiveness. The experimentation of know-how is clearly required by the Commission Regulation 330/2010 which specifies that know-how must result from the experience of the franchisor and must be tested by him/her. However, the conditions of this experimentation are not mentioned. The European code of ethics for franchising, does however, provide some guidance on this. It states in its Article 2.2. that “the franchisor shall have operated a business concept with success, for a reasonable time and in at least one pilot unit before starting its franchise network”.

Regarding the number of pilot stores in which the franchisor know-how must have been tested, French case law considers satisfactory a single store. As far as the duration of the test is concerned, no precise indication has been given except that a test period of 6 months has been considered too low⁸. The AFNOR 220-000 standard, which has no binding effect, specifies a

⁸ Gouache J.B., Behar-Touchais M. (2016), *Choix de la franchise*, Lexis, Jurisclasseur Commercial, fasc. 316-1.

minimum duration of 12 months. Furthermore, the “three-two” rule requires that the franchisor know-how be tested in three pilot stores placed in different locations for at least two years⁹. However, it must be recognized that the duration of the experimentation cannot be the same for all types of chains. It is closely linked to the level of technicality of the know-how and the nature of the activity carried out. Experimentation carried out in another country such as the US or under a brand other than the initial one are considered acceptable¹⁰. Of course, it is absolutely necessary that the franchisor pilot stores can demonstrate undeniable success and that they are profitable.

The interviewed lawyers provided a number of perspectives of the ‘tested’ know-how, and how this can be demonstrated.

“When we talk about franchise contracts and when we talk about ‘know-how’ in franchise contracts, I think we're talking about [...] the knowledge, the practices, the operations that the franchisor has developed and successfully tested over a certain period of time, and which is of interest to the franchisee to be able to use in the exploitation of his/her business.” (Interviewee 24)

“On the experience testing requirement, then there is no legal threshold on testing. It is simply said that it must have been sufficiently tested [...] Clearly, if he has a store that he has operated for less than a year, we will tell him, ‘well, we think we will have a lot of trouble demonstrating, explaining to a judge’ that it is sufficiently tested.’ Conversely, a franchisor who has ... I do

⁹ Gast O. (1982), La règle des trois-deux, Franchise Magazine, 5.

¹⁰ Gouache J.B., Behar-Touchais M. (2016), Choix de la franchise, Lexis, Jurisclasseur Commercial, fasc. 316-1.

not know, 3 stores for 3 years will have *a priori* not too much difficulty to assert the ‘testing’ requirement.” (Interviewee 9)

“We don’t franchise without having proven the system, without testing the concept successfully. We often curb clients who want to expand using franchising much too early and we explain to them that this is not how it works or they will head straight for disaster.” (Interviewee 7)

“It’s important to have pilots. [...] It allows the franchisor to test its new products, its new concepts, its new processes internally before telling the franchisees, ‘This is what you will do because I have tested it and that it works well’. Always the same ideas of, ‘I succeeded like that, I will explain to you how you will succeed’. And that’s why the franchisee is there, the franchisee pays an entry fee to have a turnkey concept. You have to give him this turnkey concept. It can only be given if it has been tested beforehand by the franchisor.” (Interviewee 7)

2.2. Identified know-how

Know-how must be identified, that is to say, it must have been formalized on one or more different written records providing proof of its existence and facilitating its transmission to the franchisees. Commission Regulation 330/2010 (Article 1 (g)) emphasizes that the identified characteristic “means that the know-how is described in a sufficiently comprehensive manner so as to make it possible to verify that it fulfils the criteria of secrecy and substantiality”. The exemption regulation of 30 November 1988 (Article 1, 3 (i)) indicated that the description of the know-how could be made in “the franchise agreement or in a separate document or recorded in any other appropriate form”. The know-how can be transmitted in writing and/or orally.

First of all, a detailed description of the know-how can be included in the franchise contract. It is, however, inadvisable to do so given the volume of information and especially for reasons of confidentiality¹¹. It is therefore preferable to describe the know-how in documents attached to the franchise contract, called most often, instruction manual, operations manual or franchise ‘Bible’. These documents are given to the franchisees at the signing of the franchise contract. Other possible forms of documentation for know-how are softwares, USB sticks, online forms, etc.

The oral communication of know-how is realized by means of initial and continuous training sessions, meetings with the franchisees, internships in a pilot store, in a franchised store, or in a special center specific to the chain. Additionally, the technical and commercial assistance that the franchisor must provide to its franchisees, serves to transmit certain elements of the know-how¹². Although the French case law accepts that the transmission of know-how can be made only orally, it is nevertheless necessary for the franchisor to provide evidence through various documents (conventions, attendance sheets, invoices, training certificates, assessment surveys, etc.). In this respect, it would seem preferable to transfer most of the know-how in an operations manual, albeit in a written or online form¹³.

The interviewed lawyers also highlighted the importance of the codification of know-how in order for it to be recognized as ‘identified’

“Identified: it means that it will be accessible somewhere. There must be documentation, material, what we call the Bible, the [operations] manual [...].” (Interviewee 1)

¹¹ Baschet D. (2005), *La franchise : Guide juridique – conseils pratiques*, Gualino.

¹² Le Tourneau P. (2016), *Contrats informatiques et électroniques*, Dalloz.

¹³ Gouache J.B., Behar-Touchais M. (2017), *Rédaction du contrat de franchise - Clauses essentielles*, Lexis, Jurisclasseur Commercial, fasc. 316-2.

“Identified means that the know-how is described in a sufficiently complete manner to make it possible to verify that it has fulfilled the conditions of secrecy and substantiality.” (Interviewee 11)

“It is common now to access the elements of the know-how with an access code on an Intranet with regular updates of access codes to avoid losses of elements.” (Interviewee 3)

“Its substance [i.e., of the know-how], is in the operations manual. So today, everything is done over the Internet. The know-how, it is transmitted by... there are platforms that are updated regularly, there is often a video to explain how to approach a customer. How to prepare a pizza... You see? [...] Digitalization is increasingly important in the knowledge... well, in the transmission of know-how.” (Interviewee 11)

Interviewees explained that identified know-how is not assessed solely from the operations manual or the Intranet site. It is also assessed from training sessions that must be of sufficient number, and from the regular assistance provided to franchisees.

“[The judges] will see if there is good training. They will see if there was a training plan, if there is something a little serious or if it's just two days of training of standing around in a store.” (Interviewee 3)

“You cannot claim to bring substantial, secret and identified know-how if the initial training you offer to franchisees is 3 days. It is not possible. So the duration of the training is important. That's why, when we advise future franchisors, after we have thoroughly brainwashed them on whether or not, there was going to be a know-how to transfer, it's to tell them, ‘Organise long

training, even if you do not have much to say, even if in fact it could be held in 3 days, do it in 15 days. Because when it comes to the judge, it will have the color, the smell and the taste of something complicated. [...] So even artificially, lengthen training times.” (Interviewee 8)

“Know-how should be complemented by assistance from the franchisor to the franchisee during the whole life of the contract.” (Interviewee 20)

2.3. Transmittable know-how

The know-how transfer normally occurs when the contract is signed and continues until termination. In order to be transmittable, knowledge forming part of the know-how must be detachable from the franchisor, and not constitute a subjective personal talent attributed to the specific franchisor who is especially able and capable, because in this case, the know-how would no longer be contractually transferable¹⁴.

The know-how must be passed on so that the franchisee can implement it, and replicate the success achieved by the franchisor in his/her own stores¹⁵. Know-how transmission is fundamental for the franchisee because it enables him/her to open a store without any experience and without any particular knowledge by holding positive (the steps to follow) and negative (behaviors to avoid) information. It also allows the new franchisee to save time and money because s/he could otherwise have only discovered all or part of this know- after long and expensive research¹⁶.

¹⁴ Simon F. L. (2009), *Théorie et pratique du droit de la franchise*, Joly.

Leloup J. M. (2004), *La franchise : Droit et pratique*, Delmas.

¹⁵ Zakharova-Renaud O., Meresse S., Grimaldi C., 2017, *Droit de la franchise : Contrat, distribution, concurrence*, Lexis Nexis.

¹⁶ Zakharova-Renaud O., Meresse S., Grimaldi C., 2017, *Droit de la franchise : Contrat, distribution, concurrence*, Lexis Nexis.

2.4. Exploited know-how

The franchisee is required to rigorously apply the know-how developed by the franchisor and described in the operations manual. Compliance with the standards set by the franchisor should normally allow the franchisee to be successful. It also promotes the maintenance of store uniformity and franchise chain homogeneity¹⁷. When the franchisee does not respect the standards defined in the operations manual, s/he incurs his/her contractual liability, and risks being confronted with a possible termination of his/her franchise contract. To ensure compliance with the template, the franchisor will implement various means of control generally foreseen in the franchise contract. The franchisor may, in particular, require the franchisee to disclose certain accounting documents and carry out visits to the premises through on-field consultants. All these controls are admitted by the Courts, provided that they do not lead to franchisor interference in the franchisee's business and that they do not compromise franchisee independence¹⁸.

3. THE 'SUBSTANTIAL' CHARACTERISTIC

Franchisor's know-how must be substantial which implies, for some legal experts, that it is also original.

3.1. Substantial know-how

The regulation of 20 April 2010 uses the same adjectives as the regulation 2790/1999 of 22 December 1999 to qualify the franchisor know-how. However, in the case of the substantial characteristic, the know-how is no longer limited to "include information which is indispensable" (Article 1 (f)) but must also be "significant and useful to the buyer [the

¹⁷ Mainguy D. (2018), *Contrats spéciaux*, Dalloz, 11th edition.

¹⁸ Gouache J.B., Behar-Touchais M. (2017), *Rédaction du contrat de franchise - Clauses essentielles*, Lexis, Jurisclasseur Commercial, fasc. 316-2.

franchisee in our case], for the use, sale or resale of the contract goods or services” (Article 1 (g)).

For some authors¹⁹, this modification in the definition of the substantial characteristic of know-how makes it easier to justify the existence of know-how by the franchisor. This interpretation of the new text is based on the fact that Commission Regulation 330/2010 takes into account know-how as a whole rather than the individual parts which combine to create the know-how. The franchisor would thus be favored because s/he no longer has to detail precisely the information that comprises the reality of the know-how. S/he simply has to attest that, as a whole, the know-how is “significant and useful” to the franchisee. This view is consistent with former Spanish jurisprudence like the Neck&Neck case.²⁰

For other authors²¹, the updated definition of the substantial characteristic does not appear as a relaxation of the definition of know-how but rather, as a consolidation of it. To support this view, it is sufficient to consider that, even if indispensable, information remains information, and not knowledge to solve problems. If it is not accompanied by training and the franchisors’ assistance, the written know-how will not be enough to ensure the success of the franchisees. It

¹⁹ Toussaint-David G. (2010), Les nouvelles règles de concurrences communautaires applicables aux réseaux de distribution, *Cahiers de Droit de l’Entreprise*, 4, 19, 29-36.

Simon F. L. (2010), Savoir-faire et droit communautaire, *Franchise Magazine*, 215, 140. <https://www.lettredesreseaux.com/P-1424-451-A1-savoir-faire-et-droit-communautaire-projet-de-reforme-du-reglement-du-traite-ce-n-2790-1999-22-decembre-1999.html> (accessed online 30 May 2018).

²⁰ STS 754/2005, 21/10 (RJ 2005\8274), Tribunal Supremo (Sala de lo Civil, Sección 1ª). Court ruling n. 754/2005, 21st October 2005.

²¹ Bensoussan H. (2010), Règlement européen : un savoir-faire mieux reconnu, *Franchise Magazine*. Meresse G. (2009), Franchise : La nouvelle définition du savoir-faire protégera les franchisés, <https://www.franchise-magazine.com/expert-franchise/tribunes/franchise-la-nouvelle-definition-europeenne-du-savoir-faire-protegera-les-franchises> (accessed online 30 May 2018).

can thus be considered that Commission Regulation 330/2010 provides a wider and more effective definition of know-how compared to the 1999 definition²²:

- wider, given that this know-how has to be taken into consideration as a whole with all its aspects, not only the indispensable information it includes;
- more effective, given that now the know-how has to be proven to be useful, i.e., the franchisee should expect to succeed more easily compared with an independent small business owner²³.

Beyond these divergent interpretations, the European code of ethics for franchising defines the substantial characteristic as “the fact that the know-how includes information which is of importance for the sale of goods or the provision of services to end users, [...] ; the know-how must be useful for the Franchisee by being capable, at the date of conclusion of the agreement, of improving the competitive position of the Franchisee, in particular by improving the Franchisee’s performance or helping it to enter a new market”.

The franchisor’s substantial know-how must have be of unquestionable utility for the franchisee, giving them an undeniable competitive advantage, which will enable him/her to face competition in better conditions and achieve high-performance results. It should also be emphasized that in the retail sector, the know-how is usually less substantial than in the service sector, and that the assessment of the substantial characteristic of know-how must take into account the level of experience or inexperience of the franchisee²⁴.

²² Meresse G. (2009), Franchise : La nouvelle définition du savoir-faire protégera les franchisés, <https://www.franchise-magazine.com/expert-franchise/tribunes/franchise-la-nouvelle-definition-europeenne-du-savoir-faire-protectera-les-franchises> (accessed online 30 May 2018).

²³ Perrigot R., Basset G. (2015), The impact of European legislation on franchising: A focus on know-how, e-commerce and resale prices, *Interfirm Networks: Franchising, Cooperatives and Strategic Alliances*, Editors : J. Windsperger, G. Cliquet, T. Ehrmann et G. Hendrikse, Springer International Publishing Switzerland, 149-170.

²⁴ Schmidt-Szalewski J. (2004), Le secret du bon savoir-faire, *Propriété Industrielle*, March, Comm. 27.

According to the interviewees, for know-how to be considered substantial, it supposes that all the procedures to be followed, all the details of how to present merchandise, all the ways to create and continue the dialogue with customers, etc., have been detailed in length. The more the know-how is detailed and illustrated, the more it will be easy to argue its substantial characteristic in front of the judges.

“Substantial: it means that it must contain a real body of rules that will allow a franchisee, when he has access to it, to set up a process that will allow him/her to manage his/her store.” (Interviewee 1)

“[The know-how] is substantial, that is to say that it must not be a small pocket of know-how. It must be a set of know-how that is sufficient for its transfer to be subject to protection.” (Interviewee 11)

“The operations manual is the book that is supposed to summarize [...] all the standards of execution and visual presentation of the concept. [...] It's finally the heart of the chain and the concept. If it's 3 pages, it means that there is nothing. So in fact, it has to be thick. [...] Even if it is blah blah..., if it contains a lot of pictures and diagrams, it must be thick.” (Interviewee 8)

The ‘substantial’ characteristic of the know-how is disputed by some lawyers who, through their experience, know some franchise chains which are very successful without having substantial know-how. According to them, the term used would be poorly chosen because it does not make enough reference to the economic aspects, and in particular, to the competitive advantage that the know-how is supposed to provide.

“Substantial, yes, I think it's a pretty good definition. [...] I would have personally preferred a more economic definition and we often talk about a

competitive advantage. That is to say regarding having access to this know-how, I do not care if it is substantial or not, what matters to me is that it provides me with a competitive advantage, to save me time and money setting up my business.” (Interviewee 3)

“[The definition does not reflect what is meant by know-how in the UK]. Know-how does not have to be substantial. [...] In the franchise context, I can’t understand why it says ‘substantial’. I know plenty of franchise systems where the know-how is not substantial, but it is still called a franchise, so I would take issue over the substantial characteristic.” (Interviewee 15)

“How do you measure substantial? Substantial could be just what you need to know in order to sell a product and operate the business, but it does not have to be substantial. I think it is very hard. That is a really subjective test about substantial and I think therefore it is open to a huge amount of interpretation.” (Interviewee 15)

“In practice, half of the franchise chains operate without ‘substantiality’. The number of franchise chains I can advise that do not even have a [operations] manual, they are performing extremely well and can have hundreds of franchisees, and yet they have know-how. So it's a word maybe to explore, but I do not have any particular comment.” (Interviewee 10)

The Commission Regulation 330/2010 and the European Code of Ethics for Franchising state that the substantial nature of know-how corresponds to significant and useful know-how. This terminology is hardly more convincing to the lawyers who referred to it.

“When we are going to plead cases of franchising and the materiality of the know-how is disputed, its significance more precisely, you can arrive with your suitcase of operations manuals to show what is communicated physically. [...] So, to convince a judge, when the know-how is attacked, you have to show him [...] concretely what it represents in volume of papers, etc. And so, it's the same, [...] it's very hard to demonstrate the usefulness. It is demonstrated by the success of the brand, the utility. So, I do not really see how it can be demonstrated otherwise. [...] Only by the success.” (Interviewee 11)

“I think franchises are still created when the know-how is significant and it is useful, but there are plenty where it is useful and it is slightly significant, so it is amazing what people franchise. It depends what you would call know-how, I suppose.” (Interviewee 15)

3.2. Original know-how

European regulations do not make any reference to the originality of the know-how, and there appears to be little consensus as to the importance of it. For some authors²⁵, the originality of the know-how is a constituent element of the franchise contract. For other authors²⁶, know-how does not have to be original because what matters is its effectiveness²⁷. French jurisprudence appears to be hesitant but it also considers that “the effectiveness of a know-how is better than

²⁵ Vogel L., Vogel J. (2015), *Traité de droit économique*, Bruylant, Tome 2.
Legeais D. (2014), *Franchise*, Lexis, Jurisclasseur Commercial, fasc. 316.

²⁶ Ferrier D. (2008), *Droit de la distribution*, Litec.

Grimaldi C., Méresse S. (2011), *Droit de la Franchise*, Litec.

²⁷ Knott A. M. (2003), The organizational routines factor market paradox, *Strategic Management Journal*, 24(10), 929-943.

its possible originality”²⁸. However, when originality is required, it is relative. On the one hand, it is not necessary for all the elements of the know-how to be original. It is sufficient that the combination of these is original. On the other hand, the original characteristic of the know-how is assessed with some flexibility²⁹.

One of the interviewed lawyers explained the fact that the word ‘original’ is not used anymore in the European texts, and compared know-how to a food recipe.

“[In the European regulations], initially, we spoke about originality of know-how. Today, there is no longer this originality because the Internet, by nature, kills the originality, because when you create something, it is known right away and then it is copied.” (Interviewee 5)

“There is no longer the word ‘original’ [in the European regulation], but still, it transpires anyway. There is a form of requirement, a form of originality, but we have deleted that and we speak of significant and useful, because [...] know-how in franchising must be something that brings [something]. A franchisor today is no longer someone who brings something original, it is someone who is an exceptional trainer. It is someone who brings a real training that is pragmatic, that has a lived experience. [...] This is the franchisor of today, it is no longer the one who found the wonderful idea [...] because it is impossible, because simply, the wonderful idea will be copied within three to four months of its release, it will be copied.” (Interviewee 5)

²⁸ Bensoussan H. (2012), Indemnisation du franchisé et savoir-faire, *Revue Lamy Droit des Affaires*, 73.

²⁹ Le Tourneau P., Zoïa M. (2017), *Franchisage - Franchisage dans le domaine des services. Le franchiseur et le franchisé*, Lexis, Jurisclasseur Contrats, fasc. 1050.

“The know-how is a combination of skills [...] that distinguishes us, like in a kitchen and cooking a recipe. Even if we know the [keys], we would not, and should not be able to reproduce this know-how. [...] These are elements which, taken in isolation, are not original, but whose combination, and most importantly implementation, are not easy to operate for the layman and that is why it brings [...] an economic advantage.” (Interviewee 5)

3.3. Know-how effectiveness

In addition to considering issues of originality, interviewees suggested that it is important to consider the effectiveness of the know-how. They proposed that the effectiveness of know-how can be assessed first of all in relation to the smooth running of the chain. The renewal of contracts and the non-questioning of the franchisor know-how are good indicators.

“For me, the best way to evaluate it [i.e., the franchisor know-how] is to see the degree of chain exit or renewal of contracts. When you have a degree of contract renewal that is 97 or 98 or 100%, that suggests the know-how is very effective. When you do not have a significant degree of renewal, it is because whether there are problems in the application of know-how, or that might be the human know-how, because in a chain, you have a relational know-how, a know-how of harmony in the chain. It is fundamental, if there is no harmony, they do not stay. It's an associative life, a life of a couple.” (Interviewee 5)

“The lawyer will tell him [i.e., the judge]: [...] ‘Have you seen my chain? I have 150 franchisees, so there are not 150 fools who pay royalties for nothing’, so the success of the chain demonstrates the existence of know-how.” (Interviewee 4)

“It seems to me that today's approach of the judges is to compare what is happening within the chain itself. That is to say, if I have a franchisee who comes to question know-how when I have 95% of the chain that works well, he has no chance to demonstrate that there is no know-how.” (Interviewee 3)

Secondly, the efficiency of the know-how is measured in relation to the balance sheets of the franchisor, of the franchisor pilot stores and of the franchisees, especially those who joined most recently. According to the lawyers we interviewed, it is also possible, even desirable, to compare the results, the profitability of the stores with those of chains close to them in terms of competition.

“The know-how quality of a franchisor? You know, success is the only criteria. [...] No one can appreciate the relevance of know-how, except at the time of the balance sheets at the end of the year. Do not complicate things. Do not sophisticate them. I do not see that we can make a grid to evaluate know-how. It would be a grotesque exercise. We are in business and the criterion in business is success.” (Interviewee 2)

“[The evaluation of the franchisor know-how is made by] its usefulness [...]. This is the success of the brand compared to a market benchmark. Is the brand more successful than its competitor, roughly on the same segment? [...] The success of utility, it is measured by the success of the brand compared to its competitors.” (Interviewee 11)

“You [i.e., franchisee candidate] look at the balance sheets of his pilots [i.e., balance sheets of the franchisor pilot stores]. First, you look at the franchisor's record. To know if he is solid, if he does not have too many debts outside. Because if he has too many debts, it means that franchisees have difficulty

paying. This means that if they have difficulty paying, one can possibly ask the question about the relevance of the know-how. Then, you look at the balance sheets of the pilots. Have the pilots done good business repeatedly? And most importantly, you look at the balance sheets of existing franchisees. So, mature franchisees and then recent franchisees. We must look at the records of the first two years when a franchisee joins. Only in this way, only by looking at the numbers, we can evaluate the relevance of know-how. [...] I can have a great idea, but if the idea does not translate into hard currency, you know, my idea, it is not worth so much.” (Interviewee 4)

4. THE ‘SECRET’ CHARACTERISTIC

The know-how must be secret and to reinforce this characteristic, it is important that it continues to be developed and updated.

4.1. Secret know-how

According to Commission Regulation 330/2010, Article 1 (g), ““Secret” means that the know-how is not generally known or easily accessible”. If the rules of the art of the profession are widely known, or at the very least, easily accessible, then they cannot, *a priori*, satisfy the requirements of the secret criteria of know-how. However, it seems difficult to become a competent baker by simply reading a cook book. Other elements contribute to the final service such as the quality of the chosen ingredients, the way to apply the recipes, the learned tricks that make the difference between various professionals. Thus, what may at first glance seem very accessible, is not necessarily so.

Regarding the secret characteristic of the know-how, the Regulation of 30 November 1988 stated that this concept should not be understood “in the narrow sense that each individual

component of the know-how should be totally unknown or unobtainable outside the franchisor's business". The secret characteristic of the know-how is therefore relative. Some elements of the know-how can be individually known or easily accessible (composition of the product ranges, presentation of the products offered for sale, etc.) without their totality being revealed (turnover rate of each item, profitability of such-and-such range of products...)³⁰.

The lawyers interviewed had differing views as to what could be considered an acceptable level of confidentiality (the 'secret') of the know-how. Some consider that the know-how should not be known outside of the chain, while others are less demanding and simply believe that the franchisor know-how should not be capable of being discovered too easily.

"And the third criterion, therefore identified, substantial and secret. Secret: it is perhaps one of the most important in that it must always, always, always be kept in the chain." (Interviewee 1)

"The 'secret' of know-how does not mean that all the elements that are transferred are absolutely secret." (Interviewee 3)

"Secret means that the know-how is not generally known and easily accessible." (Interviewee 11)

"It is said that the 'secret' is not a real secret. It's something that is not easy, not too easy to reach." (Interviewee 5)

The know-how of the franchisor must not leave the chain. It can only be communicated to franchisees and they have the obligation "not to disclose to third parties the know-how provided by the franchisor as long as this know-how is not in the public domain"³¹. However, even if, at

³⁰ Leloup J. M. (2004), *La franchise : Droit et pratique*, Delmas.

³¹ Guidelines on vertical restraints (2010/C 130/01), point 45.

the end of the franchise contract, physical documentation such as the operations manual can be returned and access to the Intranet removed, the know-how learned cannot be erased from the memory of the franchisees³². Therefore, franchisors need to protect the secrecy of his/her know-how through various contractual clauses.

However, it must be recognized that the confidentiality of know-how has its limits, given that some elements are passed on to franchisees and their staff. The interviewed lawyers explained that it is difficult to remove from a franchisee (and employees) the know-how that has been passed on to them, or to identify the origin of any leaks when they exist.

“To give you an example, at [Brand name], they will have 20, 30, 40 staff members, and they are changing all the time. So everyone can get a copy of it if they want. It is not secret as such, it is more generally issued under an obligation of confidentiality but it is never that effective.” (Interviewee 16)

“In a franchise unit, in a franchise chain, there are so many people, so how are you going to prove that the franchisee has violated the confidentiality of the know-how? It's impossible.” (Interviewee 5)

“A franchisee who exits a franchise chain and who redevelops his/her business... They cannot be prevented *a priori* from redeveloping their own business or at least within very restricted limits. So to what extent is an element he uses an element of the know-how that he has acquired from the franchisor, that he would not have the right to continue to use or that would be confidential, or is it something he could have developed? This is something that is quite difficult to demonstrate in practice.” (Interviewee 9)

³² Houtchieff D. (2016), Droit Commercial, Sirey, 4th edition.

“Imagine the guy who has a take-away pizzas franchise [...], he's going to learn a lot of things and in fact, we find these people, who are partners in independent take-away pizza companies. And of course, it's a safe bet that in these companies, without paying a fee to a franchisor, they apply the recipes they learned from the franchisor of their main brand. It's logic.” (Interviewee 8)

“You train the franchisees in how to do the business. When they stop doing the business, you cannot stop the training, they know it, so it is not, actually, that much you can do to protect it.” (Interviewee 16)

In order to protect the secrecy of the know-how, there are a number of mechanisms which franchisors can use. The confidentiality clause specified in the franchise contract obliges the franchisee not to disclose the know-how transmitted. It is sometimes supplemented by a clause of non-use of the know-how at the end of the contract. However, in practice this prohibition is little more than an illusion, given it cannot make franchisees forget what they have learnt through their application of the know-how of the franchisor³³. There are other clauses such as the non-reaffiliation clause or the non-competition clause that are also designed to protect know-how.

The importance of such clauses to protect secrecy, were also highlighted by a number of the interviewed lawyers. The use of a confidentiality clause, often coupled with a penalty clause, is highly recommended by some lawyers. Although it does not completely prevent the disclosure of know-how, it can at least have a deterrent effect.

³³ Le Tourneau P. (2016), Contrats informatiques et électroniques, Dalloz.

“Of course, there must be a confidentiality clause in the contract and also we provide for a confidentiality clause in the [franchise] disclosure document. When we give the [franchise] disclosure document to the prospective franchisee, I suggest that clients sign a very simple confidentiality agreement.” (Interviewee 21)

“We must put a confidentiality clause, we must put a penalty clause in. Once your know-how has been revealed in violation of the confidentiality clause, it's hard to go back. [...] Once it's gone, it's gone.” (Interviewee 4)

“We have a confidentiality agreement when we talk to a franchisee candidate, we will make him/her sign a confidentiality agreement, telling him/her, ‘you are given access to a certain number of documents, information, that you keep secrets for X years’. These are very standard contracts, that we do almost daily. In the franchise contract, we provide a confidentiality clause as well. So indeed, it does not prevent the disclosure to the outside, but it is essential, always, to have this know-how protection there.” (Interviewee 1)

With respect to the non-competition clause, whilst it is useful to prevent the franchisee from continuing to use the franchisor know-how on termination of the contract, interviewees explained that it must be limited in space and time.

“We will protect the know-how by clauses that organize, at the end of the contract, the return or the cessation of the use of elements that are a key part of the concept and know-how. So, it can be the return of the operations manual if there is a paper version. We will combine that with, as I said, technical and practical elements. Now, [in] most chains, operations manuals

are put online, accessible via an access code. This allows for access to be cut off when a person exits the chain.” (Interviewee 9)

“When you transmit confidential information, it is usual that you have a clause of non-competition in the contract. When you renew the contract, the franchisee should not transmit the information that they have. If they know that a third person is violating the know-how, they should inform the franchisor. That is very common to have that in the contract.” (Interviewee 20)

“Under English law, we will have both ‘in-term’, i.e., during the agreement, and ‘post-term’, after the agreement, restrictions on the franchisee using the know-how and the brand. [...] The English courts will really only recognise 12, maybe 18 months restriction within a reasonable geographical area, so it is not a huge amount of protection. However, that is the way it is and franchisors have to accept it or not to franchise, but generally, if you take someone out of the market for 18 months, it is very difficult for them to come-back and compete.” (Interviewee 13)

“We know very well that a franchisee at the end of the contract can do almost the same thing without much risk. And the answer of the judges, which is in my opinion a little easy, is to say that as the know-how must evolve, the franchisee who exits a chain will have a know-how, but not its evolution.” (Interviewee 3)

Whilst these different confidentiality clauses are widely used in practice to keep know-how secret, another complementary method is strongly recommended; the continuous updating of know-how.

4.2. Dynamic know-how

The best way to preserve the secrecy of know-how is to ensure that it continues to evolve. Whilst the European texts remain silent on this point, the European code of ethics for franchising asserts that “the franchisor guarantees the right to use the know-how transferred to the franchisee, which it is the franchisor’s responsibility to maintain and develop”. The fees paid to the franchisor also make it possible to find a justification for the obligation to continually develop the know-how. The entry fee can be seen to correspond to the provision of initial know-how while the royalties would be used to finance the development of know-how³⁴.

The know-how must adapt to its environment and be updated taking into account the evolution of markets, competition, customer expectations, etc. Improvements to know-how may concern the products offered for sale, customer services, store layout, sales methods, etc. The pace of know-how renewal depends in particular on the business sectors concerned. When they are dependent on fashion (hair styling, aesthetics, ready-to-wear, eyewear, etc.), modifications of know-how will be frequent³⁵. Any know-how should be piloted, and then franchisees consulted before being implemented across the chain. This will be all the more important as the development of know-how implies high costs (new display materials, new software, etc.). The financial resources required, the requirement of new training, etc., are not always welcome among all franchisees. The most reluctant to accept changes to know-how are often the more experienced franchisees and those whose contracts are coming soon to the end³⁶. Be that as it may, the franchisor cannot, overnight, modify, unilaterally, his/her know-how or risks seeing some franchisees requesting termination of the contract and the payment of damages.

³⁴ Gast O. (1995), Plaidoyer pour une révision de la notion de savoir-faire en matière de franchise : « Du savoir-faire au savoir-réussir », *Les Petites Affiches*, 132, 9.

³⁵ Baschet D. (2005), *La franchise : Guide juridique – conseils pratiques*, Gualino.

³⁶ Leloup J. M. (2004), *La franchise : Droit et pratique*, Delmas.

The importance of updating know-how in order to make obsolete the information transferred to franchisees who exit the chain, was highlighted by many of the lawyers interviewed

“The best protection of know-how is the permanent evolution, [...]. When I train franchisors [...], I tell them, ‘your first protection strategy is the need to constantly update your know-how.’” (Interviewee 5)

“Know-how must evolve and the franchisor must be able to always develop its know-how, adapt, integrate this or that parameter [...]. It is necessary that the franchisee has in his hands a concept that is alive and which is constantly reviewed, corrected and challenged by the franchisor. That's why we need the means to perpetuate this know-how. [...] It does have to become obsolete after 2 years.” (Interviewee 7)

“In my view, the main benefit or the main value of know-how is not the know-how today, it is the know-how of next month, and six months, and 12 months. If I buy a franchise, if you give me the know-how now, it is not a secret anymore because everyone has got it but I am paying into the fact that you are going to keep developing and improving it all the time.” (Interviewee 16)

“From the viewpoint of the franchisor, know-how is something that must be developed on a daily basis, because know-how is good today, but not tomorrow. If you want to maintain the confidentiality of know-how, but know-how is not good one year later, it does not make sense. [...] The best way to maintain the confidentiality and the value of that knowledge is to continuously improve the know-how.” (Interviewee 22)

“Between the franchisor and the franchisee, or among the franchisees, there must necessarily be a lot of working committees where we change the know-how. We exchange views, ‘I realized that the loyalty card was not very effective, when one behaves like this, when one behaves like that, etc.’ There are exchanges of views from which it results, in 9 cases out of 10, in adjustments to the know-how.” (Interviewee 5)

5. CONCLUDING REMARKS

The lawyers who participated in this study emphasized that know-how remains the most important criterion of the franchise contract. Know-how is not an unambiguous concept. It presents particularities according to the sectors of activity concerned (e.g., services, retailing). It concerns technical, administrative and commercial fields. It can originate in the front office as well as in the back office, and therefore may not be transmitted to all chain members.

The mandatory qualifiers of know-how imposed by the European authorities, i.e., substantial, secret and identified, leave perplexed many interviewed lawyers who regret that the attributes are subjective notions and not objective ones. Whatever the case may be, the professionals we met recommend the franchisor’s know-how be detailed as much as possible in a substantial operations manual.

According to them, it is the effectiveness of the know-how that is important, and it is this that will ensure the success of the franchisees. Contract renewal, chain growth, franchisor and franchisee reviews, and benchmarking with chain that are competitively close, are also indicators for assessing know-how effectiveness in a franchise chain.

Despite the allusive nature of know-how, the findings from this study suggest some consensus around its application in franchising. Firstly, know-how in franchising refers to the transmission

of know-how to franchisees. Secondly, it is a means of ensuring commercial efficiency for all chain members. Finally, although know-how may correspond to knowledge that is common to several chains within the same sector of activity, it must remain unknown to the general public.