

**International
Comparative
Legal Guides**



Franchise

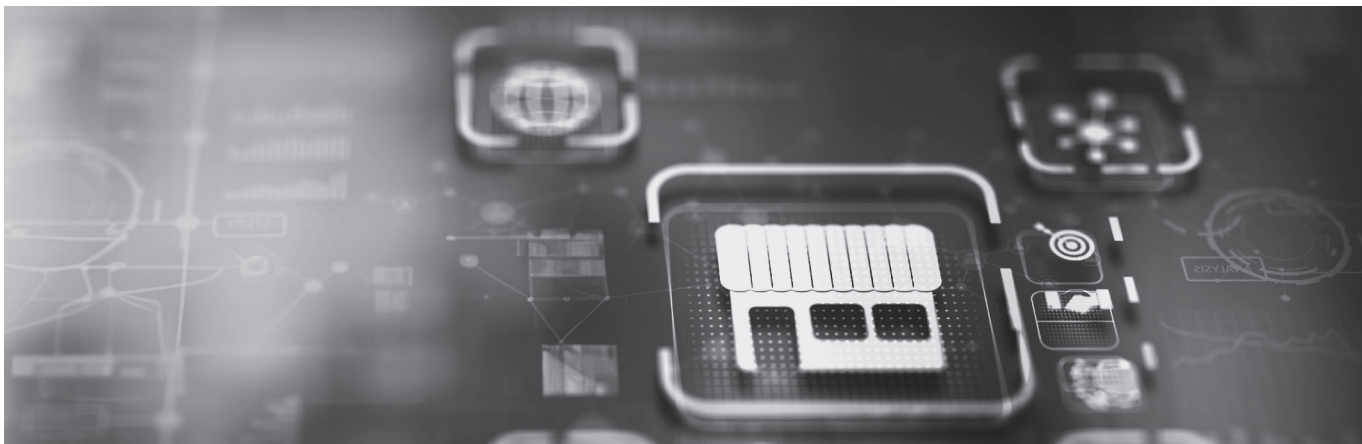
2024

10th Edition

Contributing Editor:

Iain Bowler
Freeths LLP

glg Global Legal Group



ISBN 978-1-83918-301-0
ISSN 2055-8082

Published by

glg Global Legal Group

59 Tanner Street

London SE1 3PL

United Kingdom

+44 207 367 0720

info@glgroup.co.uk

www.iclg.com

Publisher

James Strode

Production Editorial Assistant

Cameron Baillie

Head of Production

Suzie Levy

Chief Media Officer

Fraser Allan

CEO

Jason Byles

Printed by

Ashford Colour Press Ltd.

Cover image

www.istockphoto.com

Strategic Partners



International Comparative Legal Guides

Franchise 2024

10th Edition

Contributing Editor:

Iain Bowler

Freeths LLP

©2023 Global Legal Group Limited.

All rights reserved. Unauthorised reproduction by any means, digital or analogue, in whole or in part, is strictly forbidden.

Disclaimer

This publication is for general information purposes only. It does not purport to provide comprehensive full legal or other advice. Global Legal Group Ltd. and the contributors accept no responsibility for losses that may arise from reliance upon information contained in this publication.

This publication is intended to give an indication of legal issues upon which you may need advice. Full legal advice should be taken from a qualified professional when dealing with specific situations.

Introductory Chapter

- 1** **Introduction to ICLG – Franchise 2024**
Iain Bowler & Jaskeerat Sanghera, Freeths LLP

Industry Chapters

- 4** **Support a Strong Global Franchise Community**
Matthew Haller, International Franchise Association (IFA)
- 6** **The BFA: Pioneering for the Future**
Pip Wilkins QFP & Emily Price QFP, British Franchise Association (BFA)

Q&A Chapters

- | | |
|--|---|
| <p>10 Australia
Thomson Geer: Bronwyn Furse</p> <p>21 Brazil
Pitanga Bastos: Daniel Pitanga, Mônica Pinheiro & Rodrigo Rodrigues</p> <p>30 Canada
Hoffer Adler LLP: Joseph Adler, Idan Erez & Stephanie Chong</p> <p>41 China
Jones & Co.: Paul Jones & Jiahui (Jennifer) Zhang</p> <p>50 England & Wales
Freeths LLP: Iain Bowler & Jaskeerat Sanghera</p> <p>62 France
Linkea-Avocats: Cecile Peskine & Clémence Casanova</p> <p>71 Germany
Noerr PartGmbH: Dr. Tom Billing & Dr. Jasmin Schulzweida</p> <p>82 India
LexOrbis: Dr. Shivani Shrivastava & C. R. Jacob</p> <p>90 Korea
IPG Legal: Sean Hayes & Jiwon Min</p> <p>97 Netherlands
Kennedy Van der Laan: Martine de Koning & Tosca Bokhove</p> <p>109 New Zealand
Jackson Russell: Darryl King</p> | <p>118 Nigeria
ÆLEX: Tiwalola Osazuwa, Ifeoluwa Ebiseni & Nenjom Asuk</p> <p>126 Norway
Advokatfirmaet Forsberg DA: Per Forsberg & Dag Thorstensen</p> <p>133 Saudi Arabia
Hammad and Al-Mehdar Law Firm: Suhaib Hammad</p> <p>140 South Africa
Fluxmans Inc.: Ian Jacobsberg</p> <p>148 Spain
ELZABURU: Javier Fernández-Lasquetty Quintana & Jorge Parada Chacón</p> <p>157 Sweden
Sagell & Co. Advokatbyrå: Dan-Michael Sagell</p> <p>164 Turkey
Pehlivan & Güner: Haşmet Ozan Güner, Nilgün Gonca Deveci & İpek Açıkgöz</p> <p>173 United Arab Emirates
BSA Ahmad Bin Hezeem & Associates: Munir Suboh, Amala Atieh & Felicity Hammond</p> <p>184 USA
Rosen Karol Salis, PLLC: Richard L. Rosen, Leonard S. Salis & John A. Karol</p> |
|--|---|

From the Publisher

Dear Reader,

Welcome to the 10th edition of *ICLG – Franchise*, published by Global Legal Group.

This publication provides corporate counsel and international practitioners with comprehensive jurisdiction-by-jurisdiction guidance to franchise laws and regulations around the world, and is also available at www.iclg.com.

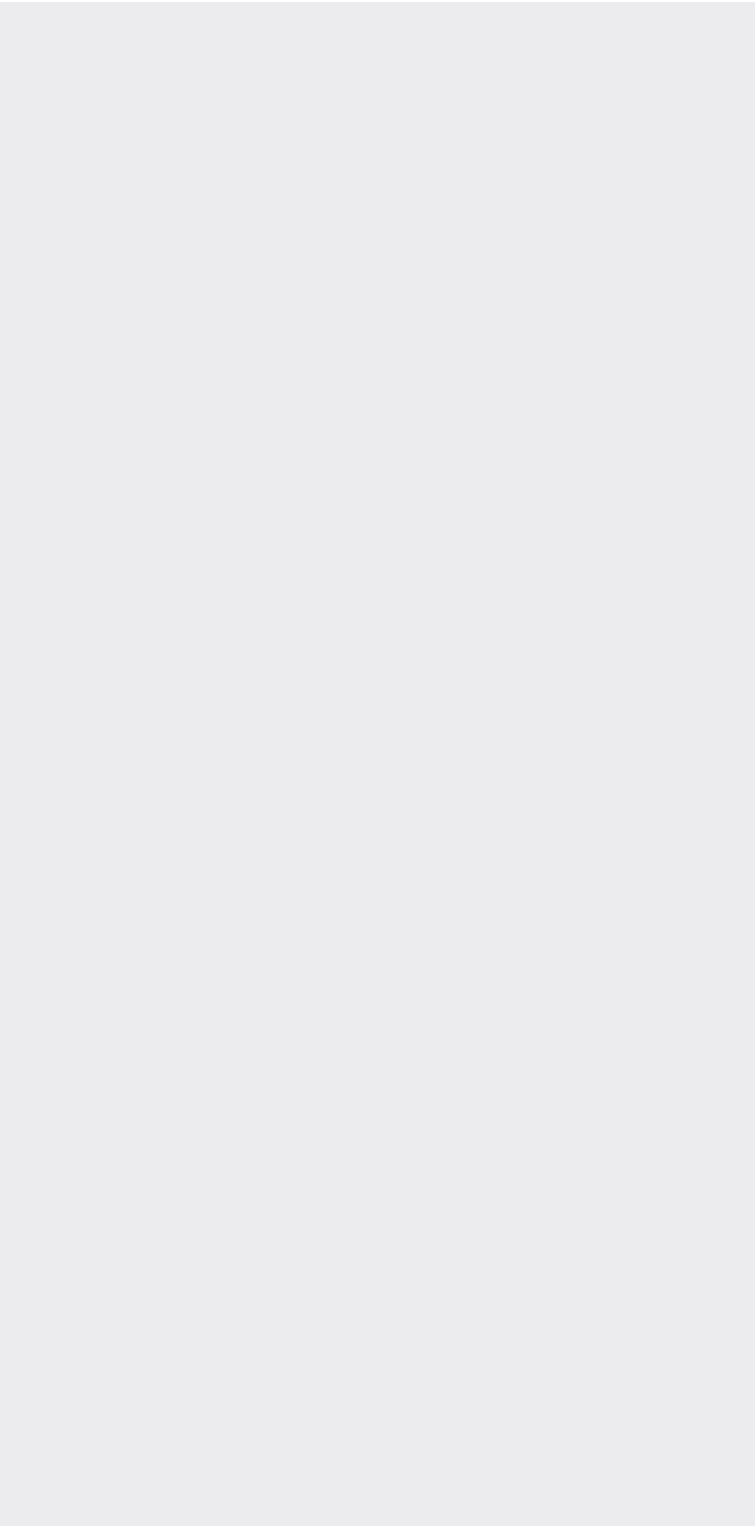
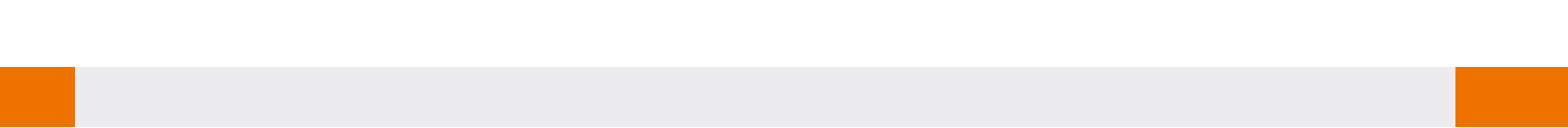
This year, two industry chapters discuss the work and significance of franchise associations.

The question and answer chapters, which in this edition cover 20 jurisdictions, provide detailed answers to common questions raised by professionals dealing with franchise laws and regulations.

As always, this publication has been written by leading franchise lawyers and industry specialists, for whose invaluable contributions the editors and publishers are extremely grateful.

Global Legal Group would also like to extend special thanks to contributing editor Iain Bowler of Freeths LLP for his introduction to the *Guide* and leadership, support and expertise in bringing this project to fruition.

James Strode
Publisher
Global Legal Group



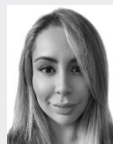
International Comparative Legal Guides

Introduction to *ICLG – Franchise 2024*

Freeths LLP



Iain Bowler



Jaskeerat Sanghera

Welcome to *ICLG – Franchise 2024*; the comprehensive guide to the world of franchising. This guide is for anyone looking to grow their business through franchising; whether considering franchising for the first time, or expanding an existing franchise system regionally or internationally, let this be your roadmap to understanding and embarking on a successful franchise journey.

This guide serves as a useful resource for anyone interested in understanding the legal aspects of franchising, and has been collated using expert knowledge and advice from lawyers and industry specialists across a number of countries, each of which features its own chapter in this guide. Such individuals are leading experts in franchise law and brand licensing, and are familiar with the needs of aspiring entrepreneurs and business owners who want to gain an understanding of the key regulatory, legal and practical considerations that must be considered when contemplating entry into franchising, or an expansion strategy using a franchise system.

Although this guide will not make you an instant expert in the laws and practice of franchising, it will equip you with what you need to know about building a franchise system for the first time, or taking your franchise system into other countries. You will gain a well-informed insight into the questions you will undoubtedly have when you decide to create a franchise system, or when you take your existing system overseas. It will enable you to be better informed, anticipate issues, scope your requirements, and ultimately be better prepared. It will also enable you to manage the external resources you will need in an efficient and cost-effective way, so that you have experts focusing and advising on the legal and regulatory factors freeing you up to prioritise the more practical day-to-day matters.

The country-specific chapters in this guide offer a comparative analysis of franchise laws across different jurisdictions, allowing you to understand the similarities and differences between each country and make an informed decision when opening a franchise for the first time, or expanding existing franchise operations globally. In order to help you navigate the complexities of international franchise law with confidence, each chapter is based on real life advice given to clients in relation to international expansion programmes, and have been sense-checked by asking a number of existing international franchisors about the issues they faced and the specific questions they wanted answering when they were planning their entry into a new territory for the first time.

Franchising is a complex legal concept that crosses over a number of disciplines, each of which have a material impact on the way you might structure your franchise system in any given country. This encompasses a combination of regulatory compliance, contract law, tax structuring, intellectual property law (in the form of trade mark protection and brand licensing),

real estate and competition law issues, as well as touching on employment law, corporate law, data privacy compliance, and cyber risk thrown in for good measure. On top of this, if you are looking to franchise internationally, you need to overlay: country-specific mandatory legal requirements; a recognition of the difference between civil law and common law jurisdictions; and cultural and business environmental considerations. As such, it is almost certainly the case that you will need to consult local legal counsel to advise on the set-up of your new franchise system in-country, as well as the “localisation” of your domestic franchise documents for use in the new territory.

Expansion or a first-time franchise, whether domestic or international, should be carefully planned; it should be strategic – carried out with the aim of delivering a pre-defined goal, and with the approach being tailored to deliver your commercial objectives. The importance of getting the system and the approach to the territory right from the outset cannot be overemphasised. The success of a franchise system depends on the dynamics of the franchise relationship, which include the franchisor providing franchisees with a proven and successful business model.

The costs of setting up a franchise system in the first place, and the additional costs of adapting an existing domestic franchise system, so that it can be rolled out and successfully replicated in new geographic locations, should not be underestimated. In fact, there can be considerable investment associated with merely testing the waters in a new territory, and undertaking exploratory talks with potential franchisees, before any decision is taken to enter that territory. Due to country-specific legal and regulatory requirements around registration and disclosure (such as in the United States), the thought of expanding a franchise overseas can be quite daunting for many. That said, it does not necessarily need to be a cost-draining exercise, as there are lower cost entry points in some countries by way of what is called “exemption-based franchising”, which should be considered as a means of getting an initial foothold in a new territory in a more cost-effective way. Exemption-based franchising uses specific exemptions from federal and/or local regulations that typically restrict the ability to offer franchises for sale in the territory without going through an extensive (and expensive) pre-sale disclosure exercise. The availability of exemptions can vary depending on the jurisdiction and the specific regulations involved, but commonly include exemptions from registration requirements, disclosure obligations or certain financial or operational restrictions imposed on franchisors.

In addition to legal and (sometimes) regulatory factors relevant to establishing and exporting a franchise system, the geopolitical and economic conditions, that are affecting every market where franchising is established as a successful business model, are making trading conditions extremely challenging. In this guide, we look at the development of online delivery

systems that have grown exponentially in response to lockdown conditions during the COVID-19 pandemic, and the demand for contactless transactions. While we may have long forgotten (or forced ourselves to forget) the impact of the pandemic, many industries and businesses around the world are still reeling from the impact of lockdowns and changes in consumer behaviours. On top of this, we have endured the effects of a war in Europe which has exacerbated pre-existing supply chain disruption and contributed to a cost of living and cost of doing business crisis that is itself fuelling rampant inflation on a global scale.

Franchising has a competitive edge and a resilience over other business models due to the benefits derived from the systems, scale, and marketing power and penetration of a larger brand. Because of its unique business model, franchising serves as an economic catalyst and, as such, has historically proven itself

to be a method of carrying on business that is generally more resilient in challenging economic times than stand-alone businesses of a similar type and size. The year 2023 was a testing time for many businesses with rising costs and interest rates. The economic outlook for 2024 is a little more optimistic, with predictions of limited growth in most developed markets, but we are not yet at pre-pandemic levels and consumers are as cost-conscious as ever. Economic uncertainty, coupled with the cost of living crisis and the continued war in Europe, will continue to test many businesses – but it will also be a time that presents new opportunities, particularly when it comes to expansion in lucrative but emerging markets such as the Middle East and Southeast Asia. One of the key issues for businesses will be how effectively they manage the risks, both externally and internally, within their chosen franchise system.

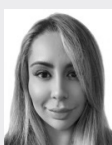


Iain Bowler qualified in 1988 and specialised in mergers and acquisitions, stock exchange and complex commercial and joint venture work. Between 1998 and 2002, Iain was Director of Corporate Finance at a corporate industrial developer headquartered in the UK and USA. He joined one of the world's largest global law firms as a Partner in 2002, where he was global Co-Chair of the Commercial Contracts and Franchise and Distribution Groups, before joining Freeths as Head of the Commercial and Franchise Group in 2019.

Iain's work includes commercial transactions of all descriptions, including supply chain management, procurement of goods and services, outsourcing, manufacturing, logistics, consultancy and services agreements, direct sale, agency, franchise, distribution, brand licensing, e-commerce and international trade. Iain is ranked as a "leading individual" for franchise work and is an Affiliate Member of the bfa.

Freeths LLP
1 Vine Street
Mayfair
London, W1J 0AH
United Kingdom

Tel: +44 7968 558 916
Email: iain.bowler@freeths.co.uk
URL: www.freeths.co.uk



Jaskeerat Sanghera qualified in 2017 as a solicitor specialising in commercial and franchise work. Jas joined Freeths in 2022 as a Senior Associate in the Commercial Group. She has worked across a range of sectors, including retail, IT, energy, sports, leisure, entertainment, financial services, media, fashion and automotive. In addition to advising on franchise transactions of all types, Jas' work also involves advising on IT, standard terms of sale/purchase, prize draw and competition terms and conditions, outsourcing, procurement, projects, IP licensing, brand partnerships, joint ventures and tech agreements.

Freeths LLP
1 Vine Street
Mayfair
London, W1J 0AH
United Kingdom

Tel: +44 345 340 4206
Email: jaskeerat.sanghera@freeths.co.uk
URL: www.freeths.co.uk

Freeths LLP is a top 50, full-service commercial law firm with 13 offices across the UK. One of the UK's fastest-growing law firms, Freeths has over 1,000 staff, and turnover in the last financial year in excess of £134 million, despite the unprecedented impact that the global COVID-19 pandemic had on the UK and international economies. *The Legal 500* and *Chambers and Partners* legal directories consistently rank Freeths' lawyers in their top tiers. We have franchise experts in a number of our offices, advising clients on all manners of franchise and distribution contracts, and we have specific expertise in exemption-based franchising in the United States. We have extensive experience in structuring, negotiating and documenting franchise transactions in the UK and internationally, including multinational master franchise, area and regional developer and area representative arrangements, joint ventures and other distribution and brand licensing relationships. Our clients come from all sectors, including retail,

coffee shops, fitness, technology, B2B services, beauty and media, and cover a broad spectrum of size and experience, from entrepreneurs and companies that are establishing new programmes, to large franchisors, manufacturers and distributors.

www.freeths.co.uk

FREETHS

Support a Strong Global Franchise Community

International Franchise Association (IFA)



Matthew Haller

The year 2023 has brought another year of strong growth for the franchise business model. While more moderate when compared with the explosive growth following the pandemic, franchising in the U.S. continues to outpace its independent business counterparts, showing the strength of the business model and the potential that lies ahead, both in the U.S. and abroad.

However, with this growth comes certain challenges and increased scrutiny. In the U.S., policymakers have placed a target on franchising – through legislative and regulatory efforts that could negatively impact the entire business model. Based in Washington, D.C., the International Franchise Association (IFA) is uniquely positioned to thwart these threats and work to ensure that policymakers understand the impact of franchising with any policy they consider.

Since 1963, IFA has been the world's oldest and largest association representing franchising worldwide, working every day to protect, enhance, and promote the franchise business model. As the U.S. is the birthplace of franchising, we have a keen focus on policies out of Washington, D.C. and the states that could have a ripple effect on systems around the globe.

This year, IFA has been increasingly focused on action stemming from the Federal Trade Commission (FTC), the key regulatory agency governing franchising in the U.S. While the FTC has been historically focused on disclosures through the Franchise Rule, the Commission has now shifted its focus to the franchise relationship. Earlier this year, the Commission issued a Request for Information, seeking public comments to answer a detailed list of 75 questions about “franchisors exerting control over franchisees”. IFA has been working to ensure the FTC, and lawmakers who oversee the agency, appropriately

understand the business model and why they need to be cautious about overstepping in a way that damages franchising.

In addition, the National Labor Relations Board (NLRB) and lawmakers in Congress have put forth proposals to fundamentally upend the franchise model through an unworkable joint employer standard that would threaten independent business ownership and expansion of business through franchising. Across various states, we have seen legislation interfering with the franchise relationship, namely in Arizona, Arkansas, and New Jersey – along with more attempts in California to target quick-service restaurants with joint liability. These proposals typically arise out of a fundamental misunderstanding of franchising, which is why IFA and our members work every day to educate policymakers across the U.S. IFA continues to be on the frontline to protect franchising – because we know it works, creating meaningful careers, uplifting communities, and expanding local economies.

Each year, IFA convenes legal experts from around the world to discuss these issues, both in the U.S. as well as other nations, arising around the world. At the IFA Legal Symposium and the International Bar Association/IFA joint conference in Washington, we were joined by representatives from 15 countries to discuss some of the most pressing challenges in international franchise law, such as ESG, artificial intelligence, franchisor/franchisee negotiation, and more.

IFA will continue to stay closely engaged with all of these issues, wherever they arise, so we can ensure the preservation of the franchise business model and all the opportunities it creates around the globe.



Matthew Haller serves as President and CEO of IFA. Matt has been a key member of the IFA team for over 10 years, building extensive relationships with all three segments of IFA membership: franchisors; franchisees; and suppliers. During his tenure leading IFA's advocacy strategy, Matt expanded the association's lobbying, coalition building, grassroots, research and communications capabilities and took on some of IFA's most difficult challenges, including defending the business model against the joint employer threat and significant legislative and regulatory issues at the federal, state and local levels.

Prior to IFA, Haller was Director of industry relations at the Pharmaceutical Care Management Association, where he developed PCMA's member and affiliate initiatives. He also served as manager of political affairs at the U.S. Chamber of Commerce, managing a \$20 million budget for political and issue advocacy campaigns.

International Franchise Association (IFA)

1900 K Street, NW, Suite 700
Washington, D.C. 20006
USA

Tel: +1 202 460 8356
Email: mhaller@franchise.org
URL: www.franchise.org

Celebrating over 60 years of excellence, education, and advocacy, IFA is the world's oldest and largest organisation representing franchising worldwide. IFA works through its government relations and public policy, media relations, and educational programs to protect, enhance and promote franchising and the approximately 775,000 franchise establishments that support nearly 8.2 million direct jobs, \$787.7 billion of economic output for the U.S. economy, and almost 3 percent of the Gross Domestic Product (GDP). IFA members include franchise companies in over 300 different business format categories, individual franchisees, and companies that support the industry in marketing, law, technology, and business development.

www.franchise.org



The BFA: Pioneering for the Future

British Franchise Association (BFA)



Pip Wilkins QFP



Emily Price QFP

Franchising in the UK: An Overview

The British Franchise Association (BFA), founded in 1977, continues to drive forward franchising in the UK, providing the essential strong foundations and standards framework that the community strives to achieve and maintain. The objective has always been to influence an environment that encourages enviable circumstances for growth, and as business landscapes evolve, the BFA has paused, for a moment of reflection, to ensure it is not only fit for purpose for now, but indeed also for the future. Overall, UK franchising remains strong: franchisors have taken steps to focus on core teams and processes; and franchisees have taken steps to improve business where needed, and expand where opportunities arise. We are currently seeing an increase in multi-unit and multi-brand expansion, evidencing the success of the (business format) franchise model, when the right investor meets the right franchise model.

When representing over 300 franchisors, 100 advisors and thousands of franchisees, we have a duty of care to our members to provide a platform for feedback; to listen, learn and act. This has resulted in a 360-degree review of the BFA operation, including its brand and objectives, to build on the strong foundations that have been upheld since its inception.

Current Legal Landscape

As UK franchising continues to operate in an unregulated environment, the BFA's work is of the utmost importance, acting as a self-regulator, and working closely with franchisors and advisors to ensure the code is executed in practice and that updates are made where necessary. The relationship between the BFA and its Legal Committee seeks to review potential threats and weaknesses, and proactively educates on leveraging case law to both advise and guide. The BFA's annual legal seminar provides franchisors with relevant and timely updates that help to strengthen and protect franchising, maintaining a healthy operating relationship between the franchisee and franchisor. Several webinars, dealing with specific challenges, have also been run to deal with industry risk. A particular issue to note is the training and enforcement of people management within franchisee businesses.

Self-regulation and Protection

The BFA accreditation process, in order to become a member, remains one of the most advanced in the world, and ensures that franchisors: are set for success; are familiar with the code of ethics; and understand their obligations as members. The BFA reaccrredits all members on a cyclical basis, and investigates, where necessary, using industry intelligence. A partnership

process is adopted through the reaccreditation process to support and influence change where needed. On occasion, franchisors do struggle, and encounter difficult scenarios for many reasons. For such cases, the BFA has introduced a consultative process to help with this, and success has been seen through this where remedial work has been needed and recommended.

Our franchisor membership categories are inclusive and representative of both the franchisor experience and network size, and we welcome international brands who are looking to export their brands into UK markets. By connecting the BFA member services with the BFA Academy (please see below for further information) education and support programmes, we are building an ecosystem where franchising can thrive.

The BFA, Forging a Path to Success

The beginning of 2022 saw the BFA's rebrand launched, resulting in a full review of the BFA's member needs, operations and connectivity to the business world in which we reside today. Crucially, this starts with purpose, vision, mission and our promise.

- **Purpose:** To empower people to make a positive impact on the world around them.
- **Vision:** Establishing ourselves as the hub for franchising in the UK.
- **Mission:** Provide and education space and accreditations that are governed by our high ethics and standards.
- **Our promise:** The place for franchising – where everybody has a story.

Alongside this vision and various mission statements, we have a clear set of values and behaviours that we believe will serve the community well in achieving a collective purpose which translates across all member categories.

Brand Values

Growth

We provide a space for individuals and collectives to come together and share their knowledge and wisdom to help one another prosper and grow. We support people and businesses with our years of knowledge, experiences and resources to enable people to develop and progress.

Innovation

We are always striving to become better, whether that be through natural progression or the adaptation of previously unknown ideas, we're always better than we were yesterday.

Positivity

Positivity breeds positivity. It's infectious. We are most definitely a half glass-full kind of brand. We use the power of positivity to make any situation a one that is positive for both ourselves and our community.

Diversity and Inclusion

People don't belong in "boxes" to be discriminated against. We love that everyone within the BFA is different, and it's our duty to make people feel welcome and valued enough to share without fear of judgment. Celebrating individuality means everything to us.

Trust

People's businesses are their livelihoods, and they trust us to help them grow. It's our responsibility to guide our members and be the people they can rely on, day in, day out, no matter what.

Passion

Passion is the ultimate fuel for anything. It is the fire within us that motivates us to get out of bed in the morning, and sends us home happy and content in the evening. Knowing that we've made a *difference*.

Brand Behaviours

Our brand behaviours are a new and important addition to the rebrand, and showcase what we need to do as an industry to increase productivity and inclusivity, as well as building a culture of continual development:

- Always offer help.
- Never stop learning.
- Have a "can do" attitude.
- Celebrate individuality.
- Be mindful of others.
- Wear your heart on your sleeve.

The rebrand has resulted in a stronger, more aligned community, where everyone has a platform to share, inspire and be inspired, depicting what franchising can achieve, while promoting the growth opportunities for all in the industry, whether franchisor, franchisee or employee.

Building Awareness of Franchising

There is still a lot of work to do in expanding the public understanding of business format franchising and showcasing the great opportunities that can come from it. The BFA has launched a magazine which serves as a window into franchising and connecting members to potential purchasers, as well as providing franchise education to prospect investors and franchisors of the future.

Included in the BFA PR calendar are digital marketing campaigns which enable collective promotion of the community, focusing on specific case study content, and serving this to target markets to expand the awareness of franchising. In 2023, the BFA launched a Diversity, Equity and Inclusion campaign, running over six months, featuring multiple people across the many facets of franchising. We are keen to provide people with confidence that there is something for everyone in franchising,

and franchising is welcoming of all into its community. Insight sessions with franchisees, franchisors and sector experts will live stream over the coming months, at the time of writing, to continue the dialogue on this topic.

The BFA PR department is focused on building trusted relationships with multiple publications, portals and press departments, in order to serve more people with rich educational content which features real people that will connect with a wider audience. Indeed, our work towards increasing awareness never stops.

Introducing the BFA Academy

The BFA Academy is the place to be for professional development in franchising. The academy has developed industry qualifications and accreditations, a suite of specialist events to support franchise businesses, community events to support networking and flagships to provide educational conferences with promotional opportunities. The annual learning calendar has evolved to represent the key challenges facing the industry, ensuring businesses remain up to date with current trends, and benefit from professional insights and advancements within the business world.

Historically, the BFA portfolio has been exclusively available to members only, focusing primarily on franchisor education. This has now changed, with the introduction of individual learning plans, an emphasis on professional development in franchising for franchisors, their teams, franchisees and people looking to enter franchising. The academy is open to all, and now provides a significant personal learning journey with career pathways and personal development plans to tailor the needs of individuals as well as businesses. This strategic development is significant in building capabilities, confidence and supporting career progression which will result in a much stronger community at the heart of British franchising.

The Qualified Franchise Professional Programme (QFP) was the first programme developed, designed to build knowledge and insight around the entire franchising lifecycle, coupled with ongoing nominated event participation to maintain ongoing know-how.

The introduction of a Qualified Franchise Coach programme will see franchisor and franchisee teams harness the opportunities that leadership, mentoring and a positive mindset can bring to building high performing teams in franchising. This, coupled with an executive coaching service, provides franchising leaders with a safe space to step out of the business and create room to think bigger and overcome obstacles which may otherwise never be dealt with in the day-to-day.

A mentor programme is being introduced to facilitate knowledge sharing and support across the community, allowing mentors to give back and help peers as we all strive to achieve bigger and better things in the community.

Membership and Representation

The BFA continues to grow and attract members of all shapes and sizes; however, the objectives is to ensure representation across all levels of franchising, including franchisees. Franchisees are the lifeblood of franchising, and operating at a grass-roots level means they see and feel the challenges head-on. The BFA franchisee membership serves this population with information, forums and programmes to overcome these challenges and collectively deal with them. The Franchisee Champion programme provides franchisees with a voice to represent on behalf of their brand and franchisor, and closes the gap between both franchisee and franchisor at an association level.

The Future

The BFA's dedication towards shaping a thriving and sustainable franchising landscape in the UK is consistent and focused. A strong head office team shares passion and enthusiasm for the future, as well as a commitment to supporting members throughout their franchising journey.

Looking ahead, we are excited to be launching a new industry survey in 2024, detailing industry trends, challenges and opportunities. There will be increased engagement with both local government and business departments, as well as building a strong network of educational institutions in order to ensure that we find a place for franchising on curriculums, to educate the franchise leaders of tomorrow.



Pip Wilkins QFP is the Chief Executive of the British Franchise Association (BFA). With more than 20 years' experience in the franchise sector, Pip has worked her way up within the Association, gaining insight from all areas of the business and the franchise industry. She is well-known and highly regarded in franchising for her dedication and depth of knowledge.

Pip regularly speaks at conferences and seminars both domestically and internationally, as well as writing on franchising matters for national, local and franchising trade press. Pip is also a regular judge for the annual BFA HSBC Franchise Awards, the Franchise Marketing Awards and Global Franchise Awards.

Pip represents the UK at both the European Franchise Federation (EFF) and World Franchise Council (WFC). The BFA has grown to be one of the largest franchise associations in Europe, and one of the most successful associations in the world.

British Franchise Association (BFA)

Merchant House, 5 East St. Helen Street
Abingdon, OX14 5EG
United Kingdom

Tel: +44 1235 820 470
Email: pipwilkins@thebfa.org
URL: www.thebfa.org



Emily Price QFP started her corporate career working alongside the Barclaycard HR Senior Leadership Team, focusing on global business transformation projects before joining the BFA in 2013. A regular judge to the BFA HSBC Franchise Awards, contributor to various publications, executive coach, mentor and public speaker, she is well-versed across multiple business disciplines.

Currently responsible for the BFA Academy and public promotion at the association, Emily works closely with colleagues from across the franchising industry to deliver high-quality, industry-changing initiatives that positively impact the sector. She is a passionate advocate of great leadership, people development and franchising, which serves her well in driving the strategic educational and promotional agenda for the association alongside the CEO.

British Franchise Association (BFA)

Merchant House, 5 East St. Helen Street
Abingdon, OX14 5EG
United Kingdom

Tel: +44 1235 820 470
Email: emilyprice@thebfa.org
URL: www.thebfa.org

The BFA is a not-for-profit, self-regulatory body for UK franchising and has been effectively representing to a high standard since 1977. If you are keen to find out more about how they can support you with your franchise development in the UK, you can visit www.thebfa.org or email mailroom@thebfa.org for more information.

www.thebfa.org



Australia

Thomson Geer



Bronwyn Furse

1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

The *Competition and Consumer (Industry Codes – Franchising) Regulation 2014* (Cth) (the Code), made under the *Competition and Consumer Act 2010* (Cth) (CCA) is a mandatory industry code that applies to all franchises operating in Australia.

Under the Code, a ‘franchise’ includes the rights and obligations under a ‘franchise agreement’, a master franchise, a sub-franchise and an interest in a franchise.

The Code defines a ‘franchise agreement’ to be a written, oral or implied agreement under which:

- (a) a person (the franchisor) grants to another person (the franchisee) the right to carry on a business of offering, supplying or distributing goods or services in Australia under a system or marketing plan substantially determined, controlled or suggested by the franchisor or an associate of the franchisor;
- (b) the operation of the business will be substantially or materially associated with a trade mark, marketing or a commercial symbol owned, used, licensed, or specified by the franchisor or an associate of the franchisor; and
- (c) the franchisee is required to pay or agree to pay fees to the franchisor or an associate of the franchisor before starting or continuing the business.

This definition is quite broad and has the capacity to capture arrangements not generally considered franchises. For example, certain licensing and supply arrangements.

The Code expressly deems some types of agreements to be franchise agreements (such as the transfer or renewal of a franchise agreement, the extension of the term or the scope of a franchise agreement, and a motor vehicle dealership agreements). For the purposes of this publication, we have not focused on motor vehicle dealerships or addressed the specific provisions under the Code that apply to these arrangements (noting they have additional and more specific rules that apply to them under the Code).

There are some limited exceptions where compliance with the Code is not required, such as where the franchise element of a franchisee’s business operations is not their whole business and only accounts for up to 20% of the franchisee’s gross turnover for goods or services of that kind for the first year of the franchise. However, this exception is limited and ceases to apply once that 20% threshold has been exceeded for three consecutive years.

1.2 What laws regulate the offer and sale of franchises?

The Code applies to the offer and sale of franchises, irrespective of whether the franchise is an existing franchise or a ‘green-field’ franchise.

The Code applies irrespective of whether the franchise sale will involve the transfer of an existing franchise agreement to the new incoming franchisee, or a new franchise agreement. Both forms of documentation are considered to be a ‘franchise agreement’ for the purposes of the Code and similar documentation and process requirements apply.

There are a range of other Australian laws that may also be applicable, for example:

- (a) Australian tax laws (such as Australian State and Territory regimes imposing stamp duty obligations and federal laws requiring the payment of capital gains tax);
- (b) the *Corporations Act 2001* (Cth);
- (c) the *Australian Securities and Investments Commission Act 2001* (Cth);
- (d) Australian State and Territory regimes applicable to such businesses (such as retail and commercial leasing legislation); and
- (e) the *Competition and Consumer Act* (such as the obligation not to mislead or deceive the franchisee/prospective franchisee during the offer and sale process).

1.3 If a franchisor is proposing to appoint only one franchisee/licensee in your jurisdiction, will this person be treated as a “franchisee” for purposes of any franchise disclosure or registration laws?

Yes, the Code will still apply to a franchise agreement, even where the franchisor only intends to appoint one ‘franchisee’ in the jurisdiction.

There are, however, some requirements for franchisors under the Code that do not apply if only one or no franchisees have been appointed in a particular period (such as the obligation to maintain a Disclosure Document).

1.4 Are there any registration requirements relating to the franchise system?

Franchisors are required to provide particular information for inclusion on the Franchise Disclosure Register hosted by the

Australian Government. Franchisors must also upload a copy of their Disclosure Document to the Franchise Disclosure Register.

Of course, other laws that require registration and apply to other business structures may also apply to a franchise.

1.5 Are there mandatory pre-sale disclosure obligations?

Yes, the Code sets out a range of pre-sale disclosure obligations on franchisors. Franchisors must provide prospective franchisees with a range of pre-sale disclosure documents at least 14 days before entering in to a franchise agreement or making a non-refundable deposit to the franchisor or an associate of the franchisor in connection with the proposed franchise agreement.

These same obligations apply to existing franchisees that are renewing or extending the term or scope of an existing franchise agreement, at least 14 days before that renewal or extension.

These pre-sale disclosure documents include the following four key documents:

- (1) the Disclosure Document in the prescribed form (containing comprehensive information about the franchise such as franchisor details, supply restrictions, future capital expenditure and initial and ongoing running costs);
- (2) a Key Facts Sheet in the prescribed form (containing a summary of the Disclosure Document described above);
- (3) an Information Statement in the prescribed form (for prospective franchisees only, containing general information about franchising); and
- (4) a copy of the Code.

Additionally, the franchisor must provide the franchisee or prospective franchisee with:

- (a) a copy of the franchise agreement in the form in which it is to be executed;
- (b) a statement that a prospective franchisee has read and understood the Code and Disclosure Document and received independent advice, or elected not to; and
- (c) where the franchisee is expected to lease a premises from the franchisor for the running of the franchised business, a copy of that lease and any disclosure information that the lessor gave the franchisor when it leased the premises.

Similar disclosure obligations (with some differences) apply to a proposed transfer of a franchise agreement, at least 14 days before the franchisor gives consent to the transfer.

If the franchisor has not already, it must register the franchise information and Disclosure Document in the Franchise Disclosure Register as discussed in question 1.4 above, and ensure that this information is updated annually.

1.6 Do pre-sale disclosure obligations apply to sales to sub-franchisees? Who is required to make the necessary disclosures?

Yes, the pre-sale disclosure obligations apply to sales to sub-franchisees. The franchisee makes those disclosures (and the Disclosure Document requires certain information about the master franchisor).

The disclosure obligations outlined in question 1.5 above must be made to the sub-franchisees by the franchisee. The Disclosure Document requires that information about the master franchisor entity and the nature of the master franchisor and franchisee arrangement be disclosed.

1.7 Is the format of disclosures prescribed by law or other regulation, and how often must disclosures be updated? Is there an obligation to make continuing disclosure to existing franchisees?

Pre-sale disclosure

In respect of the four key disclosure documents discussed at question 1.5 above:

- (1) The Disclosure Document is a prescribed form annexed to the Code, which must be updated within four months after the end of each financial year (subject to certain exception criteria).
- (2) The Key Facts Sheet is a prescribed form, which must be updated within four months after the end of each financial year (subject to certain exception criteria).
- (3) The Information Statement is a prescribed form published by the competition regulator and updated at their discretion.
- (4) The Code is amended from time to time.

Continuing disclosure

There are further continuing disclosure obligations on the franchisor. Some of these obligations include disclosing:

- (a) auditors' reports of marketing funds and other cooperative funds administered by or for the franchisor or master franchisor;
- (b) financial statements for the marketing fund;
- (c) changes in majority ownership or control of the franchisor, an associate of the franchisor or the franchise system;
- (d) legal proceedings or an award in arbitration against the franchisor for contraventions of certain laws;
- (e) a copy of the current Disclosure Document and Key Facts Sheet when requested in writing by the franchisee;
- (f) changes in intellectual property that are material to the franchise system; and
- (g) the franchisor or an associate of the franchisor being wound up, having a receiver or receiver and manager appointed to it, being under administration, executing a deed of company arrangement or restructuring.

1.8 What are the consequences of not complying with mandatory pre-sale disclosure obligations?

The regulator of the Code, the Australian Competition and Consumer Commission (ACCC) may choose to take enforcement action against the franchisor for non-compliance with the disclosure obligations under the Code.

The action taken by the ACCC will vary depending on the circumstances but may include issuing an infringement notice (which can be done without application to the court). Alternatively, or in the event that a franchisor does not comply with an infringement notice, the ACCC may initiate proceedings to seek civil penalties for relevant contraventions of the Code (noting that breach of the disclosure obligations can give rise to such civil penalties), and other orders such as injunctions or orders for compensation and damages.

Further consequences may also apply depending on the circumstances of the non-compliance. See question 5.1 below.

1.9 Are there any other requirements that must be met before a franchise may be offered or sold?

Yes, refer to question 1.2 above.

1.10 Is membership of any national franchise association mandatory or commercially advisable?

Membership of a national franchise association is not mandatory in Australia.

Nonetheless, franchisors often become members of the Franchise Council of Australia (FCA), which is the peak industry body for franchising. Franchisees and suppliers are also often members of the FCA. The FCA represents franchising sector perspectives to governments and provides a platform for members to have input into national policy, hosts networking and information sharing events, provides resources and access to expert advisory support services.

There are also industry specific franchising associations, such as the Australian Automotive Dealer Association. Depending on the franchisor's industry, they may be members of these organisations.

1.11 Does membership of a national franchise association impose any additional obligations on franchisors?

Yes, additional obligations can be imposed through membership terms.

1.12 Is there a requirement for franchise documents or disclosure documents to be translated into the local language?

There are some documents prescribed by the Code (see question 1.5 above) and those prescribed documents are written in (and must be issued in) English.

Other than this, there is no express requirement under the Code for documents to be in English, but accepted practice is that all documents should be in English (and we note that enforceability and other legal issues may arise if another language was used).

2 Business Organisations Through Which a Franchised Business Can be Carried On

2.1 Are there any foreign investment laws that impose restrictions on non-nationals in respect of the ownership or control of a business in your jurisdiction?

The *Foreign Acquisition and Takeovers Act 1975* (Cth) applies to certain foreign investments in Australia. Under this Act, foreign investors are required to notify the Treasurer of certain investments. The Treasurer then consults the Foreign Investment Review Board before deciding whether to approve, prohibit, or impose conditions on the investment.

Whether proposed foreign ownership requires such approval will depend on the circumstances including, who the foreign entity is, what the Australian business does, the proportion of the Australian business that the foreign entity will own and whether the acquisition raises any national security concerns. Broadly speaking, a foreign entity may require approval if they propose to acquire:

- (a) a substantial interest in an Australian entity that is valued above the relevant monetary threshold;
- (b) a direct interest in a national security business;
- (c) a direct interest in an agribusiness;
- (d) an interest of at least 5% in an Australian media business;
- (e) agricultural land and developed commercial land exceeding the relevant monetary threshold;

- (f) vacant commercial land;
- (g) mining or production tenements;
- (h) residential land;
- (i) land entities that have the majority of their assets in Australian land where the value of the investment is above the relevant monetary threshold; and
- (j) national security land.

Lower thresholds for approval may apply if the acquirer has foreign government investors in its ownership structure.

2.2 What forms of business entity are typically used by franchisors?

The most common form of business entity used by franchisors is a corporation. However, trusts and partnerships are also used.

2.3 Are there any registration requirements or other formalities applicable to a new business entity as a pre-condition to being able to trade in your jurisdiction?

Franchisors must register a profile and publish certain disclosure information on the Franchise Disclosure Register maintained by the Australian Government. Franchisors can also choose to publish their Disclosure Document, Key Facts Sheet and standard form franchise agreements on the Register.

In addition to this requirement under the Code, there are various other registration requirements applicable to new business entities (which are also not unique to franchises). For example, a new business entity will need to hold the appropriate registrations, licences and permits. Depending on the circumstances, this may include registration of the company and obtaining an Australian Company Number, obtaining an Australian Business Number for taxation purposes, registration of a trading name, and depending on the industry obtaining any relevant licences or permits.

3 Competition Law

3.1 Provide an overview of the competition laws that apply to the offer and sale of franchises.

The CCA is the primary legislation in Australia that regulates competition laws with the aim to enhance fair trading and competition in trade and commerce.

The offer and sale of franchises will generally be subject to the CCA. The main areas of relevance under the CCA (including the Australian Consumer Law set out in Schedule 2 of the CCA (ACL)) will be the provisions regulating:

- (a) misleading or deceptive conduct or false or misleading representations;
- (b) unconscionable conduct; and
- (c) the use of unfair contract terms to the extent that the franchise agreement is an eligible contract under the unfair contract term regime.

It is possible, that other competition-related provisions of the CCA may be relevant in some circumstances, such as where the offer or sale relates to a merger and/or acquisitions that may result in a substantial lessening of competition.

In addition, the provisions of the Code (which is a mandatory industry code prescribed under the CCA) that deal with the offer and sale of franchises must also be considered (as discussed at section 16).

3.2 Is there a maximum permitted term for a franchise agreement?

No, there is no maximum permitted term for a franchise agreement in Australia.

3.3 Is there a maximum permitted term for any related product supply agreement?

No, there is no maximum permitted term for a related product supply agreement in Australia.

3.4 Are there restrictions on the ability of the franchisor to impose minimum resale prices?

Yes, under the CCA it is illegal to impose minimum resale prices. This is commonly referred to a 'resale price maintenance'. There are various forms of conduct that constitute 'resale price maintenance' under the CCA and engaging in any such conduct is illegal.

'Resale price maintenance' can manifest in many ways; however, the broad principle is that a supplier must not make it a condition of supply that the customer will sell the products at a certain price (such as the recommended retail price) or not sell below a certain price or only discount the products as agreed.

3.5 Encroachment – are there any minimum obligations that a franchisor must observe when offering franchises in adjoining territories?

The Code does not impose any minimum obligations on the franchisor when offering franchises in adjoining territories.

The franchise agreement should clearly set out the rights and obligations of the franchisor and franchisee in relation to any territory. In doing so, consideration needs to be given not only to the location of the franchise, but also to the location of customers (including how customers who are located across multiple territories will be handled), and other related matters (such as how delivery services and online sales platforms will operate across the territories). Some of these matters need to be addressed in the Disclosure Document.

The conduct of the franchisor in granting franchises in adjoining territories must not contravene its obligation to act in good faith under the Code, and must reflect the franchisor's obligations under other relevant laws. For example, the conduct of the franchisor will also be regulated by the CCA (such as ensuring that the franchisor must ensure its conduct is not misleading or deceptive, unconscionable or otherwise in contravention of the anti-competitive provisions under the CCA).

3.6 Are in-term and post-term non-compete and non-solicitation of customers covenants enforceable?

Both in-term and post-term non-compete and non-solicitation of customers covenants are types of 'restraint of trade' provisions. Under common law in Australia, any restraint of trade provision is *prima facie* void on public policy grounds as being anti-competitive. A restraint of trade will only be valid (and enforceable) if it is reasonable, in respect of both the interests of the parties to the franchise agreement and the interests of the public. The reasonableness of the restraint will always depend on the circumstances, some of the factors for consideration include:

- (a) the geographical area covered by the restraint;
- (b) the activities restrained;
- (c) the period of the restraint;

- (d) whether the restraint is necessary to protect the goodwill in the business; and
- (e) the customs and practices within the relevant industry.

Additionally, the Code prescribes that restraint of trade clauses have no effect after a franchise agreement expires in certain circumstances. In general terms, this occurs if the franchisee sought to extend the term of the franchise agreement but the franchisor declined, in circumstances where the franchisee was not in breach of the franchise agreement (or a related agreement, and had not infringed the franchisor's intellectual property rights), and the franchisee claimed compensation for goodwill but only received a nominal amount in damages, or the franchise agreement did not allow the franchisee to seek such compensation. This exclusion requires careful drafting of restraint of trade provisions in a franchise agreement.

Despite the above, it is common for restraint of trade clauses to be included in franchise agreements.

4 Protecting the Brand and Other Intellectual Property

4.1 How are trade marks protected?

In Australia, trade marks are regulated under the *Trade Marks Act 1995* (Cth) (TM Act). A registered trade mark provides the registered owner of the trade mark the exclusive right to use the trade mark within the classes of goods and services nominated at the time of registration.

The use of a trade mark that is substantially identical or deceptively similar to a registered trade mark, without authorisation, constitutes infringement under the TM Act, for which various actions can be taken, including the commencement of proceedings and claiming of damages to compensate for loss or injunctions preventing any unauthorised use.

It is also possible to have rights in relation to common law trade marks (i.e. unregistered trade marks). Generally, franchisors (as part of the franchise agreement or related agreement) provide their franchisees with a licence to use the registered (and any unregistered) trade marks of the franchisor related to the franchise system. This right to use the specified trade marks is usually very limited and subject to the control of the franchisor (or owner of the registered trade mark).

4.2 Are know-how, trade secrets and other business-critical confidential information (e.g. the Operations Manual) protected by local law?

Trade secrets and other business-critical confidential information in relation to the operation of the franchise are not protected under any specific legislation but rather are commonly addressed by way of contractual obligations and obligations of confidentiality (that arise contractually and under common law). Such protections are critical elements of a franchise agreement to ensure that franchisor information is sufficiently protected and prevented from unauthorised use or disclosure.

4.3 Is copyright (in the Operations Manual or in proprietary software developed by the franchisor and licensed to the franchisee under the franchise agreement) protected by local law?

Copyright is protected in Australia under the *Copyright Act 1968* (Cth). Broadly speaking, copyright is protected under the Act if the particular work is:

- (a) original;

- (b) expressed in a material form;
- (c) of a particular nature (i.e. literary, dramatic, musical, artistic, sound recordings, cinematograph films, broadcasts and published editions); and
- (d) connected with Australia.

Copyright is a bundle of rights that gives the owner the exclusive right to reproduce, publish, communicate and make adaptations of the work. Copyright arises automatically upon creation of the work and it does not need to be registered in Australia. If a franchisor is the owner of copyright in materials relating to the franchise system, then the franchisor has the exclusive right to deal with the particular copyright works and can license the use of the copyrighted works to franchisees subject to necessary protections around the use and disclosure of such works.

Copyright commonly arises in operations manuals and software, and a franchise agreement should make clear who owns the intellectual property rights in those materials, as well as in any developments to those materials (which is commonly the franchisor, facilitated by an intellectual property rights assignment provision in the franchise agreement for any developments made or contributed to by the franchisee).

5 Liability

5.1 What remedies can be enforced against a franchisor for failing to comply with mandatory disclosure obligations? Is a franchisee entitled to rescind the franchise agreement and/or claim damages?

Depending on the circumstances, it may be possible for a franchisee to take civil action against a franchisor to obtain common law remedies and equitable remedies, such as damages, injunctions, rescission and other orders.

Depending on the circumstances, other civil action may also be open to the franchisee, such as action against the franchisor for misleading and deceptive conduct under the ACL.

Please also see the comments regarding the regulatory action that may be taken by the ACCC in question 1.8 above.

5.2 In the case of sub-franchising, how is liability for disclosure non-compliance or for pre-contractual misrepresentation allocated between franchisor and master franchisee? If the franchisor takes an indemnity from the master franchisee in the Master Franchise Agreement, are there any limitations on such an indemnity being enforceable against the master franchisee?

The Code requires the franchisee to provide disclosure to the sub-franchisee, but the disclosure document will contain some information about the master franchisor. Non-compliance with these disclosure obligations under the Code will therefore generally be a matter for the franchisee.

That being said, other areas of liability may also arise, such as liability for misleading and deceptive conduct and misrepresentation under the ACL. Such liability may arise for both the franchisor and master franchisee, depending on the circumstances.

A master franchise agreement may include an indemnity for the benefit of the franchisor, so long as this is not drafted in such a manner that it constitutes a general release of liability for the franchisor, or a waiver of any verbal or written representation made by the franchisor, both of which are prohibited by the Code. Any such indemnity will also need to be carefully considered and drafted in light of the unfair contract terms regimes under the CCA (to the extent that regime applies to the master franchise agreement).

5.3 Can a franchisor successfully avoid liability for pre-contractual misrepresentation by including a disclaimer in the franchise agreement?

No, the Code prohibits the franchisor from requiring that the franchisee sign:

- (a) a general release of the franchisor from liability towards the franchisee; or
- (b) a waiver of any verbal or written representation made by the franchisor.

Therefore, any such disclaimer in the franchise agreement would be void.

5.4 Does local law permit class actions to be brought by a number of aggrieved franchisees and, if so, are class action waiver clauses enforceable?

The Code allows a franchisor and two or more franchisees to agree to resolve two or more similar disputes under a franchise agreement as part of the one process (although, this is not a traditional class action).

In addition, class actions brought by aggrieved franchisees are permissible in Australia, provided the necessary criteria are met. In broad terms, this requires that seven or more persons have claims against the same person or persons, the claims of those persons to have arisen out of the same, similar or related circumstances and all claims give rise to a substantial common issue of fact or law. Further criteria may apply depending of the nature of the claim.

The enforceability of class action waiver clauses was considered for the first time in Australia in the recent case of *Karpik v Carnival PLC (The Ruby Princess)* [2022] FCAFC 149. In this case, it was found that class action waiver clauses are not inherently unlawful or contrary to the statutory purpose of the federal class action regime, and the class action waiver clause was ultimately upheld.

However, the exact position is not clear, and such waivers may be found, in some circumstances, to be void as unfair contract terms under Australian law. The exact circumstances where such waivers would be void is currently uncertain under Australian law.

6 Governing Law

6.1 Is there a requirement for franchise documents to be governed by local law? If not, is there any generally accepted norm relating to choice of governing law, if it is not local law?

There is no specific requirement under the Code for franchise documents to be governed by local law. However, the Code prohibits any provision in a franchise agreement that requires a party to bring an action or proceedings or initiate an alternative dispute resolution process in relation to a dispute under the franchise agreement in a jurisdiction other than the Australian State or Territory in which the franchised business is based.

6.2 Do the local courts provide a remedy, or will they enforce orders granted by other countries' courts, for interlocutory relief (injunction) against a franchisee to prevent damage to the brand or misuse of business-critical confidential information?

A foreign judgment may be registered under the *Foreign Judgments Act 1991* (Cth) provided that the judgment has been given

by specific courts from specified countries identified in the *Foreign Judgments Regulations 1992* (Cth) and includes monetary and non-monetary judgments given in civil proceedings. Once registered, these foreign judgments have the same force and effect as a judgment given in an Australian court and may be enforced. In addition, judgments given in the United Kingdom and New Zealand may be recognised and enforced in Australia pursuant to treaties entered into with those countries. Otherwise, foreign judgments can be enforced pursuant to common law principles, which include the requirements of recognition of the jurisdiction of the foreign court and the finality and conclusiveness of the foreign judgment. Local courts may not necessarily register or enforce judgments under these processes, as defences are available and, as a consequence, there are associated time and cost risks.

6.3 Is arbitration recognised as a viable means of dispute resolution and is your country a signatory to the New York Arbitration Convention on the Recognition and Enforcement of Foreign Arbitral Awards? Do businesses that accept arbitration as a form of dispute resolution procedure generally favour any particular set of arbitral rules?

Yes, arbitration is a viable means of dispute resolution in Australia and Australia is a signatory to the New York Arbitration Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

The Code prescribes alternative dispute resolution processes to be used in the resolution of disputes between franchisors and franchisees. The Code expressly sets out that a dispute may, by written agreement in the franchise agreement or another document, be resolved in whole or in part by arbitration. The Code sets out the procedure for the arbitration, but subject to this, the parties are free to agree on the applicable rules for the arbitration.

7 Real Estate

7.1 Generally speaking, is there a typical length of term for a commercial property lease?

Retail and commercial leases are regulated by legislation in each Australian State and Territory. Subject to certain exception criteria, the legislative minimum term for a retail shop (and in South Australia, a commercial office) lease is five years (inclusive of any options to renew).

There is no minimum term for other commercial leases; however, they typically range from a three-year lease with a two-year right of renewal, to a five-year term with a right of renewal for a further five years.

7.2 Is the concept of an option/conditional lease assignment over the lease (under which a franchisor has the right to step into the franchisee/tenant's shoes under the lease, or direct that a third party (often a replacement franchisee) may do so upon the failure of the original tenant or the termination of the franchise agreement) understood and enforceable?

Where a landlord agrees to such, a franchisor can step in (or direct that a third party step in) and take over a franchisee's lease. This is typically achieved in the form of a step-in deed, which is signed by the franchisee, franchisor and the landlord.

7.3 Are there any restrictions on non-national entities holding any interest in real estate, or being able to sub-lease property?

Under the *Foreign Acquisitions and Takeovers Act 1975* (Cth), non-national entities generally require approval from the Foreign Investment Review Board to hold any interest in real estate, or to enter into leases or licences for a period exceeding five years in duration:

- (a) agricultural land exceeding the relevant cumulative threshold;
- (b) developed commercial land exceeding the relevant monetary threshold;
- (c) vacant commercial land;
- (d) residential land; and
- (e) national security land.

The process and level of approvals required will depend on the particular circumstances of each case and specific advice should be sought on a case-by-case basis in this respect.

7.4 Give a general overview of the commercial real estate market. To what extent has the real estate market been affected by the Coronavirus pandemic? Specifically, can a tenant expect to secure an initial rent free period when entering into a new lease (and if so, for how long, generally), or are landlords demanding "key money" (a premium for a lease in a flagship location)?

The pandemic has created, at present, somewhat of a tenant-favoured market. The change in working practices so as to incorporate more work-from-home opportunities and online shopping has reduced the demand for office and retail space. On this basis we have seen some incentives. 'Key money' may vary between jurisdictions but is not permitted in South Australia under the retail and commercial leasing legislation.

8 Online Trading

8.1 If an online order for products or request for services is received from a potential customer located outside the franchisee's exclusive territory, can the franchise agreement impose a binding requirement for the request to be re-directed to the franchisee for the territory from which the sales request originated?

The Code requires that disclosure documents contain a section on online sales. Generally speaking, the franchise agreement can impose a requirement that the sale be redirected to the franchisee for the territory from which the sale originated, providing that this is fully disclosed in the Disclosure Document. Careful consideration and drafting of the provision would be required so as to ensure that the provision was not contrary to another law (for example, such a provision may be void where it was deemed to be an 'unfair contract term' for the purposes of the CCA).

8.2 Are there any limitations on a franchisor being able to require a former franchisee to assign local domain names to the franchisor on the termination or expiry of the franchise agreement?

There are no limitations on the franchisor requiring that a former franchisee assign local domain names to the franchisor post-termination. Such rights and obligations are subject to the terms of the relevant franchise agreement.

9 Termination

9.1 Are there any mandatory local laws that might override the termination rights one might typically expect to see in a franchise agreement?

Yes, the Code tightly regulates the way in which franchise agreements can be terminated. Termination provisions in the franchise agreement and associated documentation must be consistent with these requirements, and the franchisor must follow the process and timing in these provisions. At a very high level, these include the following termination rights:

- (a) a right for franchisees to 'cool off' and terminate the agreement without penalty within 14 days of entering into the agreement;
- (b) a right for franchisees to propose at any time termination of the agreement and criteria as to how and when the franchisor must respond;
- (c) a right for the franchisor to terminate if the franchisee is in breach of the franchise agreement, provided, a notice and appropriate remedy period (which need not exceed 30 days) is provided;
- (d) a right for the franchisor to terminate with seven days' notice in the event that certain specified events occur (e.g. abandonment of the franchise); and
- (e) a right for the franchisor to terminate in accordance with the franchise agreement by providing reasonable notice in circumstances where the franchisee is not in breach.

9.2 Are there local rules that impose a minimum notice period that must be given to bring a business relationship that has existed for a number of years to an end, which will apply irrespective of the length of the notice period set out in the franchise agreement?

Yes, any termination of a franchise agreement can only occur in accordance with the mechanisms (and associated timing) specified in the Code. These mechanisms (and associated timing) are usually prescriptively detailed in the franchise agreement.

In addition, where a franchisor does not intend to grant a new right to operate a franchise upon expiry of the franchise agreement, then notice of this must be given to the franchisee (see question 15.1 below for further detail).

10 Joint Employer Risk and Vicarious Liability

10.1 Is there a risk that a franchisor may be regarded as a joint employer with the franchisee in respect of the franchisee's employees? If so, can anything be done to mitigate this risk?

Australian law does not render franchisors as joint employers of their franchisee's employees. Whether the joint employment doctrine is valid in Australian law is also unsettled as it is yet to be decisively considered by an Australian court.

The *Fair Work Act 2009* (Cth) (the Fair Work Act) provides that a responsible franchisor entity (meaning a person that has a significant degree of influence or control over the franchisee entity's affairs) is responsible for certain breaches of the Fair Work Act by their franchisee or a sub-franchisee, providing that the business is substantially or materially associated with intellectual property relating to the franchise. The breaches for which a franchisor may be held liable relate to the franchisee's

employment obligations in respect of their employees and contracts with any independent contractors. The franchisor will be liable if they knew or could reasonably expected to have known that the contravention by the franchisee entity would occur or that a contravention of the same or a similar character was likely to occur. These obligations and associated penalties were created through the Fair Work Amendment (Protecting Vulnerable Workers) Act 2017, which amended the Fair Work Act in light of the 7-Eleven vulnerable worker underpayment case. In this regard, both franchisors and franchisees should be mindful that the regulator is likely to be particularly interested in enforcement with respect to vulnerable workers (for example: workers with limited skills; young workers; migrant workers or workers on a visa; and older workers).

10.2 Is there a risk that a franchisor may be held to be vicariously liable for the acts or omissions of a franchisee's employees in the performance of the franchisee's franchised business? If so, can anything be done to mitigate this risk?

If a franchisee was actually found to be an employee of a franchisor, it may follow that the franchisor is vicariously liable for the franchisee's conduct, and, as such, is also liable for the franchisee's employees. Generally, the existence of a franchise agreement will mean that a franchisee is not considered an employee and such agreements should contain a boilerplate clause expressly stating that the parties are not in an employment relationship, as well as containing an indemnity that is broad enough to cover the entirety of the franchisee's business, including any conduct of employees.

However, if this question were before an Australian court, we cannot remove the risk that a franchisor and franchisee may be regarded as in an employment relationship as the court will consider the totality of the relationship between the parties. In particular, the degree of control the franchisor has over the franchisee's work.

11 Currency Controls and Taxation

11.1 Are there any restrictions (for example exchange control restrictions) on the payment of royalties to an overseas franchisor?

There are no specific restrictions in relation to franchising law, but there may be tax implications for the payment of royalties to an overseas franchisor. Further specific professional tax advice on such implications should be sought.

11.2 Are there any mandatory withholding tax requirements applicable to the payment of royalties under a trade mark licence or in respect of the transfer of technology? Can any withholding tax be avoided by structuring payments due from the franchisee to the franchisor as a management services fee rather than a royalty for the use of a trade mark or technology?

Yes, there are withholding tax requirements for the payment of royalties under a trade mark licence or on the transfer of technology. If a double tax agreement with the non-resident franchisor's country of residence exists, this may reduce the amount payable.

Withholding tax requirements will still apply if the payment is structured as a management fee rather than a royalty payment.

11.3 Are there any requirements for financial transactions, including the payment of franchise fees or royalties, to be conducted in local currency?

There is no requirement that transactions be conducted in Australian Dollars.

12 Commercial Agency

12.1 Is there a risk that a franchisee might be treated as the franchisor's commercial agent? If so, is there anything that can be done to help mitigate this risk?

Agency relationships are governed by the common law in Australia. Much like an employment relationship, a court may find that an agency relationship exists despite the parties expressly agreeing that their relationship is not one of agency. A court will consider whether the franchisee has the authority to act on behalf of the franchisor. Such authority can be either actual (meaning that the franchisor has conferred authority on the franchisee by contract) or ostensible (where the franchisor has held out that the franchisee has such authority).

While the parties can expressly renounce an agency relationship in the franchise agreement, there is still a risk that ostensible authority may be inferred from their conduct. However, franchisors in Australia have been largely successful at mitigating this risk, such as by notifying the public of the franchising relationship, and incorporating relevant provisions in the franchise agreement around 'holding out', indemnity and insurance in franchise agreements.

13 Good Faith and Fair Dealings

13.1 Is there any overriding requirement for a franchisor to deal with a franchisee in good faith and to act fairly in its dealings with franchisees according to some objective test of fairness and reasonableness?

Yes, the Code imposes an obligation on the parties to a franchise agreement to act in good faith within the meaning of the common law in relation to carrying out their obligations under the franchise agreement and the Code. It also applies to prospective parties to a franchise agreement in relation to their negotiations, dealings and any dispute in relation to the proposed agreement, and the Code.

The Code further specifies that acting in good faith does not require that the parties disregard their own commercial interests and that the court may have regard to whether a party acted honestly and not arbitrarily and whether they cooperated to achieve the purposes of the franchise agreement. However, the exact content of the duty is uncertain, and what amounts to acting in 'good faith' will be dependant on the factual circumstances of each case.

Significantly, it is also specified that a franchise agreement that does not give the franchisee an option to renew a franchise agreement or allow the franchise agreement does not equate to a failure to act in good faith in itself.

13.2 Is there any limitation on a good faith obligation being unenforceable if it only applies from franchisee to franchisor, rather than being mutual?

The obligation to act in good faith is mutual, applying to both a franchisee and a franchisor in respect of their franchising relationship.

14 Ongoing Relationship Issues

14.1 Are there any specific laws regulating the relationship between franchisor and franchisee once the franchise agreement has been entered into?

Yes, the Code contains provisions that apply throughout the franchising relationship. While there are no other specific laws as to the franchisee/franchisor relationship, other laws will apply depending on the circumstances (for example, the CCA) or the industry in which the franchise is operating (for example, financial services regimes in relation to a financial services franchise).

15 Franchise Renewal

15.1 What disclosure obligations apply in relation to a renewal of an existing franchise at the end of the franchise agreement term?

The franchisor must notify the franchisee, in writing, as to whether the franchisor intends to extend the franchise agreement, or enter into a new franchise agreement, at least six months before the end of the term of the franchise agreement (or if the agreement term is less than six months, at least one month before the end of that term). If the franchisor does not intend to extend the franchise agreement, then the notice must inform the franchisee that they can request a Disclosure Document.

If the franchisor intends to extend the term of the franchise agreement or enter into a new franchise agreement, then the franchisor will also need to comply with the disclosure obligations explained in question 1.5 above.

It is notable that longer notice periods are required in relation to motor vehicle dealer franchises, where at least: 12 month's notice must be given by a franchisor in relation to franchise agreements where the term is 12 months or longer; at least six month's notice must be given by a franchisor in relation to franchise agreements where the term is less than 12 months but longer than six months; or at least one month's notice where the term is less than six months. Reciprocal obligations also apply to franchisees.

15.2 Is there any overriding right for a franchisee to be automatically entitled to a renewal or extension of the franchise agreement at the end of the initial term irrespective of the wishes of the franchisor not to renew or extend?

There is no such automatic right, unless it is built into the franchise agreement. The Code expressly states that a franchisor will not be in breach of their obligation to act in good faith if the franchise agreement does not give the franchisee the option to renew or extend the agreement.

15.3 Is a franchisee that is refused a renewal or extension of its franchise agreement entitled to any compensation or damages as a result of the non-renewal or refusal to extend?

A franchisee's entitlement to any compensation or damages will depend on the circumstances. However, if the franchise agreement does not give the franchisee the right to renew or extend the agreement, the Code does not provide for an alternative position (except that, depending on the circumstances, a restraint in the franchise agreement may not be enforceable – see question 3.6 above).

The Code does, however, require that a Disclosure Document set out whether a franchisee will be entitled to compensation at the end of the agreement, if it is not renewed and, if so, how that compensation will be determined.

16 Franchise Migration

16.1 Is a franchisor entitled to impose restrictions on a franchisee's freedom to sell, transfer, assign or otherwise dispose of the franchised business?

Yes, a franchisor may impose restrictions on a franchisee's ability to sell, transfer, assign or otherwise dispose of the franchised business. These restrictions must be consistent with the rights and obligations of the parties under the Code in relation to 'transfers'. As a result, it is commonplace for franchise agreements to include comprehensive provisions regulating sales, transfers and assignments.

At a high level, the Code requires that a franchisor not unreasonably withhold its consent to a franchisee's request to transfer their franchise agreement, and regulates the process and timeframes for seeking such consent. The Code also sets out a non-exhaustive list of circumstances where a franchisor may reasonably withhold consent to a proposed transfer, which include where:

- (a) the proposed transferee is unlikely to be able to meet the applicable financial obligations under the franchise agreement;
- (b) the proposed transferee does not meet a reasonable requirement of the franchise agreement for the transfer of the franchise agreement;
- (c) the proposed transferee does not meet the selection criteria of the franchisor;
- (d) the proposed transferee does not agree, in writing, to comply with the obligations of the franchisee under the franchise agreement; and
- (e) the franchisee owes a payment to the franchisor under the franchise agreement or has not remedied a breach of the franchise agreement.

16.2 If a franchisee is in breach and the franchise agreement is terminated by the franchisor, will a "step-in" right in the franchise agreement (whereby the franchisor may take over the ownership and management of the franchised business) be recognised by local law, and are there any registration requirements or other formalities that must be complied with to ensure that such a right will be enforceable?

In Australia, generally, such step-in arrangements allow the ability for the franchisor to step in and manage the franchised business (rather than assume ownership). Such provisions can be enforceable where appropriately drafted, and consistent with

the requirements of the Code. There are no specific registration requirements, though consideration will need to be given to any particular leasing requirements where the franchised business premises are leased.

16.3 If the franchise agreement contains a power of attorney in favour of the franchisor under which it may complete all necessary formalities required to complete a franchise migration under pre-emption or "step-in" rights, will such a power of attorney be recognised by the courts in the jurisdiction and be treated as valid? Are there any registration or other formalities that must be complied with to ensure that such a power of attorney will be valid and effective?

A power of attorney clause can be enforceable where appropriately drafted. Generally, there is no requirement to register the power of attorney (except in some cases in order to deal with property). However, to assist enforceability of the provision, the parties should ensure that the scope of the power of attorney is both clear and appropriately confined to that which is reasonably necessary to protect the franchisor.

Further specific advice on the form and requirements of powers of attorney should be sought for the particular circumstances of each case.

17 Electronic Signatures and Document Retention

17.1 Are there any specific requirements for applying an electronic signature to a franchise agreement (rather than physically signing a "wet ink" version of the agreement), and are electronic signatures recognised as a valid way of creating a binding and enforceable agreement?

There are no specific requirements regarding using electronic signatures in the franchising context. As with many other forms of agreements, electronic signatures are recognised as a valid means of creating a binding and enforceable agreement for both corporations (for example, changes to the *Corporations Act 2001* (Cth) now expressly recognise the use of electronic signatures for corporate entities) and individuals.

The function of a signature is to reliably signify an intention to be bound and identify the signing party. Therefore, an electronic signature is equally capable of being a valid form of execution and creating a binding contract as a wet-ink signature, providing the appropriate controls are in place to mitigate risks relating to the identity and intentions of the signing party. Difficulties with electronic signatures arise when evidence is required to confirm the identity of the signing party or their intention to be legally bound. Generally, using a reputable e-signature platform mitigates such risks, as these platforms use sophisticated authentication technologies that allow the verification of certain information.

17.2 If a signed/executed franchise agreement is stored electronically (either having been signed using e-signatures or a "wet ink" version having been scanned and saved as an electronic file), can the paper version of the agreement be destroyed?

The Code requires that the franchisor keep any documents given to it by the franchisee for at least six years after the document was created. This obligation refers to keeping 'the written thing or a copy of it'. Therefore, it is likely sufficient for the

franchisor to destroy the physical copy and retain the electronic copy. However, in practice, it is advisable to retain the physical copy of any document that was signed by wet ink.

18 Current Developments

18.1 What is the biggest challenge franchising is facing in your jurisdiction and how are franchisors responding to that challenge?

There is likely future reform to the Franchising Code. On 15 August 2023, Treasury announced the Terms of Reference for

the 2023 Franchising Code of Conduct Review. This review will consider: whether the Franchising Code remains fit for purpose; the role of the Code in regulating the automotive sector; the role of the ACCC and the Australian Small Business and Family Enterprise Ombudsman in supporting enforcement and dispute resolution under the Code; and reviewing changes in the last round of reform. Interested parties can make submissions. On 22 August 2023, a consultation paper was released, which provides stakeholders with the opportunity to provide submissions by 29 September. Following this, a report will be provided to the Minister, and it is likely that further reform to the Franchising Code will occur in 2024.



Bronwyn Furse is a trusted advisor with significant expertise assisting Australian franchisors in the ongoing development and management of their networks, as well as assisting in cross-border franchise matters. Bronwyn understands franchise compliance as well as the other regulatory, commercial, intellectual property, data protection, and competition issues that affect franchisor's businesses and networks.

Bronwyn has been recognised by her peers as 'Lawyer of the Year' by *Best Lawyers in Australia* in the area of Franchise Law (2023). She has also been recognised by her peers as one of the Best Lawyers in Australia in the areas of Franchise Law, Intellectual Property Law and Privacy and Data Security Law. Bronwyn has recently been recognised in *Doyle's Guide* as a recommended lawyer in South Australia in the areas of Intellectual Property and Technology, Media and Telecommunications Law.

Thomson Geer

Level 7, 19 Gouger Street
Adelaide, SA 5000
Australia

Tel: +61 8 8236 1121
Email: bfurse@tglaw.com.au
URL: www.tglaw.com.au

We have more than 650 people, including over 140 partners operating out of our offices in Adelaide, Brisbane, Melbourne, Canberra, Perth and Sydney. By size, we are one of the 10 largest firms operating in Australia. Thomson Geer is a full-service commercial firm and many of the firm's practitioners are acknowledged as leading lawyers. We are able to call on expertise in a wide variety of practice areas and provide our clients with comprehensive solutions for all their legal needs. Thomson Geer's team of franchising specialists are highly regarded in the Australian market.

We have built a major Australian law firm around the principles of quality and value. Add to that a unique ability to provide insights into the Australian policy and public affairs system through our consultancy TG Public Affairs, and we are well suited to the times.

www.tglaw.com.au

THOMSON GEER
LAWYERS

Brazil

Pitanga Bastos



Daniel Pitanga



Mônica Pinheiro



Rodrigo Rodrigues

1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

The definition of a franchise can be found in Article 1 of the Brazilian Franchise Law – BFL (Law N° 13,966, of December 26th, 2019), for which franchise means a business model whereby the franchisor grants the franchisee the right to use Intellectual Property assets (trademarks and others), always associated to the right of production or exclusive or non-exclusive distribution of products or services, as well as the right to use methods and systems of implementation and administration of the business or operational system developed or owned by the franchisor, by means of direct or indirect remuneration.

The BFL expressly provides that this relationship does not characterise a consumer or employment relationship, not even during the training period.

1.2 What laws regulate the offer and sale of franchises?

The governing law for franchises in Brazil is Law N° 13,966, of December 26th, 2019, which came into force on March 26th, 2020. When it comes to international franchise agreements, in the case of international contracts, it is mandatory to file such contracts with the Brazilian Patent and Trademark Office (BPTO), in order to be able to remit funds abroad, amongst other provisions.

1.3 If a franchisor is proposing to appoint only one franchisee/licensee in your jurisdiction, will this person be treated as a “franchisee” for purposes of any franchise disclosure or registration laws?

Yes, the number of franchise grants appointed by the franchisor is not relevant for the purpose of applying the provisions of the BFL, including those on registration, disclosure obligations or any other breaches of the franchise contract. In this context, there is no differentiation of treatment in any aspect, under Brazilian law, by the number of franchisees licensed by the franchisor.

1.4 Are there any registration requirements relating to the franchise system?

Under Brazilian law, a franchise is a company like any other, and, therefore, despite being bound by the franchise system, the new franchisee, among other measures, must register his franchise before the competent Commercial Agency of his jurisdiction (“*Junta Comercial*”) before the start of operations. Besides that, as pointed out in the answer to question 1.2 above, international franchise contracts need to be registered with the BPTO.

1.5 Are there mandatory pre-sale disclosure obligations?

Yes, for the implementation of the franchise, the franchisor must provide the potential franchisee with the Franchise Offering Circular, written in Portuguese, in objective and accessible language, and mandatorily containing various information relevant to the business, to guarantee security and transparency to the new franchisee.

The Franchise Offering Circular must comprise, in addition to the main information about the franchise, the contractual terms to be followed by both contracting parties. According to the BFL, the Franchise Offering Circular must be delivered to the prospective franchisee at least 10 days prior to the signing of the franchise agreement or pre-contract.

1.6 Do pre-sale disclosure obligations apply to sales to sub-franchisees? Who is required to make the necessary disclosures?

Yes; regarding the obligation to issue the Franchise Offering Circular, the law does not make any differentiation between franchisees and sub-franchisees. This document must be issued within the period established by law (at least 10 days before the signature of the franchise agreement or pre-contract). Although the BFL does not indicate who is responsible in such cases for making the pre-sale disclosure, this obligation usually lies with the master franchisee, since he would be the one responsible, under Brazilian law, for answering for the other obligations as well.

1.7 Is the format of disclosures prescribed by law or other regulation, and how often must disclosures be updated? Is there an obligation to make continuing disclosure to existing franchisees?

There is no prescribed format under the BFL. However, what is required by law, considering the relevance of the information comprised therein, is that the document must be delivered within a minimum period of 10 days and be written in Brazilian Portuguese, in clear and straightforward language, as outlined in Article N° 2 of the BFL. As the content of the Circular refers to dynamic information about the franchisor's business, even though there is no defined term for its update, it is generally recommended to update it annually.

1.8 What are the consequences of not complying with mandatory pre-sale disclosure obligations?

Non-compliance with mandatory pre-sale disclosure obligations may lead to an eventual demand for annulment or nullity of the contractual relationship, leading to the requirement of the return of any amounts already paid to the franchisor. The Circular, depending on the case, may also be used to annul the franchise agreement and request the return of fees and royalties paid. It is, therefore, important that the document is written in a clear, objective manner and reviewed by a lawyer, in order to ensure that the information was delivered in a way that guarantees the rights and duties of all parties involved in the transaction. Obviously, what has effectively not been informed should be evaluated, as should the degree of knowledge and expertise of the franchisee, in order to assess if there has been termination of the contractual relationship, with the return of amounts that have already been paid, and to even determine the suitability of compensation for damages.

1.9 Are there any other requirements that must be met before a franchise may be offered or sold?

The sale of a franchise is nothing more than the concession of use, through an agreement, of immaterial assets held by the franchisor, such as its trademark, know-how and other Intellectual Property rights. Therefore, it is required that the trademark, whose use will be granted, is registered before the competent organisation, which is the Brazilian Trademark and Patent Office.

1.10 Is membership of any national franchise association mandatory or commercially advisable?

There is no legal requirement to join a franchise association; however, it is recommended that you do so, in order to have the most efficient access to valuable information, news, discussions, events and recommendations. The Brazilian Franchise Association (ABF) is the most relevant.

1.11 Does membership of a national franchise association impose any additional obligations on franchisors?

Despite the payment of a membership fee, there are no additional relevant obligations imposed on franchisors by the ABF. However, there are several benefits for associates registering with a franchise association, such as access to several useful tools available for the conduct of its operation.

1.12 Is there a requirement for franchise documents or disclosure documents to be translated into the local language?

The BFL establishes in its Article N° 7 that international franchise agreements shall originally be written in Portuguese. If not, the law requires a sworn translation into Portuguese at the franchisor's expense, so that the contracting parties may choose, in the contract, the jurisdiction of one of their countries of residence. On the other hand, the Franchise Offering Circular (the Brazilian disclosure document) can only be written in Portuguese, as per the provisions of Article N° 2 of the BFL.

2 Business Organisations Through Which a Franchised Business Can be Carried On

2.1 Are there any foreign investment laws that impose restrictions on non-nationals in respect of the ownership or control of a business in your jurisdiction?

Brazilian corporate legislation establishes some requirements to be fulfilled by the non-resident, even though foreigners may own or control companies in Brazil. In this regard, the law establishes that foreigners and non-residents may be partners or shareholders of Brazilian companies without having residence in the country, but, on the other hand, they cannot play the role of Director or Administrator in the company's articles of incorporation. However, Brazilian law does not prevent them from participating, for instance, on the board of directors of a Limited Liability Company (LLC). In order to become partners or shareholders, non-residents and non-nationals must register with the Brazilian IRS to obtain a CPF (a Brazilian document for registration of individuals for tax purposes) and with the Central Bank of Brazil (BACEN), through the Electronic Declaratory Registry (RDE), in addition to being required to have an attorney-in-fact residing in the country with powers to receive summons. Thereafter, the foreigner/non-resident may invest in pre-existing Brazilian companies or create a new company.

2.2 What forms of business entity are typically used by franchisors?

LLCs are the most used in Brazil in general, not only by franchisors but also by franchisees. This is because the LLC consists of a business type that is characterised by the participation of the partners through the proportion of their participation in the company's capital and, also, by the characteristic related to the limitation of liability, so that there is a clear separation of the business assets and personal assets of each of its partners.

2.3 Are there any registration requirements or other formalities applicable to a new business entity as a pre-condition to being able to trade in your jurisdiction?

The Brazilian corporate legislation establishes a variety of requirements and formalities for a new company to start its operations and such requirements may vary according to the nature of the company that is intended to be created. Assuming, however, that the vast majority of the companies created in Brazil are LLCs, as mentioned above, it should first be mentioned that such business opening must be done by a qualified accountant and that the main registrations and licences required for the start of operation of an LLC are the (i) operation and location licence to be requested at the municipality, (ii) registration with

the National Tax System, and (iii) registration with the Social Security authorities.

3 Competition Law

3.1 Provide an overview of the competition laws that apply to the offer and sale of franchises.

From a competition perspective, two laws present greater relevance, applying equally to franchises that are established in Brazilian territory: Law N° 12,529/2012; and Law N° 9,279/96. The former structures the Brazilian Competition Defense System (Brazilian Antitrust Law) and the latter is the Brazilian Industrial Property Law.

In Brazil, the principles of free competition and the preservation of the economic order are in force; therefore, the rules imposed by the aforementioned laws have a predominantly repressive character, as their main purpose is to ensure the effectiveness of such principles. It is in this context that the Brazilian Antitrust Law establishes, by the means of a provision inserted in Article N° 36, some situations that are considered violations to the economic order, which may be sanctioned through the application of a penalty to be applied to companies and their managers if found guilty of violating the economic order, pursuant to the law.

The referred law also established the Administrative Council for Economic Defense (CADE) and the Secretariat for Economic Monitoring (SEAE), as part of the Antitrust System. The CADE is an administrative entity with activities nationwide. It is the most important entity to ensure the effectiveness of the law, essentially exercising a repressive role and being responsible for verifying and deciding on competition issues, as well as to promote free competition. The main limitations to competition (and consequently violation of the economic order) that franchises may face include (i) refusal to hire, (ii) preventing access to raw material markets, (iii) discriminatory prices, and (iv) preventing the access of new companies to the market, among others. Further, Brazilian Antitrust Law may be applicable to violations committed by means of abuse of Intellectual Property rights.

Regarding the Brazilian Industrial Property Law, in addition to the penalties provided by the Brazilian Antitrust Law, Article N° 68 provides that the holder of the Intellectual Property rights may have a patent compulsorily licensed if it makes abusive use thereof or abuses its economic power by means thereof. Thus, it should be noted that punishment for abusive practices related to Intellectual Property rights is provided for in both laws, so that the use of the Intellectual Property shall always be interpreted in accordance with the economic objectives and the principle of free competition.

Furthermore, the Brazilian Industrial Property Law regulates confidential information in business and prohibits the disclosure of confidential commercial information held by the franchisor. Therefore, the improper disclosure of information protected by industrial secrecy is severely punished by law.

3.2 Is there a maximum permitted term for a franchise agreement?

There is no legal provision regarding the contractual term of a franchise and, thus, a contract may be signed for an indefinite period. However, in the case of international franchises, as it is necessary to record the contract at the Brazilian Trademark and Patent Office, in order to enable the remittance of royalties overseas, it is also necessary to have a defined term. In this case, an indefinite term cannot be signed for.

3.3 Is there a maximum permitted term for any related product supply agreement?

No, there is no legal determination for a maximum term limit in contracts for the supply of any products.

3.4 Are there restrictions on the ability of the franchisor to impose minimum resale prices?

No, there are no limits imposed by Brazilian law on the definition, by the franchisor, of a minimum price for the resale of its products by the franchisee. What must be observed is whether such imposition was clear in the Franchisor-Franchisee Agreement and, before that, it is also recommended that the imposition of minimum resale prices be provided in the Franchise Offering Circular. It is the franchisor's right to set a minimum resale price to the franchisee, and this fact can even be considered part of its business strategy.

3.5 Encroachment – are there any minimum obligations that a franchisor must observe when offering franchises in adjoining territories?

The BFL does not provide for territorial restrictions on the offering of franchises in adjoining territories. Usually, such territorial delimitations and restrictions are established contractually and, therefore, should be clearly stated in the Franchise Offering Circular, if any.

3.6 Are in-term and post-term non-compete and non-solicitation of customers covenants enforceable?

Yes; in order to protect the franchisor, who has granted intangible assets of its business to the franchisee, and to avoid abusive practices such as the appropriation of such intangible assets by the franchisee, it is common in Brazil to have this type of non-compete agreement. It is necessary to observe, however, whether such information is clearly specified in the Franchise Offering Circular and in the contract between the parties, so that it can be effectively valid and enforceable.

4 Protecting the Brand and Other Intellectual Property

4.1 How are trade marks protected?

Trademarks are protected before the BPTO. Brazilian law does not require previous use of the trademark to grant the rights over the mark. According to Article N° 3 of the BFL, the franchisor must inform the franchisee of the registry's status before the BPTO. Once the registration is granted by the BPTO, the trademark to be franchised will be under protection in the Brazilian territory and the franchisee will only have the right to use it as long as the franchise agreement is in force.

4.2 Are know-how, trade secrets and other business-critical confidential information (e.g. the Operations Manual) protected by local law?

Yes, e.g., the Brazilian Industrial Property Law defines as a crime of unlawful competition, among other practices provided in its Article N° 195, one that discloses, exploits, or improperly uses

immaterial assets or improperly discloses confidential information about the know-how or secrets consisting of the business operation.

4.3 Is copyright (in the Operations Manual or in proprietary software developed by the franchisor and licensed to the franchisee under the franchise agreement) protected by local law?

Copyright is protected by Law N° 9,610/98 (Brazilian Copyright Law). It may grant protection to operating manuals beside Brazilian Industrial Property (specifically the unlawful competition rules). Concerning proprietary software, Law N° 9,609/98 (Brazilian Software Law) provides specific protection for software/computer programs beside the Brazilian Copyright Law.

5 Liability

5.1 What remedies can be enforced against a franchisor for failing to comply with mandatory disclosure obligations? Is a franchisee entitled to rescind the franchise agreement and/or claim damages?

If the franchisor fails to comply with the rules pointed out in the Franchise Offering Circular, the franchisee may plead nullity or voidness and demand the return of all amounts (duly updated) already paid to the franchisor as fees or royalties, as well as recovery for damages.

5.2 In the case of sub-franchising, how is liability for disclosure non-compliance or for pre-contractual misrepresentation allocated between franchisor and master franchisee? If the franchisor takes an indemnity from the master franchisee in the Master Franchise Agreement, are there any limitations on such an indemnity being enforceable against the master franchisee?

The franchisor and franchisee are mutually obligated by the franchise agreement celebrated and by the content presented in the Franchise Offering Circular. Regarding liability, the BFL sets forth in its Article N° 5 that the rules that refer to the franchisor or the franchisee apply, where applicable, to the sub-franchisor and the sub-franchisee, respectively, so the master-franchisee may be held liable for the acts performed towards sub-franchisees, including pre-contractual misrepresentation.

5.3 Can a franchisor successfully avoid liability for pre-contractual misrepresentation by including a disclaimer in the franchise agreement?

In general, despite the governing principle of freedom in contractual relations in Brazil, liability exemption clauses are not appropriate to exclude liabilities established by law. Accordingly, in cases of a judicial dispute over the franchise agreement, the court may review the validity of the disclaimer inserted therein; if it is against the law, its nullity will be declared by the court.

5.4 Does local law permit class actions to be brought by a number of aggrieved franchisees and, if so, are class action waiver clauses enforceable?

National legislation does not allow class actions in these cases. Under Brazilian law, only specific entities have legal standing

to file class actions to discuss a matter that benefits a public collective. In strictly private relationships, as in the case of the discussion of a franchisor-franchisee relationship, there is no such possibility. However, if this type of action were possible in Brazil, the waiver clause of the class action would not be enforceable anyway.

6 Governing Law

6.1 Is there a requirement for franchise documents to be governed by local law? If not, is there any generally accepted norm relating to choice of governing law, if it is not local law?

According to the terms of Article N° 7 of the BFL, the franchise agreements celebrated that are effective only in Brazilian territory will be governed by Brazilian law. On the other hand, in cases of international franchise agreements, the contracting parties may choose, in the agreement, the jurisdiction of one of their countries of domicile. In this case, the parties shall constitute and maintain a legal representative or attorney duly qualified and domiciled in the country of the defined jurisdiction, with powers of representation, including those to receive summons. The law also foresees that the parties may elect an arbitration court to settle disputes.

6.2 Do the local courts provide a remedy, or will they enforce orders granted by other countries' courts, for interlocutory relief (injunction) against a franchisee to prevent damage to the brand or misuse of business-critical confidential information?

Yes, the Brazilian legislation provides, in its Code of Civil Procedure, effective preventive remedies, created to avoid or even minimise damages to one of the parties when the terms agreed in the execution of a contract are not duly complied with. If the franchise agreement is governed by foreign law, foreign court decisions will only be valid in Brazilian territory after being ratified by the Superior Court of Justice (STJ). In this case, because it is a lengthy and bureaucratic procedure and, as precautionary measures require greater agility in the jurisdictional disposition, it is recommended, in such situations, that the jurisdiction adopted for the solutions of disputes regarding the franchise agreement be the Brazilian one whenever possible.

6.3 Is arbitration recognised as a viable means of dispute resolution and is your country a signatory to the New York Arbitration Convention on the Recognition and Enforcement of Foreign Arbitral Awards? Do businesses that accept arbitration as a form of dispute resolution procedure generally favour any particular set of arbitral rules?

Yes, the arbitration courts are admissible for the purposes of dispute resolution in Brazil. Therefore, when entering into any contract, the parties may elect the arbitral solution in detriment of the judicial one for the resolution of conflicts arising from such contractual relationship. The Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention) was ratified by the Brazilian legislation through Decree N° 4,311/2002. Thus, according to Article N° 4 of the Brazilian Arbitration Law (Law N° 9,307/96), the parties to a contract may agree to submit to arbitration any disputes that may arise in connection with such agreement. According to the wording of paragraph 2 of Article N° 2, the parties are free

to choose which rules of law will be applied in the arbitration, provided there is no violation of good practices and public order.

7 Real Estate

7.1 Generally speaking, is there a typical length of term for a commercial property lease?

The parties are permitted to determine the length of a lease agreement, and the Brazilian Real Estate Law (Law N° 8245/91) does not impose any type of requirement in this regard. There are, however, according to Article N° 51, some pre-defined deadlines to guarantee the tenant the right to renew the contract. In such cases, the law requires that, cumulatively, (i) the lease must be in writing and for a specified term, (ii) the minimum term of the lease must be five years, and (iii) the tenant must have been operating its business in the same industry uninterruptedly for three years.

7.2 Is the concept of an option/conditional lease assignment over the lease (under which a franchisor has the right to step into the franchisee/tenant's shoes under the lease, or direct that a third party (often a replacement franchisee) may do so upon the failure of the original tenant or the termination of the franchise agreement) understood and enforceable?

Due to the freedom conferred by law to the contracting parties, such a clause is fully valid, although unusual and difficult to negotiate. What is more common and more accepted in the practice of lease agreements in Brazil, however, is the termination of the former contract and the execution of a new one. Regardless, once such a clause has been negotiated, there will be no obstacles for it to be enforced in the event of non-compliance by the tenant.

7.3 Are there any restrictions on non-national entities holding any interest in real estate, or being able to sub-lease property?

There are no restrictions for foreign entities to hold interest in real estate in Brazil. The basic requirements to be complied with are similar to those imposed on national entities. The documents required, although for the same purposes, will need to be customised, depending on the country of origin of the interested entity.

7.4 Give a general overview of the commercial real estate market. To what extent has the real estate market been affected by the Coronavirus pandemic? Specifically, can a tenant expect to secure an initial rent free period when entering into a new lease (and if so, for how long, generally), or are landlords demanding "key money" (a premium for a lease in a flagship location)?

The real estate market in Brazil was severely affected by the Coronavirus pandemic. We noticed that many commercial properties were vacated due to the need to confine the population, as well as the consequent bankruptcies of small and medium-sized businesses. We also noted that there was substantial renegotiation in lease agreements, so that, among other flexibility measures, landlords were willing to lower rents and cancel late charges, for example. To regulate private relations during the pandemic, Federal Law N° 14.010/2020 was issued with emergency and

transitory rules, impacting the real estate market, since injunctions related to evictions actions were suspended by the law.

We are observing, however, that with the end of the Coronavirus pandemic as well as with the recovery of the Brazilian Economy, the real estate market is gradually resuming its normalcy, as it was prior to the pandemic.

8 Online Trading

8.1 If an online order for products or request for services is received from a potential customer located outside the franchisee's exclusive territory, can the franchise agreement impose a binding requirement for the request to be re-directed to the franchisee for the territory from which the sales request originated?

The contracting parties are permitted to determine any rules concerning the operation and performance of the business itself, which is the object of the franchise agreement, as long as there is no legal impediment. Therefore, considering that the BFL is silent on this matter, it is possible that the parties determine privately how they will govern the redirection of purchases originated in the online market. It is recommended, however, in order to protect the rights of both the franchisor and the franchisee, that such disposal is evident and well outlined in the Franchise Offering Circular.

8.2 Are there any limitations on a franchisor being able to require a former franchisee to assign local domain names to the franchisor on the termination or expiry of the franchise agreement?

No. The franchise agreement may state that upon termination of the contractual relationship the local domain name be assigned to the franchisor. Please bear in mind that such obligation is to be previously described under the Franchise Offering Circular.

9 Termination

9.1 Are there any mandatory local laws that might override the termination rights one might typically expect to see in a franchise agreement?

No. What has been established in the franchise contract becomes law between the parties, in such a way that the contractual rescission rules established therein, as well as the consequences for its eventual non-compliance, are lawfully applicable.

9.2 Are there local rules that impose a minimum notice period that must be given to bring a business relationship that has existed for a number of years to an end, which will apply irrespective of the length of the notice period set out in the franchise agreement?

No; in franchise agreements with pre-defined terms, the notice period set forth therein is the one to be observed by the parties. It is common, however, that automatic extension clauses are negotiated when neither of the parties manifests itself within the fixed term. In the federal franchise legislation, there is no provision in this sense, so it is understood that there is no imposition of a minimum notice period that overrules the one agreed upon by the parties.

10 Joint Employer Risk and Vicarious Liability

10.1 Is there a risk that a franchisor may be regarded as a joint employer with the franchisee in respect of the franchisee's employees? If so, can anything be done to mitigate this risk?

The franchisee is responsible for the operation of its business, including the relations with its employees. Considering the contractual relationship between the franchisor and the franchisee, the chances of being held liable for labour matters are remote. In this respect, the understanding of the Brazilian courts is that there is no direct or even subsidiary liability of the franchisor, since the requirements established in the Brazilian labour legislation are not met.

10.2 Is there a risk that a franchisor may be held to be vicariously liable for the acts or omissions of a franchisee's employees in the performance of the franchisee's franchised business? If so, can anything be done to mitigate this risk?

As mentioned above, under the Labour Law currently in effect in Brazil, the franchisee is considered the employer and, therefore, the responsible party for the acts and omissions in the management of the relationship with its employees. In this context, although the Labour Law does not grant any exceptions, it is recommended that a clause of non-liability be included in the franchise agreement, in order to reinforce the contours of the responsibility in this sense between the parties. It should be noted, however, that if we were discussing issues related to products and services, consumers would be involved, and thus issues related to liability would be adapted slightly, so that the franchisor may, under Brazilian Consumer Law, be held liable. In this case, where the franchisee is directly responsible for the damage caused to the consumer, the law guarantees the franchisor the opportunity to claim compensation for damages against the franchisee. It is recommended, however, that there is an express provision in the franchise contract in accordance with which the franchisor is not responsible for acts or omissions of employees of the franchisees.

11 Currency Controls and Taxation

11.1 Are there any restrictions (for example exchange control restrictions) on the payment of royalties to an overseas franchisor?

The payment of royalties is the franchisor's remuneration for licensing the use and exploitation of its trademark, amongst others, and while parties are contractually free to establish the amount and form of payment of royalties, they usually correspond to a certain percentage (5% to 10%) on the franchise's gross revenue. For the remittance of royalties to foreign franchisors, in addition to the usual procedures with the BACEN, the franchise agreement must be registered with the Brazilian Patent and Trademark Office. Another important observation is the legal limitation on the payment of royalties for exploitation of patents, use of trademarks and for technical or other kind of assistance contracts. The law that regulates foreign capital in Brazil and the remittance of amounts abroad (Law N° 4.131/62 – Foreign Capital Law), in its Article N° 12, limits the tax deductibility of the amounts owed as royalties to a maximum

of 5% of the net sales revenue of the product manufactured or sold. It should be noted that the remittance of royalties abroad exceeding the limits, in addition to not being deductible, may imply administrative and criminal penalties.

11.2 Are there any mandatory withholding tax requirements applicable to the payment of royalties under a trade mark licence or in respect of the transfer of technology? Can any withholding tax be avoided by structuring payments due from the franchisee to the franchisor as a management services fee rather than a royalty for the use of a trade mark or technology?

Yes; in Brazil, it is understood that the franchise agreement has a hybrid character, and is therefore not strictly limited to issues related to trademark licensing, know-how and technology transfer between the franchisor and the franchisee, including the rendering of services by the franchisor that grants the franchisee technical assistance in the conduction of its business. Therefore, based on this premise, the Withholding Income Tax (IRRF) should always be retained by the franchisee upon payment of royalties to the franchisor, and cannot be avoided even if another classification is adopted, such as management of services.

11.3 Are there any requirements for financial transactions, including the payment of franchise fees or royalties, to be conducted in local currency?

There are no restrictions in the Brazilian legal system for the payment of royalties and other fees to be made exclusively in local currency; therefore, payments in foreign currency, as long as accepted by both parties, are fully valid, as we are dealing with international contracts.

12 Commercial Agency

12.1 Is there a risk that a franchisee might be treated as the franchisor's commercial agent? If so, is there anything that can be done to help mitigate this risk?

The risk of confusion between franchise agreements and agency agreements, in Brazil, is quite remote. Franchise agreements are regulated by specific laws, with clear rules and the establishment of rights and obligations between the franchisor and franchisee in a very precise and delimited way. The agency agreements are regulated by different legislation (Law N° 4,886/92), with their own similarly detailed rules.

13 Good Faith and Fair Dealings

13.1 Is there any overriding requirement for a franchisor to deal with a franchisee in good faith and to act fairly in its dealings with franchisees according to some objective test of fairness and reasonableness?

Good faith holds the status of a Principle of Law in the Brazilian Judicial System. This implies that its observance is mandatory, whatever the interactions between individuals in this area may be. The principle of good faith is one of the pillars of Brazilian Civil Law, applying objectively to contractual relations, even after their termination. The principle of good faith is provided in Article N° 422 of the Brazilian Civil Code, which states: "The contracting parties are obligated to observe, both in the conclusion of the contract and in its performance, the principles of

probity and good faith.” The principle of objective good faith, which is applicable in a more substantial way in contractual relations, basically consists of the parties’ duty to maintain ethical, loyal and honest behaviour. In this context, every contractual relation (including franchise agreements) must necessarily observe the principle of good faith, not admitting any other requirement that overrules such principle.

13.2 Is there any limitation on a good faith obligation being unenforceable if it only applies from franchisee to franchisor, rather than being mutual?

The objective good faith, the basic principle of contractual relations under Brazilian law, always applies mutually to both parties, to the extent of what is expected from each of them within the contractual relation. Thus, in order to ensure a level of security in such contractual relations, a standard of conduct is established which, if violated, makes it subject to revision and judicial intervention. Based on this premise, it is possible to infer that, although each party has a distinct role within the contractual relationship, requiring good faith from only one of the parties would be unreasonable.

14 Ongoing Relationship Issues

14.1 Are there any specific laws regulating the relationship between franchisor and franchisee once the franchise agreement has been entered into?

The franchise agreement entered into by the parties will be the primary document to be observed by the parties in the performance of the ongoing contractual relationship. Any omissions, issues, or breaches, for instance, will always have the Brazilian Civil Code as a reference source, and its general rules will always be mandatory for the parties, regardless of the type of contractual relationship established.

15 Franchise Renewal

15.1 What disclosure obligations apply in relation to a renewal of an existing franchise at the end of the franchise agreement term?

The law does not foresee a new disclosure upon renewal of a franchise agreement, because it is understood that the parties are already aware of all the conditions of the contract, since they even intend to renew it. However, if the parties do want to include obligations regarding the renewal of the franchise agreement, they must have been clear since the Franchise Offering Circular.

15.2 Is there any overriding right for a franchisee to be automatically entitled to a renewal or extension of the franchise agreement at the end of the initial term irrespective of the wishes of the franchisor not to renew or extend?

No, there is no rule set forth in the local legislation that is capable of overriding the parties’ will to not renew or extend the term of the agreement.

15.3 Is a franchisee that is refused a renewal or extension of its franchise agreement entitled to any compensation or damages as a result of the non-renewal or refusal to extend?

According to our responses above, the contract becomes law between the parties. Therefore, the term agreed upon between the parties in the franchise agreement will prevail, so that, if not complied with by any of the contracting parties, the penalties equally agreed in the contractual instrument will be imposed. If, however, it is established that the term agreed upon is automatically renewed, it will be so, as long as there is no manifestation to the contrary by any of the contracting parties within the established advance period.

16 Franchise Migration

16.1 Is a franchisor entitled to impose restrictions on a franchisee’s freedom to sell, transfer, assign or otherwise dispose of the franchised business?

Yes, the franchisor has the right to prevent or, alternatively, impose restrictions and limitations, such as prior approval, if, for example, the franchisee, at some point during the term of the franchise agreement, has the intention of transferring the business to a third party. The franchise agreement has a very personal characteristic and simply allowing the franchisee to freely dispose of the business would directly harm the essence of a franchise.

16.2 If a franchisee is in breach and the franchise agreement is terminated by the franchisor, will a “step-in” right in the franchise agreement (whereby the franchisor may take over the ownership and management of the franchised business) be recognised by local law, and are there any registration requirements or other formalities that must be complied with to ensure that such a right will be enforceable?

The breach of the agreement by the franchisee allows the franchisor to take all measures provided in the instrument in case of such an event. So long as the franchise contract provides for such an “entry”, there will be no legal restrictions for such a measure to be claimed and enforced in court, if needed. It should be noted, however, that all the ancillary contracts to the franchise agreement, such as the lease agreement between the franchisee and the lessor, if any, should be in harmony with each other in order to make such a measure feasible in practice.

16.3 If the franchise agreement contains a power of attorney in favour of the franchisor under which it may complete all necessary formalities required to complete a franchise migration under pre-emption or “step-in” rights, will such a power of attorney be recognised by the courts in the jurisdiction and be treated as valid? Are there any registration or other formalities that must be complied with to ensure that such a power of attorney will be valid and effective?

Yes, the power of attorney would be recognised and treated as valid by local legislation, as long as it is granted with specific

powers, and there is no need for registrations or other formalities, except the need for it to be duly detailed in the franchise contract signed between the involved parties. Nevertheless, considering that the power of attorney may be revoked at any time by its grantor, this insertion in the franchise agreement might not be so effective, as suggested.

17 Electronic Signatures and Document Retention

17.1 Are there any specific requirements for applying an electronic signature to a franchise agreement (rather than physically signing a “wet ink” version of the agreement), and are electronic signatures recognised as a valid way of creating a binding and enforceable agreement?

Yes, electronic signatures are fully accepted by local law. In order for their validity to be authenticated and to avoid problems relating to further investigations into the validity of the document, it is recommended that parties who are physically in Brazil have their digital signature certified by one of the Brazilian certifying authorities or bodies accredited by the Brazilian Public Key Infrastructure. Thus, with due precautions, electronic signatures (particularly digital signatures) are recognised as valid and therefore acknowledged as capable of executing a valid and enforceable contract.

17.2 If a signed/executed franchise agreement is stored electronically (either having been signed using e-signatures or a “wet ink” version having been scanned and saved as an electronic file), can the paper version of the agreement be destroyed?

If a physical version of the instrument exists, it is not recommended that it be destroyed. Notwithstanding the increasing acceptance and recognition of electronic or even scanned documents, especially in the context of a growing virtual and digital environment, if there is a paper version of the instrument, there may eventually be disputes as to the authenticity of the signature, which may require an expert examination, and the document might have to be presented to the court. On the other hand, although the electronic document is accepted by the court, the Code of Civil Procedure states that the judge may request the original document at any time.

18 Current Developments

18.1 What is the biggest challenge franchising is facing in your jurisdiction and how are franchisors responding to that challenge?

The biggest challenge franchising is currently facing in Brazil relates to post-pandemic effects on business, as well as the need to renegotiate agreements and the payment of royalties, especially for small businesses. Due to such Coronavirus-related issues, Brazilian Tribunal have experienced a rising of number of lawsuits claiming termination of agreement and/or renegotiation of provisions.



Daniel Pitanga is the founding Partner at Pitanga Bastos. He is the former Chair of the Interactive Entertainment and Media Committee at the International Technology Law Association (ITechLaw) and a former Chair of the Anti-Piracy Committee at the Brazilian Bar Association, Rio de Janeiro section. He holds an LL.M. in Information Technology and Telecommunications Law from the University of Southampton. He also obtained a postgraduate degree in Intellectual Property Law from the Pontifical Catholic University of Rio de Janeiro and a postgraduate certificate in Entertainment Law from the Rio de Janeiro State University.

Pitanga Bastos

Av. Almirante Júlio de Sá Bierrenbach, 65
Gemini, Salas 213/214, Barra da Tijuca
Rio de Janeiro – RJ, CEP 22775-028
Brazil

Tel: +55 21 31952 214
Email: daniel@pitangabastos.com.br
URL: www.pitangabastos.com.br



Mônica Pinheiro is a Partner at Pitanga Bastos. She is the former Vice-Chair of the Anti-Piracy Committee at the Brazilian Bar Association, Rio de Janeiro section, she has more than 15 years of experience in the corporate and Intellectual Property fields, having worked mainly for large companies and multinationals. She has postgraduate qualifications in Corporate Law from FGV and in Intellectual Property Law at the Catholic University of Rio de Janeiro. Having graduated from Universidade Estácio de Sá, she also holds a postgraduate certificate in International Law from the State University.

Pitanga Bastos

Av. Almirante Júlio de Sá Bierrenbach, 65
Gemini, Salas 213/214, Barra da Tijuca
Rio de Janeiro – RJ, CEP 22775-028
Brazil

Tel: +55 21 31952 214
Email: monica@pitangabastos.com.br
URL: www.pitangabastos.com.br



Rodrigo Rodrigues is a Junior Partner at Pitanga Bastos. With over 10 years' experience in top law firms and legal departments, he has a law degree from the Universidade Vila Velha – UVV/ES and a postgraduate degree in Digital Law, Innovation Management and Intellectual Property from PUC/MG. He is also certified in Data Protection Law by Uniftec/New and in Legal Practice 4.0 by Future Law.

Pitanga Bastos

Av. Almirante Júlio de Sá Bierrenbach, 65
Gemini, Salas 213/214, Barra da Tijuca
Rio de Janeiro – RJ, CEP 22775-028
Brazil

Tel: +55 21 31952 214
Email: rodrigo.rodrigues@pitangabastos.com.br
URL: www.pitangabastos.com.br

Pitanga Bastos is a law firm specialising in Communication and Content Law. The firm provides strategic services to companies from different market segments, as well as to individuals, notably artists and celebrities, with an emphasis on Transaction and Strategic Dispute Resolution. With expertise in Media, Entertainment and Sports Law, Advertising and Marketing Law, Franchising Law, Intellectual Property, Information Technology Law and Data Protection Law (LGPD), Pitanga Bastos has a team of experienced lawyers with solid legal backgrounds and extraordinary experience.

www.pitangabastos.com.br

PITANGABASTOS

Canada

Hoffer Adler LLP



Joseph Adler



Idan Erez



Stephanie Chong

1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

Franchising in Canada is regulated at the provincial level by six provinces: Alberta; British Columbia; Manitoba; New Brunswick; Ontario; and Prince Edward Island (“PEI”) (the “Disclosure Provinces”). The Disclosure Provinces have passed the following legislation (the “Franchise Legislation”) to regulate the offer and sale of franchises: in Ontario – the Arthur Wishart Act (Franchise Disclosure), 2000, SO 2000, c 3; in British Columbia – the Franchises Act, SBC 2015, c 35; in Alberta – the Franchises Act, RSA 2000, c F-23; in Manitoba – the Franchises Act, CCSM c F156; in New Brunswick – the Franchises Act, RSNB 2014, c 111; and in PEI – the Franchises Act, RSPEI 1988 c F-14.1.

In each Disclosure Province, except for Alberta, a “franchise” is defined as: “a right to engage in a business where the franchisee is required by contract or otherwise to make a payment or continuing payments, whether direct or indirect, or a commitment to make such payment or payments, to the franchisor, or the franchisor’s associate, in the course of operating the business or as a condition of acquiring the franchise or commencing operations and,

- (a) in which,
 - (i) the franchisor grants the franchisee the right to sell, offer for sale or distribute goods or services that are substantially associated with a trade-mark, trade name, logo or advertising or other commercial symbol that is owned by or licensed to the franchisor or the franchisor’s associate, and
 - (ii) the franchisor or the franchisor’s associate has the right to exercise or exercises significant control over, or has the right to provide or provides significant assistance in, the franchisee’s method of operation, including building design and furnishings, locations, business organization, marketing techniques or training, or
- (b) in which,
 - (i) the franchisor, or the franchisor’s associate, grants the franchisee the representational or distribution rights, whether or not a trade-mark, trade name, logo or advertising or other commercial symbol is involved, to sell, offer for sale or distribute goods or services

supplied by the franchisor or a supplier designated by the franchisor, and

- (ii) the franchisor, or the franchisor’s associate, or a third person designated by the franchisor, provides location assistance, including securing retail outlets or accounts for the goods or services to be sold, offered for sale or distributed or securing locations or sites for vending machines, display racks or other product sales displays used by the franchisee.”

The definition of a “franchise” is defined in Alberta as: “a right to engage in a business;

- (i) in which goods or services are sold or offered for sale or are distributed under a marketing or business plan prescribed in substantial part by the franchisor or its associate,
- (ii) that is substantially associated with a trademark, service mark, trade name, logotype or advertising of the franchisor or its associate or designating the franchisor or its associate, and
- (iii) that involves:
 - (a) a continuing financial obligation to the franchisor or its associate by the franchisee and significant continuing operational controls by the franchisor or its associate on the operations of the franchised business, or
 - (b) the payment of a franchise fee,
- (iv) and includes a master franchise and a subfranchise.”

1.2 What laws regulate the offer and sale of franchises?

The Franchise Legislation regulates the offer and sale of franchises.

The primary purpose of Franchise Legislation is to protect franchisees by requiring franchisors to provide a disclosure document (“DD”) to prospective franchisees. In addition, the Franchise Legislation imposes the following obligations:

- Franchisors are obliged to provide prospective franchisees with a DD that includes certain statutory disclosures (found in the regulations) and material facts that would include any information about the business, operations, capital or control of the franchisor or its associate, or about the franchise system, that would reasonably be expected to have a significant effect on the value or price of the franchise to be sold, or the decision to purchase the franchise. The DD must include certain financial disclosures and also be accompanied by a certificate of disclosure from the franchisor that

is signed by two officers or directors of the franchisor (or only one officer or director, if there is only one officer and director). This certificate of disclosure certifies that all of the contents in the DD are accurate, and has the effect of making the signatories to the certificate personally liable if anything in the DD is not true, or the DD contains a misrepresentation that causes a franchisee a loss.

- A duty of fair dealing on both the franchisor and the franchisee in the performance and enforcement of the franchise agreement, and a right of action for damages against the other party to a franchise agreement who breaches the duty of fair dealing. The duty of fair dealing includes, in all provinces with franchise legislation (with the exception of Alberta), a duty to act in good faith and in accordance with reasonable commercial standards.
- A right to associate with other franchisees and to form or join an organisation of franchisees, which prohibits the franchisor from interfering with or penalising a franchisee for doing so. Any provision in a contract that restricts this right is deemed to be void.
- A right of rescission if the DD is not provided during the prescribed time period or if it does not meet the requirements outlined in the Franchise Legislation and a right of action for damages if a franchisee suffers a loss due to a misrepresentation in the DD.

In Quebec, no legislation exists specifically to regulate the offer and sale of a franchise; however, the Civil Code of Quebec:

- Imposes a fundamental legal duty of good faith that:
 - applies to both contractual and non-contractual dealings, including negotiation, performance and enforcement; and
 - institutes a positive duty to inform the prospective franchisee of any material information.
- Requires franchisees to inform themselves of any pertinent information and to conduct proper due diligence of the franchise opportunity such as by hiring counsel and accountants to provide advice.
- Obliges a franchisor not to encroach upon or compete with franchisees.
- Imposes a duty to protect the brand and the franchised network.
- Requires a franchisor to disclose any rebates and discounts received by it or its affiliates.
- Interprets ambiguous provisions in favour of the adhering party.
- Provides that terms not fully known to the adhering party at the time of signing will not be enforceable against them.
- Gives courts the right to declare null:
 - any abusive clauses or to reduce such provisions in scope; and
 - any illegible or incomprehensible clauses, unless it is proven that an adequate explanation of the nature and scope of the clause was given to the adhering party.

The Charter of the French Language (“Charter”) also requires that all materials including contracts, operating manuals, and other materials and communications be available in French and with recent amendments to the Charter, the use of the French language is required.

1.3 If a franchisor is proposing to appoint only one franchisee/licensee in your jurisdiction, will this person be treated as a “franchisee” for purposes of any franchise disclosure or registration laws?

Yes; however, the Franchise Legislation in British Columbia, Manitoba, New Brunswick, Ontario and PEI do not apply to an

arrangement arising from an agreement between a licensor and a single licensee to license a specific trademark, trade name, logo or advertising or other commercial symbol where the licence is the only one of its general nature and type to be granted by the licensor in Canada with respect to that trademark, trade name, logo or advertising or other commercial symbol. Franchisors relying upon this exemption should seek legal advice before doing so. The Franchises Act in Alberta does, however, apply in this situation.

1.4 Are there any registration requirements relating to the franchise system?

There are no registration requirements in Canada, but DDs do need to be made available to prospective franchisees in the Disclosure Provinces. Franchisees may be required, however, to register or obtain licences to establish and operate their franchised businesses.

1.5 Are there mandatory pre-sale disclosure obligations?

In the Disclosure Provinces, a franchisor is required to provide its prospective franchisees with a compliant DD at least 14 days before: 1) the franchisor and its associates and the franchisee sign any franchise agreement or related agreement (other than an agreement around a deposit); and 2) any consideration is paid to the franchisor (other than a deposit that, in some instances, meets the specific requirements of the Franchise Legislation). For example, in Ontario, the 14-day rule does not apply when there is an agreement for a deposit payment provided that it is less than 20% of the franchise fee and less than CAD\$100,000 and is fully refundable. The DD must be up to date, must be particularised for the specific franchise offering, and must contain all material facts, a certificate of disclosure, financial statements (with some exceptions), copies of all proposed franchise and other agreements, and other required disclosures as outlined in the regulations. If there are any material changes since the date of the DD but before the franchise agreement is signed that should be disclosed to the prospective franchisee, the franchisor must disclose the material changes and can do so through the issuance of a statement of material change (“SMC”). The DD must be delivered as one document and at one time. There are various exceptions and exemptions included in the Disclosure Legislation.

1.6 Do pre-sale disclosure obligations apply to sales to sub-franchisees? Who is required to make the necessary disclosures?

Disclosure obligations also apply to sales to sub-franchisees. The master franchise would be required to make the prescribed disclosure to the prospective sub-franchisee. The Franchise Legislation in the Disclosure Provinces includes a sub-franchisor and a sub-franchisee in the definition of a franchisor and franchisee.

1.7 Is the format of disclosures prescribed by law or other regulation, and how often must disclosures be updated? Is there an obligation to make continuing disclosure to existing franchisees?

While there is no exact format prescribed by law or other regulation, the regulations in the Disclosure Provinces outline certain items that must be included in the DD and, in the case of some

of the prescribed information in Ontario, the order in which the items must be included in the DD. Disclosures must contain all material information, and so a DD must be updated whenever there is any change in a material fact. There is no obligation to make continuing disclosure to existing franchisees; however, there would be an obligation to provide a new DD upon the renewal or extension of a franchise agreement where there has been a material change since the franchise agreement or the latest renewal or extension of the franchise agreement was entered into.

1.8 What are the consequences of not complying with mandatory pre-sale disclosure obligations?

Failure to provide the DD within the 14 days before entering into an agreement or an SMC before the earlier of paying any consideration to the franchisor or franchisor's associate with the exception of a deposit, where and if prescribed by the regulations, or the prospective franchisee signing the franchise agreement or any other agreement relating to the franchise, or providing a DD that does not meet the legislative requirements, grants the franchisee a 60-day right of rescission to render their agreements with the franchisor *void ab initio*. Failure to provide a DD at all grants a franchisee a two-year right of rescission. A franchisee further has a right of action against a franchisor, its agent, broker, associate, or anyone who signs a certificate of disclosure for any losses it suffers as a result of a misrepresentation in a DD or an SMC or as a result of a franchisor not complying with the disclosure requirements.

1.9 Are there any other requirements that must be met before a franchise may be offered or sold?

If there are any changes to: the business; operations; capital or control of the franchisor or franchisor's associate; a change in the franchise system; or a prescribed change, that would reasonably be expected to have a significant adverse effect on the value or price of the franchise to be granted or on the decision to acquire the franchise, the franchisor must provide the prospective franchisee with an SMC. If there is a material fact that was not included in the DD, the franchisor may be required to provide the prospective franchisee with a new DD, which also resets the 14-day "cooling off" period. If the franchisor provides the prospective franchisee with a DD by electronic transmission, the franchisor must meet certain requirements as outlined in the regulations and should in any event request a written acknowledgment of receipt from the prospective franchisee.

1.10 Is membership of any national franchise association mandatory or commercially advisable?

Membership to a national franchise association is not mandatory. In Canada, the Canadian Franchise Association ("CFA") serves franchisors and franchisees by providing resources to them. The CFA is the recognised authority on franchising in Canada and acts as the voice of the franchising community in Canada.

1.11 Does membership of a national franchise association impose any additional obligations on franchisors?

Franchisors are required to abide by the CFA's Code of Ethics as a condition of membership in that association.

1.12 Is there a requirement for franchise documents or disclosure documents to be translated into the local language?

There are two official languages in Canada – English and French. The majority of the population outside of Quebec speaks English. In Quebec, businesses must comply with the Charter, which requires that documents be available in French. The Charter will also impact the operation of a franchise in Quebec, by requiring that, among other things, all business names, signage, marketing, forms, employment agreements, etc. be in the French language.

2 Business Organisations Through Which a Franchised Business Can be Carried On

2.1 Are there any foreign investment laws that impose restrictions on non-nationals in respect of the ownership or control of a business in your jurisdiction?

Regarding ownership and control of corporations by non-Canadians, the Investment Canada Act requires that non-Canadians file a notification each time they commence a new business activity in Canada and acquire control of an existing Canadian business, although some exceptions exist. Notifications are made via a PDF form to Innovation, Science and Economic Development Canada.

Corporations formed under most provincial corporate legislation, and the federal legislation called the Canada Business Corporations Act ("CBCA"), must have a minimum number of resident Canadians on their board of directors (often 25%). One recent exception to this is corporations formed under Ontario's Business Corporations Act ("OBCA"). Such corporations are not subject to any requirements regarding Canadian representation on their boards.

2.2 What forms of business entity are typically used by franchisors?

Franchisors almost exclusively use corporations. In Canada, unlike the United States, there are no sub-types such as "S corps" and "C corps". A Canadian corporation will always have a board of directors, officers, and shareholders, and will be considered a distinct legal person. Occasionally, limited partnerships or unlimited liability corporations are also used.

2.3 Are there any registration requirements or other formalities applicable to a new business entity as a pre-condition to being able to trade in your jurisdiction?

If the entity is created under the corporate legislation for the province in which it operates, such as the OBCA, then normally it will just require a business licence from each municipality it operates within, usually available through the applicable municipal government.

If the entity is not created under the corporate legislation for the province in which it operates, or is created under the CBCA, it will need an extra-provincial registration for the province in which it operates, available through the applicable corporate registry for that province.

3 Competition Law

3.1 Provide an overview of the competition laws that apply to the offer and sale of franchises.

Canada's Competition Act applies to most businesses, including franchises, and aims to ensure truthful, fair and legal business conduct to benefit consumers and foster innovation and economic growth. The Competition Act includes criminal offences: conspiracies (cartels) for price-fixing, market allocation and restricted supply agreements; bid-rigging; criminal false or misleading representations; deceptive telemarketing; pyramid selling schemes; and newly enacted wage-fixing and no-poach agreements between employers coming into effect June 2023. The Competition Act also includes civil reviewable matters: deceptive marketing practices (civil false or misleading representations, testimonials, product and performance claims, price claims, contests and drip-pricing); restrictive trade practices (refusal to deal; price maintenance; tied selling, exclusive dealing and market restriction; abuse of dominance, etc.); and mergers. The Competition Bureau administers the Competition Act. It is an independent law enforcement agency, led by the Commissioner of Competition, with broad investigative powers. Criminal offences may be prosecuted in the appropriate courts while reviewable matters may be pursued at the Competition Tribunal, an independent adjudicative body, or in certain courts. On June 23, 2023, amendments to the Competition Act came into effect that make it a criminal offence for two or more unaffiliated employers to conspire, agree or arrange to: fix; maintain; decrease; or control wages, salaries or terms and conditions of employment, or not solicit or hire each other's employees.

3.2 Is there a maximum permitted term for a franchise agreement?

There is no maximum permitted term.

3.3 Is there a maximum permitted term for any related product supply agreement?

There is no maximum permitted term.

3.4 Are there restrictions on the ability of the franchisor to impose minimum resale prices?

A franchisor may impose minimum resale prices as long as the price maintenance provisions of the Competition Act are not violated. The Competition Bureau recognises that not all instances of price maintenance are anti-competitive. The Competition Act prohibits price maintenance that had, is having or is likely to have an adverse effect on competition in a relevant market. Whether the franchisor has market dominance is a factor in the competition effects analysis.

3.5 Encroachment – are there any minimum obligations that a franchisor must observe when offering franchises in adjoining territories?

Franchisors are generally unrestricted in offering franchises in adjoining territories. However, franchisors must adhere to disclosure requirements under the Franchise Legislation. In the Disclosure Provinces, the DD must outline policies regarding

territorial exclusivity and identify the proximity between franchisees or other entities having rights to use the same trademarks.

3.6 Are in-term and post-term non-compete and non-solicitation of customers covenants enforceable?

Both in-term and post-term non-compete and non-solicitation clauses in franchise agreements may be found enforceable by an arbitrator or court in disputes between franchisors and franchisees regarding these restrictive covenants. Clauses that are unambiguous and reasonable are generally upheld. The reasonableness requirement is met when the temporal and territorial restrictions are sufficiently limited to protect only the legitimate interest of the party seeking to rely on the covenant. Such clauses must be carefully drafted to reduce conflict between franchisor and franchisee when their relationship ends.

4 Protecting the Brand and Other Intellectual Property

4.1 How are trade marks protected?

Canadian law recognises common law trademark rights acquired through use of the trademark in Canada. In some circumstances, a foreign trademark owner can establish trademark rights when a trademark has a significant reputation in Canada, even though the mark has not actually been used in Canada. Trademarks are also protected through registration, which is initiated either by filing an application directly with the Canadian Intellectual Property Office ("CIPO"), or by designating Canada in an application for an International Registration filed with the World Intellectual Property Office, pursuant to the Madrid Protocol.

The governing statute is the Trademarks Act, which is federal in scope. Significant amendments to the Trademarks Act were implemented in 2019 to align Canadian practice with several international treaties. The corresponding Regulations, as well as various Practice Notices issued by CIPO, should also be considered.

Trademarks can be enforced through proceedings for passing off and/or infringement. The superior court of a province has concurrent jurisdiction with the Federal Court of Canada with respect to wrongdoing arising in that province, but only the Federal Court has jurisdiction to consider the validity of a Canadian trademark registration. The Federal Court also has sole jurisdiction to consider appeals of decisions of CIPO's Registrar of Trademarks. Such decisions can include refusing a trademark application, striking a trademark registration due to non-use, as well as decisions made pursuant to third-party opposition proceedings.

It is recommended that a franchisor carefully monitor the marketplace for confusingly similar marks so that timely action can be taken in the event of potential passing off/infringement of the franchise brand by others.

4.2 Are know-how, trade secrets and other business-critical confidential information (e.g. the Operations Manual) protected by local law?

While there is no statute that specifically covers confidential information, such information is recognised as being protectable pursuant to common law as long as certain criteria are met. In particular, the information must be kept confidential (meaning that it is not publicly disclosed) and reasonable steps must be taken to maintain its confidentiality. This is usually achieved by having recipients of the information sign agreements obliging

them to maintain its confidentiality. Sometimes the recipient of the information owes a duty (such as a fiduciary duty to the disclosing party), in which case tort remedies can be relied upon in addition to contractual remedies for any breach. A franchisor should ensure that any franchise agreement explicitly refers to the obligations of the recipients of any confidential information.

Note that other types of intellectual property are protected by specific statutes, most notably the Patent Act (which covers new and useful inventions), the Trademarks Act (which covers “signs” used to distinguish a trader’s goods and/or services from those of others) and the Copyright Act (which covers the right to produce and reproduce a “work”, such as a literary work [which can include an Operations Manual], or an artistic work [which can include a logo], etc.).

4.3 Is copyright (in the Operations Manual or in proprietary software developed by the franchisor and licensed to the franchisee under the franchise agreement) protected by local law?

Copyright is governed by the federal Copyright Act and protects original works. Copyright arises upon creation of the work in issue; it is not necessary to register copyright in the work. Under Canadian law, the first owner of copyright in a work will usually be the author(s) of that work. For example, the individual(s) who write an Operations Manual or who develop software are deemed to be the first owner(s) of copyright in the Operations Manual or the software. This is the case even if those individuals were specifically hired for that task, unless they are employees of the franchisor, they created the works in the course of their employment, and their employment agreements explicitly state that ownership of copyright in any such works will belong to the franchisor. If independent contractors are hired to create manuals, software or other works for use in the franchise, it is essential to obtain a written agreement assigning ownership of the copyright to the franchisor.

Copyright can be registered, although registration is not mandatory. Registration is typically recommended if the copyright owner wishes to commence proceedings for copyright infringement.

5 Liability

5.1 What remedies can be enforced against a franchisor for failing to comply with mandatory disclosure obligations? Is a franchisee entitled to rescind the franchise agreement and/or claim damages?

In the Disclosure Provinces, franchisees are entitled to two statutory remedies against the franchisor for failure to comply with the franchisor’s mandatory disclosure obligations.

The first remedy is the statutory right of rescission, by which the parties are relieved of their contractual obligations under the franchise agreement and the franchisor must reimburse the franchisee for the franchisee’s expenses incurred in connection with the franchise. More particularly, the franchisor must: (a) refund to the franchisee any money received from the franchisee (other than money for inventory, supplies or equipment); (b) purchase from the franchisee any inventory, supplies and equipment that the franchisee had purchased pursuant to the franchise agreement; and (c) compensate the franchisee for any losses that the franchisee incurred in acquiring, setting up and operating the franchise, less the amounts set out in (a) and (b).

A franchisee seeking to assert its statutory right of rescission must do so within 60 days from receipt of the DD in the case of minor deficiencies in the DD or SMC; however, if the franchisor failed to deliver a DD altogether, or if the DD provided was egregiously defective, then a franchisee is entitled to assert its rescission right up to two years from entering into the franchise agreement.

The second remedy is a statutory right to damages for misrepresentation. Generally, such damages will be available when the franchisee suffers a loss as a result of a misrepresentation contained in the DD or in an SMC, or as a result of a franchisor’s failure to comply with the franchisor’s disclosure obligations. Notably, the Franchise Legislation in the Disclosure Provinces permits the franchisee to sue for misrepresentation not only the franchisor but also persons closely related to the franchisor, such as any person who signed the DD or SMC. Also notable is that franchisees in the Disclosure Provinces are deemed by statute to have relied on any misrepresentation contained in the DD or SMC.

In the Disclosure Provinces, these statutory remedies are available to franchisees in addition to whatever remedies they may be entitled to under the common law or equity. In provinces and territories other than the Disclosure Provinces, the franchisee’s remedies are limited to those arising under common law or equity.

5.2 In the case of sub-franchising, how is liability for disclosure non-compliance or for pre-contractual misrepresentation allocated between franchisor and master franchisee? If the franchisor takes an indemnity from the master franchisee in the Master Franchise Agreement, are there any limitations on such an indemnity being enforceable against the master franchisee?

In the traditional master franchise arrangement, the master franchisee: (i) assumes the sole responsibility to provide its sub-franchisees with the required statutory disclosure; and (ii) indemnifies the franchisor against claims by the sub-franchisees concerning the franchise, including claims for rescission and misrepresentation.

While the parties are generally free to allocate risk in this way, their agreement will not displace any obligations that may be imposed on the franchisor by the Franchise Legislation. That means that the franchisor may potentially remain liable both to the sub-franchisees and to the master franchisee notwithstanding the contractual arrangements existing between the franchisor and the master franchisee.

Vis-à-vis the sub-franchisees, for instance, if the franchisor maintains significant operational control over the master franchisee and is involved in any way in the grant of the franchise to the sub-franchisee, the franchisor may be liable to claims for rescission or misrepresentation asserted by the sub-franchisee. Similarly, if the franchisor acts as the master franchisee’s agent with respect to the sub-franchisee, the franchisor may be liable for a misrepresentation claim by the sub-franchisee.

Vis-à-vis the master franchisee, any indemnity granted by that master franchisee in favour of the franchisor will generally be enforceable but only to the extent that indemnity does not waive or release from (i) any right given to the master franchisee under any operative franchise legislation, or (ii) any obligation or requirement imposed on a franchisor or franchisor’s associate under any such legislation.

5.3 Can a franchisor successfully avoid liability for pre-contractual misrepresentation by including a disclaimer in the franchise agreement?

Yes, but only in a limited fashion. In Ontario, at least, it is clear that a franchisor can successfully avoid liability for pre-contractual misrepresentation (provided those representations clearly relate to the subject matter of the franchise agreement, and provided those misrepresentations were not fraudulently made) by including a disclaimer in the franchise agreement, but only to the extent such misrepresentations were not contained in the DD. The franchisor will remain liable for misrepresentations contained in the DD (and for damages resulting from the franchisor's failure to comply with its disclosure obligations) notwithstanding the inclusion of any disclaimer in the franchise agreement.

5.4 Does local law permit class actions to be brought by a number of aggrieved franchisees and, if so, are class action waiver clauses enforceable?

Yes, aggrieved franchisees are permitted to sue collectively, pursuant to class proceedings legislation in each of the Disclosure Provinces.

The extent to which that right may be modified through the use of class action waivers in franchise agreements remains unsettled: (i) recent court decisions have called into question whether class action waivers are enforceable in light of public policy concerns; and (ii) a mandatory arbitration clause in the franchise agreement may have the effect of prohibiting franchisees from asserting their claims collectively by means of a class action.

6 Governing Law

6.1 Is there a requirement for franchise documents to be governed by local law? If not, is there any generally accepted norm relating to choice of governing law, if it is not local law?

The franchise statutes in each of the Disclosure Provinces mandate that local law apply to the subject franchise agreement, but only with respect to claims to which the legislation applies. Theoretically, claims that would not be the subject of a statutory right or obligation, such as claims based on common law misrepresentation, could be governed by non-local law.

The parties to a franchise agreement concerning a franchise that is outside of the Disclosure Provinces are free to choose any governing law.

6.2 Do the local courts provide a remedy, or will they enforce orders granted by other countries' courts, for interlocutory relief (injunction) against a franchisee to prevent damage to the brand or misuse of business-critical confidential information?

Canadian courts will recognise and enforce monetary orders granted by foreign courts when the foreign order is final, where the court that issued it had the jurisdiction to do so, and where the judgment was not obtained in breach of natural justice or public policy, etc.

The degree to which Canada courts will recognise and enforce foreign non-monetary awards is unsettled.

6.3 Is arbitration recognised as a viable means of dispute resolution and is your country a signatory to the New York Arbitration Convention on the Recognition and Enforcement of Foreign Arbitral Awards? Do businesses that accept arbitration as a form of dispute resolution procedure generally favour any particular set of arbitral rules?

Canadian courts strongly support the use of arbitration as a means of dispute resolution where the parties have agreed to arbitrate.

Canada is a party to the New York Arbitration Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

No particular set of arbitral rules predominates over others in franchise agreements that include arbitration provisions. It is not uncommon for the parties to select the arbitration rules published by private institutions, such as the ADR Institute of Canada.

7 Real Estate

7.1 Generally speaking, is there a typical length of term for a commercial property lease?

Ten years is typical and very common for the initial term of a commercial lease. However, the renewal terms, if available, will often be for five years each. The franchisor and franchisee will often attempt to ensure that the timeline of the lease and the franchise agreement are *co-terminus*.

7.2 Is the concept of an option/conditional lease assignment over the lease (under which a franchisor has the right to step into the franchisee/tenant's shoes under the lease, or direct that a third party (often a replacement franchisee) may do so upon the failure of the original tenant or the termination of the franchise agreement) understood and enforceable?

If properly drafted, it will be enforceable. The landlord, franchisor, and franchisee must each agree to such an arrangement. Merely having the franchisee agree to such options in the franchise agreement will not suffice, as that is a contract between the franchisor and franchisee, but not usually the landlord. Such options affect the lease and, to be enforceable, they must be accepted by all parties to the lease, including the landlord.

It is common for the franchisor to require that the franchisee, when securing a lease, also secure the landlord's consent to the above options. These options are usually found in an addendum to lease or three-party agreement, which is signed by the franchisor, franchisee, and landlord.

7.3 Are there any restrictions on non-national entities holding any interest in real estate, or being able to sub-lease property?

Generally no, although there may be additional taxes imposed depending on the type and location of the property.

7.4 Give a general overview of the commercial real estate market. To what extent has the real estate market been affected by the Coronavirus pandemic? Specifically, can a tenant expect to secure an initial rent free period when entering into a new lease (and if so, for how long, generally), or are landlords demanding "key money" (a premium for a lease in a flagship location)?

Currently, rent-free periods that encompass the time necessary

to construct the business premises are somewhat common, and these can sometimes be followed by a period where no base rent is owed (but additional rent is still owed, such as the tenant's proportionate share of building expenses). The no-base-rent period can be for one or more months, depending on local market conditions and bargaining power.

While key money is a possibility, it is a rare occurrence. If a location is particularly valuable, that value is more likely to be reflected in the base rent amount, and possibly higher and more numerous ongoing fees in the form of additional rent.

Some opportunities for negotiation arose during periods of government-mandated lockdowns, such as rent abatement for brief periods, but landlords have not changed their overall approach to commercial leasing, including the terms of leases and their willingness to bargain.

8 Online Trading

8.1 If an online order for products or request for services is received from a potential customer located outside the franchisee's exclusive territory, can the franchise agreement impose a binding requirement for the request to be re-directed to the franchisee for the territory from which the sales request originated?

Yes, under the franchise agreement a franchisor can require a franchisee to re-direct an online order/request to the appropriate franchisee holding exclusive territory rights related to that order/request. It is prudent for the franchise agreement to be specific about such online activities, particularly the process for resolving any potential disagreement between franchisees or infringement of territorial rights.

8.2 Are there any limitations on a franchisor being able to require a former franchisee to assign local domain names to the franchisor on the termination or expiry of the franchise agreement?

No, a franchisor can require a former franchisee to assign local domain names to the franchisor upon termination or expiry of the franchise agreement. There should be, and usually is, a clear provision in the agreement that communicates this requirement.

9 Termination

9.1 Are there any mandatory local laws that might override the termination rights one might typically expect to see in a franchise agreement?

The parties' freedom to negotiate their rights and obligations concerning the termination of a franchise agreement will be constrained in two ways: (i) the parties must conduct themselves in accordance with the duty of good faith they owe one another both under statute and at common law, which generally means that the termination provisions must be performed and enforced honestly and in a commercially reasonable manner; and (ii) in the Disclosure Provinces, the termination provisions cannot have the effect of waiving or releasing by a franchisee of a right given under the relevant franchise statute or of an obligation or requirement imposed on a franchisor under the statute.

9.2 Are there local rules that impose a minimum notice period that must be given to bring a business relationship that has existed for a number of years to an end, which will apply irrespective of the length of the notice period set out in the franchise agreement?

Canadian courts will not generally interfere with any express notice period contained in a franchise agreement. In the unusual case where a franchise agreement does not provide for a notice period with respect to termination, the court may imply a minimum notice period by reference to industry custom.

10 Joint Employer Risk and Vicarious Liability

10.1 Is there a risk that a franchisor may be regarded as a joint employer with the franchisee in respect of the franchisee's employees? If so, can anything be done to mitigate this risk?

Yes, there is some risk that a franchisor may be regarded as a joint employer with the franchisee with respect to the franchisee's employees.

That risk can be mitigated by expressly allocating to the franchisee sole responsibility and discretion in connection with employment matters; the more discretion the franchisor reserves for itself concerning the approval of the franchisee's employees, their scheduling, and their training, the greater the franchisor's liability to be deemed a joint employer.

The franchisor can also mitigate the risk somewhat by including in the franchise agreement express provisions stipulating that the franchisor and franchisee are independent contractors and not in an employment or agency relationship; while the presence of such provisions will not, on its own, be determinative of how a court or tribunal may characterise the legal relationship between the parties, the provisions will be taken into account.

An indemnity by the franchisee in favour of the franchisor in connection with claims by the franchisee's employees will also serve to mitigate the franchisor's risk.

10.2 Is there a risk that a franchisor may be held to be vicariously liable for the acts or omissions of a franchisee's employees in the performance of the franchisee's franchised business? If so, can anything be done to mitigate this risk?

Yes, there is some risk that a franchisor may be held vicariously liable for the acts or omissions of a franchisee's employees. The magnitude of that risk will be a function of the degree to which the franchisor controls the franchisee or the franchisee's employees in connection with the act or omission in dispute.

The franchisor can mitigate that risk by: (i) expressly allocating to the franchisee sole responsibility and discretion in connection with employment matters; (ii) including in the franchise agreement provisions stipulating that the franchisor and franchisee are independent contractors and not in employment or agency provision; (iii) obtaining an indemnity from the franchisee in favour of the franchisor in connection with claims by the franchisee's employees; and (iv) requiring the franchisee prominently to post signage proclaiming to the public the franchisee's status as an independent contractor.

11 Currency Controls and Taxation

11.1 Are there any restrictions (for example exchange control restrictions) on the payment of royalties to an overseas franchisor?

There are no exchange control restrictions in Canada, and it is unlikely a franchisor will be based in a country that imposes exchange control restrictions (so-called “transitional economies”). Generally, there are no special restrictions on the payment of royalties to overseas entities, although there are many tax rules surrounding payments to and from “non-resident persons”, which should be discussed with appropriate professional advisors.

11.2 Are there any mandatory withholding tax requirements applicable to the payment of royalties under a trade mark licence or in respect of the transfer of technology? Can any withholding tax be avoided by structuring payments due from the franchisee to the franchisor as a management services fee rather than a royalty for the use of a trade mark or technology?

Royalty payments to non-Canadian franchisors or their non-Canadian affiliates are subject to a 25% withholding tax; however, for example, payments to US franchisors or their US affiliates are subject to the US-Canada Tax Treaty, which tax convention reduces this withholding tax to 10%. In the US, franchisors may also seek a foreign tax credit from the Internal Revenue Service to recover the amount of this cost.

More generally, any payment from a Canadian franchisee to a non-Canadian franchisor will be subject to a 25% withholding tax if it falls within the category of a “rent”, meaning payment made to the owner of property (the franchisor) for the right to use that property for a given period of time. This can include payments for the use of trademarks, technology, and even franchise renewal fees (but not the initial franchise fee). Such requirements will not change if the payment is in a lump sum *versus* regular payments based on a percentage or set amount.

If a payment can be characterised as a royalty or a rent, describing such payment as a management or service fee for the purpose of avoiding the above tax is not likely to succeed. It is worth noting that the initial franchise fee has been considered by Canadian courts to be a legitimate example of a service fee, and therefore not subject to the above tax; the prospective franchisee is paying the franchisor to assess the prospect and conduct the needed administrative and legal work.

11.3 Are there any requirements for financial transactions, including the payment of franchise fees or royalties, to be conducted in local currency?

No. A franchisor can, in theory, insist it be paid in a foreign currency, such as by making payments to a USD account it maintains at a Canadian or foreign bank. The currency to be used should be specified in the franchise agreement and the DD, plus any exceptions (such as only the franchise fee being payable in USD).

12 Commercial Agency

12.1 Is there a risk that a franchisee might be treated as the franchisor's commercial agent? If so, is there anything that can be done to help mitigate this risk?

There is a risk that a franchisee may be seen as a franchisor's agent if: (a) the franchise agreement does not make the nature of their legal relationship clear; and/or (b) their conduct suggests to the public that the franchisee is an authorised representative or agent of the franchisor. To mitigate this risk, the franchise agreement, and their business conduct, should clearly demonstrate that they are independent contractors and not agents of one another. Canada does not have commercial agency legislation that applies to the franchise relationship.

13 Good Faith and Fair Dealings

13.1 Is there any overriding requirement for a franchisor to deal with a franchisee in good faith and to act fairly in its dealings with franchisees according to some objective test of fairness and reasonableness?

Yes, both the franchisor and the franchisee owe one another a duty of good faith in the performance and enforcement of the franchise agreement. That duty is imposed on the parties by statute (in the case of those franchise agreements that operate within one of the Disclosure Provinces) and at common law.

The duty of good faith requires the parties to: (a) perform and enforce the contract honestly and in a commercially reasonable manner; and (b) have regard for one another's commercial interests.

The duty of good faith is not a fiduciary duty, and neither party is obligated to prefer the other party's interests over its own. The duty of good faith does not extend so far as to permit the court to replace or amend express contractual provisions.

13.2 Is there any limitation on a good faith obligation being unenforceable if it only applies from franchisee to franchisor, rather than being mutual?

In Canada, the duty of good faith is reciprocally imposed on both franchisors and franchisees; the franchisor accordingly has no freedom to impose the duty unilaterally on the franchisee.

14 Ongoing Relationship Issues

14.1 Are there any specific laws regulating the relationship between franchisor and franchisee once the franchise agreement has been entered into?

The legislation referenced in question 1.2 places a duty of fair dealing on both the franchisor and the franchisee in the performance and enforcement of their agreements. This duty of fair dealing includes a duty to act in good faith and in accordance with reasonable commercial standards. For further information, please see section 13 above.

15 Franchise Renewal

15.1 What disclosure obligations apply in relation to a renewal of an existing franchise at the end of the franchise agreement term?

Disclosure is required unless the renewal is for the renewal of a franchise agreement where there has been no interruption in the operation of the business operated by the franchisee under the franchise agreement and there has been no material change since the franchise agreement or latest renewal or extension of the franchise agreement was entered into. In Alberta, disclosure is not required for a renewal or extension of an existing franchise agreement.

It may be unwise for a franchisor to rely on this exemption given that what is deemed a material fact includes any information about the business that would reasonably be expected to have a significant effect on the value or price of the franchise to be granted or the decision to acquire the franchise. This definition casts a wide net and a franchisor would be exposing itself to potential liability should it decide to take advantage of the exemption where it should not have.

15.2 Is there any overriding right for a franchisee to be automatically entitled to a renewal or extension of the franchise agreement at the end of the initial term irrespective of the wishes of the franchisor not to renew or extend?

No; however, if the franchisee has complied with all of the conditions necessary for renewal in the franchise agreement and has not breached the terms of the franchise agreement, failure by the franchisor to grant the renewal or extension may be a breach of the franchisor's duty of fair dealing.

15.3 Is a franchisee that is refused a renewal or extension of its franchise agreement entitled to any compensation or damages as a result of the non-renewal or refusal to extend?

If a franchisee is entitled to a renewal based on the terms of the franchise agreement and the franchisor declines, the franchisee may have cause to commence an action against the franchisor for contractual breach and/or breach of the franchisor's duty of fair dealing.

16 Franchise Migration

16.1 Is a franchisor entitled to impose restrictions on a franchisee's freedom to sell, transfer, assign or otherwise dispose of the franchised business?

Yes, a franchisor is entitled to impose restrictions on a franchisee's freedom to sell, transfer, assign or otherwise dispose of the franchised business. Commonly, the franchisor will reserve for itself the right to approve any assignee or transferee and may as well reserve for itself a right of first refusal.

16.2 If a franchisee is in breach and the franchise agreement is terminated by the franchisor, will a "step-in" right in the franchise agreement (whereby the franchisor may take over the ownership and management of the franchised business) be recognised by local law, and are there any registration requirements or other formalities that must be complied with to ensure that such a right will be enforceable?

Yes, Canadian courts will generally enforce "step-in" rights; such step-in rights need not be registered. The franchisor's operation of the franchised business will be subject to its overarching statutory and common law duty of good faith.

16.3 If the franchise agreement contains a power of attorney in favour of the franchisor under which it may complete all necessary formalities required to complete a franchise migration under pre-emption or "step-in" rights, will such a power of attorney be recognised by the courts in the jurisdiction and be treated as valid? Are there any registration or other formalities that must be complied with to ensure that such a power of attorney will be valid and effective?

Yes, Canadian courts will recognise any power of attorney granted by the franchisee in favour of the franchisor to facilitate the franchisor's "step-in" rights. Such powers of attorney need not be registered; however, to be enforceable, they must be drafted in a manner that complies with legal requirements, such as their execution in the presence of two witnesses.

17 Electronic Signatures and Document Retention

17.1 Are there any specific requirements for applying an electronic signature to a franchise agreement (rather than physically signing a "wet ink" version of the agreement), and are electronic signatures recognised as a valid way of creating a binding and enforceable agreement?

Electronic signatures can be used to execute franchise agreements, and other agreements that are appended to franchise agreements, as long as certain statutory requirements are met. That said, some documents must use wet ink signatures, including wills, promissory notes, certain powers of attorney, specific real estate documents and others. To address practical challenges created by the global pandemic, some rules may have been temporarily relaxed. It is prudent to seek legal advice for documents requiring signatures.

Canada's Personal Information Protection and Electronic Documents Act ("PIPEDA") requires that an electronic signature:

1. Be unique and distinctive to the person using it.
2. Be created under the signer's sole control.
3. Be created by technology that can confirm the identity of the signer.
4. Be protected by technology that can detect any subsequent changes to the e-signature.

Most provinces have legislation based on the Uniform Electronic Commerce Act ("UECA"), except Quebec, which has

the Act to Establish a Legal Framework for Information Technology. Requirements under these statutes are very similar to those under PIPEDA.

17.2 If a signed/executed franchise agreement is stored electronically (either having been signed using e-signatures or a “wet ink” version having been scanned and saved as an electronic file), can the paper version of the agreement be destroyed?

It is always advisable to securely file all executed hard copies of legal documents, including a franchise agreement and its appendices. That said, electronic copies of duly executed agreements that meet e-signature requirements are legally valid and enforceable. Corporate document retention policies should be implemented for compliance and other practical reasons.

18 Current Developments

18.1 What is the biggest challenge franchising is facing in your jurisdiction and how are franchisors responding to that challenge?

Franchisors in Canada are concerned about the state of the North American economy, as talk of a recession persists, and interest rates continue to rise in an effort to control inflation. Adding to this significant issue is a continuing labour shortage, as well as supply-chain disruptions, which, while lessening, appear to be persisting, in some respects, following the COVID-19 pandemic.

Franchisors and franchisees are having some difficulty filling vacant positions. Not all franchise systems have fully recovered from the effects of the COVID-19 pandemic on their industries.

The supply chain disruptions that emerged soon after the pandemic developed appear to be decreasing, although clear challenges remain. The enduring impact consists of inordinate delays in, and increased costs of, acquiring goods such as inventory and construction material.

It is rather difficult to mitigate these challenges when attempting to respond to inflationary pressures, personnel vacancies, and supply chain disruptions. Some Canadian franchisors continue to be cautious in their spending and in incurring additional debt, and they are looking for ways to streamline their operations; others have looked to increase their pricing, both at the franchisee and customer levels.

Acknowledgments

The authors would like to thank Stefan Ayache for his contributions to this chapter.

Stefan Ayache graduated from the faculty of law at the University of Windsor, where he has consistently performed in the top 5% of his class, and obtained his J.D. Stefan is an articling student at Hoffer Adler LLP, where he assists in matters of franchise law, commercial law, commercial litigation, and intellectual property. Prior to attending law school, Stefan earned a Bachelor of Commerce, specialising in finance from York University, and spent four years working in the financial services industry.

Tel: +1 416 977 6666 / Email: sayache@hofferadler.com



Joseph Adler is a senior franchise lawyer and a registered trademark agent. He has over 33 years of franchising related experience. Joseph serves as legal counsel for Canadian, US and other foreign franchisors doing business in Canada and Canadian franchisors doing business in the US and abroad. Joseph served as the Secretary and General Counsel to the CFA (2011–2015) and a Director and an Executive Member of the CFA's Board of Directors (2007–2015). Recognised by his peers, Joseph is consistently listed as a leading practitioner in franchise law in the *International Who's Who of Franchise Lawyers*, *Legal LEXPERT Directory*, *Franchise Times* as a "Legal Eagle", one of the top franchise lawyers in the US and Canada, *The National Post's Best Lawyers in Canada* (Franchising) and *Chambers and Partners' Franchising* legal rankings.

Hoffer Adler LLP
595 Bay Street, Suite 1102
Toronto, Ontario, M5G 2C2
Canada

Tel: +1 416 977 3444
Email: jadler@hofferadler.com
URL: www.hofferadler.com



Idan Erez is a commercial litigator with Hoffer Adler LLP. His practice includes a strong emphasis on franchising and involves acting for both franchisors and franchisees across a wide range of industries. Idan has both written and spoken extensively about franchising law in various publications and conferences. He is recognised by the *Franchise Times* as a "Legal Eagle". Idan is called to the Bar in Ontario as well as the State of Georgia. He has appeared successfully in various courts in Ontario, Alberta, and British Columbia. Idan has a Bachelor of Science (Honours) in Molecular Genetics and Molecular Biology.

Hoffer Adler LLP
595 Bay Street, Suite 1102
Toronto, Ontario, M5G 2C2
Canada

Tel: +1 416 977 2553
Email: ierez@hofferadler.com
URL: www.hofferadler.com



Stephanie Chong is a partner with Hoffer Adler LLP, and practises exclusively in intellectual property law, with an emphasis on trademark acquisition, management, licensing, enforcement and strategy. Her clients range from SMEs to large multi-nationals in a broad range of industries. Stephanie is a Past President of the Intellectual Property Institute of Canada ("IPIC"), the country's leading association for intellectual property professionals, and the first racialised person to have served as IPIC President in the near-100-year history of the organisation. Stephanie is also an active member of the International Trademark Association, and she has served as a Past Chair of the Canadian Bar Association's National IP Section. Stephanie has been recognised as a leading intellectual property lawyer by both *Lexpert* and *Best Lawyers Canada*, and is ranked among the world's leading trademark professionals by the prestigious *World Trademark Review* ("WTR"). In 2021, WTR further bestowed Stephanie with the recognition of Global Leader.

Hoffer Adler LLP
595 Bay Street, Suite 1102
Toronto, Ontario, M5G 2C2
Canada

Tel: +1 416 977 4559
Email: schong@hofferadler.com
URL: www.hofferadler.com

At Hoffer Adler LLP, we deeply value our close relationships with our clients. We are experienced franchise, commercial, IP and litigation counsel. Several of our lawyers have been recognised by their peers in their areas of expertise (*Best Lawyers of Canada*, *Franchise Times' Legal Eagles*, *Lexpert* and *Martindale-Hubbell*) and are highly respected by our clients and colleagues in Canada and around the world. We have represented over 580 franchise systems, including franchisors, franchisees (unit, multi-unit and master) and franchise associations. We also act as commercial and litigation counsel to our franchise clients. We represent domestic and international brand owners in acquiring and enforcing their trademarks and implementing brand management strategies and intellectual property proceedings. We are experienced advocates in trial and appellate courts, as well as before administrative tribunals, and in a broad variety of subject matter, including commercial, franchising, intellectual property, professional liability, and other litigation.

www.hofferadler.com

HOFFER ADLER

China

Jones & Co.



Paul Jones



Jiahui (Jennifer) Zhang

1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

The definition of “franchising”, (特许经营, *texujingying*), is provided in the Commercial Franchise Administration Regulation (商业特许经营管理条例, *Shangye Texujingying Guanli Tiaoli*), Ordinance No. 485 of January 31, 2007 (**Franchise Regulation**). A franchise must have three elements: (i) a franchisor, through an agreement, grants other operators (franchisees) the right to use the franchisor’s business-operating resources, including registered trademarks, logos, patents, and proprietary technologies; (ii) the franchisee conducts business under a uniform mode of operation; and (iii) the franchisee pays franchise fees according to the agreement.

The Chinese definition of franchising is very broad and may also include distribution systems if all three elements of the definition are met.

1.2 What laws regulate the offer and sale of franchises?

All franchise agreements must conform to the general contractual principles, found in Chapter three of the PRC Civil Code (民法典, *Minfadian*).

Franchise arrangements must also comply with the franchise-specific regulations, including:

- the Franchise Regulation;
- Commercial Franchise Registration Administrative Measures (商业特许经营备案管理办法, *Shangye Texujingying Bei'an Guanli Banfa*), Ministry of Commerce (**MOFCOM**) Decree No. 5 of 2011 (**Registration Measures**);
- Commercial Franchise Information Disclosure Administrative Measures (商业特许经营信息披露管理办法, *Shangye Texujingying Xinxì Pílu Guanli Banfa*), Decree No. 2 of 2012 (**Information Disclosure Measures**); and
- Foreign Investment Law of the PRC (2019) (外商投资法, *Waishang Touzi fa*) and the Special Administrative Measures for Access of Foreign Investments (Negative List) (负面清单, *Fu Mian Qing Dan*) released by MOFCOM annually.

1.3 If a franchisor is proposing to appoint only one franchisee/licensee in your jurisdiction, will this person be treated as a “franchisee” for purposes of any franchise disclosure or registration laws?

Yes, they will be treated as such.

1.4 Are there any registration requirements relating to the franchise system?

The Registration Measures require a franchisor to register with MOFCOM within 15 days of the date the first franchise contract is signed. The list of documents to be submitted is set out in Article 6 of the Registration Measures. International franchisors should register with MOFCOM in Beijing, rather than with local MOFCOM departments. The franchisor should register any changes with MOFCOM within 30 days.

Registration with MOFCOM is a relatively straightforward process; however, international franchisors may experience difficulties in demonstrating their compliance with the 2+1 Rule (see question 1.9).

Trademark licences must be recorded with the China National Intellectual Property Administration (**CNIPA**).

There is no requirement to register the franchise disclosure document with any governmental authority.

1.5 Are there mandatory pre-sale disclosure obligations?

Yes. Articles 21 to 23 of the Franchise Regulation require the franchisor to disclose certain information to the franchisee in writing at least 30 days before signing the franchise agreement. The list of information required to be disclosed is set out in Article 5 of the Information Disclosure Measures. Article 23 of the Franchise Regulation provides that a franchisor shall not conceal any relevant information, even if it is not specifically listed, which can be interpreted as a requirement to disclose all material facts.

General contract law provisions also apply to disclosure. Article 500 of the Civil Code (民法典) of the PRC requires parties to act in “good faith” during negotiations and prohibits them from intentionally concealing material facts related to the making of a contract. This provision is based on the civil law doctrine of *culpa in contrahendo* (“fault in negotiating”) and was interpreted in other civil law jurisdictions to require disclosure of all material facts.

1.6 Do pre-sale disclosure obligations apply to sales to sub-franchisees? Who is required to make the necessary disclosures?

Pre-sale disclosure is mandatory in a sale to a sub-franchisee. The sub-franchisor has the same obligations towards a sub-franchisee as the franchisor has towards a franchisee.

1.7 Is the format of disclosures prescribed by law or other regulation, and how often must disclosures be updated? Is there an obligation to make continuing disclosure to existing franchisees?

The disclosure shall be in writing. There is no prescribed format, but Article 5 of the Information Disclosure Measures can serve as an example of the order in which information can be presented.

There is no obligation to make continuing disclosure, but disclosure must be updated before signing the franchise agreement if there was a significant change in the information provided by the franchisor.

1.8 What are the consequences of not complying with mandatory pre-sale disclosure obligations?

If a franchisor conceals relevant information or provides false information, the franchisee may terminate the franchise agreement. There is no time limit to effect the rescission under the Franchise Regulation. However, some Chinese courts deny franchisees' termination claims if there was no substantial negative impact on the franchisee caused by the failure to disclose, or if the franchisee failed to prove that the failure to disclose had substantially affected its decision to sign the franchise agreement.

The franchisee can claim damages under the Civil Code, which are generally low in franchise cases.

The Franchise Regulation also provides for an administrative penalty of up to RMB 100,000 (approximately USD 15,000), but MOFCOM rarely acts on it.

1.9 Are there any other requirements that must be met before a franchise may be offered or sold?

Yes. In addition to the disclosure and registration obligations, the franchisor shall:

- have a mature business model and be able to provide continuous operational guidance, technical support, training and other services to franchisees;
- have at least one trademark, patent, design patent, copyright or other business resource registered in the PRC (although in some cases it seems that this requirement has been slightly relaxed); and
- have owned and operated at least two outlets for at least one year (the 2+1 Rule). Corporate-owned outlets may be operated directly or through subsidiaries or, in some cases, other affiliates. Corporate-owned outlets located outside of the PRC will satisfy the 2+1 Rule if they are operated under the same franchise brand. If the outlets are located outside of the PRC, franchisors may use statements issued by trade organisations (such as the International Franchise Association) to establish compliance with the 2+1 Rule.

According to the interpretation issued by the Beijing High People's Court, failure to comply with the 2+1 Rule is an administrative offence and does not invalidate the franchise agreement as long as the lack of qualifications has been disclosed to the franchisee.

1.10 Is membership of any national franchise association mandatory or commercially advisable?

No, membership with a franchise association in China is not mandatory.

1.11 Does membership of a national franchise association impose any additional obligations on franchisors?

The Chinese business association for the franchise industry, the China Chain Store & Franchise Association (<https://www.ccfa.org.cn>), requires its members to abide by its Code of Ethics.

1.12 Is there a requirement for franchise documents or disclosure documents to be translated into the local language?

There is no requirement to provide disclosure in Chinese. In practice, providing a Chinese language version is highly recommended to avoid a franchisee's claims that the English version was not understood.

All documents submitted to MOFCOM for registration must be translated into Chinese. A translation will also be required for courts if there is a dispute, or by the authorities for an administrative hearing.

2 Business Organisations Through Which a Franchised Business Can be Carried On

2.1 Are there any foreign investment laws that impose restrictions on non-nationals in respect of the ownership or control of a business in your jurisdiction?

Foreign investment in China is restricted or prohibited in some industry sectors. See Special Administrative Measures for Access of Foreign Investments (Negative List) (外商投资准入特别管理措施 (负面清单)), updated by the National Development and Reform Commission and MOFCOM in January 2022. Generally, the types of activities found in franchising are not restricted. The new Foreign Investment Law (外商投资法), which came into force on January 1, 2020, has further opened up the Chinese market to foreign investment. The National Development and Reform Commission and MOFCOM released the Catalogue of Industries Encouraged for Foreign Investment (2022 Edition) (Decree No. 2022), which became effective from January 1, 2023.

2.2 What forms of business entity are typically used by franchisors?

Most international franchisors prefer to grant franchises in China without establishing a local entity. Franchisors who decide to incorporate in China used to establish a wholly foreign-owned enterprise (WFOE), but this type of entity is now abolished. Now, legal entities incorporated in the PRC by foreigners are governed by the same law (the Company Law of the PRC) as the domestic entities.

Chinese partners often suggest forming a joint venture. The special laws on joint ventures have also been abolished and equity joint ventures are now governed by the Company Law. However, contractual arrangements still offer more flexibility and easier winding up than equity joint ventures.

2.3 Are there any registration requirements or other formalities applicable to a new business entity as a pre-condition to being able to trade in your jurisdiction?

Every business entity in China must obtain a business licence,

the scope of which must include offering franchises and the activities covered by the franchise model. Within 30 days after obtaining the business licence, the company should also register with the local State Tax Administration.

Doing business in certain sectors may require additional permits, such as catering service licences, fire protection approvals, etc.

3 Competition Law

3.1 Provide an overview of the competition laws that apply to the offer and sale of franchises.

The PRC's competition laws include the Anti-Unfair Competition Law (反不正当竞争法, *Fan Bu Zhengdang Jingzheng Fa*) and the Anti-Monopoly Law (反垄断法, *Zhonghua Renmin Gongheguo Fan Longduan Fa*).

The Anti-Unfair Competition Law provides statutory protection to trade secrets in addition to contractual obligations of the parties. The statute also prohibits unfair business practices, such as the fraudulent or misleading use of trademarks, fraudulent advertisement and the unauthorised use of domain names.

The Anti-Monopoly Law prohibits monopoly agreements in vertical relationships that: (i) fix prices for resale; and (ii) restrict the lowest price for resale. There are also restrictions on horizontal agreements among competitors, abuses of dominant positions, and administrative monopolies.

3.2 Is there a maximum permitted term for a franchise agreement?

There is no statutory maximum term.

3.3 Is there a maximum permitted term for any related product supply agreement?

No, there is not. However, the existence of a material product supply agreement and its terms and conditions must be disclosed to a potential franchisee.

3.4 Are there restrictions on the ability of the franchisor to impose minimum resale prices?

The PRC's Anti-Monopoly Law prohibits vertical agreements that fix resale prices or set minimum resale prices. In the last few years, retail price maintenance has become a significant issue for Chinese anti-monopoly authorities (especially in sectors such as pharmaceuticals and auto dealers). Franchise agreements that set "recommended prices" will likely attract scrutiny if there is evidence that the franchisor enforces the recommendation.

The PRC's amended Anti-Monopoly Law came into force on August 1, 2022. The existence of a resale price maintenance provision in an agreement is not sufficient to be considered as a breach. It is now established that further analysis of the anti-competition effects is always required. However, the burden of proof of no anti-competition effects falls on the business operator if it wishes to invoke the "safe harbour" rule.

3.5 Encroachment – are there any minimum obligations that a franchisor must observe when offering franchises in adjoining territories?

There are no such obligations.

3.6 Are in-term and post-term non-compete and non-solicitation of customers covenants enforceable?

Both in-term and post-term non-compete and non-solicitation covenants are enforceable in Chinese courts. However, overbroad restrictive clauses may not be enforced based on the doctrine of good faith set out in the Civil Code.

Under the Labour Contract Law (劳动合同法, *Lao Dong He Tong Fa*), a post-term non-compete covenant is generally not enforceable against an individual employee unless compensation is paid for the term of the non-compete period, which is restricted to two years.

4 Protecting the Brand and Other Intellectual Property

4.1 How are trade marks protected?

The PRC is a party to all major international conventions related to trademark protection. The PRC is a "first to file" jurisdiction. Trademarks registered outside of the PRC are generally not protected in China without a local registration.

The CNIPA has been working on expediting the examination process, and it now takes around six to nine months for the Trademark Office to finish all the procedures and issue the Registration Certificate if the application passes the examination smoothly, without any amendment notification, official rejection or a third-party opposition. The registration is valid for 10 years, with an option to renew.

Despite the significant improvement of intellectual property enforcement in the PRC, it is recommended to apply for the registration of trademarks in the PRC as early as possible, as Chinese trademark squatters are still quite active. More importantly, franchisors should consider registering their trademarks in Chinese characters to avoid giving a franchisee the opportunity to register it and "break away" from the franchise.

Distributors, franchisees and agents should never register trademarks without permission from the trademark holder. Recourse for this infringement can be made to the courts under Article 15 of the Trademark Law (商标法, *Shangbiao Fa*).

4.2 Are know-how, trade secrets and other business-critical confidential information (e.g. the Operations Manual) protected by local law?

Trade secrets are protected under the Anti-Unfair Competition Law, Criminal Law and can also be protected by a contract between the parties.

While trade secret infringement lawsuits are difficult to win, often due to the poor collection of evidence by the parties, the volume of trade secrets litigation in China has increased. The 2019 amendments to the Anti-Unfair Competition Law expanded the definition of a trade secret, and the scope of persons that can be liable for an infringement, and shifted the burden of proof in favour of claimants.

Practically speaking, a franchisor should ensure that a non-disclosure agreement is properly executed and keep track of what information is disclosed and when the disclosure occurred. Narrower non-disclosure agreements, with a clear scope of the information covered, should be considered.

4.3 Is copyright (in the Operations Manual or in proprietary software developed by the franchisor and licensed to the franchisee under the franchise agreement) protected by local law?

Yes. The PRC is a party to all major copyright treaties. The PRC Copyright Law (著作权法, *Zhuozhuoquan Fa*) protects copyright in written works and computer software. PRC courts recognise and protect copyright without registration. However, registration of a copyrighted object with the Copyright Protection Centre of China is useful where online enforcement is anticipated.

If a translation of an operations manual is made, it is advisable to obtain a written assignment of copyright from the translator, even if the translator is the franchisor's employee.

5 Liability

5.1 What remedies can be enforced against a franchisor for failing to comply with mandatory disclosure obligations? Is a franchisee entitled to rescind the franchise agreement and/or claim damages?

The franchisee is entitled to terminate the agreement if the franchisor conceals relevant information or provides false information (see question 1.8). Damages can be claimed under the Civil Code; however, damages awards are generally low in franchise cases.

5.2 In the case of sub-franchising, how is liability for disclosure non-compliance or for pre-contractual misrepresentation allocated between franchisor and master franchisee? If the franchisor takes an indemnity from the master franchisee in the Master Franchise Agreement, are there any limitations on such an indemnity being enforceable against the master franchisee?

Generally, the master franchisee is responsible for providing complete and accurate disclosure to sub-franchisees. As there are no statutory rules governing relationships between franchisors and sub-franchisees, there is no guidance from MOFCOM or the courts regarding liability of the franchisor for non-disclosure or misrepresentation by the master franchisee.

General principles set out in the Civil Code, including "good faith" requirements (see questions 1.5 and 13.1), apply to contractual indemnity for disclosure non-compliance or pre-contractual misrepresentation. Under PRC laws, limitation of liability for bodily injuries or death, or exclusion of liability on the grounds of negligence or gross negligence, are unenforceable.

5.3 Can a franchisor successfully avoid liability for pre-contractual misrepresentation by including a disclaimer in the franchise agreement?

No, they cannot.

5.4 Does local law permit class actions to be brought by a number of aggrieved franchisees and, if so, are class action waiver clauses enforceable?

Civil Procedure Law of the PRC (民事诉讼法, *Minshi Susong Fa*) regulates three different categories of collective actions, which can be considered an alternative to the concept of class actions:

- a claim by a party or against a party that consists of two or more persons;

- a claim by numerous plaintiffs, whose number and identity are known when the action is initiated; and
- a claim on behalf of an undetermined number of unidentified plaintiffs at the point at which the case is filed.

An authorised public body in the PRC or the People's Procuratorate can also bring a public interest claim before a court, particularly in areas such as environmental protection and consumers' rights.

Representative actions are not common in China, including in a franchising context.

Waivers of a right to sue (including a collective action) are not enforceable under PRC law.

6 Governing Law

6.1 Is there a requirement for franchise documents to be governed by local law? If not, is there any generally accepted norm relating to choice of governing law, if it is not local law?

If the transaction is foreign-related, parties are generally free to select foreign law to govern their contract and other franchise documents. However, there are a number of advantages for selecting PRC law as the governing law.

If the parties choose Chinese courts as a dispute resolution forum (which is generally recommended, as the enforcement of foreign judgments and arbitral awards is difficult in China), explaining foreign law to the judge will be expensive and cumbersome. If the judge is unclear as to the effect of the foreign law, the judge will likely apply Chinese law.

Chinese judges have a good track record of enforcing commercial contracts governed by PRC law: China is ranked fifth in The World Bank Group's Enforcing Contracts ranking (<https://www.doingbusiness.org/en/rankings>), while Hong Kong, a popular jurisdiction of choice in international transactions related to China, is ranked 31st.

A choice of foreign law by the parties may be trumped by the public policy interests. The Law on the Application of Laws to Foreign-related Civil Relationships (涉外民事关系法律适用法) provides that if the application of the laws of a foreign country would harm the public interest of the PRC, Chinese laws will govern. The prevention of fraud is generally considered to be in the public interest, and PRC courts consider an intentional violation of the disclosure requirement to be fraud.

The enforcement of foreign judgments and orders is difficult in China. There are very few treaties between the PRC and western countries allowing the mutual recognition and enforcement of judgments. In the absence of treaties, many western countries are not prepared to enforce the judgments of Chinese courts and, accordingly, judgments from such jurisdictions will not be enforced in China. Where there is reciprocity, the judgment of the foreign court will still be examined by local courts as to whether it contradicts the basic principles of the PRC law, or violates state sovereignty, security, or the social and public interest of the country.

International franchisors should strongly consider choosing PRC laws and Chinese courts when the enforcement against assets of a franchisee located in China is anticipated.

6.2 Do the local courts provide a remedy, or will they enforce orders granted by other countries' courts, for interlocutory relief (injunction) against a franchisee to prevent damage to the brand or misuse of business-critical confidential information?

Successful preservation measures requests (a Chinese equivalent of injunctions) are still rare in the PRC. There is also no legal

basis for PRC courts to grant interlocutory preservation measures based on a foreign judgment before the foreign judgment is recognised.

At this time, PRC courts are unlikely to enforce the orders of foreign courts, although this may change in the future.

6.3 Is arbitration recognised as a viable means of dispute resolution and is your country a signatory to the New York Arbitration Convention on the Recognition and Enforcement of Foreign Arbitral Awards? Do businesses that accept arbitration as a form of dispute resolution procedure generally favour any particular set of arbitral rules?

China is a party to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958). Arbitration is available for both domestic and foreign-related disputes. Parties to a cross-border commercial agreement may choose between Chinese arbitral institutions (for example, Shanghai International Economic and Trade Arbitration Commission) and international bodies. *Ad hoc* arbitration is generally not recognised.

The downsides of choosing arbitration for a PRC-related dispute are the added cost and time delay of enforcing the award. Any arbitral award must be approved by a local court for enforcement, and such hearings take almost as much time and money as a trial. In addition, all refusals to enforce an arbitral award must be approved by the higher court, which adds significant delay to the proceedings.

7 Real Estate

7.1 Generally speaking, is there a typical length of term for a commercial property lease?

Domestic leases of commercial property are usually between three and five years.

7.2 Is the concept of an option/conditional lease assignment over the lease (under which a franchisor has the right to step into the franchisee/tenant's shoes under the lease, or direct that a third party (often a replacement franchisee) may do so upon the failure of the original tenant or the termination of the franchise agreement) understood and enforceable?

Yes, a conditional lease assignment is enforceable. However, under PRC law, a foreign legal entity cannot be a tenant for the purpose of operating a business without incorporating in the PRC and registering with the PRC government first.

7.3 Are there any restrictions on non-national entities holding any interest in real estate, or being able to sub-lease property?

Yes, foreign entities are prohibited from purchasing or leasing real estate other than for self-use. To be able to purchase, lease or sub-lease real estate for the purpose of operating a business, a foreign entity should incorporate a Chinese company and obtain approvals from the local MOFCOM.

7.4 Give a general overview of the commercial real estate market. To what extent has the real estate market been affected by the Coronavirus pandemic? Specifically, can a tenant expect to secure an initial rent free period when entering into a new lease (and if so, for how long, generally), or are landlords demanding "key money" (a premium for a lease in a flagship location)?

The commercial real estate market in major cities was very competitive pre-pandemic. Rental rates in those locations were on a par with other regional commercial hubs such as Toronto, although other costs of doing business were lower. It was quite difficult to find a good location for a franchise store in a major city in China. The commercial real estate market in major cities has mostly rebounded to pre-pandemic levels.

The terms of leases, including rent-free periods or key money, will depend on the location of the property and negotiations with the landlord. Franchise systems may consider the so-called "second tier cities" (for example, Wuhan, Foshan) for market conditions more favourable for tenants.

8 Online Trading

8.1 If an online order for products or request for services is received from a potential customer located outside the franchisee's exclusive territory, can the franchise agreement impose a binding requirement for the request to be re-directed to the franchisee for the territory from which the sales request originated?

At this time, there is no statutory prohibition for a franchisor to impose such requirement.

8.2 Are there any limitations on a franchisor being able to require a former franchisee to assign local domain names to the franchisor on the termination or expiry of the franchise agreement?

A franchise agreement may require a franchisee to assign local domain names to the franchisor when the franchise is terminated. Although the registration of a domain name in China to a non-resident is not prohibited, in practice, foreign entities and individuals may encounter procedural difficulties when registering or assuming a ".cn" domain name.

9 Termination

9.1 Are there any mandatory local laws that might override the termination rights one might typically expect to see in a franchise agreement?

No, there are not. However, because there are no statutory termination provisions, it is advisable for the parties to include a detailed termination clause in the agreement. Otherwise, the provisions of the Civil Code will apply.

9.2 Are there local rules that impose a minimum notice period that must be given to bring a business relationship that has existed for a number of years to an end, which will apply irrespective of the length of the notice period set out in the franchise agreement?

Subject to the good faith requirements (see question 13.1), there are no such rules.

10 Joint Employer Risk and Vicarious Liability

10.1 Is there a risk that a franchisor may be regarded as a joint employer with the franchisee in respect of the franchisee's employees? If so, can anything be done to mitigate this risk?

This risk is very remote in the PRC.

10.2 Is there a risk that a franchisor may be held to be vicariously liable for the acts or omissions of a franchisee's employees in the performance of the franchisee's franchised business? If so, can anything be done to mitigate this risk?

Like many emerging economies, China has a significant problem with consumer fraud. Franchisors should take steps to avoid consumer fraud and monitor quality control issues.

Article 15 of the Franchise Regulation requires that the quality and standards of the products and services supplied by the franchise system comply with the law and regulations. Article 11(7) requires that the franchise agreement contains provisions for "the protection of consumer rights and interests by the franchisee and franchisor and allocation of responsibilities and liabilities for compensation".

Parties should also agree on the standards for the quality of products or services, and how these will be monitored and maintained. Contractual provisions that unfairly restrict the liability of the franchisor for quality deficiencies of its products or services may be overridden by the Consumer Protection Law or other public interest legislation, such as food safety laws and regulations.

11 Currency Controls and Taxation

11.1 Are there any restrictions (for example exchange control restrictions) on the payment of royalties to an overseas franchisor?

The Chinese currency, "renminbi" (also known as "yuan"), is still not freely exchangeable, although controls have loosened over the last decade. The controls are administered by the State Administration of Foreign Exchange (SAFE) and are implemented by the banks.

In order to be allowed to purchase foreign currency above the quota (up to USD 50,000 per resident), the payor must submit documents evidencing the requirement to make the payment outside the country (for example, a franchise agreement) to a bank. Franchisors should note that franchise agreements must be registered with MOFCOM, and trademark licence agreements must be registered with the CNIPA, otherwise a bank may refuse to make the payment.

There are also tax regulations applicable to overseas remittances by local payors. The bank will not wire the money until the tax authority issues a tax recordal form. Many tax authorities require Chinese payors to pay all withholding taxes before the tax recordal form is issued.

11.2 Are there any mandatory withholding tax requirements applicable to the payment of royalties under a trade mark licence or in respect of the transfer of technology? Can any withholding tax be avoided by structuring payments due from the franchisee to the franchisor as a management services fee rather than a royalty for the use of a trade mark or technology?

Royalties to a foreign licensor are subject to VAT at a rate of 6% and withholding tax at a rate of 10%, unless a tax treaty between China and the licensor's home jurisdiction sets out a different rate. Management fees and other active income generated from China is subject to various taxes and is not an effective option to avoid taxation. Moreover, the tax authorities may be aggressive in applying withholding tax to service fees and other payments that should not be subject to withholding tax, in an effort to prevent withholding tax avoidance.

Some franchisors have incorporated in Hong Kong to take advantage of a lower withholding tax rate for money transfers from China to Hong Kong. However, this option is only available to Hong Kong entities carrying out actual business activity in Hong Kong and complying with the 2+1 Rule.

If a foreign franchisor incorporates in China, its profit will be subject to an enterprise income tax at the rate of 25%.

Taxes paid by a foreign franchisor in China may be credited against the income tax of the franchisor in its home country, depending on the tax laws of the home jurisdiction.

11.3 Are there any requirements for financial transactions, including the payment of franchise fees or royalties, to be conducted in local currency?

Aside from the foreign exchange restrictions, there are no such requirements.

12 Commercial Agency

12.1 Is there a risk that a franchisee might be treated as the franchisor's commercial agent? If so, is there anything that can be done to help mitigate this risk?

Under PRC law, there is little risk of confusion between franchising and commercial agency. Commercial agency (known as "entrustment contracts" in China) is a nominal contract, i.e., it is regulated by a separate chapter in the Civil Code and is distinct from franchise arrangements (see the definition of "franchise" in question 1.1 above). Further, China has not adopted a European law principle that entitles a commercial agent for a payment for goodwill upon termination.

13 Good Faith and Fair Dealings

13.1 Is there any overriding requirement for a franchisor to deal with a franchisee in good faith and to act fairly in its dealings with franchisees according to some objective test of fairness and reasonableness?

Yes, the concept of fair dealing runs throughout legislation in the PRC. Articles 7 and 509 of the Civil Code and Article 4 of the Franchise Regulation require the parties to act fairly, honestly and in good faith.

13.2 Is there any limitation on a good faith obligation being unenforceable if it only applies from franchisee to franchisor, rather than being mutual?

The good faith obligation under the Civil Code applies equally to the franchisee and franchisor. Generally, Chinese contract law is based on the principle of voluntariness, so if there are clear unilateral rights reserved to one party of the franchise agreement, and those rights do not contradict the mandatory provisions of the Civil Code or the Franchise Regulations, such unilateral rights are enforceable.

14 Ongoing Relationship Issues

14.1 Are there any specific laws regulating the relationship between franchisor and franchisee once the franchise agreement has been entered into?

There is a general principle under the Civil Code requiring the parties to perform their contractual obligations in good faith. The Franchise Regulation requires the franchisor to provide ongoing operational guidance, technical support and business training in accordance with the franchise agreement, and to disclose to the franchisee any promotional and marketing expenses. The franchisee is required to obtain the franchisor's consent before transferring a franchise to a third party.

There are, however, no mandatory requirements similar to the U.S. franchise rules allowing termination of the franchise solely on the grounds specified in the regulations.

15 Franchise Renewal

15.1 What disclosure obligations apply in relation to a renewal of an existing franchise at the end of the franchise agreement term?

If the franchise agreement is renewed on the same terms and conditions, a new disclosure is not necessary. Otherwise, Information Disclosure Measures require the franchisor to provide disclosure at least 30 days before signing the franchise agreement.

15.2 Is there any overriding right for a franchisee to be automatically entitled to a renewal or extension of the franchise agreement at the end of the initial term irrespective of the wishes of the franchisor not to renew or extend?

There is no such statutory right.

15.3 Is a franchisee that is refused a renewal or extension of its franchise agreement entitled to any compensation or damages as a result of the non-renewal or refusal to extend?

No, the franchisee is not entitled to any compensation.

16 Franchise Migration

16.1 Is a franchisor entitled to impose restrictions on a franchisee's freedom to sell, transfer, assign or otherwise dispose of the franchised business?

Yes, subject to the good faith requirements (see question 13.1), a franchisor can restrict the franchisee's freedom to dispose of the

franchised business. The Franchise Regulation also prohibits the franchisee from assigning the business to a third party without the franchisor's consent.

16.2 If a franchisee is in breach and the franchise agreement is terminated by the franchisor, will a "step-in" right in the franchise agreement (whereby the franchisor may take over the ownership and management of the franchised business) be recognised by local law, and are there any registration requirements or other formalities that must be complied with to ensure that such a right will be enforceable?

"Step-in" rights are recognised by PRC laws. However, "step-in" rights are not a practical option for most foreign franchisors because their implementation requires the establishment of a Chinese legal entity with a proper scope of business in its business licence. For a foreign franchisor without presence in China, it is more efficient to use other remedies, such as termination rights.

16.3 If the franchise agreement contains a power of attorney in favour of the franchisor under which it may complete all necessary formalities required to complete a franchise migration under pre-emption or "step-in" rights, will such a power of attorney be recognised by the courts in the jurisdiction and be treated as valid? Are there any registration or other formalities that must be complied with to ensure that such a power of attorney will be valid and effective?

Such powers of attorney are known as "authorisations" in China. They are not prohibited, but there are certain practical issues that must be considered in advance of signing the franchise agreement.

To complete the migration of the franchise to the franchisor, some government approvals will likely be required. The officials at the relevant governmental bodies may be unwilling to grant the approvals to a holder of an authorisation, as this is not a widespread practice.

17 Electronic Signatures and Document Retention

17.1 Are there any specific requirements for applying an electronic signature to a franchise agreement (rather than physically signing a "wet ink" version of the agreement), and are electronic signatures recognised as a valid way of creating a binding and enforceable agreement?

Electronic signatures that comply with the reliability requirements of the PRC's Electronic Signature Law (电子签名法, *Dianzi Qianming Fa*) are recognised as a valid way of signing a franchise agreement. In practice, however, "wet ink" is still the preferred method of signing franchise agreements.

17.2 If a signed/executed franchise agreement is stored electronically (either having been signed using e-signatures or a "wet ink" version having been scanned and saved as an electronic file), can the paper version of the agreement be destroyed?

The rules of evidence in the PRC are stricter than in many common law jurisdictions, and uncertified copies of paper

documents are generally not admissible as evidence. It is recommended to keep the original paper versions of franchise agreements, in case they are required to be presented to a court or an administrative body.

18 Current Developments

18.1 What is the biggest challenge franchising is facing in your jurisdiction and how are franchisors responding to that challenge?

As of the time of writing, the Chinese economy is actively recovering from the COVID-19 pandemic. Travelling restrictions came to an end in the first quarter of 2023. According to data released by the National Bureau of Statistics on May 15, 2023, from January to May the total retail sales of consumer

goods increased 9.3% year-on-year. According to data from MOFCOM, as of April 2023 the total number of registered franchisors reached 9,549, nearly double the number of 2017. The total sales of the top 100 franchise systems in China increased 250 billion Yuan from 2017 to 2021.

Traditionally, a significant challenge for Western franchisors and Chinese franchisees was navigating the cultural differences between their respective business cultures. For this reason, master franchising is a preferred mode of expansion to China, unless the franchise system is big enough to set up its own operations in China. Engaging trusted advisors familiar with both cultures, customs, and legal systems can help bridge the gap between the franchisor and its franchisees in China.

Also, China has a high level of innovation in goods and services, and digitalisation in business management and marketing. International brands will face fierce competition with local brands.



Paul Jones' practice is broadly focused on the national and international distribution of goods and services. Paul helps clients develop franchise systems and licensing and distribution programmes, including the preparation of disclosure documents and agreements, and negotiates disputes. He assists many foreign and Canadian businesses expanding internationally. He has been consulted by the Government of the People's Republic of China on the preparation of franchise legislation, and his papers on Chinese franchise laws are widely used as references by practitioners and academics around the globe.

He regularly advises on national and multijurisdictional trademark and domain name applications and disputes, including counterfeiting matters, and on copyright protection issues. Paul has developed significant expertise in marketing and pricing practices, and advises clients on the interaction between intellectual property and competition law. Paul is familiar with both the common law and civil law systems. He has studied Mandarin Chinese and follows legal developments in the PRC.

Jones & Co.
67 Yonge Street, Suite 602
Toronto, Ontario
M5E 1J8
Canada

Tel: +1 416 703 5716
Email: pjones@jonesco-law.ca
URL: www.jonesco-law.ca



Jiahui (Jennifer) Zhang is a lawyer at Jones & Co, based in Toronto. She graduated from the University of Toronto, Faculty of Law. She also acquired a Bachelor of Law and a Master of Law degree from Beijing Foreign Studies University in China.

Jennifer serves Canadian and International clients, drafts Master Franchise Agreements, unit franchise agreement, and franchise disclosure document for use in Canada. She also advises on corporate matters with a focus on competition law and foreign investment.

Prior to being called to the Ontario Bar in 2021, Jennifer practiced in other jurisdictions on international investment transactions. Jennifer is fluent in both Chinese (Mandarin) and English.

Jones & Co.
67 Yonge Street, Suite 602
Toronto, Ontario
M5E 1J8
Canada

Tel: +1 416 836 3749
Email: zhang.jiahui@jonesco-law.ca
URL: www.jonesco-law.ca

Jones & Co. is a multilingual law firm in Toronto, Canada. It provides legal advice to international businesses regarding the protection and distribution of their goods and services. It is particularly known for its work in intellectual property, licensing and franchising, and international law. The firm has a well-established China practice and staff include native Chinese speakers. Experienced in both common law and civil law jurisdictions, the firm works for clients from Asia, Europe and the Americas, often coordinating work in several jurisdictions.

With established expertise in a number of areas of law, and understanding of both common law and civil law systems, the firm finds innovative solutions to problems that more traditionally segregated practices may overlook.

www.jonesco-law.ca

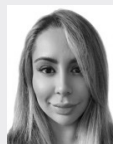


England & Wales

Freeths LLP



Iain Bowler



Jaskeerat Sanghera

1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

“Franchise” is not defined under English statutes and there is no clear definition under case law.

The British Franchise Association’s (“bfa”) Code of Ethical Conduct (“**Code**”) (described further in question 1.9 below) adopts the following definition of “franchising”, taken from the European Code of Ethics for Franchising (“**European Code**”):

“Franchising is a system of marketing goods and/or services and/or technology, which is based upon a close and on-going collaboration between legally and financially separate and independent undertakings, the franchisor and its individual franchisees. The franchisor grants its individual franchisees the right, and imposes the obligation, to conduct a business in accordance with the franchisor’s concept. The right entitles and compels the individual franchisee, in exchange for a direct or indirect financial consideration, to use the franchisor’s trade name, and/or trade mark and/or service mark, know-how, business and technical methods, procedural system, and other industrial and/or intellectual property rights. This is supported by the continuing provision of commercial and technical assistance, within the framework and for the term of a written franchise agreement, concluded between parties for this purpose.”

1.2 What laws regulate the offer and sale of franchises?

There is no legislation specifically regulating franchising in the UK. General English contract, intellectual property, real estate and competition laws apply to franchising.

The franchising industry also self-regulates through the bfa and its Code. (See question 1.9 below.) The Code promotes fair dealings between a franchisor and its franchisees throughout the franchise relationship.

Pyramid selling legislation (The Trading Schemes Act 1996) in the UK has specific application to franchising. This legislation applies to certain multiple-layered franchises, whereby the franchisee is encouraged (by the promise of a benefit or payment) to appoint sub-franchisees (who in turn may appoint other sub-franchisees) to promote and sell goods and/or services. Breach of the pyramid selling legislation can be a criminal offence. The pyramid selling legislation does not apply to a single-tier trading scheme (franchisor and one level of franchisee beneath it).

Where the pyramid selling legislation applies, the franchisor (and any franchisee who is sub-franchising) will be under onerous obligations: (i) to include certain information and warnings in adverts; (ii) to include in any agreement with new sub-franchisees warnings and statements of rights and a 90-day cooling-off period; and (iii) imposing restrictions on the timing of certain payments.

It is essential therefore that either the franchise is a single-tier trading scheme (with a single layer of franchisees beneath a franchisor) or, if the franchise system is multi-layered, e.g. a master franchise structure, that it falls outside the pyramid selling legislation. A system where the franchisor and all franchisees are registered for VAT is excluded from the trading schemes regulation.

1.3 If a franchisor is proposing to appoint only one franchisee/licensee in your jurisdiction, will this person be treated as a “franchisee” for purposes of any franchise disclosure or registration laws?

English law contains no legal definition of a “franchise” or “franchisee”. Accordingly, whether a proposed licensee (being the only licensee in the UK) should be treated as a “franchisee” should be considered from a commercial (not a legal) point of view. The absence of any franchise-specific disclosure and registration laws in the UK means the classification of the licensee as a “franchisee” has no regulatory compliance consequences.

1.4 Are there any registration requirements relating to the franchise system?

There are no franchise registration requirements in the UK.

1.5 Are there mandatory pre-sale disclosure obligations?

There are no mandatory disclosure obligations in the UK. However, Article 3.3 of the bfa’s Code requires bfa member franchisors to provide a copy of the Code to prospective franchisees, along with a “full and accurate written disclosure of all information material to the franchise relationship within a reasonable time prior to the execution of binding documents”. The Guide to the Code contains further guidance on the extent of “full and accurate written disclosure”.

Voluntary disclosure along the lines specified by the bfa’s Code is one of the most effective ways of managing the risk associated with misrepresentation claims by franchisees.

1.6 Do pre-sale disclosure obligations apply to sales to sub-franchisees? Who is required to make the necessary disclosures?

There are no mandatory disclosure obligations applicable to the sale of sub-franchisees.

If the master franchisee is a member of the bfa then the pre-sale disclosure requirements specified in Article 3 of the Code apply, and the master franchisee will be bound to make the relevant disclosures. This will inevitably require the cooperation of the franchisor.

As noted above, appropriate disclosure is one of the most effective ways of managing the risk associated with misrepresentation claims by sub-franchisees.

1.7 Is the format of disclosures prescribed by law or other regulation, and how often must disclosures be updated? Is there an obligation to make continuing disclosure to existing franchisees?

There are no mandatory disclosure obligations either at the start of the franchise relationship or on a continuing basis.

1.8 What are the consequences of not complying with mandatory pre-sale disclosure obligations?

There are no mandatory pre-sale disclosure obligations, so non-compliance is not relevant.

1.9 Are there any other requirements that must be met before a franchise may be offered or sold?

There are no specific laws governing the offer for sale and purchase of a franchise.

Note that Article 2.2 of the bfa's Code obliges a bfa member franchisor to:

- (i) operate "a business concept with success, for a reasonable time and in at least one pilot unit before starting its franchise network";
- (ii) be the owner, or have legal rights to the use of its network's trade name, trade mark or other distinguishing identification; and
- (iii) provide the individual franchisee with initial training and continuing commercial and/or technical assistance during the entire life of the agreement.

1.10 Is membership of any national franchise association mandatory or commercially advisable?

Membership of the bfa is not compulsory.

The role of the bfa is to promote ethical franchising in the UK. Many (but not all) franchisors become members of the bfa as it operates as an accreditor of franchising companies as well as a trade association. Membership does carry certain obligations – see question 1.11 below.

1.11 Does membership of a national franchise association impose any additional obligations on franchisors?

The bfa provides a self-regulatory framework for its members and applies strict criteria for membership relating to operational practices, business procedures, franchise agreement terms and support offered to franchisees.

The bfa requires its members to comply with:

- (i) its disciplinary procedure;
- (ii) its complaints procedure;
- (iii) its appeals procedure;
- (iv) the Advertising Standards Agency's Code of Advertising Practice;
- (v) the Code; and
- (vi) certain reporting requirements.

The Code incorporates the European Code, along with certain UK-specific provisions that clarify the European Code position.

The bfa has published a guide entitled "The Guide to the Code of Ethics", which supplements the Code. This is not publicly available without charge, but can be purchased via the bfa's website.

Because of these requirements, some franchisors are reluctant to become members of the bfa, notwithstanding that they may be highly reputable and ethical franchisors.

1.12 Is there a requirement for franchise documents or disclosure documents to be translated into the local language?

There is no legal requirement for franchise or disclosure documents to be in English. However, a franchisor that provides documents that are not in English is unlikely to attract much interest in relation to its franchise system from prospective franchisees in the UK.

Note that Article 5.2 of the Code stipulates that every agreement and contractual arrangement in connection with the franchise should be written in, or translated into, the official language of the country where the individual franchisee is established.

Article 4 of the Code further provides that "franchisors should seek to ensure that they offer to franchisees contracts in a language in which the franchisee is competent".

2 Business Organisations Through Which a Franchised Business Can be Carried On

2.1 Are there any foreign investment laws that impose restrictions on non-nationals in respect of the ownership or control of a business in your jurisdiction?

No, generally there are no laws that impose any such restrictions. However, The National Security and Investment (NSI) Act 2021 has introduced new requirements for foreign direct investment in certain business sectors with the potential to impact national security. Mandatory pre-notification requirements apply in respect of entities in "key sectors", and there are 17 sectors identified as such. The focus is on companies whose activities have a close link to UK government activities, so this is unlikely to apply to the majority of franchises, but is worth noting for those in certain sectors such as defence sector supply chain, those who supply products subject to UK export control, critical industries such as energy and communications and sensitive industries such as artificial intelligence or data infrastructure.

2.2 What forms of business entity are typically used by franchisors?

Small franchises can be sole traders or partnerships, but most franchisors value the protection of limited liability and are therefore structured as limited liability companies. Franchisors can be public companies whose shares are listed on a recognised stock exchange.

When expanding into foreign markets, franchisors may establish a presence in the new market from which to service the local franchise network. In such cases, the franchisor may open a branch or establish a local subsidiary, or even enter into a joint venture with a locally based entity, to benefit from the local party's knowledge of, and established infrastructure in, the new territory. Tax and transfer pricing issues will need to be taken into account.

In the case of multi-jurisdictional franchising, intellectual property rights might be held in a specific intellectual property holding company resident in a certain jurisdiction (e.g. Ireland or Luxembourg), to take advantage of beneficial tax rates.

2.3 Are there any registration requirements or other formalities applicable to a new business entity as a pre-condition to being able to trade in your jurisdiction?

Once a limited liability company has been duly incorporated at Companies House, the company may begin trading. Information on incorporation requirements is available on the Companies House website. There are no additional registration requirements relating to the commencement of business, although the company must register for corporation tax, VAT and employment withholding taxes with His Majesty's Revenue and Customs ("HMRC").

3 Competition Law

3.1 Provide an overview of the competition laws that apply to the offer and sale of franchises.

Following Brexit, the UK is a third country and no longer part of the EU internal market. Therefore, whether EU Competition law continues to apply in relation to a franchise agreement depends on where the agreement is implemented or where the effects of the agreement can be said to be felt. If the franchise agreement will be implemented in the UK and its effects will be felt only in the UK, or in part of the UK, then EU Competition law is probably no longer relevant to that agreement, and the only applicable law will be the UK Competition Act 1998 (as amended). If, on the other hand, it cannot be said with any confidence that the franchise agreement operates on a purely UK domestic basis, then other competition law rules (such as EU Competition law) may apply.

Although the UK is a third country, under the principle of extraterritorial application of EU Competition law, the EU Competition rules, namely Articles 101(1) and 102 of the Treaty on the Functioning of the European Union ("TFEU") and the EU block exemption regulations (such as the Technology Transfer Block Exemption), still apply following the end of the Brexit transitional period to agreements and to activities of UK companies that are implemented or have an effect within the EU. UK franchisors active within the EU must therefore still comply with EU Competition law as well as UK Competition law. Note, however, that the EU Commission no longer has jurisdiction to conduct dawn raids in the UK (though the CMA has similar powers) and the EU Commission may only issue information requests to businesses in the UK.

Nevertheless, since 1 January 2021, the offer and sale of a franchise in the UK on a purely domestic basis is subject to UK competition law provisions relating to agreements between undertakings and the abuse of a dominant market position under the UK Competition Act 1998 and the Enterprise Act 2002.

In relation to such domestic UK franchise systems, Articles 101(1) and 102 of the TFEU no longer apply, although the EU block exemption regulations remain in force in the UK until

they expire. Accordingly, companies carrying on business in the UK will continue to benefit from these block exemptions if they meet the relevant criteria.

Importantly, the EU's Vertical Agreements Block Exemption Regulation ("VABER") expired on 31 May 2022. On the same day, it was replaced in the UK by the Vertical Agreements Block Exemption Order ("VABEO") and in the EU by the Vertical Block Exemption Regulation ("VBER"). Both the VABEO and VBER continue to exempt and provide a "safe harbour" for franchise agreements that comply with their respective requirements.

3.2 Is there a maximum permitted term for a franchise agreement?

There is no maximum permitted term. If the franchise agreement contains territorial exclusivity provisions, there may be restrictions that apply to the term of the franchise agreement if it is not to be regarded as potentially anti-competitive. This will require individual assessment based on market share data, which will vary from franchise to franchise.

3.3 Is there a maximum permitted term for any related product supply agreement?

There is no maximum permitted term. If the franchisor requires the franchisee to purchase more than 80% of the products to be sold through the franchise from the franchisor or its nominated suppliers, the supply agreement will not qualify for the automatic "safe harbour" treatment under the VABEO or VBER if: it is for a term of more than five years; or the franchisee operates from premises or land owned or leased by the franchisor, for a term that exceeds the period of occupancy of those premises. If the supply agreement does not fall within the "safe harbour" treatment (and the requirement is not necessary to maintain the common identity and reputation of the franchise network), any potential anti-competitive effect will require individual assessment based on market share data, which will vary from franchise to franchise.

3.4 Are there restrictions on the ability of the franchisor to impose minimum resale prices?

Yes. In general terms, any restriction on a franchisee's ability to determine its sale prices or the imposition of minimum resale prices may be deemed "hardcore" restrictions of competition under both the UK and EU competition law rules. The inclusion of such a "hardcore" restriction could invalidate the entire franchise agreement and may also render the franchisor open to the payment of fines of up to 10% of worldwide turnover and claims for damages.

Maximum resale prices can be imposed, provided that the maximum is not set so low that it acts as a *de facto* minimum price.

There are some very limited exceptions to the prohibition on resale price maintenance. Published guidelines on both the VABEO and VBER provide that, in certain circumstances, resale price maintenance can be permitted; for example, in a franchise system, fixed resale prices may be permitted where necessary for the launch of a new product or to implement a short-term, low-price campaign (e.g. for two to six weeks) that will benefit consumers.

Separately, in certain circumstances, it may now be permissible under both the VABEO and VBER to adopt dual pricing (i.e. charge a higher price for products intended to be sold online than for products intended to be sold offline).

3.5 Encroachment – are there any minimum obligations that a franchisor must observe when offering franchises in adjoining territories?

There are no statutory or relationship laws that govern the question of competing franchisees being granted neighbouring territories where one franchisee claims that its ability to optimise its income is being impaired due to the proximity of the neighbouring franchise. However, the English legal principle of “non-derogation from grant” may be relevant. It is sometimes said that the principle of non-derogation from grant embodies the rule of common honesty. If A agrees to confer a benefit on B, then A should not do anything that substantially deprives B of the enjoyment of that benefit. The obligation not to derogate from grant is implied into the franchise agreement.

Under English law there is, at least as yet, no general over-riding duty of good faith and fair dealing that applies to franchise agreements. There is a developing body of case law, however, which may be leading the courts to the position where they may be prepared to imply a general duty of good faith and fair dealing into certain “relational” contracts, including franchise agreements. Circumstances where the courts may be willing to imply such a term will be fact-specific and will require “a core value of honesty”. This is not a big stretch from the fundamental tenet that underpins the principle of non-derogation from grant, and so it is easy to see a way for the courts to find for a franchisee who has invested his or her life savings in a franchise, only to find a substantial part of the benefit of that investment being eroded as a result of “encroachment”.

Franchisors must be vigilant, as there are risks here. Granting a clearly defined exclusive geographic territory to each franchisee, and being clear about the geographical limits in franchise sale documentation, is one way of mitigating this risk. Note, however, that, as a general rule, competition law requires that franchisees must not be prevented from making “passive” sales outside of their exclusively allocated geographic territories.

See also the comments in question 18.1 below, in respect of the impact that third-party-provided online delivery services may have on the territorial operation of franchises.

3.6 Are in-term and post-term non-compete and non-solicitation of customers covenants enforceable?

Non-compete obligations are those that prevent a franchisee from being involved in a business that competes with the franchised business or that requires the franchisee to purchase from the franchisor/franchisor’s designated suppliers more than 80% of the franchisee’s total purchases – calculated by value or volume, depending on the segment of the market.

In general, in-term non-compete obligations are permitted where the duration is limited to five years or less, and there are no obstacles that potentially hinder the franchisee from terminating the non-compete at the end of this period (tacitly renewable obligations that extend beyond five years will not work). Where the franchisee operates from premises and land owned or leased by the franchisor, the non-compete obligation may extend to the period of occupancy of those premises.

Importantly for franchisors, where there is a transfer of know-how and intellectual property rights, non-compete clauses may be permissible for the duration of the franchise agreement (irrespective of length) provided that: they are directly related to the franchised business; the primary object of the agreement is not to transfer such know-how or IPRs; and the agreement does not contain any “hardcore” restrictions. These conditions are generally fulfilled under most franchise agreements.

Furthermore, a non-compete obligation on the goods or services purchased by the franchisee falls outside competition law principles where the obligation is necessary to maintain the “common identity and reputation of the franchised network”, provided the non-compete obligation does not exceed the duration of the franchise agreement itself.

In other circumstances, in-term non-compete obligations may be invalid, but as they are not deemed “hardcore” restrictions of competition they will not invalidate the entire franchise agreement.

Post-term non-compete obligations generally raise competition law concerns outside of the VABEO and VBER. In the UK and where the VABEO applies to a franchise agreement, a one-year post-termination non-compete is permitted, provided it meets the following criteria:

- (i) it relates to products/services competing with the contract product/services;
- (ii) it is limited to the premises from which the franchisee operated during the contract; and
- (iii) it is indispensable to protect know-how transferred by the franchisor, but this know-how must comprise information that is not generally known or easily accessible and which is significant and useful to the franchisee for the use, sale or resale of the contract goods or services.

However, English common law may also rule a post-term non-compete clause unenforceable if it goes beyond what is reasonable to protect the franchisor’s legitimate business interests. Traditionally, a 12-month post-term non-compete clause has generally been regarded as being reasonable and therefore enforceable. However, in 2022 the Court of Appeal ruled that in certain circumstances, where the franchise was terminated relatively early on and where there was inequality of bargaining power between the franchisor and a franchisee, a 12-month non-compete clause was unreasonable and unenforceable. This makes the drafting of effective non-compete clauses more difficult, as there is no one-size-fits-all approach, and care must be taken to try to ensure they are reasonable in a number of different potential factual circumstances. These circumstances include considering, amongst other factors, who owns any goodwill, what exactly the non-compete clause is seeking to protect and whether it applies for too long or in a location too far outside of the contractual franchise territory.

4 Protecting the Brand and Other Intellectual Property

4.1 How are trade marks protected?

In the UK, trade marks can be registered under the Trade Marks Act 1994 (“**TMA**”) (as amended) at the Intellectual Property Office (“**IPO**”).

A UK trade mark registration lasts for 10 years (from the date of the application) and can be renewed for further periods of 10 years, subject to the payment of renewal fees.

Process

It is prudent to conduct searches to ensure the trade mark is not already being used by a third party. An official application must then be made to the IPO’s Trade Marks Registry (“**Registry**”). The Registry will examine the application and perform its own searches. This will include consideration of “absolute” (e.g. is the mark distinctive?) and “relative” (e.g. does the mark conflict with any earlier third-party right?) grounds for refusal, as set out in Sections 3 and 5 of the TMA. There is a substantial body of UK case law in relation to the registrability of trade marks.

Once any objections are resolved, the application will be advertised in the Trade Marks Journal and objectors may raise objections (generally within a two-month period). In the absence of any successful objections, the trade mark will be registered following the expiry of that period.

If the trade mark is to be used in the EU, it may be preferable to obtain a Community Trade Mark (“CTM”), which applies across all EU Member States. This can be achieved by making an application to the Office for Harmonization in the Internal Market. UK-based businesses should therefore apply for a UK trade mark, and a separate CTM application will be necessary to cover any EU territories.

Effect of registration

The proprietor of a registered trade mark has exclusive rights to use the mark and may sue any party who uses it without consent.

If a trade mark is not registered, the proprietor of the trade mark may have some common law protection under the tort of “passing off”. The general components for passing off are: goodwill; misrepresentation; and damage. It can be difficult (and expensive) to bring an action for passing off, so it is almost always preferable to register the trade mark.

4.2 Are know-how, trade secrets and other business-critical confidential information (e.g. the Operations Manual) protected by local law?

It is not possible to register general know-how, trade secrets and other business-critical confidential information in the UK. However, patents and certain design rights can be registered.

The law contains some protection of know-how, trade secrets and other business-critical confidential information, provided such information has “the necessary quality of confidence” and is “disclosed in circumstances importing an obligation of confidence”. Where those criteria apply, the provider of confidential information could bring an action for breach of confidence if it has suffered a loss due to it being used or disclosed without permission.

It is significantly easier to prove and enforce a breach of a contractual obligation of confidence than a right existing under general law, so it is preferable for the franchise agreement to include specific obligations defining “confidential information” and setting out the circumstances under which any confidential information can and cannot be disclosed. It is also prudent to take practical steps to protect confidential information by including appropriate notices on documents and restricting disclosure.

4.3 Is copyright (in the Operations Manual or in proprietary software developed by the franchisor and licensed to the franchisee under the franchise agreement) protected by local law?

The Copyright, Designs and Patents Act 1988 (“CDPA”) provides copyright protection in the UK. A piece of work (recorded in any form) will receive automatic copyright protection, provided the CDPA applies.

Copyright subsists for specific periods, depending on the type of work and whether the creator is known. For example, under Section 12(2) of the CDPA, copyright for “literary, dramatic, musical or artistic works” (which could include an Operations Manual) lasts for 70 years from the end of the calendar year in which the author dies.

A “computer program” and “preparatory design material for a computer program” fall under the definition of “literary work” under Section 3(1) of the CDPA. However, the application of copyright protection to software is complex, so it is prudent to

include specific contractual restrictions on the use, copying and dissemination of any software. Practical measures should also be considered, such as limiting access to source code.

5 Liability

5.1 What remedies can be enforced against a franchisor for failing to comply with mandatory disclosure obligations? Is a franchisee entitled to rescind the franchise agreement and/or claim damages?

There are no mandatory disclosure requirements in the UK. There is also no legal requirement for contracting parties to volunteer information, as the onus for diligence is on the purchaser under the principle of “*Caveat Emptor*” (buyer beware). However, direct questions must be answered fairly and honestly.

A franchisee may bring a claim for misrepresentation against a franchisor that has made untrue statements of fact that led the franchisee to enter into the franchise agreement and suffer loss (see question 5.3 below). There are various forms of misrepresentation (i.e. fraudulent, negligent or innocent). The franchisee could also bring a tortious claim for negligent misstatement, but remedies for misrepresentation are generally more favourable.

Damages and rescission of the franchise agreement are available as remedies for misrepresentation, although a court will order only damages for innocent or negligent misrepresentation *in lieu* of any right of the franchisee to rescind the franchise agreement.

5.2 In the case of sub-franchising, how is liability for disclosure non-compliance or for pre-contractual misrepresentation allocated between franchisor and master franchisee? If the franchisor takes an indemnity from the master franchisee in the Master Franchise Agreement, are there any limitations on such an indemnity being enforceable against the master franchisee?

There are no mandatory disclosure requirements in the UK.

In a typical arrangement (where the sub-franchise agreement is made between the master franchisee and sub-franchisee), any liability for misrepresentation would rest with the master franchisee (as the parties must have a contractual relationship to bring a claim for misrepresentation). The sub-franchisee could also bring a claim for negligent misstatement against each of the franchisee and the franchisor, if it can establish that the franchisor owed the sub-franchisee a duty of care.

The Unfair Contract Terms Act 1977 (“UCTA”) imposes limits on the validity of exclusion clauses in standard form agreements. Franchise agreements are generally classed as standard form agreements, depending on how heavily they are negotiated.

Under the UCTA, if an indemnity in a standard form agreement indirectly operates to exclude or limit a contracting party’s liability, then a court could strike out the provision as “unreasonable”. As an example, this could apply to a wide obligation for the master franchisee to indemnify the franchisor for all of the master franchisee’s acts or omissions (as those acts or omissions could be caused by the franchisor’s own negligence).

5.3 Can a franchisor successfully avoid liability for pre-contractual misrepresentation by including a disclaimer in the franchise agreement?

The franchise agreement should include “entire agreement” and “non-reliance” clauses, which are designed to prevent either party from bringing a misrepresentation claim based on pre-sale/pre-contract data.

However, case law suggests that exclusions of fraudulent misrepresentation are likely to be “unreasonable” under the UCTA, and could be struck out. For this reason, a well-drafted agreement will confirm that it does not seek to exclude or limit liability for fraud or fraudulent misrepresentation, to try to ensure that exclusions of liability for negligent or innocent misrepresentation might survive.

Where the use of exclusion clauses leaves a claimant with no practical remedy against the other party, the courts are likely to consider such exclusions to be unreasonable, and strike them out. Franchisors should be mindful of the need, therefore, to leave a franchisee with some reasonable level of claim in the event of a breach or misrepresentation (subject to higher level limitations), or else risk being left with unlimited liability if the limitations of liability are struck out completely.

5.4 Does local law permit class actions to be brought by a number of aggrieved franchisees and, if so, are class action waiver clauses enforceable?

English law permits class actions, but these are less aggressive than the US equivalent. Class action waivers are enforceable, but are rarely used.

6 Governing Law

6.1 Is there a requirement for franchise documents to be governed by local law? If not, is there any generally accepted norm relating to choice of governing law, if it is not local law?

There is no legal requirement for franchise agreements to be governed by English law. However, to increase the marketability of a franchise system in the UK, the majority of franchise agreements are subject to English law. In some limited cases, franchise agreements in the UK might be subject to the law of one of the US states, for example, but there is no generally accepted norm where English law is not the governing law of the agreement.

6.2 Do the local courts provide a remedy, or will they enforce orders granted by other countries' courts, for interlocutory relief (injunction) against a franchisee to prevent damage to the brand or misuse of business-critical confidential information?

UK courts will enforce judgments (including interim orders) made in courts of overseas jurisdictions.

There are wide-ranging enforcement regimes in place between the UK and various jurisdictions. In the absence of an enforcement regime with the relevant country, the English common law position would apply.

6.3 Is arbitration recognised as a viable means of dispute resolution and is your country a signatory to the New York Arbitration Convention on the Recognition and Enforcement of Foreign Arbitral Awards? Do businesses that accept arbitration as a form of dispute resolution procedure generally favour any particular set of arbitral rules?

Arbitration is a common and widely recognised means of resolving disputes, especially in relation to international franchise agreements that operate across geographic borders, whether

from the UK to other countries or *vice versa*. The UK is a signatory to the New York Convention and the Geneva Convention, and so arbitral awards are internationally enforceable in the UK.

There are many different recognised rules of arbitration. Those frequently used in relation to the UK include the London Court of International Arbitration (“LCIA”) and the International Chamber of Commerce International Court of Arbitration (“ICC”). Different organisations impose different procedures and different cost structures, so it is worth taking advice to find the arbitral process that best suits your commercial requirements.

7 Real Estate

7.1 Generally speaking, is there a typical length of term for a commercial property lease?

The typical length of a lease of certain types of commercial property has been falling over recent years. In the retail sector, leases of 10 years (with a right to break after five) or five years are common. In other sectors (such as hotels or licensed premises) where initial fit-out/investment costs are substantial, longer terms are normal – 20/25-year leases at market rent are common for licensed premises/restaurants, and 99/200-year leases with low rents (but with an initial premium) are common for hotels.

7.2 Is the concept of an option/conditional lease assignment over the lease (under which a franchisor has the right to step into the franchisee/tenant's shoes under the lease, or direct that a third party (often a replacement franchisee) may do so upon the failure of the original tenant or the termination of the franchise agreement) understood and enforceable?

Although this concept does not tend to be standard in precedent commercial leases, it is reasonably well understood that a franchisor may want rights to step into a failed franchisee's lease, and appropriate wording to cover this issue can be included in the original lease with the landlord's agreement. This would require the assignment of the lease to the franchisor (and that would generally require the franchisor to assume responsibility for the accrued liabilities of the franchisee to the landlord).

7.3 Are there any restrictions on non-national entities holding any interest in real estate, or being able to sub-lease property?

There are no general rules preventing non-UK entities from holding real estate assets. However, in practice, landlords generally prefer a local entity to be the tenant, as it is easier to issue legal proceedings against them. If the local entity is newly formed and without a trading history, the landlord may require a parent company guarantee, which is often given by the non-national holding company.

7.4 Give a general overview of the commercial real estate market. To what extent has the real estate market been affected by the Coronavirus pandemic? Specifically, can a tenant expect to secure an initial rent free period when entering into a new lease (and if so, for how long, generally), or are landlords demanding “key money” (a premium for a lease in a flagship location)?

Symbolised by vacant office buildings, empty shopping malls, and an increasing number of empty retail units and closed

restaurants on many high streets, the Coronavirus pandemic and subsequent difficulties in the global supply chain, and more recently the cost of doing business and cost of living crisis, has severely impacted real estate markets in the UK. Retail and casual dining sectors in particular are continuing to experience very difficult trading conditions, where the factors mentioned above have exacerbated the pre-existing (pre-Coronavirus) difficult trading conditions in these sectors. There are many challenges that continue to confront the commercial real estate market in the UK. This is widening the gap between those sectors that are benefitting from change and those that are being left behind, with the main losers in the retail, as well as hospitality and leisure, sectors.

It is normal to negotiate a rent-free period to reflect the cost to the tenant of fitting out the premises – and this applies to most types of business premises. In many parts of the UK, it is also possible to negotiate additional rent-free allowances by way of incentives to take a lease at market rent, due to the current balance of supply and demand. As already noted, this is especially relevant in the retail sector. For substantial assets in sectors that are heavily dependent on location, such as hotels and quick service restaurants, local competition may result in key money needing to be paid. A premium will almost certainly be required for a long lease if it reserves a rent other than a market rent.

8 Online Trading

8.1 If an online order for products or request for services is received from a potential customer located outside the franchisee's exclusive territory, can the franchise agreement impose a binding requirement for the request to be re-directed to the franchisee for the territory from which the sales request originated?

The proposed requirement effectively prohibits the franchisee from making passive sales outside its territory. A passive sale is one where the customer is located outside the franchisee's allocated territory but has nevertheless approached the franchisee directly. Compare this to an "active sale" where the franchisee actively approaches the out-of-territory customer in an attempt to secure a sale.

A ban on passive sales is a "hardcore" restriction under both the VABEO and VBER, which provide that every franchisee must be allowed to use the internet to sell its products or offer its services. Most sales made via the internet are passive sales.

The inclusion of such a restriction in a franchise agreement could render the whole agreement void and unenforceable, and parties to the agreement could be exposed to significant fines and potential third-party damages actions.

8.2 Are there any limitations on a franchisor being able to require a former franchisee to assign local domain names to the franchisor on the termination or expiry of the franchise agreement?

There are no such limitations, although any obligations intended to apply after termination or expiry of the franchise agreement should be expressly stated to "survive" the termination or expiry of the franchise agreement. It may also be worth considering including a limited power of attorney ("POA") in the franchise agreement, entitling the franchisor to effect such assignment if the former franchisee refuses to do so. Under English law, a POA must be executed as a deed, so careful attention must be paid to the execution formalities of any agreement that contains a POA.

9 Termination

9.1 Are there any mandatory local laws that might override the termination rights one might typically expect to see in a franchise agreement?

No. However, see the comments on Transfer of Undertaking Regulations (2006) ("TUPE") in section 14 below.

9.2 Are there local rules that impose a minimum notice period that must be given to bring a business relationship that has existed for a number of years to an end, which will apply irrespective of the length of the notice period set out in the franchise agreement?

There are no statutorily imposed minimum notice periods that will have the effect of overriding the contractual notice period set out in the franchise agreement. See question 12.1 below relating to minimum statutory notice periods in relation to commercial agency agreements.

10 Joint Employer Risk and Vicarious Liability

10.1 Is there a risk that a franchisor may be regarded as a joint employer with the franchisee in respect of the franchisee's employees? If so, can anything be done to mitigate this risk?

There is very little English case law addressing the issue of whether a franchisee or a franchisee's employees can be treated as employees of the franchisor. In deciding the issue, typical considerations may include: whether the individual receives any wage or remuneration from the franchisor; the degree of control the franchisor exercises over the individual; and the provisions of the contractual documents. In a franchise network, it is unlikely that any employees of the franchisee will receive remuneration from the franchisor, and the income that the franchisee receives tends to be profit from the franchisee's business, rather than remuneration. Further, although the franchisor indirectly may exercise some degree of control over the franchisee's staff, this control tends to be limited to outcomes and not day-to-day control over the actions of individual employees. Nevertheless, the concept of joint employer risk is gaining momentum outside the US where it began, and is now recognised in a number of other common law and civil law jurisdictions. As such, it is not an issue that can be ignored when structuring the terms of franchise agreements and master franchise agreements that are to operate in the UK.

Franchisors must also be aware of the importance of ensuring that the franchise agreement sets out the true nature of the relationship between franchisor and the franchisees, particularly where the franchise involves owner driver franchisees, for example in final mile parcel delivery and collection systems. The distinction between a franchisee, an employee and a worker can turn on small differences but the consequences for a franchisor can be significant.

10.2 Is there a risk that a franchisor may be held to be vicariously liable for the acts or omissions of a franchisee's employees in the performance of the franchisee's franchised business? If so, can anything be done to mitigate this risk?

It is rare that a franchisor is found vicariously liable for the acts of a franchisee. It is good practice for franchise agreements

to contain a clause expressly stating that there is no relationship of partnership, agency or employment between the franchisor and franchisee, which can reduce the likelihood of potential liability. However, it remains a question of fact, and factors that may contribute to a risk of vicarious liability include: the degree of control the franchisor exercises over the franchisee's day-to-day operations; whether there is common ownership of the franchisor and franchisee; and whether the franchisee was in fact acting as the franchisor's agent (disclosed or undisclosed), notwithstanding any wording to the contrary in the franchise agreement. Controls intended to maintain uniformity of appearance and products are typically considered insufficient to create a duty under which a franchisor may be vicariously liable for a franchisee's acts or omissions.

11 Currency Controls and Taxation

11.1 Are there any restrictions (for example exchange control restrictions) on the payment of royalties to an overseas franchisor?

No, there are no such restrictions.

11.2 Are there any mandatory withholding tax requirements applicable to the payment of royalties under a trade mark licence or in respect of the transfer of technology? Can any withholding tax be avoided by structuring payments due from the franchisee to the franchisor as a management services fee rather than a royalty for the use of a trade mark or technology?

If the franchisee is resident in the UK but the franchisor is not resident in the UK and has no "permanent establishment" within the UK (i.e. a branch), royalties may be subject to UK withholding tax, which would be deducted by the franchisee from payments to the franchisor. The amount (if any) of withholding tax payable will depend on whether there is a double taxation treaty between the UK and the country where the franchisor is based. Within the EU, payments between associated companies may be relieved from withholding tax. Advice should be taken in relation to withholding tax implications in respect of payments to and from the UK and any EU territory.

Franchise fees sometimes include a combination of a royalty for the use of intellectual property rights (which is potentially subject to withholding tax) and payments for goods and services (which are not).

11.3 Are there any requirements for financial transactions, including the payment of franchise fees or royalties, to be conducted in local currency?

No, there are no such requirements.

12 Commercial Agency

12.1 Is there a risk that a franchisee might be treated as the franchisor's commercial agent? If so, is there anything that can be done to help mitigate this risk?

Depending on the nature of the franchisee's duties, there could be a risk that the franchisee is acting as the franchisor's commercial agent.

The franchisor's risk profile would be significantly impacted if the franchisee is deemed a "Commercial Agent" for the

purposes of the Commercial Agents (Council Directive) Regulations 1993 (as amended) ("**Regulations**"). The Regulations include (amongst other non-excludable obligations) implied duties between the parties including good faith, the length of termination notice, and an obligation for the principal to pay severance payments to its commercial agent following either termination or expiry of the agency agreement (other than in certain limited circumstances).

It is important to structure the franchise agreement to ensure the Regulations will not apply. The franchise agreement should include a disclaimer stating that the agreement is not intended to constitute an agency or partnership relationship between the parties. Such a disclaimer will not, however, be conclusive, as the strict legal status of the relationship will be determined on the facts.

13 Good Faith and Fair Dealings

13.1 Is there any overriding requirement for a franchisor to deal with a franchisee in good faith and to act fairly in its dealings with franchisees according to some objective test of fairness and reasonableness?

There has been a great deal of activity in this area under English law since 2013, and the law continues to develop through successive decisions in the English and also the Irish courts. Nevertheless, at present there is no general duty of good faith and fair dealings in English contract law, although there is a school of thought that it is only a matter of time before the English courts will imply such a term into certain contracts, including franchise agreements.

Under Article 2.4 of the European Code (incorporated into the bfa's Code), each party is obliged to "exercise fairness in their dealings with each other" and "...resolve complaints, grievances and disputes with good faith and goodwill through fair and reasonable direct communication and negotiation".

13.2 Is there any limitation on a good faith obligation being unenforceable if it only applies from franchisee to franchisor, rather than being mutual?

English law generally does not require mutuality where the franchise agreement seeks to impose a good faith obligation on only one of the parties. Nor does English law generally regard such asymmetrical good faith obligations as objectionable from an enforcement point of view. Nevertheless, enforcement of asymmetric clauses can sometimes be tricky. In some jurisdictions, including within the EU, there is a perception that asymmetric clauses depart from the cornerstone principle of agreement between the parties and, as such, are unenforceable. Care should be used therefore if the franchise agreement imposes good faith obligations on the franchisee without the franchisor ostensibly being subject to corresponding obligations.

14 Ongoing Relationship Issues

14.1 Are there any specific laws regulating the relationship between franchisor and franchisee once the franchise agreement has been entered into?

There is no specific "relationship" or other such laws regulating the ongoing dealings between franchisor and franchisee once the franchise agreement comes into effect. The Code contains general obligations on the franchisor in relation to its treatment of the franchisee throughout the term of the franchise agreement.

General principles of law will, however, apply.

Data privacy: UK data protection legislation underwent huge changes on 25 May 2018, when the EU General Data Protection Regulation (“**GDPR**”) came into force. As the GDPR came into effect in the UK pre-Brexit, the GDPR is now having a direct effect on businesses with operations in the UK. Since Brexit, the UK GDPR applies specifically in the UK in place of the EU GDPR.

Additionally, the UK Government enacted a new Data Protection Act in 2018. The Act addresses how the GDPR applies in the UK, including: (i) implementing certain derogations under the EU GDPR that the UK Government negotiated; (ii) applying the new data protection standards to all areas, not just areas of EU competence; and (iii) repealing the Data Protection Act 1998 to avoid inconsistencies with the EU GDPR. The DPA 2018 sits alongside the UK GDPR, which came into effect on 1 January 2021 (“**UK GDPR**”). It is important, therefore, that the UK GDPR and the DPA 2018 are read side by side. Of particular significance in the franchise scenario, where franchisors have a vested interest in a franchisee’s customer database for a number of valid commercial reasons, it is worth bearing in mind that unlike the previous Data Protection Act 1998, which regulated only “data controllers”, the UK GDPR directly regulates “data processors” as well for the first time.

Failure to comply with the UK GDPR and the DPA 2018 will make businesses subject to competition law-style revenue-based fines, as well as to private claims by individuals. This new regime represents a fundamental overhaul of the data privacy environment, which cannot be adequately summarised here.

For businesses that operate in Europe as well as domestically in the UK, they may need to comply with both the UK GDPR and the EU GDPR. Furthermore, if you hold any overseas (non-UK) data collected before 1 January 2021 (“legacy data”), this will remain subject to the EU GDPR as it stood on 31 December 2020. However, in the short term, there is unlikely to be any significant difference between the EU GDPR as it stood at 31 December 2020 and the UK GDPR.

Where franchisors are based outside the UK or the EEA, the transfer of personal data to the franchisor by franchisees in the UK is also of significance, given recent developments in relation to international data transfers. Privacy shield is no longer a valid transfer mechanism for the US, and international transfers more generally face added scrutiny. Franchisees in these scenarios must ensure they have conducted relevant assessments and due diligence in relation to such transfers, and have entered into the correct contractual documentation (e.g. the UK’s International Data Transfer Addendum) and are not relying on outdated standard contractual clauses which may not be suitable for the transfer. Franchisors expanding into the UK from overseas (outside of the EEA) will also need to ensure their standard contractual documentation is up-to-date and tailored specifically for the UK in this regard.

Businesses that intend to engage customers through electronic direct marketing channels should be aware of the requirements of the Privacy and Electronic Communications Regulations 2003 (as amended). These regulations set out rules for unsolicited direct marketing by email, text and fax, which may require prior opt-in consent from the recipient. They also include requirements in relation to the provision of information notices and consent mechanisms for the placing of website cookies on users’ devices.

Bribery: The Bribery Act 2010 created various bribery offences. These include a Section 7 offence where a commercial organisation fails to prevent bribery on its behalf by a person it is “associated with”. Where such bribery takes place, the commercial organisation will only have a defence if it can show that it has adequate procedures in place to prevent persons associated with

it from bribing. The offence has wide extraterritorial application, so a UK company or an overseas entity that carries on a business or part of a business in the UK can be prosecuted if the bribery takes place in the UK or overseas by a British citizen or someone with a “close connection” to the UK.

Modern slavery: The Modern Slavery Act 2015 requires businesses to be transparent with regard to the slavery, forced and compulsory labour and human trafficking implications in their supply chains. Businesses that operate in the UK, which supply goods or services and which have an annual turnover (including all group companies) of at least £36 million are required to produce an annual Slavery and Human Trafficking statement. This applies to companies even if they are not registered in the UK if they carry on any business in the UK. Crucially for franchisors, the turnover of third-party franchisees does not count towards the £36 million threshold, even though it could be said that franchisees participate in the same supply chain as the franchisor. If a franchisee itself meets the threshold, it must prepare an annual statement.

Advertising and consumer protection: Any promotions or advertisements should comply with the UK Committee of Advertising Practice Code of Non Broadcast Advertising, Sales Promotion and Direct Marketing (“**CAP Code**”) and its broadcasting equivalent. The Advertising Standards Authority administers these codes and investigates complaints.

Advertising is regulated by the Consumer Protection from Unfair Trading Regulations 2008 (which covers advertising to consumers) and the Business Protection from Misleading Marketing Regulations (which covers advertising to traders and comparative advertising). Significant consumer protection reforms are currently proposed to give consumers a direct right of redress.

UCTA: The UCTA limits the franchisor’s ability to limit and exclude its liability through its standard franchise agreement (see question 5.3 above). Any exclusion clauses in the franchise agreement will only be valid if they are fair and reasonable. The UCTA also prohibits limitations or exclusions of liability for death or personal injury caused by negligence.

Consumer Rights Act 2015: An act that consolidates and updates UK consumer protection law and provides a modern framework of consumer rights. The Consumer Rights Act combines the provisions of the Unfair Terms in Consumer Contracts Regulations 1999, the UCTA, the Sale of Goods Act 1979 and the Supply of Goods and Services Act 1982 insofar as they relate to transactions with consumers.

Implied terms: The Sale of Goods Act 1979 (as amended) and the Supply of Goods and Services Act 1982 (as amended), to the extent that they survive the coming into force of the Consumer Rights Act 2015, imply certain terms into contracts, which include implied terms in relation to the satisfactory quality and fitness for purpose of goods sold or services provided.

Environment Agency CRC Energy Efficiency Scheme: The CRC Energy Efficiency Scheme Order (2010) (“**Order**”) obliges certain franchisors to participate in the Carbon Reduction Commitment (“**CRC**”) scheme and imposes liability on participating franchisors for failures by their franchisees who trade under their control and corporate name. This is different from the Modern Slavery Act regime, which does not combine the activities of franchisors with those of their franchisees.

TUPE: Where TUPE applies to a transfer of an economic undertaking from one party to another, any employee rights will be transferred from the transferor to the transferee. There have been instances where TUPE has been found to apply to franchising arrangements, and appropriate protections (including indemnities) should be included in the franchise agreement where this could apply.

15 Franchise Renewal

15.1 What disclosure obligations apply in relation to a renewal of an existing franchise at the end of the franchise agreement term?

Please see question 1.5 above.

15.2 Is there any overriding right for a franchisee to be automatically entitled to a renewal or extension of the franchise agreement at the end of the initial term irrespective of the wishes of the franchisor not to renew or extend?

There are no mandatorily imposed rights in relation to automatic renewals of a franchise agreement at the end of the initial or any subsequent term.

However, Article 6 of the Code states that: “The basis for contract renewal should take into account the length of the original term, the extent to which the contract empowers the franchisor to require investments from the franchisee for refurbishment or renovation, and the extent to which the franchisor may vary the terms of a contract on renewal. The overriding objective is to ensure that the franchisee has the opportunity to recover his franchise-specific initial and subsequent investments and to exploit the franchised business for as long as the contract persists.”

15.3 Is a franchisee that is refused a renewal or extension of its franchise agreement entitled to any compensation or damages as a result of the non-renewal or refusal to extend?

No compensation or damages will be payable unless the contract provided for an extension right that the franchisor refused to honour (in which case contractual damages for breach could apply).

16 Franchise Migration

16.1 Is a franchisor entitled to impose restrictions on a franchisee's freedom to sell, transfer, assign or otherwise dispose of the franchised business?

The franchise agreement can include an absolute prohibition on the franchisee's ability to transfer the franchise to a third party. However, it is more common for the franchise agreement to include an express assignment clause, setting out a process whereby the franchisee may transfer the franchise subject to the franchisor's prior written consent (which may be conditioned in certain circumstances).

16.2 If a franchisee is in breach and the franchise agreement is terminated by the franchisor, will a “step-in” right in the franchise agreement (whereby the franchisor may take over the ownership and management of the franchised business) be recognised by local law, and are there any registration requirements or other formalities that must be complied with to ensure that such a right will be enforceable?

English law will recognise any express step-in rights set out in the franchise agreement. There are no registration requirements

or other formalities. The use of step-in rights tends to be sector- and context-specific, and may apply particularly in the retail and restaurant sectors if a franchisee has secured the lease of a key location. On the other hand, many franchisors do not want to get involved in commercial property transactions notwithstanding the relative attraction of any given location as a means of promoting the brand.

16.3 If the franchise agreement contains a power of attorney in favour of the franchisor under which it may complete all necessary formalities required to complete a franchise migration under pre-emption or “step-in” rights, will such a power of attorney be recognised by the courts in the jurisdiction and be treated as valid? Are there any registration or other formalities that must be complied with to ensure that such a power of attorney will be valid and effective?

A POA does not need to be registered, but must be a written document validly executed as a deed under Section 1(1) of the Powers of Attorney Act 1971 (“POAA”).

To be valid, a deed must clearly state that it is a deed, be delivered as a deed, and be executed in line with statutory requirements (including the Companies Act 2006 requirements for limited companies, where appropriate). The POAA also contains specific requirements in relation to certifying copies of POAs.

While the attorneys should be clearly identified, it is legally permissible for a POA to specify a class of persons as being the attorney, for example, “any Director of the Franchisor”. Any person relying on the POA is likely to seek verification that the attorney is actually a director.

17 Electronic Signatures and Document Retention

17.1 Are there any specific requirements for applying an electronic signature to a franchise agreement (rather than physically signing a “wet ink” version of the agreement), and are electronic signatures recognised as a valid way of creating a binding and enforceable agreement?

Increasingly, agreements are being signed remotely using electronic means rather than being signed in a traditional way in a “completion meeting” attended by all of the parties. This is even more so in connection with cross-border transactions where the parties are geographically remote from each other. Electronic signatures create a way to sign franchise documents in the online world, as one signs with a pen in the offline world. Depending on the type of electronic signature – a simple electronic signature, e.g. a scanned copy of a “wet ink” signature; an advanced electronic signature, which is uniquely linked to the signatory and capable of identifying them; or qualified electronic signatures, which are created using a signature creation device – the process for executing the document will differ.

The EU Electronic Signatures Directive 1993 created a legal framework for electronic signatures. This framework has been implemented into English law by the Regulation on electronic identification and trust services for electronic transactions in the internal market (“eIDAS”). The eIDAS Regulation ensures the recognition of electronic signatures in legal proceedings, thus enabling binding legal agreements to be executed in this way.

17.2 If a signed/executed franchise agreement is stored electronically (either having been signed using e-signatures or a “wet ink” version having been scanned and saved as an electronic file), can the paper version of the agreement be destroyed?

The short answer is “yes”, so long as you are confident that you will always have access to the electronic copy of the document, so that it can, if necessary, be produced in evidence if there is a dispute as to its terms or meaning, or if it is to be the subject of an inquiry or due diligence exercise. This then illustrates the need to have an effective, robust and secure document management system on which your digital records can be stored and accessed. Remember also to ensure that your digital records are backed up and that you have a disaster recovery plan in place to enable you to access your contracts and other critical documents in the event of a cyber-attack or some other disabling interruption to your business.

18 Current Developments

18.1 What is the biggest challenge franchising is facing in your jurisdiction and how are franchisors responding to that challenge?

The last two years have seen unprecedented growth in e-commerce resulting from the Coronavirus pandemic. Businesses faced with the devastating consequences of having to close their doors had to look for new and innovative ways to reach their customers. This has accelerated and cemented a change in buying habits that was already in train, with consumers increasingly looking for convenience and a contactless way of interacting with retailers. Consumers are now, more than ever before, looking for a platform that gives them what they want, when they want it. For franchises in the retail and food sectors, this has meant that quick delivery to the customer’s chosen location (rather than the customer coming to the business) is no longer a luxury but a necessity in order for the business to remain competitive.

It is not just the speed of delivery that is important but the whole delivery experience, with various surveys finding that the delivery service plays a key role in customer satisfaction. Many customers now make their purchasing decisions based on who provides the best delivery service.

This creates a dilemma for any franchisor looking to introduce a delivery service option into their franchise systems: do they allow franchisees to choose the delivery app and fulfilment provider at a local level, with the obvious potential for the brand to be associated with different (and sometimes inferior) delivery service levels; does the franchisor implement a centralised fulfilment solution by entering into a framework arrangement with a delivery app that is then made available or mandated to all of the system franchisees; or, as a third option, does the franchisor develop its own app and delivery solution, which is made available to all franchisees and mandated by the franchisor? The development of a bespoke platform specifically for the franchisor’s system will require extensive and expensive development and maintenance, meaning that significant additional resource and infrastructure is required. However, allowing franchisees to opt in (or not) to a third-party delivery platform means that the franchisor can lose control over the quality of the delivery service, risks the goodwill that is generated going to the

delivery platform provider rather than the franchised brand, and loses a vital opportunity to capture customer data.

To keep up with their competitors and fast-paced changes in technology, many franchisors are turning to “gig economy” service providers like Deliveroo, Uber and Just Eat. This allows franchises to achieve economies of scale through reliance on an existing delivery system, whilst significantly reducing the managerial and operational costs associated with the provision of such delivery services.

With these “final mile” delivery and “gig economy” models are obvious tensions created with the franchise model. Two key elements of the franchise agreement are the territory assigned to the franchisee and the fees payable to the franchisor in return for granting exclusivity and/or access to the franchise system in that territory.

Delivery means that the potential geographical coverage for the franchisee is much wider than from a bricks and mortar outlet, with customers making decisions based on the speed and quality of the delivery service rather than the location of the franchisee’s outlet. Different apps also have different fee structures, which will in turn impact the franchisee’s profitability. The fees charged by the delivery platform providers can be high, and the platform providers, in their desire to be competitive against their competitors, often prohibit the retailer/fast food outlet from increasing prices as a means of offsetting the increased cost of sale associated with the charges payable to the delivery platform provider. The franchisor might therefore seek to mitigate these risks by partnering with a delivery app provider to negotiate the terms of the agreement with the delivery app provider on behalf of all its franchisees, thus securing economies of scale. However, this does not avoid the issues that still arise due to a disparity between the density of population in different areas and the availability of apps and online delivery platforms, which means that a franchisee might not have the option of using a certain app in their franchise territory, or might not have the same infrastructure and therefore might not be able to offer the same speed of delivery in their franchise territory as compared with that of a competing neighbouring franchisee. Essentially, the available delivery territory provided by the delivery platform in respect of any given location may change in accordance with demand, with the effect that a franchisee may not be able to offer a delivery solution to consumers across all of its franchise territory, while others may be able to service a territory that exceeds the geographical territory granted to them under the franchise agreement, and which therefore encroaches on the territory allocated to a competing franchisee.

If a third-party app is being used, there is the added complication of how the franchisor calculates the franchise fees it receives from its franchisees: are gross revenues to be calculated on the basis of the consumer’s total order; and does this take into account the commission and fees taken by the app provider? Since an element of the franchise fee will usually be calculated as a percentage of gross revenues, this in large part will come down to the definition of “gross revenues” in the franchise agreement, but may be impacted by the accounting and ordering systems used as part of the franchise system and/or the app.

Consumers now expect a seamless delivery service and anything that falls short of that risks the customer choosing to go elsewhere. As such, any franchise system must focus not only on the quality of its selected delivery system but also on remaining flexible and being able to meet the changing technology offering and the preferences of its customers.

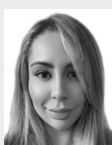


Iain Bowler qualified in 1988 and specialised in mergers and acquisitions, stock exchange and complex commercial and joint venture work. Between 1998 and 2002, Iain was Director of Corporate Finance at a corporate industrial developer headquartered in the UK and USA. He joined one of the world's largest global law firms as a Partner in 2002, where he was global Co-Chair of the Commercial Contracts and Franchise and Distribution Groups, before joining Freeths as Head of the Commercial and Franchise Group in 2019.

Iain's work includes commercial transactions of all descriptions, including supply chain management, procurement of goods and services, outsourcing, manufacturing, logistics, consultancy and services agreements, direct sale, agency, franchise, distribution, brand licensing, e-commerce and international trade. Iain is ranked as a "leading individual" for franchise work and is an Affiliate Member of the bfa.

Freeths LLP
1 Vine Street
Mayfair
London, W1J 0AH
United Kingdom

Tel: +44 7968 558 916
Email: iain.bowler@freeths.co.uk
URL: www.freeths.co.uk



Jaskeerat Sanghera qualified in 2017 as a solicitor specialising in commercial and franchise work. Jas joined Freeths in 2022 as a Senior Associate in the Commercial Group. She has worked across a range of sectors, including retail, IT, energy, sports, leisure, entertainment, financial services, media, fashion and automotive. In addition to advising on franchise transactions of all types, Jas' work also involves advising on IT, standard terms of sale/purchase, prize draw and competition terms and conditions, outsourcing, procurement, projects, IP licensing, brand partnerships, joint ventures and tech agreements.

Freeths LLP
1 Vine Street
Mayfair
London, W1J 0AH
United Kingdom

Tel: +44 345 340 4206
Email: jaskeerat.sanghera@freeths.co.uk
URL: www.freeths.co.uk

Freeths LLP is a top 50, full-service commercial law firm with 13 offices across the UK. One of the UK's fastest-growing law firms, Freeths has over 1,000 staff, and turnover in the last financial year in excess of £134 million, despite the unprecedented impact that the global COVID-19 pandemic had on the UK and international economies. *The Legal 500* and *Chambers and Partners* legal directories consistently rank Freeths' lawyers in their top tiers. We have franchise experts in a number of our offices, advising clients on all manners of franchise and distribution contracts, and we have specific expertise in exemption-based franchising in the United States. We have extensive experience in structuring, negotiating and documenting franchise transactions in the UK and internationally, including multinational master franchise, area and regional developer and area representative arrangements, joint ventures and other distribution and brand licensing relationships. Our clients come from all sectors, including retail,

coffee shops, fitness, technology, B2B services, beauty and media, and cover a broad spectrum of size and experience, from entrepreneurs and companies that are establishing new programmes, to large franchisors, manufacturers and distributors.

www.freeths.co.uk

FREETHS

France

Linkea-Avocats



Cecile Peskine



Clémence Casanova

1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

Under French law, there is no regulation that defines a franchise. The franchise definition has been constructed by the French Courts and authors, and any relationship containing the following elements is considered a franchise agreement:

- a right to use a registered trademark; and
- the transfer of know-how.

Even if the relationship is not qualified by the parties as a franchise agreement, each agreement containing the above-mentioned elements might be regarded as a franchise agreement, and implies that the Franchisor provides the Franchisee with support, with the final aim being the profitability of the franchise business.

1.2 What laws regulate the offer and sale of franchises?

The offer and sale of franchises is specifically regulated by articles L.330-1 and R.330-3 of the French Commercial Code, which covers, in general, all exclusive trademark licence relationships.

Franchise operations are also governed by French contract rules that are established in the French Civil Code, as well as by the general rules applying to all commercial relationships in the French Commercial Code.

1.3 If a franchisor is proposing to appoint only one franchisee/licensee in your jurisdiction, will this person be treated as a “franchisee” for purposes of any franchise disclosure or registration laws?

Yes, this person will be regarded as a “Franchisee” and treated as such, even if it is the only Franchisee in the French territory. However, if this unique “Franchisee” is entitled to sub-franchise its rights in the French territory, it may be regarded as a “Master Franchisee”.

1.4 Are there any registration requirements relating to the franchise system?

Under French law, the only registration requirement relating to the franchise system is to deposit and register the trademark that will be granted to the Franchisee.

There is, however, no obligation on the Franchisor to register their franchising activity, or to register the franchise agreements

executed with Franchisees. The trademark licence granted to the Franchisee may, however, be registered before the trademark office that has generated the related trademark (for a national brand, that is the French National Register (“INPI”)), even if there is no obligation to do so.

1.5 Are there mandatory pre-sale disclosure obligations?

Pursuant to article L.330-3 of the French Commercial Code, the Franchisor must provide the Franchisee with a “Pre-contractual Information Document” (disclosure document) at least 20 days before the signing of a franchise agreement, and at least 20 days before the payment of any sum or any investment in relation to the franchise relationship.

This disclosure document shall contain the following information, which is detailed at article R.330-1 of the French Commercial Code:

- the Franchisor’s information (company name, registered office, form, capital, manager, registration number);
- their trademark registration number and registration number of the trademark licence agreement, if relevant;
- the Franchisor’s banking information (bank address, account number);
- the Franchisor’s audited financial statements regarding the past two years;
- the history and presentation of the company and of the network;
- the general and local market “statements” (presentation) and development prospects of the general and local market;
- a list of the undertakings of the network, and the nature of their relationship with the Franchisor (franchise agreement, subsidiaries, joint ventures, etc.);
- the address of the franchised undertakings located in France, conclusion and renewal dates of the related franchise agreements;
- the number of Franchisees that have left the network the year before the issuance of this document, detailing whether this has resulted from expiry, cancellation or termination of the agreement;
- the presence of any undertaking member of the network in the same territory, and distribution of services or products that are the subject of the franchised business in the same territory;
- the most important provisions of the contract: duration; renewal; termination; assignment; and exclusive rights; and
- the investments linked to the franchise operation.

The Franchisor shall also deliver any other information that may be relevant in the candidate’s decision to enter into the

franchise agreement. This general obligation was incorporated into the French Civil Code in 2016.

1.6 Do pre-sale disclosure obligations apply to sales to sub-franchisees? Who is required to make the necessary disclosures?

Yes, the obligation to provide a Pre-contractual Information Document complying with articles L.330-3 and R.330-1 of the French Commercial Code also applies to sales performed to Sub-Franchisees. The Master Franchisee in charge of recruiting the Sub-Franchisees located in France shall thus provide the candidate for a sub-franchise agreement with the Pre-contractual Information Document at least 20 days prior to the related sub-franchise agreement's execution and at least 20 days before any payment or investment in relation to the sub-franchise relationship.

1.7 Is the format of disclosures prescribed by law or other regulation, and how often must disclosures be updated? Is there an obligation to make continuing disclosure to existing franchisees?

The disclosure document shall contain the information listed at articles L.330-3 and R.330-1 of the French Commercial Code, which are detailed in question 1.5 above. However, there is no format prescribed by the law.

The disclosure document shall be updated for each candidate.

There is no obligation to provide updated information to the current Franchisees during the franchise relationship.

1.8 What are the consequences of not complying with mandatory pre-sale disclosure obligations?

The consequences are the same as those described in question 5.1 below.

1.9 Are there any other requirements that must be met before a franchise may be offered or sold?

French Courts dictate that the Franchisor has a duty to experiment with or test the concerned business and concept before franchising it, and will usually request the Franchisor to prove that the concept has been operated in owned operations for at least two years before the franchise development started, and that this experimentation has been profitable.

1.10 Is membership of any national franchise association mandatory or commercially advisable?

Membership of a national franchise association is not mandatory. However, membership of the French Federation for Franchising (*Fédération Française de la Franchise*) is advisable, *inter alia*, since the *Fédération Française de la Franchise* provides training regarding franchising in France, and contributes to Franchise Expo Paris, which is a well-known annual French franchise exhibition.

1.11 Does membership of a national franchise association impose any additional obligations on franchisors?

The *Fédération Française de la Franchise* will, *inter alia*, verify if the franchise disclosure document and franchise agreements comply with the European Code of Ethics for Franchising.

1.12 Is there a requirement for franchise documents or disclosure documents to be translated into the local language?

There is no mandatory obligation to translate the documents into French. However, translation is strongly advisable, particularly in order to be able to prove that the Franchisee has been provided with clear and understandable information before signing the franchise agreement.

In the course of a litigation, French Courts will require an official translation of any documents drafted in a foreign language.

2 Business Organisations Through Which a Franchised Business Can be Carried On

2.1 Are there any foreign investment laws that impose restrictions on non-nationals in respect of the ownership or control of a business in your jurisdiction?

No, there is no longer any such regulation under French law, unless it concerns sensitive sectors that might cause harm to public policies, public security, national defence interests or activities related to the production of weapons. In these limited cases, the related investment shall be subject to the Minister of Economy's prior approval and declared to the French Treasury Tax Department.

2.2 What forms of business entity are typically used by franchisors?

Private limited liability companies – such as a *société par actions simplifiée*, *société à responsabilité limitée* or *société anonyme* – are usually chosen by Franchisors. These three types of company are easy-to-build vehicles for the operation of commercial activities in France. The Franchisor will choose the most accurate type, taking into account its resources as well as social and tax considerations.

2.3 Are there any registration requirements or other formalities applicable to a new business entity as a pre-condition to being able to trade in your jurisdiction?

Even if the Franchisor is operating through a foreign company, there are obligations to be registered with the French Répertoire des Entreprises (register for undertakings) or the National Centre for Foreign Companies, as well as the French law administration.

These obligations are described here: <https://www.service-public.fr/professionnels-entreprises/vosdroits/F31191>.

3 Competition Law

3.1 Provide an overview of the competition laws that apply to the offer and sale of franchises.

The offer and sale of franchising is regulated by:

- Articles L.420-1 and subsequent of the French Commercial Code, which prohibit anti-competitive practices where they are intended to: fix prices; restrict market access; restrict or control production, opportunities, investment or technical progress; or divide up markets or sources of supplies. Any abuse of a dominant position or economic dependency, and any predatory pricing that might upset the balance of economic activities, are also prohibited. However, such anti-competitive practices might become permitted if they

lead to economic progress and give final users a fair share of the resulting benefits. The agreement must not afford the parties the possibility of eliminating competition in respect of a substantial part of the related products.

- Articles L.442-1 and subsequent of the French Commercial Code, which prohibits restrictive trade practices, such as resale below costs and the “brutal” termination of established commercial relationships.

Franchise networks active in France shall also comply with the European regulation regarding anti-competitive practices. In particular, Commission Regulation (EU) no. 2022/720 of May 10th, 2022 (on the application of article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices) shall apply, together with the Guidelines on Vertical Restraints (2022/C 248/01).

3.2 Is there a maximum permitted term for a franchise agreement?

There is no maximum permitted term provided *per se* for franchise agreements. However, exclusive supply agreements are only permitted for a limited duration. See question 3.3 below.

3.3 Is there a maximum permitted term for any related product supply agreement?

Pursuant to article L.330-1 of the French Commercial Code, any exclusive supply agreement shall be limited to 10 years.

3.4 Are there restrictions on the ability of the franchisor to impose minimum resale prices?

French and EU regulations prohibit the imposition of any minimum resale prices.

3.5 Encroachment – are there any minimum obligations that a franchisor must observe when offering franchises in adjoining territories?

Under French law, the Franchisor has no obligation to provide the Franchisee with an exclusive territory. If he does so, the Franchisor has a duty not to open – directly or indirectly – another point of sale in the Franchisee’s exclusive territory.

3.6 Are in-term and post-term non-compete and non-solicitation of customers covenants enforceable?

In-term non-compete obligations are enforceable under French law.

Post-term non-compete provisions are regulated by article L.341-2 of the French Commercial Code, under which non-compete provisions are valid only if they are:

- limited to the products and/or services subject to the franchise agreement;
- limited to the location where the Franchisee was operating its activity;
- justified by the need to protect the transfer of substantial, specific and secret know-how; and
- limited to a one-year duration.

These four conditions must all be satisfied.

In-term non-solicitation of customer obligations are valid only if the Franchisee has been granted an exclusive territory and if it is to prevent the Franchisee from performing active

sales outside this territory (passive sales outside the Franchisee’s territory cannot be prohibited).

Post-term non-solicitation of customer obligations is not valid: the Franchisee shall remain the owner of its customer database and is entitled to use it after the agreement’s termination, under the condition that such use shall not be made with the Franchisor’s trademarks or distinctive signs. However, the franchise agreement may expressly provide that Franchisor is the co-owner of the customers database and thus entitled to keep using it after the franchise agreement termination.

4 Protecting the Brand and Other Intellectual Property

4.1 How are trade marks protected?

Trademarks must be registered in order to be protected.

The Franchisor is able to register a national French trademark before the INPI or a European trademark before the European Union Intellectual Property Office (“EUIPO”).

4.2 Are know-how, trade secrets and other business-critical confidential information (e.g. the Operations Manual) protected by local law?

Know-how, trade secrets and other business-critical information are not protected *per se* under French law. However, the Franchisor may request the Franchisee to sign a non-disclosure commitment listing precisely which information and data shall be regarded as confidential and not disclosed to third parties, and shall only be used for the need to perform the franchise agreement.

4.3 Is copyright (in the Operations Manual or in proprietary software developed by the franchisor and licensed to the franchisee under the franchise agreement) protected by local law?

Copyright protection may only apply if the Franchisor is able to demonstrate that the operations manuals or other data are original.

Also, French law does not protect ideas or concepts. Therefore, work needs to be sufficiently materialised in a developed form to be eligible for copyright protection.

5 Liability

5.1 What remedies can be enforced against a franchisor for failing to comply with mandatory disclosure obligations? Is a franchisee entitled to rescind the franchise agreement and/or claim damages?

Failure to provide the mandatory disclosure document may incur (i) the cancellation of the contract, or (ii) the Franchisor’s liability.

(i) Cancellation of the contract

Failure to provide the said information may be regarded as fraudulent, justifying the cancellation of the franchise agreement.

However, the cancellation of a franchise agreement is subject to the demonstration, by the Franchisee, that the incomplete information/absence of pre-contractual information has invalidated his consent to the contract (Cour de Cassation, Commerciale, February 10th, 1998).

Therefore, the French Courts analyse if the information provided by the Franchisor is sincere and verify if a part of it has been consciously hidden from the Franchisee in order to make him enter into the contract, and/or if missing information that should have been disclosed would have led the Franchisee not to enter into the franchise agreement. Many decisions state that the Franchisor's presentation is very general and imprecise, or even incorrect, which characterises wilful misrepresentation and justifies the cancellation of the agreement (e.g. Cour de Cassation, Commerciale, May 6th, 2003).

On February 11th, 2003, the highest French Court specified that the obligation to give a sincere presentation applies not just to the information that is required by articles L.330-3 and R.330-1 of the French Commercial Code, but also to any other facultative information voluntarily given by the Franchisor to the Franchisee before it entered into the agreement.

Court cases have tended to focus on business plans/figures provided by Franchisors to future Franchisees. Even if the Courts admit that the Franchisee should personally proceed with a precise analysis of the future commercial operation in order to measure the potential of the business, the Franchisor must ensure that the business plans/figures provided to the Franchisee are not unrealistic or over-optimistic.

On October 26th, 2006, the Orleans Court of Appeal was particularly clear on this:

“Even if the Law doesn't oblige the Franchisor to provide local market research or to establish provisional operating accounts, this task being up to the Franchisee who shall, regarding his investment, proceed to this analysis and evaluate the related risks; it is constant that when providing this information and particularly business plans, the observance of article L.330-3 and of the general obligation to act in good faith in contract law requires the Franchisor to give a sincere presentation of the local market and to establish reasonable budgets by reference to tangible sales figures. [...] Even if the Franchisor is not due to get the results when establishing a provisional operating account, in consideration of commercial contingencies and hazard inherent to every forecast, he must carry out the statistical, economic and financial tools he can get as a franchise professional in the relevant market as well as conduct sufficient research on the local market to provide a reliable provisional study, as this information could be outside the knowledge of the Franchisee candidate. The significant gap between the forecast and the results testifies to the levity of this study.” (Our translation.)

In the same field, the Court of Appeal of Versailles, on June 7th, 2007, ruled that a gap of 50% between the Franchisor's forecast and the results is not sufficient to involve the Franchisor's liability, as the provisional plan was based on the average sales figures of the time period for equivalent shops effectively generated in the same geographical area. The Franchisor's obligation to give sincere and loyal information was thus fulfilled, with the Court also confirming the Franchisee's obligation to make enquiries on the project's profitability and to verify the information given by the Franchisor, with the assistance of professionals if necessary.

Courts can also be very tolerant of Franchisees' behaviour if they had no previous experience in the operation of a commercial activity before executing the franchise agreement. Thus, the highest French Court, on April 3rd, 2007, ruled against the reasoning of the Court of Appeal that had limited, without any debate, the amount of damages to be awarded to the Franchisee because it considered that, with non-existent or imprecise

pre-contractual information, the Franchisee should have asked about the relevant details before contracting and had been at fault not to do so.

(ii) Franchisor's civil liability

Even if the missing information has not been regarded as justifying the cancellation of the franchise agreement, the Franchisor may be held liable, and ordered to indemnify the Franchisee's damage.

Indeed, the Franchisee may demonstrate that the knowledge of the missing information might have led him to enter into the agreement on different conditions, and that the absence of this information had caused him damage.

For instance, the Paris Court of Appeal considered that the Franchisee's damage consisted of the absence of having the opportunity “not to contract” or “to limit its financial obligations” (e.g. Paris Court of Appeal, September 20th, 2000, confirmed by the Cour de Cassation, Commerciale, February 4th, 2004).

However, the Franchisee still has to demonstrate the existence of a direct link between his damage and the Franchisor's failure to provide the Pre-contractual Information Document.

5.2 In the case of sub-franchising, how is liability for disclosure non-compliance or for pre-contractual misrepresentation allocated between franchisor and master franchisee? If the franchisor takes an indemnity from the master franchisee in the Master Franchise Agreement, are there any limitations on such an indemnity being enforceable against the master franchisee?

Usually, the Master Franchise Agreement will provide an obligation – for the Master Franchisee – to comply with all mandatory local regulations and to provide Sub-Franchisees with any required disclosure document. In such a case, the Master Franchisee will be liable towards its Sub-Franchisees for disclosure non-compliance or pre-contractual misrepresentation, except if such non-compliance or misrepresentation found its origin in the information or element provided by the Franchisor to the Master Franchisee.

5.3 Can a franchisor successfully avoid liability for pre-contractual misrepresentation by including a disclaimer in the franchise agreement?

No, such disclaimer shall be regarded as unenforceable, since the obligation to provide pre-contractual information complying with articles L.330-3 and R.330-1 is mandatory under French law.

5.4 Does local law permit class actions to be brought by a number of aggrieved franchisees and, if so, are class action waiver clauses enforceable?

To date, there is *per se* no class action proceeding open to Franchisees regarding a franchise agreement. Class actions are limited to litigation concerning B-to-C relationships. Class action waiver clauses are, in consequence, purposeless.

However, several Franchisees may decide to bring the same individual action against their Franchisor. Also, the French Minister of Economy or the Public Prosecutor is entitled to sue the Franchisor in case it is in breach with mandatory regulations governing “restrictive trade practice”. The Franchisees may in such case join the claim brought by the Minister or the Prosecutor to request damages compensating their own prejudice.

6 Governing Law

6.1 Is there a requirement for franchise documents to be governed by local law? If not, is there any generally accepted norm relating to choice of governing law, if it is not local law?

Parties are free to decide to submit the franchise relationship to French or any other foreign law.

However, French mandatory regulations cannot be circumvented by using a “choice of law” clause. Therefore, even if French law is not applicable to the franchise relationship, a disclosure document shall be provided in accordance with French mandatory regulations as long as a French Franchisor is involved or if the franchise is aiming to operate its activity in France.

6.2 Do the local courts provide a remedy, or will they enforce orders granted by other countries’ courts, for interlocutory relief (injunction) against a franchisee to prevent damage to the brand or misuse of business-critical confidential information?

The French Civil Procedure Code provides for general urgent injunctive relief and injunction, which may be sought by the Franchisor before local Courts in order to immediately stop any such damage or misuse.

Orders from foreign Courts may also be enforced by the French Courts, taking into consideration international treaties and European regulations.

6.3 Is arbitration recognised as a viable means of dispute resolution and is your country a signatory to the New York Arbitration Convention on the Recognition and Enforcement of Foreign Arbitral Awards? Do businesses that accept arbitration as a form of dispute resolution procedure generally favour any particular set of arbitral rules?

In France, arbitration is recognised as a viable means of dispute resolution. France was one of the first signatories to the New York Arbitration Convention, and, as such, accepts the enforcement of foreign arbitral awards. It is indeed recommended to insert into the agreement the arbitration rules and bodies that will govern the arbitration proceeding to avoid any debate afterwards in this respect. There are specialised arbitration bodies with their own rules, such as the Fédération Française de la Franchise, and the Paris Centre for Mediation and Arbitration (“CMAP”).

7 Real Estate

7.1 Generally speaking, is there a typical length of term for a commercial property lease?

Commercial lease agreements are executed for a nine-year duration. However, the tenant has the right to terminate the commercial lease agreement every three years.

7.2 Is the concept of an option/conditional lease assignment over the lease (under which a franchisor has the right to step into the franchisee/tenant’s shoes under the lease, or direct that a third party (often a

replacement franchisee) may do so upon the failure of the original tenant or the termination of the franchise agreement) understood and enforceable?

This concept is enforceable under French law if the franchise agreement, as well as the lease agreement, so provide. Indeed, the lessor has to expressly agree with that principle, otherwise the option specified in the franchise agreement will not be enforceable towards the lessor.

7.3 Are there any restrictions on non-national entities holding any interest in real estate, or being able to sub-lease property?

To our knowledge, there are no restrictions on non-national entities holding an interest in real estate.

7.4 Give a general overview of the commercial real estate market. To what extent has the real estate market been affected by the Coronavirus pandemic? Specifically, can a tenant expect to secure an initial rent free period when entering into a new lease (and if so, for how long, generally), or are landlords demanding “key money” (a premium for a lease in a flagship location)?

The French market is usually known to be a very expensive market for real estate costs, in particular concerning “A” locations or mall locations, where key money is indeed generally demanded by landlords.

It is therefore very exceptional to be able to negotiate a rent-free period when entering into a lease agreement, unless specific circumstances justify this free period (such as a need to revamp the location, or a revamping being in progress around the location).

The COVID-19 pandemic has strongly affected the real estate market and lessors are now more inclined to propose temporary lease agreements for tenants (less than three years) instead of commercial lease agreements. These temporary lease agreements do not usually provide for key money, but have higher rents than those of commercial lease agreements.

8 Online Trading

8.1 If an online order for products or request for services is received from a potential customer located outside the franchisee’s exclusive territory, can the franchise agreement impose a binding requirement for the request to be re-directed to the franchisee for the territory from which the sales request originated?

No, pursuant to EU competition guidelines on vertical restrictions, it is not possible to require the Franchisee to refuse “passive sales” and redirect said sales to another Franchisee.

8.2 Are there any limitations on a franchisor being able to require a former franchisee to assign local domain names to the franchisor on the termination or expiry of the franchise agreement?

Local domain names deposited by the Franchisee can remain in their ownership after the termination or expiry of the agreement, unless they contain a trademark registered by the Franchisor. In this case, the Franchisor will be permitted to force the Franchisee to transfer the related domain names. It is recommended to anticipate this situation and insert a clause in the franchise agreement

prohibiting the Franchisee to deposit any domain name containing any trademark and/or distinctive sign of the Franchisor.

9 Termination

9.1 Are there any mandatory local laws that might override the termination rights one might typically expect to see in a franchise agreement?

French Courts are within their rights not to apply the termination rights provided in the franchise agreement in case the termination has not been caused by a breach of a party and is “brutal”. French Courts can thus allocate damages to the party suffering from such brutal termination.

Also, Judges have the right to moderate, reduce or increase a penalty clause.

9.2 Are there local rules that impose a minimum notice period that must be given to bring a business relationship that has existed for a number of years to an end, which will apply irrespective of the length of the notice period set out in the franchise agreement?

Article L.442-1, II of the French Commercial Code provides that: “Any (legal or natural) person operating production, distribution or service activities that terminates abruptly, even partially, an established commercial relationship, without written notice having regard to the duration of the business relationship by reference to usage of trade or to trade agreements, and, for the purpose of determining the price applicable during the duration of the relationship, the economic conditions of the market on which the parties operate – shall be liable towards its counter-part and indemnify the latter of the related damage.

In the event of a dispute between the parties regarding the duration of the prior notice period, the party at the origin of the termination shall not be held liable for an insufficient duration of the prior notice period if a prior notice period of eighteen months has been granted.

The provisions of this § II shall not prevent the right for a party to terminate the related relationship without notice, in the event of non-performance by the other party of its obligations or in the event of a ‘*force majeure*’ event.”

This rule shall be complied with, even in the case where an agreement provided the prior notice period applicable to the contractual relationship.

Furthermore, it is frequently the case that French Courts increase the prior notice period provided in the franchise agreement, taking into consideration the length of the relationship between the parties, the notoriety of the products concerned by the agreement, the dependence of the party victim of the termination towards the other party, the possibility to source rapidly new counterparts in order to perform the same business, or the fact that there would be some unamortised investments linked to the relationship after the termination of the agreement.

10 Joint Employer Risk and Vicarious Liability

10.1 Is there a risk that a franchisor may be regarded as a joint employer with the franchisee in respect of the franchisee's employees? If so, can anything be done to mitigate this risk?

There is such a risk if the Franchisor acts as the employer of

the Franchisee's employees, in particular if the Franchisor gives them instructions, and is in charge of the labour law duties.

In order to mitigate this risk, it is strongly recommended that the Franchisor has no direct relationship with the Franchisee's employees, except for the training to be provided by the Franchisor directly to the Franchisee's staff regarding the application of know-how.

There is also a risk that the franchise agreement be qualified as an employment agreement, if the Franchisee is not independent from the Franchisor.

10.2 Is there a risk that a franchisor may be held to be vicariously liable for the acts or omissions of a franchisee's employees in the performance of the franchisee's franchised business? If so, can anything be done to mitigate this risk?

The Franchisee is, in essence, independent from the Franchisor and alone bears all liabilities related to its employees' acts and omissions.

In order to mitigate the risk of a claim directly brought against the Franchisor, the Franchisee has a duty to inform third parties of the fact that it is acting as an independent Franchisee. Such information shall be indicated in the shop, as well as in all commercial documents of the Franchisee.

11 Currency Controls and Taxation

11.1 Are there any restrictions (for example exchange control restrictions) on the payment of royalties to an overseas franchisor?

No, there are no such restrictions.

11.2 Are there any mandatory withholding tax requirements applicable to the payment of royalties under a trade mark licence or in respect of the transfer of technology? Can any withholding tax be avoided by structuring payments due from the franchisee to the franchisor as a management services fee rather than a royalty for the use of a trade mark or technology?

Yes, royalties will be taxed, unless a treaty for the avoidance of double taxation has been entered into between France and the country of origin of the Franchisor. The percentage of taxes will depend on the amounts invoiced. Any arrangement in order to reduce and/or avoid a tax payment may be regarded as fraudulent. Therefore, any specific avoidance strategy shall be subject to the specific advice of a French specialised attorney.

11.3 Are there any requirements for financial transactions, including the payment of franchise fees or royalties, to be conducted in local currency?

There are no specific requirements other than those provided by French tax law.

12 Commercial Agency

12.1 Is there a risk that a franchisee might be treated as the franchisor's commercial agent? If so, is there anything that can be done to help mitigate this risk?

Such a risk does exist in the case that the Franchisee is acting on behalf of the Franchisor. In order to mitigate this risk, it is, *inter*

alia, necessary to make sure that the Franchisee is the owner or tenant of his location, and is directly paid by consumers.

13 Good Faith and Fair Dealings

13.1 Is there any overriding requirement for a franchisor to deal with a franchisee in good faith and to act fairly in its dealings with franchisees according to some objective test of fairness and reasonableness?

All agreements governed by French law are required to be performed in compliance with a general good faith principle. However, there is no test of fairness that needs to be done, and Judges will assess whether the Franchisor's bad faith has incurred damages to the Franchisee.

13.2 Is there any limitation on a good faith obligation being unenforceable if it only applies from franchisee to franchisor, rather than being mutual?

Under the French law, the relationship between the parties is governed by a general good faith principle. This principle applies to any agreement. Specifying that the good faith obligation only applies to Franchisees could be regarded as excessively unbalanced. It is therefore recommended to maintain the principle of a bilateral good faith obligation under the franchise agreement.

14 Ongoing Relationship Issues

14.1 Are there any specific laws regulating the relationship between franchisor and franchisee once the franchise agreement has been entered into?

The relationship between the parties will be governed by the general principles of civil and commercial French laws and regulations.

Furthermore, even though France is not a case-law jurisdiction, as may be the case in common-law countries, French case-law regarding franchise litigation should also be taken into account when drafting and performing a franchise agreement.

15 Franchise Renewal

15.1 What disclosure obligations apply in relation to a renewal of an existing franchise at the end of the franchise agreement term?

If the renewal is operated through a new franchise agreement, the Franchisor has a duty to provide the Franchisee with the mandatory disclosure document (see question 1.5 above).

15.2 Is there any overriding right for a franchisee to be automatically entitled to a renewal or extension of the franchise agreement at the end of the initial term irrespective of the wishes of the franchisor not to renew or extend?

No, unless the Franchisor has expressly made such a commitment in the franchise agreement or in a separate document.

15.3 Is a franchisee that is refused a renewal or extension of its franchise agreement entitled to any compensation or damages as a result of the non-renewal or refusal to extend?

No, unless the refusal is abusive or "brutal", which, for instance, could be the case if they had requested the Franchisee to undertake substantial investments/revamping costs in the concept a few months before the termination, where those costs have not been amortised on the expiry date and where the Franchisee would be forced to stop using said concept after the term of the agreement.

16 Franchise Migration

16.1 Is a franchisor entitled to impose restrictions on a franchisee's freedom to sell, transfer, assign or otherwise dispose of the franchised business?

Yes, it is possible to provide a right for the Franchisor to refuse the transfer of the franchise agreement to a third party, as well as a first refusal right in favour of the Franchisor.

16.2 If a franchisee is in breach and the franchise agreement is terminated by the franchisor, will a "step-in" right in the franchise agreement (whereby the franchisor may take over the ownership and management of the franchised business) be recognised by local law, and are there any registration requirements or other formalities that must be complied with to ensure that such a right will be enforceable?

No, there is no such step-in right, with the Franchisee being the owner of its business.

16.3 If the franchise agreement contains a power of attorney in favour of the franchisor under which it may complete all necessary formalities required to complete a franchise migration under pre-emption or "step-in" rights, will such a power of attorney be recognised by the courts in the jurisdiction and be treated as valid? Are there any registration or other formalities that must be complied with to ensure that such a power of attorney will be valid and effective?

This is not applicable in France.

17 Electronic Signatures and Document Retention

17.1 Are there any specific requirements for applying an electronic signature to a franchise agreement (rather than physically signing a "wet ink" version of the agreement), and are electronic signatures recognised as a valid way of creating a binding and enforceable agreement?

French law recognises and values electronic signatures as equal to physical signing, provided that it uses a reliable means of identification that guarantees its link with the act to which it is attached. The reliability of these means shall be presumed, until proof to the contrary, when an electronic signature is created,

the identity of the signatory is assured, and the integrity of the act is guaranteed, under the conditions laid down by decree of the Conseil d'État (article 1367 of the French Civil Code).

Therefore, an electronic signature may be used by Franchisors, but it is not common, with physical signing being always preferred.

17.2 If a signed/executed franchise agreement is stored electronically (either having been signed using e-signatures or a "wet ink" version having been scanned and saved as an electronic file), can the paper version of the agreement be destroyed?

French law recognises a reliable copy as having the same probative value as the original. The reliability of the copy shall be presumed, until proof to the contrary is provided, when the integrity of the act is guaranteed, under the conditions laid down by decree of the Conseil d'État (article 1379 of the French Civil Code). Therefore, for safety reasons, it is recommended to keep the original.

18 Current Developments

18.1 What is the biggest challenge franchising is facing in your jurisdiction and how are franchisors responding to that challenge?

The current inflation arising out of the crisis may impact the profitability of franchise business and therefore lead to the anticipated termination of franchise agreements. On the other hand, the heads of networks may also not develop their own operations, as their financial means could be affected by the related economic crisis. This could therefore lead to a strategy of developing franchise operations rather than owned operations. On the Franchisees' side, persons who are unemployed due to the pandemic may decide to create their own businesses and join a franchise network in order to benefit from the related advantages of implementing a "ready-to-use" and known concept.



Cecile Peskine is a member of the Paris Bar and Partner at Linkea, assisting and defending Franchisors and heads of networks.

Education:

- Degree in law "DJCE" from the University of Montpellier, France.
- Specialisation certificates in Economic and IP law.

Membership:

- Expert before the French Federation for Franchising (Fédération Française de la Franchise).
- Vice-President of the International Franchise Lawyers Association ("IFLA").
- Teacher at Sciences Po Paris.
- Member of the Club de la Franchise.

Main Areas of Practice:

- Distribution.
- Franchising.
- Communication.
- Consumer law.
- Commercial leases.

Languages:

- French.
- English.

Linkea-Avocats

37 passage du Désir
75010 Paris
France

Tel: +33 1 8508 0508
Email: cpeskine@linkea-avocats.com
URL: www.linkea-avocats.com



Clémence Casanova is a member of the Paris Bar, assisting and defending Franchisors and heads of networks.

Education:

- Degree in law "DJCE" from the University of Montpellier, France.
- Specialisation certificate in Economic law.

Main Areas of Practice:

- Distribution.
- Franchising.
- Communication.
- Consumer law.
- Commercial leases.

Languages:

- French.
- English.

Linkea-Avocats

37 passage du Désir
75010 Paris
France

Tel: +33 1 8508 0508
Email: ccasanova@linkea-avocats.com
URL: www.linkea-avocats.com

From the creation of a network to its development, while avoiding litigation and carrying out training along the way, our expert distribution lawyers (franchises, trademark licensing, concessions, etc.) work with brands of all sizes – in their national dealings as much as international – with a purposely ultra-specialised slant.

Linkea-Avocats lawyers advise their clients while drafting the contractual elements needed (franchise, affiliation, licence, master franchise, commercial agreements, general terms and conditions, B-to-C agreements), training them in pre-litigation skills, and representing their clients before the French Courts and arbitration jurisdictions.

Linkea-Avocats work for a varied clientele: fast food networks; seated catering; sports clubs; ready-to-wear; personal care services; retail; real estate; delicatessens; ice cream makers; bazaars; household equipment; home staging; and construction, etc.

www.linkea-avocats.com

Link&A
Avocats - Conseils en réseaux

Germany

Noerr PartGmbH



Dr. Tom Billing



Dr. Jasmin Schulzweida

1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

There is no statutory definition of ‘franchise’ or ‘franchising’ in Germany. The German Franchise Association (GFA) (<https://www.franchiseverband.com>) provides a definition (recognised in certain parts by the courts) as follows:

‘Franchising is a sales and distribution system by means of which goods, services or technologies are marketed. It is based on a close and ongoing cooperation between legally and financially separate and independent companies, the franchisor and the franchisees. The franchisor grants its franchisees the right, at the same time as imposing the obligation on them, to conduct a business in accordance with the franchisor’s concept. This right entitles and obliges the franchisee, in return for direct or indirect remuneration, to use the system’s name, trademark, service mark, copyright and/or other intellectual property rights, as well as know-how, economic and technical methods and the business system of the franchisor, under ongoing commercial and technical support by the franchisor, within the framework and for the term of a written franchise agreement, concluded between the parties for this purpose.’

1.2 What laws regulate the offer and sale of franchises?

In Germany, there are no specific laws or government agencies that regulate the offer and sale of franchises. Therefore, the offer and sale of franchises is only governed by the general provisions of German contract law (the German Civil Code), consumer law, commercial law (the German Commercial Code), competition law and unfair trade law.

In particular, the provisions of the German Civil Code concerning standard terms and conditions can be applied where the franchisor uses standard franchise agreements being signed by the franchisee on a take-it-or-leave-it basis (section 305 German Civil Code). According to section 307 German Civil Code, all standard-term provisions need to be reasonable and may not unduly disadvantage the other party contrary to the requirements of good faith; otherwise, they are null and void.

Further, according to German consumer credit law, a franchisee that is not organised in the form of a company limited by shares is entitled to withdraw from the franchise agreement within a period of 14 days of its conclusion if it thereby establishes an independent business enterprise, the agreement contains an obligation to repeatedly take supplies of goods and the total value of the franchisee’s investments does not exceed the amount of €75,000.

1.3 If a franchisor is proposing to appoint only one franchisee/licensee in your jurisdiction, will this person be treated as a “franchisee” for purposes of any franchise disclosure or registration laws?

As there are no specific laws on franchising in Germany, the same general provisions that would apply to a franchise system with more than one franchisee/licensee will apply. However, the application of the same general provisions with regard to disclosure requirements will lead to a reduced amount of information that needs to be provided to the franchisee given that the franchisor has less experience and information itself. In order to comply with its disclosure obligations, the franchisor needs to disclose to the franchisee/licensee the fact that he is the first/only franchisee and that therefore the franchisor is not able to provide him with information/experience regarding other franchisees (see also question 1.5).

1.4 Are there any registration requirements relating to the franchise system?

There are no specific government consents or official authorisations required relating to the offer and sale of a franchise.

1.5 Are there mandatory pre-sale disclosure obligations?

Under German law, pre-contractual disclosure in connection with franchise agreements is not regulated by a special statute or monitored by a specific agency. Only the general provisions regarding the opening of contractual negotiations apply, in particular the principle of *culpa in contrahendo*. This principle provides that before the conclusion of a franchise agreement, the franchisor must ensure that all relevant facts have been clearly presented to the potential franchisee. The scope and content of the duty depend on each individual case, taking the experience and knowledge of the franchisee into account.

German courts have stressed that, as a general rule, the franchisee is obliged to obtain information at its own initiative about the general market conditions and their impact on the prospective franchise business. However, if there are particular circumstances of which only the franchisor is aware and which are recognisably of importance to the potential franchisee’s decision as to whether to enter into the franchise agreement or not, the franchisor must disclose such information. It also follows from German case law that the franchisor must refrain from providing misleading information on the franchise system and must disclose all relevant information about it in order to avoid

subsequent damage claims. A non-binding guideline for franchisors about disclosure in Germany is the GFA's guideline on pre-contractual disclosure obligations.

It may be derived from German case law that at least the following items should be disclosed:

- information about the franchise concept, including, in particular, the date of the beginning of the franchise system and the actual number of franchisees and the fluctuation rate;
- an indication of people in charge to act on behalf of the franchisor;
- the franchise offer, including, amongst others, location, performance and experience of the pilot business, required investment and manpower for the franchisee's business;
- information that enables the franchisee to elaborate its own location analysis and profitability calculation of the franchise business;
- information on situations where compulsory statutory pension insurance for the franchisee applies;
- the franchise agreement and the franchise handbook (including all standard appendices);
- memberships in franchise associations;
- information on other distribution channels for the franchise product or service;
- pending lawsuits with a potential impact on the franchisee's business; and
- an indication of the initial and ongoing support from the franchisor.

The pre-contractual information should be disclosed within a reasonable period prior to the conclusion of the franchise agreement. This applies also to any (preliminary) binding agreement between the parties. Conversely, the rules of pre-contractual disclosure in connection with franchise agreements shall not apply to reservation agreements between the franchisor and a potential franchisee. As the term of such agreements is shorter, there are minor economic consequences and usually no obligation to enter into a franchise agreement is provided.

1.6 Do pre-sale disclosure obligations apply to sales to sub-franchisees? Who is required to make the necessary disclosures?

In case of a sub-franchising structure, it is up to the sub-franchisor to make pre-sale disclosures to sub-franchisees. As a result, the sub-franchisor must provide information about the way the franchise system works and its prospects of success.

However, as there are no statutory provisions with regard to pre-contractual disclosure obligations (see question 1.5), the scope and content of the disclosure requirements depends on the sub-franchisee's need for information and its existing possibilities to obtain information. Therefore, the sub-franchisor must, at least, offer information about the master franchise and the allocation of tasks between the franchisor and sub-franchisor. Moreover, the sub-franchisor must show the extent of the derivation of rights from the franchisor (particularly as to trademarks and know-how).

1.7 Is the format of disclosures prescribed by law or other regulation, and how often must disclosures be updated? Is there an obligation to make continuing disclosure to existing franchisees?

Unlike common law countries, and contrary to the legal situation in, for example, France, Italy and Spain, there is no specific format of disclosure prescribed by German law or under German

franchise practice. A written standard compliance procedure does not exist. Nevertheless, it would be advisable for franchisors to expressly disclose to their potential partners in writing all information that is deemed necessary according to German case law and to the non-binding GFA guideline on pre-contractual disclosure obligations (reflecting the actual constitution of the franchise system).

An obligation for continuing disclosure can follow from the principle of good faith that is a basic principle of German law (see question 13.1). By invoking good faith, a court may establish collateral obligations owed between contracting parties. This may include protective obligations, such as information (disclosure) about developments having an impact on the franchisee's business or on the franchise system in general (for example, the franchisor's trademark being challenged by a third party).

1.8 What are the consequences of not complying with mandatory pre-sale disclosure obligations?

Under German law, only the general provisions regarding pre-contractual obligations, in particular the principle of *culpa in contrahendo* (see question 1.5), and no special statute apply to non-compliance with pre-sale disclosure obligations. Under the principle of *culpa in contrahendo*, the franchisee might be entitled to damages, if pre-sale disclosure obligations have culpably not been complied with by the franchisor. As a general principle under German law, a party who is liable for damages must restore the damaged party's position that would exist if the circumstance obliging the party to damages would not have occurred. Usually, the franchisee's claim for damages will therefore comprise, for example, an operating loss that has arisen due to the establishment of the franchise outlet. Further, the franchisee might claim contract adjustment and sometimes also cancellation of the whole franchise agreement. Damage claims based on non-compliance with pre-sale disclosure obligations might not only be directed against the franchisor but also against third parties (for example, directors of a franchisor that is organised as a private limited company, business consultants or tax advisers), who are not themselves intended to be parties to the franchise agreement but who have substantially influenced the pre-contractual negotiations or the entering into the agreement without complying with the pre-sale disclosure obligations.

1.9 Are there any other requirements that must be met before a franchise may be offered or sold?

German statutory law does not provide for special requirements that a franchisor must meet prior to offering franchises. Nevertheless, the GFA lists numerous guiding principles in its code of ethics, *inter alia*:

- the franchisor must have successfully run a business concept for an appropriate period of time and with at least one pilot project before founding its franchise network;
- the franchisor must be the owner or legitimate user of the company name, trademark or any other special labelling of its network; and
- the franchisor must carry out initial training of the individual franchisee and must assure ongoing commercial and/or technical support to the franchisee during the entire term of the agreement.

Observance of the stated principles is obligatory in order to become and remain a member of the GFA and to demonstrate fair business practices.

1.10 Is membership of any national franchise association mandatory or commercially advisable?

Members of the GFA must conduct a strict quality review before being admitted as a full member to the GFA.

In addition, franchisors as members of the GFA must comply with the GFA's code of ethics, which thereby influences franchise relationships at least to some extent. The GFA's code of ethics was adopted on the basis of the European Franchise Federation's code of ethics, which the GFA, as a member, must comply with.

1.11 Does membership of a national franchise association impose any additional obligations on franchisors?

Members of the GFA must conduct a severe quality review before being admitted as a full member to the GFA.

In addition, franchisors as members of the GFA must comply with the GFA's code of ethics, which thereby influences franchise relationships at least to some extent. The GFA's code of ethics was adopted on the basis of the European Franchise Federation's code of ethics, which the GFA, as a member, must comply with.

1.12 Is there a requirement for franchise documents or disclosure documents to be translated into the local language?

German law does not require an international franchisor to provide the franchisee with pre-contractual information or a franchise agreement drafted in the German language. Nevertheless, in order to avoid misunderstandings and future disputes, it is advisable that the franchisee is at least provided with a translation of the franchise agreement for convenience, as long as it cannot be excluded that the franchisee might have difficulties with the interpretation of the franchise agreement. Moreover, if the franchise agreement provides for the jurisdiction of a German court, a translation of the agreement will become necessary if it is brought before a court, given that the language in court needs to be German (this applies to all documents involved).

2 Business Organisations Through Which a Franchised Business Can be Carried On

2.1 Are there any foreign investment laws that impose restrictions on non-nationals in respect of the ownership or control of a business in your jurisdiction?

Under German law, there is no difference between franchisors from EU and non-EU Member States.

2.2 What forms of business entity are typically used by franchisors?

Franchisors wishing to set up business in Germany have a variety of legal forms (partnerships and limited liability companies) from which to choose. Nevertheless, the most common form of corporate vehicle to be established by a typical franchisor in Germany is a private limited liability company (GmbH). This corporate form requires a minimum amount of capital investment (at least €25,000) and offers limited liability, so only the company's assets are liable to the company's creditors. Furthermore, the GmbH offers a great deal of flexibility as regards internal structures and procedures.

2.3 Are there any registration requirements or other formalities applicable to a new business entity as a pre-condition to being able to trade in your jurisdiction?

If the business entity is to be classified as a partnership, its formation is governed by the German Civil Code and the German Commercial Code. The incorporation of a private limited liability company is subject to the German Limited Liability Company Act. Limited liability companies must be registered in the Commercial Register, which is maintained by the local courts.

3 Competition Law

3.1 Provide an overview of the competition laws that apply to the offer and sale of franchises.

In 2005, German antitrust law was completely harmonised with European antitrust law. All forms of competition restraints contained in distribution agreements, such as non-compete clauses, price-fixing, guaranteed exclusive areas and purchasing restrictions, are now treated in full compliance with European antitrust law. European antitrust law (article 101(1) Treaty on the Functioning of the European Union (TFEU)) prohibits agreements between undertakings that may affect trade between Member States and that have as their object or effect the prevention, restriction or distortion of competition within the common market. Exemptions are made either on an individual basis or, if applicable, under a block exemption. Vertical restraints, such as those typically encountered in franchise agreements, can be, to some extent, exempted under the EC Block Exemption Regulation (BER). The new BER (No. 2022/720) entered into force on 1 June 2022. Companies had until 31 May 2023 to adapt existing contracts to the new regulations.

3.2 Is there a maximum permitted term for a franchise agreement?

German law is characterised by the principle of contractual freedom that allows the parties to agree on the provisions of a contract at their discretion. Therefore, restrictions on provisions in franchise agreements are an exemption and mainly follow from German antitrust law and the laws regarding conditions in standardised agreements (in particular, section 307 German Civil Code).

The laws regarding standard terms and conditions specify the principle of good faith and ban standardised provisions that unreasonably disadvantage the franchisee in a manner contrary to the requirements of good faith. Against this background, a provision stipulating that the duration of the franchise agreement shall be 30 years would presumably be considered void, given that it unreasonably restricts a franchisee's entrepreneurial freedom. On the other hand, a duration that is too short (for example, one year) could also be regarded as unreasonable, as it would be practically impossible for the franchisee to recover the costs of its investment in setting up the franchise business within the agreed term.

3.3 Is there a maximum permitted term for any related product supply agreement?

It is often agreed in franchise agreements that the franchisee is only allowed to acquire goods from the franchisor and not from other sources, including other franchisees.

The franchisee's obligation to sell only the contract goods is lawful and does not violate competition law if it is essential for

maintaining the identity and reputation of the franchise network (European Court of Justice, judgment of 28 January 1986, case No. 161/84, ECR 1986, 353, *Pronuptia*). If a purchase obligation is not essential for the identity and reputation of the franchise network, the BER can still apply. According to article 5 BER, purchase obligations are exempted by the BER where the duration is neither indefinite nor exceeds five years. Agreements with purchase obligations that are tacitly renewable beyond a period of five years are therefore not exempted by the BER. However, if the goods or services are resold by the franchisee from the premises and land owned by the franchisor or leased by the franchisor from third parties not connected to the franchisee, the non-compete obligation may be of the same duration as the period of occupancy of the point of sale by the franchisee. Please note that the BER only applies to franchise systems with a market share of less than 30 per cent. If the market share is higher than 30 per cent, the block exemption does not apply, but an individual exemption under article 101(3) TFEU might still be possible.

Apart from that, restrictions with regard to the maximum permitted term for a product supply agreement only follow from the laws regarding conditions in standardised agreements (see question 3.2).

3.4 Are there restrictions on the ability of the franchisor to impose minimum resale prices?

Every form of direct or indirect price-fixing is prohibited by German and European antitrust law. The franchisee must be free to determine at what price it wants to sell its products or render its services. The exemptions of the BER do not apply to agreements with price-fixing clauses. The franchisor is only entitled to set a maximum for the prices at which the product or service of the franchise system are to be sold. Additionally, the franchisor is entitled to issue non-binding price recommendations. Fixed resale prices may also be permissible to organise a coordinated short-term low-price campaign in a franchise system (two to six weeks in most cases).

3.5 Encroachment – are there any minimum obligations that a franchisor must observe when offering franchises in adjoining territories?

Under European and German antitrust law, a franchisee cannot be provided with a completely exclusive area. Nevertheless, there is a large array of exemptions to that rule. Exclusivity can be provided in the sense that the franchisees can be prohibited from actively distributing outside their exclusive areas. Active distribution is defined as all forms of marketing where the franchisee actively approaches potential customers. In contrast, passive distribution cannot be prohibited; passive distribution being all forms of marketing where the franchisee does not actively approach potential customers, but only responds to their requests. Therefore, the franchisee cannot be prohibited from delivering goods or rendering services at the request of its customer even if this customer is located outside of the exclusive area. The establishment of an internet homepage is expressly deemed by the European Commission to be passive distribution. The franchisee cannot therefore be deprived of the right to present itself on the internet.

3.6 Are in-term and post-term non-compete and non-solicitation of customers covenants enforceable?

Obligations not to compete during the term of the franchise agreement are subject to German competition law, as they restrict

the franchisee's freedom of business activities and prevent other suppliers from distributing their products or services through the franchisee involved. Under German competition law, non-compete obligations are treated like purchasing obligations. Consequently, they are lawful if they are essential for maintaining the identity and reputation of the franchise system or to protect the know-how transferred by the franchisor to the franchisee (European Court of Justice, *Pronuptia*, see above). If a non-compete clause is not essential, the BER can still apply. According to the BER, non-compete clauses during the term of the agreement must not be agreed for more than five years.

Under German competition law, post-term non-compete clauses may fall under the ban on cartels (article 101(1) TFEU) if they have an appreciable impact on competition. Those post-term non-compete clauses are generally not exempted by the BER. Nevertheless, the BER states an exemption that non-compete clauses can be agreed for one year after termination of the agreement if they: only apply to competing products or services; are essential for the protection of know-how; and are restricted to the business location of the franchisee during the term of the agreement. Moreover, after the term of the agreement, the franchisee can be prohibited from using and disclosing know-how provided by the franchisor that has not entered the public domain. There are no time restrictions for such clauses. Please note that the franchisee may claim reasonable compensation for a post-term non-compete obligation.

Again, the exemptions of the BER are only available to franchisors and franchisees with a market share of less than 30 per cent. If the market share is higher, the block exemption does not apply and the clause is invalid.

Under German procedural law, in-term and post-term non-compete clauses can be enforced by way of an action for injunction (i.e. omission of a certain breach of contract) and by way of a court-ordered interim injunction (section 940 German Code of Civil Procedure).

In order to obtain such an injunction, the plaintiff must prove the risk of infringement. This can be done in two different ways: either an infringement already has been committed and can be proven, then the risk of repetition is generally assumed (unless the nature of infringement or unusual circumstances indicate otherwise). The defendant then carries the burden of proof and has to refute this assumption. Harder to prove for the plaintiff is the so-called 'preventive injunction'. Here, an infringement has not yet occurred but the claimant claims a risk of initial infringement. The burden of proof lies fully with the claimant. The imminent danger of an infringement has to be demonstrated through objective facts.

Such German court-ordered injunction is enforced by levying a coercive penalty payment and, as *ultima ratio*, by coercive penalty detention, for example, of the managing directors of the franchisee (section 888 German Code of Civil Procedure).

4 Protecting the Brand and Other Intellectual Property

4.1 How are trade marks protected?

Apart from well-known or famous brands, trademark protection in Germany requires registration either with the German Patent and Trademark Office or as a Community trademark with the European Trademark Office (Alicante, Spain) or a designation of international trademarks for Germany. Trademarks such as words, letters, numbers, pictures, sounds, colours and colour combinations are protected by the German Trademark Act.

4.2 Are know-how, trade secrets and other business-critical confidential information (e.g. the Operations Manual) protected by local law?

Although know-how is part of a franchisor's intellectual property rights, the protection of know-how is not subject to specific statutes such as the German Trademark Act or the German Copyright Act. As a result, there is no registration requirement for licensing know-how. Even so, franchisors' know-how is confidential information under the franchise agreement or other confidentiality agreements and the use of intellectual property rights and know-how is limited to the purpose of the franchise system. Breach of business confidentiality constitutes a breach of those agreements and, moreover, is punishable under the German Act Against Unfair Competition.

4.3 Is copyright (in the Operations Manual or in proprietary software developed by the franchisor and licensed to the franchisee under the franchise agreement) protected by local law?

Copyrights are protected under the German Copyright Act. In case of a copyright infringement, German law offers instruments from civil law, criminal law and competition law. The owner of the copyright may, amongst others, claim removal, omission or damages. Certain conduct that infringes a copyright may also be considered a criminal offence (in this case, the owner of the copyright may file a criminal complaint to the Public Prosecutor). In rare cases, the infringement of a copyright may also be considered an unfair business practice under the German Act Against Unfair Competition.

therefore only claim damages against the franchisor by German tort law or by product liability (for example, a defect product manufactured by the franchisor causes a body injury). Consequently, a sub-franchisor is solely responsible for fulfilling the disclosure obligations with regard to the sub-franchisees (see question 1.6). Nevertheless, the sub-franchisor may have a right of recourse against the franchisor if the sub-franchisor has used and relied on the franchisor's disclosure material containing misleading information (breach of duties by franchisor). Due to the German law on standard terms, it is not possible to exclude liability for injury to life, body or health and in case of gross fault in the franchise agreement. An indemnity that the franchisor takes from the master franchisee would have to comply with German law on standard terms as well. Therefore, an indemnity would have to be reasonable and not unduly disadvantage the master franchisee in order to be valid.

5.3 Can a franchisor successfully avoid liability for pre-contractual misrepresentation by including a disclaimer in the franchise agreement?

Under German law, it is not possible for a franchisor to avoid liability for pre-contractual misrepresentation by including disclaimer clauses in the franchise agreement.

5.4 Does local law permit class actions to be brought by a number of aggrieved franchisees and, if so, are class action waiver clauses enforceable?

Generally, German law follows the idea of individual remedy, which means that every franchisee needs to bring its claim before a court. Since November 2018, the German Civil Procedure Code has introduced a completely new kind of declaratory action, the new Model Declaratory Action (*Musterfeststellungsklage*), which serves as a collective redress mechanism for consumers in mass damage cases and is directed against entrepreneurs. Under the German Civil Code, a 'consumer' is any natural person who, when acquiring the claim or establishing the legal relationship, does not act predominantly within the framework of his or her commercial or self-employed professional activity. It is established German case law that franchisees, when entering into the franchise agreement, are not to be considered 'consumers'. Therefore, it is unlikely that the new Model Declaratory Action would be open to franchisees.

5 Liability

5.1 What remedies can be enforced against a franchisor for failing to comply with mandatory disclosure obligations? Is a franchisee entitled to rescind the franchise agreement and/or claim damages?

If the franchisor infringes its duty regarding disclosure, the franchisee is entitled to claim damages. The franchisor must put the franchisee in the position it would have been in if the franchisor had fulfilled its disclosure obligation. As the franchisee may have not agreed to the franchise agreement under full disclosure, he or she may rescind the franchise agreement. The franchisor, therefore, can be ordered to consent to the cancellation of the franchise agreement, to pay all obtained franchise fees back to the franchisee and to reimburse the franchisee for all expenses incurred in connection with the franchise business. However, income the franchisee earned from the exercise of the franchise business must be deducted.

5.2 In the case of sub-franchising, how is liability for disclosure non-compliance or for pre-contractual misrepresentation allocated between franchisor and master franchisee? If the franchisor takes an indemnity from the master franchisee in the Master Franchise Agreement, are there any limitations on such an indemnity being enforceable against the master franchisee?

As sub-franchisors are usually self-employed entrepreneurs who are not permitted to act on behalf and for the account of the franchisor, there is no direct contractual relationship between the franchisor and the sub-franchisees. Sub-franchisees can

6 Governing Law

6.1 Is there a requirement for franchise documents to be governed by local law? If not, is there any generally accepted norm relating to choice of governing law, if it is not local law?

In principle, parties are free to choose the governing law applicable to their contractual relationship (article 3 of Regulation (EC) No. 593/2008, 'Rome I'). Nevertheless, according to the European provisions on conflict of laws, there are certain provisions that cannot be excluded even by a valid choice of law; for instance, competition law (see article 9 Rome I), consumer protection law (see article 6 Rome I) and employment law (see article 8 Rome I). Furthermore, German law can apply where provisions of a foreign law interfere with fundamental principles of the German jurisdiction (so-called '*ordre public*', article 21 Rome I). These are, in particular, cases in which the application of such provisions would be incompatible with civil rights.

In cases where all other elements relevant to the situation at the time of the choice are located in a country other than the country whose law has been chosen, the choice of the parties does not prejudice the application of provisions of the law of that other country, which cannot be derogated from by agreement. That might be relevant for the choice of law in a sub-franchise relationship if the master franchisee has its registered office in Germany, as it is unsure if the connection to the MFA or the place of arbitration alone would be considered a 'foreign element' within the sub-franchise relationship that would lead to the freedom of choice of law according to article 3 Rome I.

6.2 Do the local courts provide a remedy, or will they enforce orders granted by other countries' courts, for interlocutory relief (injunction) against a franchisee to prevent damage to the brand or misuse of business-critical confidential information?

In order to enforce foreign judgments from a country that is not a member of the EU, in Germany, an *exequatur* procedure is necessary. Pursuant to sections 328, 722, 723 German Code of Civil Procedure, a final judgment issued by a foreign court will, in principle, be recognised and enforced by the courts of Germany. The judgment will be enforced if an action for judicial enforcement (*Vollstreckungsklage*) is brought to have the judgment declared enforceable by a court of the Federal Republic of Germany. The judgment of enforcement (*Vollstreckungsurteil*) will be of the same force and effect as if a material judgment had been originally given by a German court. The courts of Germany will only examine whether the foreign judgment is legally effective and final, and whether there is an impediment to recognition pursuant to section 328 German Code of Civil Procedure (such as a lack of competence of the foreign court according to international jurisdiction), or whether there are any defences that have arisen after the date on which the foreign judgment became legally effective and final.

Judgments issued by courts of EU Member States, which are enforceable in the Member State in which they were issued, are enforceable in all other Member States, including Germany, without the need for a declaration of enforceability (article 39 Regulation (EU) No. 1215/2012).

6.3 Is arbitration recognised as a viable means of dispute resolution and is your country a signatory to the New York Arbitration Convention on the Recognition and Enforcement of Foreign Arbitral Awards? Do businesses that accept arbitration as a form of dispute resolution procedure generally favour any particular set of arbitral rules?

Arbitration in Germany offers a number of advantages, such as significant flexibility (for example, number of arbitrators, place and language of the arbitration proceedings), potential cost and time efficiencies, greater confidentiality and a binding and non-appealable resolution of the dispute. However, arbitration proceedings may be more expensive than court proceedings, particularly if the matter in dispute is of relatively low value. In those cases, additionally, the parties may find it difficult to appoint their favoured (meaning highly specialised) arbitrators, given the relatively low arbitrators' fees following on from the low value of the dispute. Furthermore, the enforcement of an arbitral award is more difficult than a decision of a state court, as arbitral awards must be declared enforceable by a state court (section 1060 German Code of Civil Procedure).

Germany has been a signatory to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York

Convention) since 1961. Worldwide-known arbitration institutes are, amongst others, the ICC International Court of Arbitration, the London Court of Arbitration (LCIA), and the International Centre for Dispute Resolution (ICDR). The parties are free to choose the arbitral rules under which the arbitral proceedings shall be conducted. In Germany, the German Institution for Arbitration (DIS) is the most important organisation for arbitration.

7 Real Estate

7.1 Generally speaking, is there a typical length of term for a commercial property lease?

German law does not provide for any special franchise-related regulations concerning the real estate market or real estate law. Thus, the general rules of the German Civil Code apply. Commercial leases and subleases may be freely concluded between lessor and lessee. Usually the lease is made coterminous with the franchise agreement regarding term and expiry.

Unless otherwise agreed, in case of a commercial property lease with no definite term, a notice of termination is admissible at the latest on the third working day of a calendar quarter to the end of the next calendar quarter, leading to a notice period of generally six months.

7.2 Is the concept of an option/conditional lease assignment over the lease (under which a franchisor has the right to step into the franchisee/tenant's shoes under the lease, or direct that a third party (often a replacement franchisee) may do so upon the failure of the original tenant or the termination of the franchise agreement) understood and enforceable?

It is a possibility, in order to prevent the occupation of the premises by the franchisee after the franchise agreement has ended, to stipulate in the franchise agreement an obligation of the franchisee/tenant to agree with the landlord on a clause within the lease agreement according to which the franchisor is entitled to enter into the lease agreement upon the termination of the franchise agreement. In order to enforce such right in case the franchisee does not vacate the premises, the landlord would have to sue against the franchisee as its tenant. If the landlord – given that he usually has no self-interest in such proceedings – is not willing to sue against the franchisee, the franchisor would have to sue against the landlord in order to force him to proceed against the franchisee.

7.3 Are there any restrictions on non-national entities holding any interest in real estate, or being able to sub-lease property?

There are no restrictions on non-national entities holding any interest in real estate, or being able to sublease.

In general, under German law, subleasing requires the permission of the landlord. In case of commercial leases, the lessee may neither be entitled to the grant of such permission nor claim damages against the landlord. However, if the landlord refuses to give his or her consent, the lessee can extraordinarily terminate the lease with the statutory notice period of three months, unless the person of the sublessee constitutes cause for the refusal. Such special termination right cannot be excluded within standard terms and conditions. A general permission to sublet may be granted in advance but is limited to the permitted purpose of the lease. On the other hand, it is also possible to contractually prohibit subleasing in general, if residential space is not concerned.

7.4 Give a general overview of the commercial real estate market. To what extent has the real estate market been affected by the Coronavirus pandemic? Specifically, can a tenant expect to secure an initial rent free period when entering into a new lease (and if so, for how long, generally), or are landlords demanding “key money” (a premium for a lease in a flagship location)?

With regard to commercial leases, German law provides for less restrictions of the parties’ freedom to contract than it does for residential leases. For example, it is possible to agree on a fixed term without any reason. In general, a tenant cannot expect an initial rent-free period when entering into a new lease but the parties are, of course, free to agree on an initial rent-free period. A rent-free period is often granted if structural alteration works have to be carried out by the tenant before opening its business. It is possible that landlords demand ‘key money’ for commercial leases (unlike for residential leases). Whether or not key money is paid is also up to negotiation between the parties.

The outbreak of the Coronavirus pandemic has affected the real estate market in Germany, especially in the area of commercial leases. Some tenants refused to pay their rent during government-ordered shutdowns. The tenants argued that the government-ordered shutdowns constitute a defect in the leased premises (*Mietmangel*, section 536 German Civil Code) or, in any case, that there is a contractual adjustment due to the German law on frustration of contract (section 313 German Civil Code). In its ruling dated 12 January 2022, the Federal Court of Justice made it clear that where commercial leases are concerned, Coronavirus-related business closures do not constitute a defect in the leased premises (*Mietmangel*, section 536 German Civil Code), although a rent reduction may be possible on the basis of the law on frustration of contract (section 313 German Civil Code). However, the Court has rejected the idea of a blanket 50 per cent cut in the rent. Instead, the effects of the business closure on both tenant and landlord need to be weighed up in detail in a case-by-case assessment. It will now be interesting to see how the courts of first instance will further specify the guidelines set by the Federal Court of Justice for making such an assessment.

8 Online Trading

8.1 If an online order for products or request for services is received from a potential customer located outside the franchisee’s exclusive territory, can the franchise agreement impose a binding requirement for the request to be re-directed to the franchisee for the territory from which the sales request originated?

See question 3.5.

8.2 Are there any limitations on a franchisor being able to require a former franchisee to assign local domain names to the franchisor on the termination or expiry of the franchise agreement?

There are no limitations with regard to the franchisor’s ability to require local domain names from its franchisees on the termination or expiry of the franchise agreement, given that the parties have agreed on such transfer.

9 Termination

9.1 Are there any mandatory local laws that might override the termination rights one might typically expect to see in a franchise agreement?

Irrespective of the contractual provisions, according to German law, neither the necessity nor the requirements for a termination for ‘good cause’ can be waived within standard terms and conditions (and therefore most franchise agreements). The same applies to the necessity for a formal reminder before termination without notice (see also question 9.2).

9.2 Are there local rules that impose a minimum notice period that must be given to bring a business relationship that has existed for a number of years to an end, which will apply irrespective of the length of the notice period set out in the franchise agreement?

Franchise agreements can be entered into for a definite or an indefinite term. In both cases, the franchise agreement can end by conclusion of an agreement to annul the franchise relationship.

A franchise agreement with a definite term can end as a result of lapse of time or by termination for cause. Under German law, a termination for cause without notice requires good cause and (usually) a warning letter beforehand. That said, only major infringements of the duties of the franchise agreement constitute good cause in this respect, resulting in the right for termination for cause even without notice. Since this right is considered a last resort (*ultima ratio*), default of payment and the violation of certain contractual provisions alone do not make the continuation of a longstanding franchise relationship unreasonable for the franchisor (*Kammergericht Berlin*, judgment of 21 November 1997, file No. 5U 5398/97, *Burger King*). There may be circumstances that lead to sudden friction in the relationship between the franchisor and the franchisee; for example, the refusal to pay the franchise fees or the repeated breach of important rules of the franchise system (such as the prohibition on cooperating with competitors). To assess whether an action justifies the termination of the agreement for good cause requires an overall evaluation of the circumstances of the individual case and weighing the interests of the franchisor and the franchisee. The termination declaration has to take place within a reasonable time after the occurrence of the activity that led to the friction in the relationship. Please note that neither the necessity nor the requirements for good cause (including the warning letter) can be waived within a pre-formulated standard franchise agreement.

Franchise agreements with an indefinite term can be terminated either for good cause (without notice, as specified above) or without cause. In case of termination without cause, contractual or statutory periods of notice must be considered. German law provides for the following statutory notice periods depending on the duration of the agreement: one month within the first year of the term; two months within the second year of the term; three months within the third to fifth year of the term; and five months after five years of the term. The parties may agree on a longer notice period as provided for by the German Commercial Code but may not shorten it. Unless otherwise agreed by the parties, any termination is valid only until the end of a calendar month.

10 Joint Employer Risk and Vicarious Liability

10.1 Is there a risk that a franchisor may be regarded as a joint employer with the franchisee in respect of the franchisee's employees? If so, can anything be done to mitigate this risk?

Depending on the nature of the relationship between a franchisor and a franchisee, there may be a risk that the franchisee is considered an employee or quasi-employee of the franchisor, leading the franchisor to be confronted with employer obligations and employee rights of the franchisee. Whether a franchisee will be classified as an independent businessman or as an employee (or quasi-employee) depends on the scope of the control exercised by the franchisor, and on the extent of the entrepreneurial risk assumed by the franchisee.

In this respect, the courts rely on the criteria of personal dependency (employees) or economic dependency (quasi-employees). Personal dependency will be assumed if the franchisee is excessively bound to the franchisor's instructions regarding the subject matter, conduct, time, length and place of its activity. Self-employment on the other hand will be assumed where the franchisee is mainly free to determine its activity and bears the entrepreneurial risk. A franchisee organised in the form of a company limited by shares will not run the risk of being qualified as an employee (except for the particular case of a one-person company in which the characteristics of dependant employment prevail).

If the franchisee – in the case of self-employment – is considered a quasi-employee, some German employment law provisions are expressly declared applicable (no general application of German employment law). This requires, however, the franchisee's economic dependency on the franchisor (i.e., the franchisee's basis of existence must arise out of the franchise business).

In order to avoid the risk of German employment law being applicable, the franchisor has to make sure that the franchisee is not personally or economically dependent. This can be achieved by tailoring the franchise agreement respectively, as well as the corresponding execution of the agreement.

10.2 Is there a risk that a franchisor may be held to be vicariously liable for the acts or omissions of a franchisee's employees in the performance of the franchisee's franchised business? If so, can anything be done to mitigate this risk?

As franchisees are usually self-employed entrepreneurs who are not allowed to act on behalf and for the account of the franchisor, there is no direct contractual relationship between the franchisor and the franchisee. Therefore, the franchisor may not be held liable for the acts or omissions of its franchisees or their employees if the franchisee is not classified as an employee (or quasi-employee) (see question 10.1).

11 Currency Controls and Taxation

11.1 Are there any restrictions (for example exchange control restrictions) on the payment of royalties to an overseas franchisor?

Germany currently does not enact any exchange controls to an overseas franchisor.

11.2 Are there any mandatory withholding tax requirements applicable to the payment of royalties under a trade mark licence or in respect of the transfer of technology? Can any withholding tax be avoided by structuring payments due from the franchisee to the franchisor as a management services fee rather than a royalty for the use of a trade mark or technology?

A business entity that has its registered office or place of management in Germany is considered tax-resident in Germany. Unless otherwise provided for in an applicable double tax treaty, a tax-resident entity is subject to unlimited tax liability in Germany on its worldwide income. The tax system for corporate entities can be characterised as a combination of corporate income tax and trade tax.

Corporate income tax is payable at a rate of 15 per cent (plus a solidarity surcharge of 5.5 per cent of the corporate income tax, resulting in an aggregate corporate income tax rate of 15.825 per cent). Individuals who conduct business in Germany or are partners in a partnership in Germany are subject to progressive German income tax rates of up to 45 per cent (plus a solidarity surcharge of 5.5 per cent of income tax), depending on their income.

Trade tax is a municipal tax, individually imposed by local authorities at the company location, and varies between approximately 7 per cent and 18 per cent. The trade tax base is the taxable profit for income tax or corporate income tax purposes, modified by some add-backs and deductions. To mitigate the double burden of income tax and trade tax, income tax on business income is to a certain extent reduced by trade tax (trade tax rate relief allowance). Trade tax cannot, however, be deducted from the total corporate income tax amount.

Non-tax-resident business entities or entrepreneurs are subject to limited tax liability on their domestically sourced income. Income received from a permanent German establishment is regarded as domestically sourced income and is therefore subject to income tax (for individuals not tax-resident in Germany) or corporate income tax (for companies not tax-resident in Germany), as well as trade tax at the normal rate.

Income tax on domestic taxable income from the licensing of know-how or rights of use of non-tax-resident business entities or entrepreneurs not having a permanent establishment in Germany is levied at source by way of a withholding tax, unless otherwise provided for in an applicable double tax treaty. The withholding tax is normally paid by the debtor (the franchisee) on account of the creditor (the franchisor). The tax rate is 15 per cent. The solidarity surcharge amounts to 5.5 per cent of the income tax or the corporate income tax.

Deliveries and services supplied in Germany against consideration by an entrepreneur are generally subject to German value-added tax (VAT). Services relating to the licensing of rights or the provision of know-how supplied by an entrepreneur are generally subject to VAT, if the recipient of these services is situated in Germany. Deliveries of goods from abroad are either subject to German VAT on the intra-Community acquisition of goods or to German import VAT. The standard rate is 19 per cent; however, some deliveries are taxed at the rate of 7 per cent and some supplies are tax-exempt (for example, financial services).

In order to mitigate the economic consequences of the Coronavirus pandemic, certain standard tax rates have been temporarily reduced until the end of 2020.

11.3 Are there any requirements for financial transactions, including the payment of franchise fees or royalties, to be conducted in local currency?

No, there are no such requirements.

12 Commercial Agency

12.1 Is there a risk that a franchisee might be treated as the franchisor's commercial agent? If so, is there anything that can be done to help mitigate this risk?

A commercial agent is entitled to an indemnity at the end of the agreement pursuant to section 89b German Commercial Code, if the commercial agent has generated new customers for the principal's business, or has significantly increased the extent of business with already existing customers and the principal continues to derive substantial benefits from business with said customers. This right to claim indemnity cannot be waived in advance. German law provides some exemptions; for example, if the agreement is terminated for cause owing to culpable conduct of the commercial agent. As the franchisor or a replacement franchisee can continue to sell to the former franchisee's customers, the franchisee may be entitled to an indemnity as well. Section 89b German Commercial Code applies analogously in the case of termination of a franchise agreement if two conditions are met:

- the franchisee needs to be included in the franchisor's sales organisation to the extent that it has duties that to a considerable extent are financially comparable to those of a commercial agent; and
- the franchisee needs to be contractually obliged to (directly or indirectly) transfer its customer base to the franchisor no later than at the termination of the agreement.

Regarding this, in order to mitigate the risk of an indemnity payment, franchisors should make sure that the franchise agreement does not stipulate an obligation to transfer the franchisee's customer base to the franchisor – neither directly nor indirectly.

13 Good Faith and Fair Dealings

13.1 Is there any overriding requirement for a franchisor to deal with a franchisee in good faith and to act fairly in its dealings with franchisees according to some objective test of fairness and reasonableness?

German law stipulates that the parties to a contract effect performance according to the requirements of good faith (section 242 German Civil Code). This is a basic principle of German law and a 'general provision', enabling a court to tailor its decision to the circumstances of the particular case. An implementation of this basic principle of good faith is the assessment of standard terms and conditions in terms of its reasonableness pursuant to section 307 German Civil Code. The principle of good faith requires that contractual rights are exercised in a manner consistent with good faith. However, the decision whether a certain behaviour violates the principle of good faith depends on the facts of the individual case. Courts make restrained use of the principle of good faith and refrain from introducing new contractual terms that might be regarded as more appropriate by means of this sweeping clause.

13.2 Is there any limitation on a good faith obligation being unenforceable if it only applies from franchisee to franchisor, rather than being mutual?

Under German law, each party must act in good faith in the exercise of its rights and the performance of its obligations. This duty is therefore always mutual and does not only apply from franchisee to franchisor. As the principle of good faith is the basic principle of German law, the law cannot be restricted in favour of one party.

14 Ongoing Relationship Issues

14.1 Are there any specific laws regulating the relationship between franchisor and franchisee once the franchise agreement has been entered into?

As well as the offer and sale of franchises, the ongoing relationship between franchisor and franchisee is only governed by the general provisions of the German Civil Code, the German Commercial Code, German competition and antitrust law (see question 1.2). In practice, the laws of the German Civil Code concerning standard terms play an important role for the ongoing franchise relationship; for example, regarding franchisees' obligation to effect changes to the franchise system that are introduced by the franchisor during the term of the agreement.

15 Franchise Renewal

15.1 What disclosure obligations apply in relation to a renewal of an existing franchise at the end of the franchise agreement term?

In relation to a renewal of an existing franchise, no specific disclosure obligations apply that exceed the franchisor's continuing disclosure obligations to existing franchisees as described in question 1.7.

15.2 Is there any overriding right for a franchisee to be automatically entitled to a renewal or extension of the franchise agreement at the end of the initial term irrespective of the wishes of the franchisor not to renew or extend?

According to German law, the renewal of a franchise agreement is exclusively subject to agreement between the parties. Therefore, a franchisor may refuse to renew the franchise agreement without having to give reasons for its decision.

15.3 Is a franchisee that is refused a renewal or extension of its franchise agreement entitled to any compensation or damages as a result of the non-renewal or refusal to extend?

The franchisors' freedom to refuse the renewal of the franchise agreement may be limited under particular circumstances. From the principle of good faith derives a certain protection for investments made by the franchisee at the franchisor's instigation shortly before the termination of the franchise agreement. For example, if a franchisor has announced its intention to renew the franchise agreement and thereby encouraged the franchisee to further investments on the verge of contract expiry, the refusal to renew the franchise agreement without good reason may entitle the franchisee to claim damages.

16 Franchise Migration

16.1 Is a franchisor entitled to impose restrictions on a franchisee's freedom to sell, transfer, assign or otherwise dispose of the franchised business?

It is possible to regulate such restrictions within the franchise agreement. Normally, the transfer of the franchise is subject to the franchisor's prior written approval in order to protect the

know-how and integrity of the franchise system and to prevent entry of the franchisor's competitors. Likewise, it is possible (and enforceable) to make the franchisee's transfer of ownership (including assignment or pledge) in the franchisee entity subject to the prior approval of the franchisor.

16.2 If a franchisee is in breach and the franchise agreement is terminated by the franchisor, will a "step-in" right in the franchise agreement (whereby the franchisor may take over the ownership and management of the franchised business) be recognised by local law, and are there any registration requirements or other formalities that must be complied with to ensure that such a right will be enforceable?

A 'step-in' right would be subject to the German law regarding standard terms and conditions, which basically means a test of whether the clause is reasonable or not (fairness test). This means that the step-in right would have to be drafted carefully and fairly in order to comply with German law and be enforceable. However, a step-in right is not subject to a registration requirement.

16.3 If the franchise agreement contains a power of attorney in favour of the franchisor under which it may complete all necessary formalities required to complete a franchise migration under pre-emption or "step-in" rights, will such a power of attorney be recognised by the courts in the jurisdiction and be treated as valid? Are there any registration or other formalities that must be complied with to ensure that such a power of attorney will be valid and effective?

Given that the implementation of a step-in right/purchase option itself bears a risk of being considered an undue disadvantage of the franchisee (see question 16.2), such power of attorney would most likely not be valid.

17 Electronic Signatures and Document Retention

17.1 Are there any specific requirements for applying an electronic signature to a franchise agreement (rather than physically signing a "wet ink" version of the agreement), and are electronic signatures recognised as a valid way of creating a binding and enforceable agreement?

German law does not provide for a certain form requirement for franchise agreements. Hence, a franchise agreement could be concluded orally as well as by electronic signature. Form requirements might only arise from a franchisee's right of withdrawal (pursuant to section 513 German Civil Code) or a post-term non-compete obligation (pursuant to section 90a German Commercial Code).

However, with regard to possible court proceedings and the question of cogency of proof, a signed 'wet ink' version is advisable. According to section 416 German Code of Civil Procedure, private records and documents shall – to the extent that they are signed by the parties issuing them – establish full proof that the declarations they contain have been made by the parties who prepared such records and documents. According

to section 371a para. 1 German Code of Civil Procedure, the rules concerning the evidentiary value of private records and documents shall be applied only to private electronic documents bearing a qualified electronic signature (as defined in article 3(12) Regulation (EU) No. 910/2014: '*qualified electronic signature means an advanced electronic signature that is created by a qualified electronic signature creation device, and which is based on a qualified certificate for electronic signatures*'). In case of an electronic signature that does not meet the requirements of a qualified electronic signature, in this sense a franchisee could argue in court that it was not actually him who signed the franchise agreement.

17.2 If a signed/executed franchise agreement is stored electronically (either having been signed using e-signatures or a "wet ink" version having been scanned and saved as an electronic file), can the paper version of the agreement be destroyed?

For the existence of the franchise agreement, it is not necessary to store a paper version but, with regard to possible court proceedings, it is advisable not to destroy the paper version of the franchise agreement (see question 17.1). Furthermore, scanned documents alone cannot be used for proceedings in which the claimant relies entirely on documentary evidence according to section 591 German Code of Civil Procedure.

18 Current Developments

18.1 What is the biggest challenge franchising is facing in your jurisdiction and how are franchisors responding to that challenge?

The Coronavirus pandemic is still a threat to many enterprises in the franchise industry, especially those active in the food (fast food restaurants) and leisure sectors (e.g. fitness centres). The biggest threat is still that, due to significantly reduced transactions with customers, both the franchisees and the franchisor have already at least partially lost the basis for their income, and will likely lose further income in this respect. However, what became visible is that franchisees and the franchisor stood together and tried to find solutions (for the stressed relationships – especially with suppliers, landlords and banks), instead of focusing on the legal situation under a franchise agreement and debating about legal questions, such as to what extent franchise fees must be paid notwithstanding the economic difficulties caused by the Coronavirus pandemic. Although such behaviour, at first glance, seems to be a matter of course, it was sometimes quite rarely seen in the market. So, although not really a 'new opportunity', the benefits of a truthful cooperation between franchisee and franchisor became more (and are still) visible during the Coronavirus pandemic, which might be preserved in the future.

Further, like in many other industries, the Coronavirus pandemic accelerated the initiatives in the franchise industry to further develop and intensify the use of digital distribution channels. Although it was already broadly accepted by franchisees with a 'brick-and-mortar' business that an online presence by the franchisor is vital for the whole franchise system, the intensified acceptance of alternative distribution channels due to the Coronavirus pandemic could also bring new opportunities to the franchise industry.



Dr. Tom Billing is a partner at Noerr PartGmbH. As a lawyer he has, over the years, advised on the structure of a number of well-known national and international distribution systems and the expansion of those systems nationally and internationally. Dr. Billing has lectured on various issues of franchising and distribution law. He is the author of several published texts in relation to franchising and contract law. On a regular basis, Dr. Billing is ranked by JUVE publications as one of the lawyers frequently recommended in Germany in the field of franchising.

Noerr PartGmbH
Charlottenstrasse 57
10117 Berlin
Germany

Tel: +49 30 20942 178
Email: tom.billing@noerr.com
URL: www.noerr.com



Dr. Jasmin Schulzweida is a senior associate at Noerr PartGmbH's Hamburg office and advises national and international clients on distribution, commercial and, in particular, franchise law. She specialises in assisting the contractual implementation of franchise systems, as well as expansions of franchise systems. She also advises on the drafting and negotiation of distribution and supply relationships and the enforcement of claims in the supply chain.

Noerr PartGmbH
Jungfernstieg 51
20354 Hamburg
Germany

Tel: +49 40 300397 145
Email: jasmin.schulzweida@noerr.com
URL: www.noerr.com

Noerr PartGmbH is an international partnership with more than 500 attorneys, tax advisors, notaries, and auditors in offices in Germany (Berlin, Dusseldorf, Dresden, Frankfurt, Hamburg and Munich), in Europe (Alicante, Bratislava, Brussels, Bucharest, Budapest, London, Prague and Warsaw) and in New York. Noerr PartGmbH is one of Europe's leading law firms in the field of franchise and distribution law. Noerr PartGmbH advises in all areas of commercial law (e.g. labour law, real estate/property, product liability and corporate law). Leading experts in many legal areas and branches of industry deliver tailor-made, solution-oriented advice based on our industry know-how.

www.noerr.com

||| NOERR

India

LexOrbis



Dr. Shivani Shrivastava



C. R. Jacob

1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

Consumer demand is poised for growth in India, especially since there is a largely unserved market to be capitalised in tier-2 and tier-3 cities. India does not have a franchise law, hence an interpretation of the definition can be inferred from the Finance Act, 1999 in the context of service tax, which has since been repealed following the introduction of goods and service tax (GST). From the Finance Act, 1999, one can define a franchise as an agreement that grants the franchisee the right to sell or manufacture goods, provide services, or undertake any process identified with the franchisor, whether or not a trademark, service mark, trade name or logo, is involved.

1.2 What laws regulate the offer and sale of franchises?

Parties involved in the Franchise agreement must take cognisance of the applicable Goods and services tax (GST) and Income tax. Generally, the offer and sale of franchises find a legal basis in laws such as:

- The Indian Contract Act, 1872.
- The Foreign Exchange Management Act, 1999 (FEMA).
- The Competition Act, 2002.
- The Trademarks Act, 1999.
- The Copyright Act, 1957.
- The Patents Act, 1970.
- The Design Act, 2000.
- The Income Tax Act, 1961.
- The Arbitration and Conciliation Act, 1996.
- The Specific Relief Act, 1963.
- The Information Technology Act, 2000.

1.3 If a franchisor is proposing to appoint only one franchisee/licensee in your jurisdiction, will this person be treated as a “franchisee” for purposes of any franchise disclosure or registration laws?

In India, it is frequently observed that business structures involve the franchisor granting master franchise rights to a single franchisee for the entire country. Alternatively, the franchisor may choose to appoint multiple franchisees, with each franchisee assigned to a specific jurisdiction.

1.4 Are there any registration requirements relating to the franchise system?

Registration is not obligatory, but it is necessary to obtain Goods and Services Tax (GST) registration based on the turnover.

1.5 Are there mandatory pre-sale disclosure obligations?

There is no legal requirement that compels a franchisor to disclose information to a franchisee. Generally, franchise transactions are conducted in good faith, and it is the responsibility of both parties to conduct thorough due diligence before entering into a franchising agreement. However, it is considered best practice to have a franchisee disclosure document in place as it enhances the credibility of the franchisor and franchisee in the arrangement.

1.6 Do pre-sale disclosure obligations apply to sales to sub-franchisees? Who is required to make the necessary disclosures?

There are no specific pre-sale disclosure obligations.

1.7 Is the format of disclosures prescribed by law or other regulation, and how often must disclosures be updated? Is there an obligation to make continuing disclosure to existing franchisees?

There are no specific statutory obligations to make continuing disclosure to existing franchisees.

1.8 What are the consequences of not complying with mandatory pre-sale disclosure obligations?

In the absence of specific statutes governing franchising and pre-sale disclosure obligations, any failure to comply would be addressed under the common law doctrine of equity.

1.9 Are there any other requirements that must be met before a franchise may be offered or sold?

There are no statutory requirements, but it is good practice to conduct due diligence, protect trademarks, and have watertight franchise contracts in compliance with the Indian Contract Act, 1872.

1.10 Is membership of any national franchise association mandatory or commercially advisable?

There is no requirement for membership in any national franchise association.

1.11 Does membership of a national franchise association impose any additional obligations on franchisors?

Since there is no requirement for membership in a national franchise association, there exist no other obligations. It is completely at the discretion of parties involved in franchising to be part of any national franchise association.

1.12 Is there a requirement for franchise documents or disclosure documents to be translated into the local language?

There is no requirement for any translation into a local language.

2 Business Organisations Through Which a Franchised Business Can be Carried On

2.1 Are there any foreign investment laws that impose restrictions on non-nationals in respect of the ownership or control of a business in your jurisdiction?

Any franchisor from outside India who wishes to invest in an Indian company should first be aware of India's foreign direct investment (FDI) policy. According to FDI policy, investments can be made by non-residents in the: equity shares; fully, compulsorily, and mandatorily convertible debentures; and fully, compulsorily, and mandatorily convertible preference shares of an Indian company, through the Automatic Route or the Government Route. Under the Automatic Route, the non-resident investor or the Indian company does not require any approval from the Government of India for the investment. Under the Government Route, prior approval of the Government of India is required. Proposals for foreign investment under the Government Route are considered by the respective administrative ministry/department. Further, payments to the overseas franchisor must conform to the Reserve Bank of India (RBI) norms and FEMA regulations.

2.2 What forms of business entity are typically used by franchisors?

There are various business structures that franchisors can opt for. A franchisor can establish a presence in India through a subsidiary or a joint venture. If a subsidiary is being set up, the franchise should follow the guidelines laid down by the FDI policy and check for compliances regarding the percentage stake that a foreign national can have and the type of incorporation of the new subsidiary, i.e., as a private limited company or any other type of incorporation.

2.3 Are there any registration requirements or other formalities applicable to a new business entity as a pre-condition to being able to trade in your jurisdiction?

If a new business entity is created, then the new entity must be registered under a relevant business incorporation structure, i.e.,

a private limited company or limited liability partnership. The new entity must apply for relevant tax certificates such as GST.

3 Competition Law

3.1 Provide an overview of the competition laws that apply to the offer and sale of franchises.

The Competition Act, 2002 deals with the prohibition of agreements that are anti-competitive and arrangements that constitute abuse of a dominant position. Recently, the highly anticipated Competition (Amendment) bill, 2023 was passed by both the lower house and the upper house of the Indian parliament and came into effect on April 11, 2023, after receiving assent from the President. One of the important changes made in the Amendment Act is the deal value threshold. A person or business is not allowed to participate in a combination, such as a merger, acquisition, or amalgamation, under the Amendment Act, if it could have a significant negative impact on competition. The definition of combination has been widened by the Amendment Act to now encompass deals with a value greater than INR 2000 crore (about GBP 192 million). Additionally, transactions involving businesses that have "substantial business operations in India" must be reported.

Another important facet of the Amendment Act is with regard to IPR. According to the Act's Section 3, an entity's Intellectual Property Rights in Copyright, Patents, Trademarks, and Designs may be utilised as a defence in cases involving anti-competitive agreements. However, this justification is not available in cases involving the abuse of a dominating position. The Amendment Act has not changed this position, and entities cannot use the protection of their IPRs as a defence in cases involving unfair/discriminatory pricing, predatory pricing, conditions in the purchase or sale of goods or services, limitations, or restrictions on the production of goods, technological or scientific development relating to goods or services to the detriment of consumers, denying other players access to the market, or any other abuse of a dominant position.

3.2 Is there a maximum permitted term for a franchise agreement?

There is no maximum or minimum term for a franchise agreement, and it is at the discretion of the franchisor and franchisee to set the term in the agreement.

3.3 Is there a maximum permitted term for any related product supply agreement?

No, there is no maximum permitted term.

3.4 Are there restrictions on the ability of the franchisor to impose minimum resale prices?

A franchisor can control the prices at which its franchisee partner resells its products in India provided that the terms of the agreement and price control mechanism comply with the provisions of the Competition Act, 2002. This resale price provision is referred to as resale price maintenance (RPM). Care must be taken to have RPM, as they may attract the scrutiny of the Competition Commission (CCT) by being anti-competitive.

3.5 Encroachment – are there any minimum obligations that a franchisor must observe when offering franchises in adjoining territories?

There are no minimum obligations that a franchisor must observe; however, it is based on the territory assigned in a franchise agreement. The territory assigned can differ in each agreement, i.e., it can be exclusive or non-exclusive. The territory assigned can include an exclusive territory, i.e., when a franchise is sold with an exclusive territory, it means the franchisor cannot sell other franchises in that area. The second form of territorial franchising is on a non-exclusive territory basis, i.e., where a franchise is sold in a non-exclusive territory, the franchisor can sell other franchises to people in that territory.

3.6 Are in-term and post-term non-compete and non-solicitation of customers covenants enforceable?

Both in-term and post-term non-compete and non-solicitation covenants can be enforceable if found reasonable and not a complete restraint of trade.

4 Protecting the Brand and Other Intellectual Property

4.1 How are trade marks protected?

Trademark registration in India is regulated by the Trademark Act of 1999. This legislation outlines the procedures for registering trademarks and the enforcement of trademark rights in cases of infringement. Under Indian trademark law, significant importance is given to the prior use of a mark.

To obtain registration, an application must be filed with the Indian Trademark Registry. It is important to note that trademark rights are limited to the territory of India. A trademark registered in India is only valid within the country. The initial validity period of a registered trademark is 10 years, and it can be renewed periodically.

Trademark registration grants exclusive rights to the registered owner for using the trademark and provides recourse in cases of trademark infringement. Additionally, Indian laws recognise the concept of “passing off” under common law tort. This allows users to take legal action against unauthorised use of an unregistered trademark. In such cases, it is necessary to establish that the business’s goodwill or reputation is associated with the unregistered trademark.

4.2 Are know-how, trade secrets and other business-critical confidential information (e.g. the Operations Manual) protected by local law?

India lacks dedicated legislation to protect know-how, trade secrets, and other confidential business information. Nevertheless, such intellectual assets can be safeguarded under common law principles, contractual agreements, and relevant statutes such as the Indian Contract Act of 1872, the Indian Penal Code of 1860, the Copyright Act of 1957, etc.

4.3 Is copyright (in the Operations Manual or in proprietary software developed by the franchisor and licensed to the franchisee under the franchise agreement) protected by local law?

Certainly, the operations manual and proprietary software created by the franchisor and licensed to the franchisee through

the franchise agreement can be safeguarded under the Copyright Act of 1957. It is important to note that copyright registration is not compulsory in India. However, obtaining a copyright registration certificate can serve as *prima facie* evidence in legal proceedings pertaining to copyright infringement.

5 Liability

5.1 What remedies can be enforced against a franchisor for failing to comply with mandatory disclosure obligations? Is a franchisee entitled to rescind the franchise agreement and/or claim damages?

There are no specific legal requirements for disclosure in franchising. Nevertheless, a franchisee has the option to take legal action against a franchisor for non-compliance with mandatory disclosure obligations. In such cases, a franchisee may initiate a civil lawsuit or file a criminal complaint for criminal breach of trust. The entitlement to rescind the franchise agreement or claim damages would be contingent upon the terms and conditions outlined in the franchise agreement.

5.2 In the case of sub-franchising, how is liability for disclosure non-compliance or for pre-contractual misrepresentation allocated between franchisor and master franchisee? If the franchisor takes an indemnity from the master franchisee in the Master Franchise Agreement, are there any limitations on such an indemnity being enforceable against the master franchisee?

Regarding sub-franchising, the responsibility for disclosing non-compliance or pre-contractual misrepresentation would be determined by the contractual agreement established between the franchisor and the master franchisee. The specific terms and provisions outlined in the contract would dictate the liability and obligations related to disclosure and misrepresentation in the sub-franchise arrangement.

5.3 Can a franchisor successfully avoid liability for pre-contractual misrepresentation by including a disclaimer in the franchise agreement?

Disclaimer clauses in an agreement are acceptable in India. As per the Indian Contract Act, 1872, “when consent to an agreement is caused by coercion, fraud or misrepresentation, the agreement is a contract voidable at the option of the party whose consent was so caused”. Therefore, the franchisee has the option to rescind the contract in the case of pre-contractual misrepresentation. However, including a disclaimer in the franchise agreement can limit the remedies excluding the right to revoke the agreement.

5.4 Does local law permit class actions to be brought by a number of aggrieved franchisees and, if so, are class action waiver clauses enforceable?

Indian law permits class actions to be brought by a number of aggrieved franchisees. As per the Code of Civil Procedure, 1908 (Order 1 Rule 8) “one person may sue or defend on behalf of all in same interest”. Section 28 of the Indian Contract Act, 1872 states that any agreement that restrains any of the parties enforcing his legal rights is void. Therefore, any illegal waiver is not allowed in India. Even though the provision of class action suits exists for aggrieved franchisees, they are not very common.

6 Governing Law

6.1 Is there a requirement for franchise documents to be governed by local law? If not, is there any generally accepted norm relating to choice of governing law, if it is not local law?

There is no obligatory mandate for franchise documents to be governed by local laws. The decision regarding the governing law is left to the discretion of the franchisor and franchisee. There is no universally established standard or norm concerning the choice of governing law in franchise agreements.

6.2 Do the local courts provide a remedy, or will they enforce orders granted by other countries' courts, for interlocutory relief (injunction) against a franchisee to prevent damage to the brand or misuse of business-critical confidential information?

Yes, Indian laws may enforce orders granted by other countries' courts. Indian law also entertains applications for interlocutory relief and enforces any order to prevent damage to the brand or misuse of business-critical confidential information.

6.3 Is arbitration recognised as a viable means of dispute resolution and is your country a signatory to the New York Arbitration Convention on the Recognition and Enforcement of Foreign Arbitral Awards? Do businesses that accept arbitration as a form of dispute resolution procedure generally favour any particular set of arbitral rules?

Yes, arbitration is recognised as a viable means of dispute resolution in India. India is a signatory to the New York Arbitration Convention. The Indian arbitration is governed and regulated by the Arbitration and Conciliation Act, 1996, which derives its basis from the 1985 UNCITRAL Model on International Commercial Arbitration and the UNCITRAL Arbitration Rules of 1976.

The Mumbai Centre for International Arbitration, Delhi International Arbitration Centre, and Arbitration & Conciliation Centre – Bengaluru are amongst the most popular domestic arbitral institutions. When domestic arbitral institutions are not chosen, the International Chamber of Commerce, Singapore International Arbitration Centre, London Centre of International Arbitration, and Hong Kong International Arbitration Centre are often the preferred institutions for arbitration.

7 Real Estate

7.1 Generally speaking, is there a typical length of term for a commercial property lease?

In India, the length of term for a commercial property lease is typically negotiated between the landlord and the tenant based on their mutual agreement. Indian laws do not specify a specific or mandatory length of term for commercial property leases. The lease term can vary and is influenced by factors such as the nature of the business, rental market conditions, and the preferences of the parties involved. It is common for commercial leases in India to have terms ranging from three to 10 years, but the actual duration can be shorter or longer based on the agreement reached between the landlord and tenant. It is important for both parties to clearly define the lease term and other terms and conditions in a written lease agreement to ensure legal clarity and protection of their respective rights.

7.2 Is the concept of an option/conditional lease assignment over the lease (under which a franchisor has the right to step into the franchisee/tenant's shoes under the lease, or direct that a third party (often a replacement franchisee) may do so upon the failure of the original tenant or the termination of the franchise agreement) understood and enforceable?

In India, the concept of an option/conditional lease assignment, where a franchisor has the right to step into the franchisee/tenant's shoes under the lease or direct a third party (such as a replacement franchisee) to do so upon the failure of the original tenant or termination of the franchise agreement, is generally understood and enforceable.

The enforceability of such provisions will depend on various factors, including the specific terms and conditions of the lease agreement, any applicable laws or regulations, and the interpretation of the courts. It is crucial to ensure that the lease agreement clearly outlines the rights, obligations, and conditions related to an option/conditional lease assignment to avoid ambiguity and potential disputes.

7.3 Are there any restrictions on non-national entities holding any interest in real estate, or being able to sub-lease property?

According to Indian laws, there are restrictions on non-national entities holding an interest in real estate or being able to sub-lease property. The acquisition and ownership of real estate in India by non-national entities are regulated under the Foreign Exchange Management Act (FEMA) and the regulations issued by the Reserve Bank of India (RBI).

Non-national entities, including foreign companies, are generally prohibited from directly acquiring or owning agricultural land in India. However, they may be allowed to acquire and own immovable property for specific purposes, such as establishing a branch office, liaison office, or wholly owned subsidiary for conducting business activities in India. Such acquisitions would typically require prior approval from the RBI or comply with prescribed conditions.

Similarly, the sub-leasing of property by non-national entities is subject to restrictions and would need to comply with applicable laws and regulations. The specific terms and conditions for sub-leasing, including the eligibility and permissions required, would depend on the nature of the property and the purpose of the sublease.

7.4 Give a general overview of the commercial real estate market. To what extent has the real estate market been affected by the Coronavirus pandemic? Specifically, can a tenant expect to secure an initial rent free period when entering into a new lease (and if so, for how long, generally), or are landlords demanding "key money" (a premium for a lease in a flagship location)?

The Union Cabinet approved the Model Tenancy Act in 2021 and it has since been sent to the various Indian states for adaptation. According to the Act, the security deposit will be an utmost of two months of monthly rent for residential premises and six months of monthly rent for Commercial premises.

Like any other market, the commercial real estate market also depends on supply and demand, which has been severely affected by the COVID-19 pandemic due to lockdowns across the country and the remote working of the workforce. Rent-free periods or key money depend on the negotiating capabilities of

the parties and the nature of the property. However, considering the current situation of the COVID-19 pandemic, the likelihood of rent-free periods has increased. Typically, a rent-free period is one to three months, but more can be negotiated. Demanding key money based on a premium location is very common, although the same has also been reduced by up to 50 per cent in the current situation.

8 Online Trading

8.1 If an online order for products or request for services is received from a potential customer located outside the franchisee's exclusive territory, can the franchise agreement impose a binding requirement for the request to be re-directed to the franchisee for the territory from which the sales request originated?

There are no statutory restrictions in India, although these can be enforced if mentioned in the franchise agreement.

8.2 Are there any limitations on a franchisor being able to require a former franchisee to assign local domain names to the franchisor on the termination or expiry of the franchise agreement?

There are no limitations on a franchisor being able to require a former franchisee to assign local domain names to the franchisor on the termination or expiry of the franchise agreement.

9 Termination

9.1 Are there any mandatory local laws that might override the termination rights one might typically expect to see in a franchise agreement?

In India, there are no specific mandatory local laws that explicitly override the termination rights typically included in a franchise agreement. The termination rights in a franchise agreement are generally governed by the contractual terms agreed upon by the franchisor and franchisee. However, it is important to consider that the termination provisions must comply with applicable laws and regulations, such as the Indian Contract Act, 1872, which governs the validity and enforceability of contracts in India.

Under the Indian Contract Act, parties have the right to terminate a contract based on the agreed-upon terms or due to certain specified circumstances, such as a breach of contract. Additionally, Indian courts may intervene in cases where termination is done unfairly or arbitrarily, and they may provide remedies or damages to the aggrieved party.

9.2 Are there local rules that impose a minimum notice period that must be given to bring a business relationship that has existed for a number of years to an end, which will apply irrespective of the length of the notice period set out in the franchise agreement?

Under Indian laws, there are no specific local rules that impose a minimum notice period for ending a business relationship, such as a franchise agreement, irrespective of the notice period mentioned in the agreement. The notice period for terminating a business relationship, including a franchise agreement, is generally governed by the terms and conditions specified in the agreement itself.

The Indian Contract Act, 1872, provides the framework for contract termination, which includes the right to terminate based on the agreed-upon terms and conditions. Parties are expected to adhere to the contractual obligations and notice periods as mutually agreed upon in the franchise agreement.

It is important for franchisors and franchisees to carefully review and negotiate the notice provisions in the franchise agreement to ensure they comply with their intended business relationship and provide sufficient notice for termination. Parties can agree on specific notice periods that meet their requirements, taking into consideration the nature of the business, industry practices, and any specific legal provisions that may be applicable.

10 Joint Employer Risk and Vicarious Liability

10.1 Is there a risk that a franchisor may be regarded as a joint employer with the franchisee in respect of the franchisee's employees? If so, can anything be done to mitigate this risk?

In general, a franchisor is not responsible for the acts/omissions of a franchisee's employees. A franchisee is an independent contractor, and no agency relationship exists between a franchisor and a franchisee. The franchisee is solely responsible for its day-to-day operations and the Indian courts will not find a franchisor to be vicariously liable for its franchisee's acts/omissions. However, in the event there is a principal-agent relationship or an employer-employee relationship between the franchisor and the franchisee, the franchisor could be held liable for any acts/omissions committed by the franchisee contrary to the agreement, during the course of the business.

10.2 Is there a risk that a franchisor may be held to be vicariously liable for the acts or omissions of a franchisee's employees in the performance of the franchisee's franchised business? If so, can anything be done to mitigate this risk?

A franchisor would not typically be held vicariously liable for the acts of the franchisee's employees, as the franchisor-franchisee relationship is a principal-to-principal relationship. In the event there is a principal-agent relationship or an employer-employee relationship, the franchisor could be held liable for any acts/omissions committed by the franchisee's employees.

11 Currency Controls and Taxation

11.1 Are there any restrictions (for example exchange control restrictions) on the payment of royalties to an overseas franchisor?

Payments of royalties to an overseas franchisor for use of trademark, or fees for technical services or other services under the franchise agreement are governed by foreign exchange regulations under the FEMA. According to the Security Exchange Board of India (SEBI), payments made to related parties overseas towards brand usage or royalty may be considered material if the transaction(s) exceed five per cent of the annual consolidated turnover of the listed entity during a financial year and would require approval of the shareholders, with no related party having a vote to approve such resolutions. In short, royalty payments should not exceed 5 per cent on local sales and 8 per cent on exports and lump-sum payment does not exceed USD 2 million.

11.2 Are there any mandatory withholding tax requirements applicable to the payment of royalties under a trade mark licence or in respect of the transfer of technology? Can any withholding tax be avoided by structuring payments due from the franchisee to the franchisor as a management services fee rather than a royalty for the use of a trade mark or technology?

The direct taxation of the franchisee arrangement is governed by the Income Tax Act, 1961. Where there is any payment in the form of royalty or franchise fees to the franchisor, the franchisee is required to deduct a withholding tax of 10 per cent on the payments made. However, if the franchisor is overseas and is entitled to double tax agreement benefits agreed by India, then the franchisor can claim the benefit of the more beneficial tax provisions.

11.3 Are there any requirements for financial transactions, including the payment of franchise fees or royalties, to be conducted in local currency?

No, there is no such requirement.

12 Commercial Agency

12.1 Is there a risk that a franchisee might be treated as the franchisor's commercial agent? If so, is there anything that can be done to help mitigate this risk?

The franchisor-franchisee relationship is a principal-to-principal relationship. If the franchisee has been given the power to conclude contracts on behalf of the franchisor, then the latter runs the risk of treating the franchisee as a commercial agent. The underlying contract and business terms need to be carefully drafted in the franchise agreement to avoid such risks.

13 Good Faith and Fair Dealings

13.1 Is there any overriding requirement for a franchisor to deal with a franchisee in good faith and to act fairly in its dealings with franchisees according to some objective test of fairness and reasonableness?

Under Indian laws, there is no specific statutory requirement for a franchisor to deal with a franchisee in good faith or to act fairly in its dealings with franchisees according to an objective test of fairness and reasonableness. The relationship between a franchisor and a franchisee is primarily governed by the terms and conditions outlined in the franchise agreement.

However, it is important to note that the Indian Contract Act, 1872, which governs the general principles of contract law in India, imposes an obligation of good faith on the parties to a contract. This means that the parties are expected to act honestly and reasonably in their contractual dealings. While the Act does not specifically address franchising, the principle of good faith is generally recognised and applied by Indian courts in contractual relationships.

In practice, it is advisable for franchisors to deal with franchisees fairly and reasonably to maintain a positive working relationship and protect the reputation of their brand. This can include providing support, timely communication, and addressing any concerns or disputes reasonably and transparently. Operating in good faith and acting fairly in dealings with franchisees can help foster a successful and sustainable franchise system.

Franchise agreements often include provisions that outline the rights, responsibilities, and expectations of both parties. It is

crucial to review and negotiate the terms of the franchise agreement carefully to ensure a fair and balanced relationship between the franchisor and franchisee.

While there is no specific legal requirement for good faith dealing, parties may seek legal remedies if there are instances of bad faith, fraud, or unconscionable conduct that could be challenged under general contract law principles or other applicable laws.

13.2 Is there any limitation on a good faith obligation being unenforceable if it only applies from franchisee to franchisor, rather than being mutual?

There is no limitation on good faith obligations being unenforceable. In case of a breach of trust between the parties, legal remedies exist for both parties.

14 Ongoing Relationship Issues

14.1 Are there any specific laws regulating the relationship between franchisor and franchisee once the franchise agreement has been entered into?

In India, there are no specific laws that exclusively regulate the relationship between franchisors and franchisees once the franchise agreement has been entered into. The rights and obligations of both parties are primarily governed by the terms and conditions stipulated in the franchise agreement itself.

However, certain general laws and regulations may apply to aspects of the franchisor-franchisee relationship. These can include:

- **Indian Contract Act, 1872:** The general principles of contract law govern the validity, interpretation, and enforcement of the franchise agreement. It establishes the contractual rights and obligations of both parties and provides remedies for breaches of contract.
- **Competition Law:** The Competition Act, 2002, regulates anti-competitive practices and prohibits agreements that cause an appreciable adverse effect on competition. Franchise agreements that include provisions restricting competition may be subject to scrutiny under this law.
- **Intellectual Property Laws:** Franchise agreements often involve the use of intellectual property, such as trademarks, copyrights, or patents. The Trademarks Act, 1999, the Copyright Act, 1957, and other relevant intellectual property laws govern the protection and enforcement of these rights.
- **Consumer Protection Laws:** The Consumer Protection Act, 2019, aims to protect the interests of consumers and provide remedies in case of unfair trade practices. Franchisees who are considered consumers may seek recourse under this law for any unfair treatment or deceptive practices.

While there are no specific laws governing the ongoing relationship between franchisors and franchisees, both parties need to adhere to the terms of the franchise agreement, maintain open communication, and resolve any disputes or issues amicably.

15 Franchise Renewal

15.1 What disclosure obligations apply in relation to a renewal of an existing franchise at the end of the franchise agreement term?

In India, there are no specific statutory disclosure obligations that apply specifically to the renewal of an existing franchise at

the end of the franchise agreement term. The renewal process and the obligations associated with it are primarily governed by the terms and conditions outlined in the original franchise agreement.

Typically, the renewal provisions, including the terms, conditions, and requirements for renewal, are outlined in the initial franchise agreement. It is crucial for both the franchisor and franchisee to carefully review these provisions to understand their rights and obligations regarding the renewal process.

In practice, the franchisor should provide the franchisee with any necessary information and documentation relevant to the renewal decision. This may include updated terms, conditions, fees, or any changes that would be applicable for the renewed term. Open communication between the parties is essential to ensure a smooth renewal process.

Franchise agreements often include provisions regarding the notice period for renewal, the franchisee's eligibility for renewal, any renewal fees, and any conditions or requirements that must be met for renewal to occur. Both parties should adhere to these provisions and follow the agreed-upon renewal process.

While there are no specific disclosure obligations for renewal, it is generally considered good business practice for the franchisor to provide the franchisee with relevant information to make an informed decision about whether to renew the franchise agreement. This may include financial disclosures, updated operations manuals, or any other relevant information that would assist the franchisee in evaluating the renewal opportunity.

15.2 Is there any overriding right for a franchisee to be automatically entitled to a renewal or extension of the franchise agreement at the end of the initial term irrespective of the wishes of the franchisor not to renew or extend?

There is no such right for a franchisee to be automatically entitled to a renewal or extension of the franchise agreement at the end of the initial term, and it is at the discretion of the parties to set the terms related to the renewal or extension of the franchise agreement.

15.3 Is a franchisee that is refused a renewal or extension of its franchise agreement entitled to any compensation or damages as a result of the non-renewal or refusal to extend?

The franchisee may be entitled to any compensation or damages if the franchise agreement has any clause related to the renewal or extension.

16 Franchise Migration

16.1 Is a franchisor entitled to impose restrictions on a franchisee's freedom to sell, transfer, assign or otherwise dispose of the franchised business?

The franchisor can validly restrict a franchisee from selling, transferring, assigning, or disposing of its franchise. To make restrictions effective, relevant terms and conditions must be expressly provided in the franchise agreement.

16.2 If a franchisee is in breach and the franchise agreement is terminated by the franchisor, will a "step-in" right in the franchise agreement (whereby the franchisor may take over the ownership and

management of the franchised business) be recognised by local law, and are there any registration requirements or other formalities that must be complied with to ensure that such a right will be enforceable?

Yes, one can include "step-in" rights in the franchise agreement; however, the "step-in" rights must be drafted under FEMA regulations. In the event of a breach in the franchise agreement, the franchisor, if a foreign company, cannot directly enter into a lease for the property in India, except in limited circumstances. In this scenario, the franchisor will need to establish a legal entity in India to whom the franchise may be assigned.

16.3 If the franchise agreement contains a power of attorney in favour of the franchisor under which it may complete all necessary formalities required to complete a franchise migration under pre-emption or "step-in" rights, will such a power of attorney be recognised by the courts in the jurisdiction and be treated as valid? Are there any registration or other formalities that must be complied with to ensure that such a power of attorney will be valid and effective?

While the existing power of attorney can be used to ascertain the powers entitled to the franchisor as provided in the franchise agreement, it is advisable to have a separate power of attorney to complete all necessary formalities required for the migration of the franchise.

17 Electronic Signatures and Document Retention

17.1 Are there any specific requirements for applying an electronic signature to a franchise agreement (rather than physically signing a "wet ink" version of the agreement), and are electronic signatures recognised as a valid way of creating a binding and enforceable agreement?

Electronic signatures that meet the requirements of the Information Technology Act, 2000 are considered at par with agreements executed with wet ink and are recognised as a valid way of creating and binding an enforceable agreement.

17.2 If a signed/executed franchise agreement is stored electronically (either having been signed using e-signatures or a "wet ink" version having been scanned and saved as an electronic file), can the paper version of the agreement be destroyed?

Executed franchise agreements stored electronically are valid for any future use. However, it is advisable to keep the paper version of the agreement.

18 Current Developments

18.1 What is the biggest challenge franchising is facing in your jurisdiction and how are franchisors responding to that challenge?

Tier-2 and tier-3 cities in India have a lot of scope for business expansion. However, there are challenges while doing business in India by way of the franchise model, some of them being finding the right franchisee partners as well as logistics that can cater to tier-2 and tier-3 cities.



Dr. Shivani Shrivastava is an Advocate and a registered Patent and Trademark Agent, and is currently an Associate Partner at Lexorbis. With over 17 years of professional experience, she specialises in the field of Intellectual Property (IP). Her educational background includes a Ph.D. in Bioinformatics and an M.Sc. in Plant Science. In addition, she has completed the Executive Programme (TLPWE) from IIM Calcutta. Dr. Shivani Shrivastava actively engages with clients, playing a crucial role in managing their IP portfolios. Her expertise extends to providing guidance and mentorship to individuals, start-ups, and small and medium enterprises, assisting them in developing effective IP strategies and managing their IP portfolios. She is well-versed in various aspects of IP-related business dealings, such as IP valuation, due diligence, technology transfer, and licensing, among others.

LexOrbis

606–607, 6th Floor, Gamma Block, Sigma Soft Tech Park
No.7 Whitefield Main Road, Varthur Hobli
Bengaluru – 560066
India

Tel: +91 80 4324 5900

Email: shivani@lexorbis.com

URL: www.lexorbis.com



C. R. Jacob is a Senior Strategist for Intellectual Property & Business at LexOrbis. At LexOrbis, he regularly advises large and small organisations on their IP strategy, IP prosecution, IP Valuation, and IP commercialisation. He founded IP Astra, a boutique IP firm which was later merged with LexOrbis. He is also the director at BPE Biotree India Pvt Ltd, a company that manufactures bioprocess equipment for vaccine producers, where his role involves investor relations, IP protection, legal compliance, and raising capital for the organisation. Mr. Jacob regularly conducts IP sessions for startups at IIM Kozhikode LIVE startup incubation centre and is also a mentor at the Kerala Startup Mission. He has an M.Tech from Vellore University, a B.Tech from Mangalore University and has done his EPGBM from the IIM, Calcutta. He is a Certified Patent Valuation Analyst (CPVA).

LexOrbis

606–607, 6th Floor, Gamma Block, Sigma Soft Tech Park
No.7 Whitefield Main Road, Varthur Hobli
Bengaluru – 560066
India

Tel: +91 80 4324 5900

Email: jacob@lexorbis.com

URL: www.lexorbis.com

LexOrbis is a premier full-service IP law firm with over 260 personnel including 150+ attorneys at its four Indian offices in New Delhi, Bengaluru, Mumbai, and Chennai. The firm provides client-oriented and cost-effective solutions for the protection, enforcement, transaction, and commercialisation of all forms of intellectual property in India and globally. The firm has been consistently ranked amongst the Top 5 IP firms in India over the past decade and is well-known for managing global patent, designs and trademark portfolios of many technology companies and brand owners. The firm has dedicated teams to cater to the IP lifecycle including attorneys, engineers, scientists, and specialists to deal with patent, trademark and copyright filing, research, portfolio building and management, enforcement, protection, spotting, transacting, procurement, and consultation. The trademark practice group at the firm has over 30 attorneys experienced in partnering with brand owners and advising on the entire IP lifecycle

from selection to enforcement. The team provides risk assessment by conducting trademark searches in over 120 trademark registers across the world and common law searches using advanced internet-based tools. The firm manages large and complex trademark portfolios of many global companies, small and medium enterprises and start-ups expanding businesses in India and overseas.

www.lexorbis.com

LexOrbis | Intellectual
Property Attorneys
& Advocates

Korea

IPG Legal



Sean Hayes



Jiwon Min

1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

In the Republic of Korea (“Korea”), a franchise, in general, is a continuous business relationship under which a franchisor allows a franchisee to use its business marks (trademarks, service works, etc.) to sell goods or services in accordance with certain quality standards, business methods, training and control requirements, in exchange for the payment of a franchise fee (Fair Transactions in Franchise Business Act (“Franchise Act”).

The Korean Fair Trade Commission and the Court of Korea have broadly interpreted the definition to the benefit of the franchisee. The majority of the disputes concerning the definition of a franchise related to the degree of control over the franchisee.

1.2 What laws regulate the offer and sale of franchises?

The Franchise Act and the Fair Transactions in Large Franchises and Retail Business (“LFBA”), are the main governing statutory law governing the relationship between a franchisor and its franchisee. At the same time, the general provisions of the Monopoly Regulation and Fair Trade Act (“MRFTA”), Commercial Act and Civil Act, additionally, regulate franchise relationships.

The Franchise Act, LFBA and MRFTA have detailed and comprehensive enforcement decrees, as well as a substantial body of case law interpreting these statutory laws and enforcement decrees.

1.3 If a franchisor is proposing to appoint only one franchisee/licensee in your jurisdiction, will this person be treated as a “franchisee” for purposes of any franchise disclosure or registration laws?

All relationships that meet the definition of a franchise are governed by Korean Franchise Law, notwithstanding the number of franchisees appointed.

1.4 Are there any registration requirements relating to the franchise system?

Franchises, in Korea, must register a disclosure document with the Korean Fair Trade Commission (“KFTC”) in the Korean language in a format proposed by the KFTC. All franchisees must be provided with the disclosure document, including sub franchisees and master franchisees.

1.5 Are there mandatory pre-sale disclosure obligations?

A franchise must be registered, in Korea, with the KFTC prior to the sale of a franchise.

1.6 Do pre-sale disclosure obligations apply to sales to sub-franchisees? Who is required to make the necessary disclosures?

Pre-sale disclosure obligations apply to sub-franchises. Disclosure may be made by the Master Franchisee if authorised in contract.

1.7 Is the format of disclosures prescribed by law or other regulation, and how often must disclosures be updated? Is there an obligation to make continuing disclosure to existing franchisees?

The KFTC recommends the use of a standard form disclosure document created by the KFTC. IPG Legal recommends the use of the disclosure document to assist in preventing delay.

Disclosure requirements are perpetual and are required to be updated annually.

1.8 What are the consequences of not complying with mandatory pre-sale disclosure obligations?

If a franchisor fails to register a franchise, in Korea: administrative fines may be imposed; the franchise agreement may be deemed null and void; the franchisor may be required to refund fees paid; and/or criminal and civil sanctions may be imposed.

1.9 Are there any other requirements that must be met before a franchise may be offered or sold?

A recent revision to the Korean Franchise Act requires that a franchisor have at least one-year experience operating a directly owned store locally or abroad prior to offering to franchise in Korea. Thus, this requirement needs to be met before approval of the registration of a franchise disclosure document and approval of the franchisor to franchise in Korea. Limited exceptions apply based on the particular unique circumstances.

Furthermore, prior to execution of a franchise agreement, the franchisor must be provided with the franchise agreement, related documents and the disclosure document 14 days (seven if they hired a franchise lawyer or franchise professional) prior to execution of the Agreement.

The Related Documents necessary to be provided to the prospective franchisee include a document noting the location of stores in proximity to the store proposed by the franchisor and a sales projection document.

1.10 Is membership of any national franchise association mandatory or commercially advisable?

Korean Law does not impose a requirement to join a national franchise association.

1.11 Does membership of a national franchise association impose any additional obligations on franchisors?

A franchisor with a registered disclosure documents may apply to the join the Korean Franchise Association. Membership is not mandatory. The Korean Franchise Association has a code of ethics for all members.

1.12 Is there a requirement for franchise documents or disclosure documents to be translated into the local language?

The disclosure document must be in the Korean language.

2 Business Organisations Through Which a Franchised Business Can be Carried On

2.1 Are there any foreign investment laws that impose restrictions on non-nationals in respect of the ownership or control of a business in your jurisdiction?

Few restrictions exist for non-Korean nationals conducting business in Korea. Limited general restrictions exist under the Korean Foreign Promotion law and other related laws and ordinances.

These restrictions do not, typically, affect franchisors. Banned industries include: management of pensions; securities and future exchanges; universities; professional bodies; certain grain cultivation; and financial market management. Share percentage prohibitions exist in which a foreign owner may not own more than 49% interest in the business in the following sectors: broadcasting supply; landline telephone and other wired communications; wireless communications; and other telecommunication businesses.

2.2 What forms of business entity are typically used by franchisors?

Typically, franchisors wishing to have presence in Korea incorporate as *Yuhan Hoesa* (LLC) or *Chusik Hoesa* (stock company). Around 90% of incorporated business, in Korea, are *Chusik Hoesa* (stock companies).

2.3 Are there any registration requirements or other formalities applicable to a new business entity as a pre-condition to being able to trade in your jurisdiction?

There is no requirement for a non-Korean franchisor to register a company in Korea before offering franchises in Korea.

3 Competition Law

3.1 Provide an overview of the competition laws that apply to the offer and sale of franchises.

Korea's Competition Law is, primarily, governed by the MRFTA. The MRFTA prohibits, generally, "unfair trade practices", including: resale price maintenance; product tying; post-term covenants; minimum sales requirements; refusal to deal; abuse of bargaining power; and unfair damage compensation. The main government body that is responsible for enforcement of the MRFTA is the KFTC.

3.2 Is there a maximum permitted term for a franchise agreement?

The typical term for a franchise in Korea is 10 years with the option to renew. No maximum permitted term is declared in law.

3.3 Is there a maximum permitted term for any related product supply agreement?

The typical term for a franchise in Korea is 10 years. Korean Law does not impose a maximum permitted term.

3.4 Are there restrictions on the ability of the franchisor to impose minimum resale prices?

Minimum sale price maintenance regimes are generally prohibited in Korea.

For online sales transactions, the KFTC proactively monitors and imposes corrective orders on businesses it believes are engaged in retail price maintenance. For other transactions, the KFTC has imposed fines and corrective orders, mainly based on complaints by franchisees, consumers and distributors.

Exemptions to the general applicable prohibition exist for: publications; periodicals; books; newspapers; and products designated by the KFTC (no case to date).

3.5 Encroachment – are there any minimum obligations that a franchisor must observe when offering franchises in adjoining territories?

Korea has no set, specific rule regarding minimum obligations that a franchisor must observe when offering franchises in adjoining territories that are not encroaching on the territory defined in the franchise agreement.

3.6 Are in-term and post-term non-compete and non-solicitation of customers covenants enforceable?

In-term and post-term covenants are, generally, enforceable in Korea. Korean courts utilise a "totality of the circumstances" test to determine the enforceability of, for example, a covenant not to compete.

The courts, normally, consider if: (1) a valid business interest of the franchisor exists; (2) the scope of the restriction is narrowly tailored; (3) compensation was paid for such non-compete; and (4) the geographic and temporal scope is narrowly tailored.

Typical franchise agreements, in Korea, impose a one-year post-term covenant against competition.

4 Protecting the Brand and Other Intellectual Property

4.1 How are trade marks protected?

The Korean Trademark act implements a first-to-file system. Thus, in all but a limited number of circumstances (well-known international trademark/violation of good faith obligations as a franchisee or other business relationship), the first to file the trademark is the party with the rights to the trademark.

4.2 Are know-how, trade secrets and other business-critical confidential information (e.g. the Operations Manual) protected by local law?

Know-how, trade secrets and other confidential information is protected by Korea's criminal law and Fair-Trade laws, rules and practices.

4.3 Is copyright (in the Operations Manual or in proprietary software developed by the franchisor and licensed to the franchisee under the franchise agreement) protected by local law?

In most cases of litigation on violation of a copyright to the Operations Manual, challenges are prosecuted under Korea's Criminal Laws and Korea's Fair-Trade laws, rules and regulations.

5 Liability

5.1 What remedies can be enforced against a franchisor for failing to comply with mandatory disclosure obligations? Is a franchisee entitled to rescind the franchise agreement and/or claim damages?

In Korea, if a franchisor fails to register a franchise: administrative fines may be imposed; the franchise agreement may be deemed null and void; the franchisor may be required to refund all fees paid; and/or criminal and civil sanctions may be imposed. Additionally, franchisees have sued franchisors for losses that occurred in civil damage suits.

5.2 In the case of sub-franchising, how is liability for disclosure non-compliance or for pre-contractual misrepresentation allocated between franchisor and master franchisee? If the franchisor takes an indemnity from the master franchisee in the Master Franchise Agreement, are there any limitations on such an indemnity being enforceable against the master franchisee?

Courts have been willing to entertain indemnity clauses, even when they are specifically excluded in contract, mainly where the action of the defendant in the matter was crime.

5.3 Can a franchisor successfully avoid liability for pre-contractual misrepresentation by including a disclaimer in the franchise agreement?

A disclaimer clause shall likely be deemed an invalid clause in

Korea that is in conflict with Korean Franchise Law and other laws.

5.4 Does local law permit class actions to be brought by a number of aggrieved franchisees and, if so, are class action waiver clauses enforceable?

Class actions are available in Korea in only a limited number of cases and, presently, not in cases of disputes between franchisees and franchisors. We advise having a class action waiver in your franchise agreement, since some legal practitioners and scholars have pushed for class action legislation in Korea.

6 Governing Law

6.1 Is there a requirement for franchise documents to be governed by local law? If not, is there any generally accepted norm relating to choice of governing law, if it is not local law?

No requirement exists in Korean Law that the franchise agreement shall be governed by Korean Law. However, many mandatory provisions of Korean Franchise Law and Distribution Law shall invalidate any clauses that are in conflict with these laws. The major compulsory requirements under Korean Law relate to renewal, termination, imposition of cost sharing for remodelling and the protected business territory. Thus, it is essential to have a locally drafted nuanced franchise agreement that addresses the unique features of Korean franchise law.

6.2 Do the local courts provide a remedy, or will they enforce orders granted by other countries' courts, for interlocutory relief (injunction) against a franchisee to prevent damage to the brand or misuse of business-critical confidential information?

Korea only recognises "final and conclusive" foreign judgments; thus, interim relief/injunctions are not enforceable in Korean courts.

6.3 Is arbitration recognised as a viable means of dispute resolution and is your country a signatory to the New York Arbitration Convention on the Recognition and Enforcement of Foreign Arbitral Awards? Do businesses that accept arbitration as a form of dispute resolution procedure generally favour any particular set of arbitral rules?

Arbitration is encouraged in Korea by the courts. Korea is a signatory to the New York Arbitration Convention on the Recognition and Enforcement of Foreign Arbitral Awards. Awards in arbitration are enforceable in Korea.

7 Real Estate

7.1 Generally speaking, is there a typical length of term for a commercial property lease?

Terms depend on the type of property and market area conditions, and are based on landlord practices. No set term is considered accepted.

7.2 Is the concept of an option/conditional lease assignment over the lease (under which a franchisor has the right to step into the franchisee/tenant's shoes under the lease, or direct that a third party (often a replacement franchisee) may do so upon the failure of the original tenant or the termination of the franchise agreement) understood and enforceable?

The practice of step-in rights is not widely known in Korea. However, cases do exist where franchisors have stepped into the relationship based on the terms of the franchisee lease agreement with the landlord.

Typically, consent by a landlord is not difficult to obtain when transferring leases or granting subleases from a franchisor to the franchisee if the market price of the rent did not increase. The main formality when transferring a lease is the transfer of the security and registration of the security deposit with a local government office.

7.3 Are there any restrictions on non-national entities holding any interest in real estate, or being able to sub-lease property?

Foreigners have few restrictions on the owning and leasing of real estate, other than registration requirements. Restrictions only exist with regard to the ownership of certain protected land, such as former military bases.

7.4 Give a general overview of the commercial real estate market. To what extent has the real estate market been affected by the Coronavirus pandemic? Specifically, can a tenant expect to secure an initial rent free period when entering into a new lease (and if so, for how long, generally), or are landlords demanding "key money" (a premium for a lease in a flagship location)?

The Korean Commercial Real Estate market is in a state of transition. The market is being gradually weaned off of "key money". Normally, a deposit is required in the amount of 10 times the monthly rent.

Inflation has drastically increased the value and cost of commercial real estate in major metropolitan areas, and this increase in costs squeezed many food and beverage franchises.

8 Online Trading

8.1 If an online order for products or request for services is received from a potential customer located outside the franchisee's exclusive territory, can the franchise agreement impose a binding requirement for the request to be re-directed to the franchisee for the territory from which the sales request originated?

It is possible to enforce by contract that the franchisee has an affirmative obligation to provide the contact information of the owner of the exclusive territory.

8.2 Are there any limitations on a franchisor being able to require a former franchisee to assign local domain names to the franchisor on the termination or expiry of the franchise agreement?

No limitations exist if the franchise is legally terminated or has legally expired.

9 Termination

9.1 Are there any mandatory local laws that might override the termination rights one might typically expect to see in a franchise agreement?

The Franchise Act is the governing law regulating the termination and non-renewal of franchise agreements that trumps any contrary rules noted in the franchise agreement. If a franchisee requests to renew a franchise during the 90 to 180 days period prior to expiration of the franchise agreement, the franchisor must renew, unless the franchisee is behind on payments; materially breached the franchise agreement; or the franchise is more than 10 years old. Thus, the "guaranteed term" of a franchise for a franchisee in Korea is 10 years (Article 13(1) Franchise Act).

A franchisor may terminate a franchise agreement if they: (1) clearly indicate to the franchisee that the franchise agreement was breached; (2) provided the franchisee two months to remedy the breach; and (3) provide at least two written notices of the breach.

9.2 Are there local rules that impose a minimum notice period that must be given to bring a business relationship that has existed for a number of years to an end, which will apply irrespective of the length of the notice period set out in the franchise agreement?

The normal practice in Korea is to provide 180 days' notice if the franchisor does not intend to renew the franchise. Additionally, the franchisor should comply with the non-renewal and termination requirements noted in question 9.1.

10 Joint Employer Risk and Vicarious Liability

10.1 Is there a risk that a franchisor may be regarded as a joint employer with the franchisee in respect of the franchisee's employees? If so, can anything be done to mitigate this risk?

To date, no cases were concluded in court in which a franchisor was deemed a "joint employer" with a franchisee's employees.

10.2 Is there a risk that a franchisor may be held to be vicariously liable for the acts or omissions of a franchisee's employees in the performance of the franchisee's franchised business? If so, can anything be done to mitigate this risk?

To date, no cases holding a franchisor vicariously liable for the actions of the franchisee's employees exist in Korea.

11 Currency Controls and Taxation

11.1 Are there any restrictions (for example exchange control restrictions) on the payment of royalties to an overseas franchisor?

Korea has foreign exchange control regime. However, over the last few decades liberalisations have occurred that have made it easier to forward funds outside of Korea. Prior to remitting

funds abroad, the sender of the funds must register and open an account with a foreign exchange bank, and sometimes meet information request requirements of the local bank branch.

11.2 Are there any mandatory withholding tax requirements applicable to the payment of royalties under a trade mark licence or in respect of the transfer of technology? Can any withholding tax be avoided by structuring payments due from the franchisee to the franchisor as a management services fee rather than a royalty for the use of a trade mark or technology?

In Korea, withholding taxes are governed, in most cases, by an applicable treaty. For example, Article 14(1) of the Tax Convention with the Korea and United States of America (August 14, 1976) imposes a 15% withholding tax and a 10% surcharge, making the effective withholding tax amount 16.5%.

The common practices of a franchisor that are in common use reduce and often eliminate withholding tax obligations on payments of royalties, for example, into the United States.

11.3 Are there any requirements for financial transactions, including the payment of franchise fees or royalties, to be conducted in local currency?

Payment of franchise fees can be paid in foreign or the domestic currency by franchisees to the franchisor.

12 Commercial Agency

12.1 Is there a risk that a franchisee might be treated as the franchisor's commercial agent? If so, is there anything that can be done to help mitigate this risk?

The risk of a franchisee, in Korea, being treated as a franchisor's commercial agent is near nil if the franchisor complies with all franchise disclosure requirements and receives the approval to franchise by the KFTC. However, some legal commentators have proposed extending the commercial agency compensation rules for termination, and not extension of terms to Korean Franchise Law.

13 Good Faith and Fair Dealings

13.1 Is there any overriding requirement for a franchisor to deal with a franchisee in good faith and to act fairly in its dealings with franchisees according to some objective test of fairness and reasonableness?

Specific and general obligations are mandated in Korean Law to act in good faith. With regard to a specific requirement, a franchisor must not provide false or exaggerated information in franchise disclosure documents (Article 9, Franchise Act). For violation of this good faith obligation, the KFTC may impose a fine, order corrective measures and request a prosecutor to file a criminal complaint.

For a general requirement, the Korean Civil Act stipulates good faith in Article 2 (1), noting that: the exercise of rights and the performance of duties shall be in accordance with the principle of trust and good faith.

13.2 Is there any limitation on a good faith obligation being unenforceable if it only applies from franchisee to franchisor, rather than being mutual?

The Korean Civil Act is applicable to all business relationships, including the franchisor-franchisee relationship.

14 Ongoing Relationship Issues

14.1 Are there any specific laws regulating the relationship between franchisor and franchisee once the franchise agreement has been entered into?

The Franchise Act, LFBA, Civil Law, Criminal Law, MRFTA and related acts and ordinances are applicable pre- and post-execution of a franchise agreement.

15 Franchise Renewal

15.1 What disclosure obligations apply in relation to a renewal of an existing franchise at the end of the franchise agreement term?

Franchisors are obligated to update their franchise registration annually and immediately if material changes occur in regard to the franchisor or the franchise system.

15.2 Is there any overriding right for a franchisee to be automatically entitled to a renewal or extension of the franchise agreement at the end of the initial term irrespective of the wishes of the franchisor not to renew or extend?

If a franchisee requests to renew a franchise during the 90–180 days' period prior to expiration of the franchise agreement, the franchisor must renew unless the franchisee is behind on payments, materially breached the franchise agreement or the franchise is more than 10 years old. Thus, the "guaranteed term" of a franchise for a franchisee in Korea is 10 years, unless exceptions exist based on the fault of the franchisee (Article 13(1) Franchise Act).

15.3 Is a franchisee that is refused a renewal or extension of its franchise agreement entitled to any compensation or damages as a result of the non-renewal or refusal to extend?

Administrative fines and/or criminal and civil sanctions may be imposed on a franchisor that is in violation of the renewal/extension laws of Korea. The KFTC may, also, implement a corrective order, ordering the franchisor to renew/extend the franchise term.

16 Franchise Migration

16.1 Is a franchisor entitled to impose restrictions on a franchisee's freedom to sell, transfer, assign or otherwise dispose of the franchised business?

Franchisors in Korea may impose limitations on the franchisee's freedom to sell, transfer, assign or otherwise dispose of the franchised business without the approval of the franchisor.

16.2 If a franchisee is in breach and the franchise agreement is terminated by the franchisor, will a “step-in” right in the franchise agreement (whereby the franchisor may take over the ownership and management of the franchised business) be recognised by local law, and are there any registration requirements or other formalities that must be complied with to ensure that such a right will be enforceable?

Yes, step-in rights are recognised in Korea. However, litigation often proceeds regarding the rights of the franchisor to terminate the franchise agreement, and for compensation of the buildout.

16.3 If the franchise agreement contains a power of attorney in favour of the franchisor under which it may complete all necessary formalities required to complete a franchise migration under pre-emption or “step-in” rights, will such a power of attorney be recognised by the courts in the jurisdiction and be treated as valid? Are there any registration or other formalities that must be complied with to ensure that such a power of attorney will be valid and effective?

The use of power of attorney as a tool to step-in to rights in Korea is possible in Korea.

17 Electronic Signatures and Document Retention

17.1 Are there any specific requirements for applying an electronic signature to a franchise agreement (rather than physically signing a “wet ink” version of the agreement), and are electronic signatures recognised as a valid way of creating a binding and enforceable agreement?

The Digital Signature Act implemented in 2013 authorised the use of electronicsignatures. The standard practices of using a

document signing programme is accepted as valid legally signed documents in Korea, unless the documents require, under law, a notarisation or apostille.

17.2 If a signed/executed franchise agreement is stored electronically (either having been signed using e-signatures or a “wet ink” version having been scanned and saved as an electronic file), can the paper version of the agreement be destroyed?

Electronic signatures are recognised as valid executed documents in Korea. Korea has recognised electronic signatures since 2013 under the the Digital Signature Act.

18 Current Developments

18.1 What is the biggest challenge franchising is facing in your jurisdiction and how are franchisors responding to that challenge?

The major issue facing franchisors, in recent years, is inflation. Franchisors and franchisees are using technology to lower labour costs, including the use of ordering kiosks, online ordering and implementing technology to lower waste.



Sean Hayes, a top-rated international lawyer and business consultant, is engaged in legal and business development projects in New York, Korea, China, Hong Kong and Southeast Asia. Sean ran for elected office in NY, and as a service to the community he runs a business startup center that assists those deserving a second chance; an opportunity to start and accelerate a business in the United States, Korea or the Philippines.

Sean is the first non-Korean lawyer (NY Attorney) employed by the Korean Courts, and one of the first non-Koreans to be a full-time regular member of a Korean law faculty. He spends his time between New York, Manila, Hong Kong and Seoul after spending 20 years living in Korea. Sean managed a team that was ranked the Dispute Resolution Firm of the Year by two different publications. Sean is ranked a Top 100 Lawyer, and *LAWASIA* has rated Sean as one of only two non-Korean lawyers as a Leading Attorney.

In addition, Sean is regularly rated a Top Attorney in Arbitration, IP, Franchising, Dispute Resolution and Corporate Compliance by various legal rating services, and is regularly quoted by the *Wall Street Journal*, *New York Times*, *Bloomberg* and other leading news sources.

Sean is known for his aggressive advocacy, proactive street-smart advice and strategic approach to resolving legal and business challenges. Sean is, also, one of a few legal professionals with experience managing non-consulting companies. He worked as an interim General Manager/HR Manager for oil and gas, new tech, pharmaceutical, franchise and manufacturing companies.

Sean regularly appears in and is quoted by international media organisations, including the *New York Times*, *Wall Street Journal* and international law journals.

Sean is a New York Bar Member and a member of the U.S. Southern District Court of NY.

Sean is member of the International Bar Association, NY Country Bar Association and is a Chartered Arbitrator.

IPG Legal

D & O Gangnam Building, 12th Floor
2621 Nambusunhwan-ro, Gangnam-gu
Seoul, 06276
Korea

Tel: +1 646 249 0381
Email: seanhayes@ipglegal.com
URL: www.ipglegal.com



Jiwon Min is renowned in law for her proactive client-centred approach to the practice of law. She was a top graduate of Fordham University, Korea University and Sungkyunkwan University. Prior to law, Attorney Min worked in the business world. Attorney Min is regularly quoted in international and Korean vernaculars.

IPG Legal

D & O Gangnam Building, 12th Floor
2621 Nambusunhwan-ro, Gangnam-gu
Seoul, 06276
Korea

Tel: +82 70 7847 9050
Email: jiwonmin@ipglegal.com
URL: www.ipglegal.com

IPG Legal professionals are recognised internationally for delivering tailored and effective solutions to the most rewarding opportunities and perplexing challenges via our Strategy First focus, intense dedication and love in assisting clients in winning opportunities and resolving challenges. We are consistently ranked in legal and business publications as top lawyers and business professionals because of our candid street-smart advice, global experience, local connections and passion to consistently develop top talent.

We work on matters for companies and individuals in North America, throughout most of Asia and in the Middle East.

www.ipglegal.com



Netherlands

Kennedy Van der Laan



Martine de Koning



Tosca Bokhove

1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

The Dutch Franchise Act ('Franchise Act') sets forth a legal definition of 'franchise agreement' and 'franchise formula'. The following definition is given to a franchise agreement: 'An agreement under which the franchisor grants the franchisee the right, for a monetary compensation, and imposes the obligation on the franchisee to commercialise a franchise formula in a manner to be designated by the franchisor for the production or sale of goods or the provision of services.' The Franchise Act uses the following definition of a franchise formula: 'An operational, commercial and organisational formula for the production or sale of goods or the provision of services, which is decisive for a uniform identity and appearance of the franchise companies within the chain where this formula is used, and which comprises in any case: 1°. a trademark, model or trade name, corporate identity (house style) or drawing; and 2°. know-how, consisting of a whole of practical information not protected by any intellectual property right, arising from the experience of the franchisor and the examinations performed by him, which information is secret, essential and identified.'

In leading case law of the Dutch Supreme Court prior to the introduction of the Franchise Act (Supreme Court 25 January 2002, ECLI:NL:HR:2002:AD7329 (*Paalman v. Lampenier*)), franchise was defined as: 'An agreement whereby one undertaking, the franchisor, grants the other, the franchisee, in exchange for direct or indirect financial consideration, the right to exploit a franchise for the purpose of marketing specified types of goods and/or services. The agreement includes at least obligations relating to the communication by the franchisor to the franchisee of know-how.'

Depending on the context (this is only relevant for so-called distribution franchise, e.g. where there is a vertical relationship between the franchisor and franchisee regarding the sale of products or services), reference is sometimes made to the EU Vertical Block Exemption Regulation's ('VBER') accompanying Guidelines on Vertical Restraints ('Guidelines') for a definition of the franchise agreement.

It is important to note that the use, or non-use, of the term 'franchise' in contracts, including the explicit application or exclusion of the Franchise Act in an agreement, cannot in itself be of decisive significance for the question as to whether a relationship between parties qualifies as a franchise under the legal definition of franchise set out above. Lower court case law has confirmed that the actual content of the agreement and characteristics of the relationship between parties are of decisive influence.

1.2 What laws regulate the offer and sale of franchises?

There are no specific laws or authorities regulating the offer and sale of franchises. The offer and sale of franchises is thus governed by the Franchise Act, general contract law and consumer laws and competition laws.

Franchise Act. The pre-contractual phase, including the selection of a candidate franchisee and the offer and conclusion of a franchise agreement, is governed by the Franchise Act. The Franchise Act regulates the relationship between the franchisor and franchisee and contains specific provisions on the conclusion of franchise agreements that apply to the pre-contractual phase (e.g. disclosure obligations and a cooling-off period) during which term the parties cannot conclude any agreement that can be deemed to be inextricably linked thereto. In addition, insofar as not regulated specifically in the Franchise Act, general contract law is applicable. According to the Franchise Act, the franchise agreement must determine whether goodwill exists in the franchisee's business and, if so, the extent of that goodwill and the extent to which it is attributable to the franchisor. If, on termination of the franchise agreement, the franchisor takes over the relevant franchise company in order to continue it independently or transfer it to a third party with whom the franchisor enters into a new franchise agreement, the franchise agreement must provide how the goodwill that can reasonably be attributed is reimbursed on termination.

General contract law. The transfer and assignment of a franchise agreement is governed by general contract law, more specifically Section 6:159 ('*overdracht van overeenkomst*') of the Dutch Civil Code ('DCC'), which demands the permission of the contracting party to assign and transfer an agreement. Therefore, in principle, the franchisor must approve the sale and transfer of a franchise business to a new franchisee.

Act on Acquisition Fraud. The Act on Acquisition Fraud is applicable to specific situations of misinforming a prospect franchisee (ECLI:NL:PHR:2018:461; ECLI:NL:RBZWB:2017:8013).

1.3 If a franchisor is proposing to appoint only one franchisee/licensee in your jurisdiction, will this person be treated as a "franchisee" for purposes of any franchise disclosure or registration laws?

Yes. The Franchise Act applies to all franchisees established in the Netherlands despite the law governing the relationship. Whether he or she is an exclusive, sole or master franchisee is not relevant for the applicability of the Franchise Act. The Franchise Act contains disclosure obligations for the pre-contractual phase and for the term of the franchise agreement.

1.4 Are there any registration requirements relating to the franchise system?

There are no specific registration requirements for franchises in the Netherlands. All companies are obliged to register in the trade register of the Dutch Commercial Register of the Chamber of Commerce. Foreign entities that are not located in a country that is a member of the European Economic Area can be subject to the Companies Formally Registered Abroad Act if they want to operate on the Dutch market. On the basis of this Act, companies must comply with statutory and registration requirements that are applicable to Dutch companies, such as registration in the Dutch Commercial Register of the Chamber of Commerce.

1.5 Are there mandatory pre-sale disclosure obligations?

Franchise Act. Yes; under the Franchise Act, the franchisor must provide the franchisee, at least four weeks before conclusion of the franchise agreement, with: (i) the draft franchise agreement including annexes; (ii) a representation on the contents and purport of the provisions on payment, surcharges or other financial contributions or regarding the investments required to be made by the franchisee; (iii) (a) information about the way in which and the frequency by which the franchisor and the franchisees will consult with each other, and, if present, the contact details of the representative body of the franchisees, (b) the extent to which and the way in which the franchisor, whether or not through a derived formula, may compete with the franchisee, and (c) the extent to which, the frequency with which and the way in which the franchisee can take note of turnover-related information that concerns the franchisee or is relevant to his or her business operations; (iv) as far as it is available to the franchisor, information on his or her financial position, financial information regarding one or more company/companies considered comparable by the franchisor, while the franchisor clearly indicates on which grounds he or she considers this/these comparable; and (v) all other information he or she knows or can reasonably suspect to be relevant for the conclusion of the franchise agreement (Sections 913 and 914 of the Franchise Act). In practice, it is recommended that franchisors that make precontractual disclosures are clear about the extent to which such disclosure already forms an ‘offer’, or could reasonably be interpreted as an offer, for example by making a clear reservation in writing (and not merely in general terms, or in the disclosure documentation). The Franchise Act does not include an explicit obligation to provide a financial (business) forecast (see answer under question 1.8).

The prospective franchisee must provide to the franchisor in a timely manner information about his or her financial position but only insofar as this is reasonably relevant for the conclusion of the franchise agreement.

General contract law and the doctrine of reasonableness and fairness. General contract law places an obligation on the franchisor to provide relevant information to a franchisee. A franchisee has a duty to ask questions to obtain relevant information. The scope of these duties depends on the power and specific position and knowledge of each party. Nevertheless, the duty to inform the other party of relevant information generally outweighs the duty to investigate. The doctrine of reasonableness and fairness, in principle, does not place an obligation on franchisors to provide a financial forecast to a prospective franchisee except in special circumstances (the *Paalman/Lampenier* case and *Albert Heijn/Albert Heijn Franchising B.V.* case). The obligation, included in the European Code of Ethics, to provide information in the pre-contractual phase is not regarded

as ‘prevalent Dutch legal views’ pursuant to Article 3:12 DCC. It follows from lower court case law that if the franchisor does provide a profitability assessment to the franchisee, such financial assessment must be diligently prepared. This means that the financial assessment must be based on a careful and thorough location survey and market investigation, and must contain a clear substantiation of the figures. If the financial forecast is prepared by a third party, for example, a consultancy firm, the franchisor must timely inform the franchisee if he or she is aware of any serious flaws in the forecast.

1.6 Do pre-sale disclosure obligations apply to sales to sub-franchisees? Who is required to make the necessary disclosures?

There are no specific statutory rules concerning sub-franchisees. Sub-franchisees are franchisees of the (master) franchisee and the Franchise Act is applicable if the definitions of the Franchise Act of ‘franchise agreements’ and ‘franchise formula’ are met and the sub-franchisee is established in the Netherlands.

1.7 Is the format of disclosures prescribed by law or other regulation, and how often must disclosures be updated? Is there an obligation to make continuing disclosure to existing franchisees?

Yes (see answer under question 1.5). The Franchise Act provides for a list of information that must be disclosed during the term of the franchise agreement. In addition, during the course of the franchise agreement, the franchisor must provide information on, for example, intended amendments to the franchise agreement, required investments, etc. The information must be provided in a way that, after consulting the information, the information remains unchanged and available at a later time. The Franchise Act also provides that parties must consult each other at least once per year. Additional rules regarding the nature, content and way of provision of information can be designated by governmental decree in the future.

1.8 What are the consequences of not complying with mandatory pre-sale disclosure obligations?

The statutory pre-sale disclosure obligations in the Franchise Act are of mandatory law and cannot be avoided by a choice for a foreign law in the case of a franchise established in the Netherlands. A franchise agreement is subject to the franchisee’s right of annulment in case of non-compliance with the statutory pre-sale disclosure obligations (see answer under question 1.5).

Financial forecasts. The Franchise Act does not include an explicit obligation to provide a financial (business) forecast. If a financial forecast was provided, it must be prepared diligently by the franchisor (see above) and flaws can create a right for the franchisee to nullify the franchise agreement if he or she would not have concluded the franchise agreement if he or she had received a diligently prepared forecast (and the franchisor may be liable for damages caused by his or her negligence). If the franchisor provides the franchisee with a financial prognosis that has been prepared by a third party, and the franchisor is aware that the prognosis contains serious flaws but does not notify the franchisee of those flaws, the franchisor may be found to have acted wrongfully and can be held liable for damages (the *Paalman/Lampenier* case). However, if the revenues of the franchisee turn out lower than the financial prognosis of the franchisor, this does not automatically mean that the financial prognosis was not

of the required quality. Disappointing results may also derive from unexpected circumstances (i.e. flaws in the exploitation of the store by the franchisee or an economic recession). The franchisee has a duty to independently investigate the proposition. Case law confirms that a prospect franchisee must have a critical attitude towards information provided by the franchisor regarding future revenues of a new franchise concept. It follows from case law that there is no duty on the franchisee to investigate the correctness of the forecast in the event that the franchisor is a large professional party, who ensured that the prognosis was conducted with ‘great care’ and if the franchisor put the franchisee under time pressure to sign the (franchise) agreement. If the franchisor prepares a forecast him or herself (or a party for which the franchisor is liable pursuant to Article 6:170–172 DCC such as an employee), the franchisor is responsible for errors if the forecast was not diligently prepared (the *StreetOne* case). If the franchisee relies on incorrect information (regardless of whether the franchisor knew it was flawed) and proves that he or she would not have entered into the agreement without that information, he or she may nullify the agreement afterwards. Consequently, the franchisee must be placed in a position as if the agreement had not been concluded (Article 6:228 DCC).

1.9 Are there any other requirements that must be met before a franchise may be offered or sold?

See answer under question 1.2. There are no franchise-specific statutory requirements for the offer and sale of franchises in the Netherlands. However, the Franchise Act stipulates that, in a franchise agreement, provision must be made for the way in which the compensation for accrued goodwill must be determined (insofar as this can reasonably be attributed to the franchisee and therefore not goodwill arising from the franchise concept itself) upon termination. According to the Explanatory Memorandum, this is aimed at addressing the situation where the franchise agreement contains a favourable purchase option for the franchisor, e.g. the opportunity to buy the franchise unit below its market value.

1.10 Is membership of any national franchise association mandatory or commercially advisable?

Membership of the Netherlands Franchise Association (‘NFV’) is not mandatory but it is advisable for franchisors to join. The NFV acts as the branch organisation for franchise in the Netherlands and holds itself (among others) responsible for the healthy and balanced development of franchising in the Netherlands. The NFV has more than 200 members and is affiliated with the European Franchise Federation and the World Franchise Council.

1.11 Does membership of a national franchise association impose any additional obligations on franchisors?

Franchisors who are members of the NFV must comply with the European Franchise Federation’s European Code of Ethics for Franchising.

1.12 Is there a requirement for franchise documents or disclosure documents to be translated into the local language?

Dutch law does not require translations into a local language of a contracting party, but it is important that the contracting party

understands what he or she signs and is bound to. It can therefore be advisable to submit non-binding translations.

2 Business Organisations Through Which a Franchised Business Can be Carried On

2.1 Are there any foreign investment laws that impose restrictions on non-nationals in respect of the ownership or control of a business in your jurisdiction?

Foreign investors looking to invest in the Netherlands may be subject to the EU FDI Screening Regulation that establishes a framework for the screening of foreign direct investments, which has been applicable since 11 October 2020. Pursuant to this regulation, the European Commission may, for example, issue opinions if an investment poses a threat to the security or public order (of more than one Member State) or if it could undermine a project or programme of EU interest.

2.2 What forms of business entity are typically used by franchisors?

Franchisors generally operate by way of a Dutch private company with limited liability (*‘besloten vennootschap met beperkte aansprakelijkheid’*) in which they are protected from personal liability. A limited liability company may also be used in a joint venture structure with common ownership by the franchisor and the franchisee. Some franchisees are set up as a one-man business or other legal form.

2.3 Are there any registration requirements or other formalities applicable to a new business entity as a pre-condition to being able to trade in your jurisdiction?

There are no franchise-specific registration requirements. When a Dutch legal entity is set up, this new entity must be registered with the Dutch Commercial Register of the Chamber of Commerce. Foreign legal entities can also operate in the Netherlands by setting up a branch. In that case, the branch must be registered with the Dutch Commercial Register but does not have to be a separate legal entity. Lastly, a foreign capital company having legal personality (from outside the European Economic Area) operating in the Netherlands may qualify as a company formally registered abroad in case the company operates (almost) entirely in the Netherlands and has no real connection with its country of incorporation. This company is also required to register with the Dutch Commercial Register.

3 Competition Law

3.1 Provide an overview of the competition laws that apply to the offer and sale of franchises.

Franchise agreements or franchises operated in the Netherlands are, regardless of the choice of law and forum, subject to Dutch competition law, and if there is an appreciable effect on trade between Member States of the EU, EU competition law. As such, franchise agreements must comply with Article 101 of the Treaty on the Functioning of the European Union (‘TFEU’) and Article 6 of the Dutch Competition Act (‘DCA’). The European Commission’s VBER and Guidelines also apply – through a clause in the DCA – to vertical agreements in the Netherlands that have no cross-border effect.

As of 1 June 2022, revised EU competition law rules apply that are relevant for vertical agreements, including franchising. The

revised rules aim to keep up with market developments that have transformed the way businesses operate, including the growth of e-commerce and online platforms and changes or further guidance with respect to dual distribution, active sales restrictions, indirect measures restricting online sales and parity obligations.

3.2 Is there a maximum permitted term for a franchise agreement?

No. The principle of freedom of contract establishes that parties are free to agree on the term of the franchise agreement. Franchise agreements are often concluded for a period of five or 10 years. This may depend on lease agreements to which they are linked. Non-compete and exclusive purchasing provisions during the term of a franchise agreement are generally considered to fall outside EU and Dutch competition law if they are necessary to protect the know-how and goodwill of the franchisor that is licensed to the franchisee, and to maintain the common identity and reputation of the franchised network (the *Pronuptia* case). If these requirements are not met, the VBER provides for an exemption of the applicability of Article 101 TFEU, but only for agreements that do not exceed five years in duration and are not tacitly renewable. Post-termination non-compete clauses are only block-exempted if their duration does not exceed one year and the location is limited to the premises of the franchise operated by the franchisee. Moreover, the Franchise Act states that a non-compete clause is only permissible if this is recorded in writing, is essential for the protection of transferred know-how of the franchisor formula, is limited to one year after the termination of the franchise agreement and, lastly, if the geographical scope of the area is not broader than the area within which the franchisee has operated its franchise business in relation to the franchise agreement. Recently, the lower courts seem to apply the test of presence of know-how rather strictly, which seems out of line with international practice as well as legal doctrine.

3.3 Is there a maximum permitted term for any related product supply agreement?

No, but competition law may restrict the duration of certain exclusivity, non-compete and other competition-sensitive clauses (see answer under question 3.2).

3.4 Are there restrictions on the ability of the franchisor to impose minimum resale prices?

Yes. Any form of (direct or indirect) minimum resale price maintenance is considered a restriction by object and prohibited and subject to fines (Article 101 TFEU and Article 4(a) VBER). Franchise agreements including such restrictions, as a consequence, lose the benefit of the exemption under the VBER. It is very difficult to show that minimum resale price maintenance is nonetheless meeting the requirements of an individual exemption under Article 101(3) TFEU, and generally such restrictions are null and void. Recommended retail prices and maximum retail prices are permitted as long as they do not constitute in reality a fixed or minimum price. Indirect forms of price maintenance or supportive measures taken by the franchisor, such as fixing a price margin for the franchisee or granting rebates for following the recommended retail price (or threatening with termination or other punishment if the franchisee does not follow the recommended retail price) also qualify as impermissible conduct and create a risk of – among other things – fines (see Guidelines) and private enforcement actions. Direct or indirect restrictions that prevent the effective use of internet sales

by franchisees (see Article 4(e) VBER and Guidelines) are also restrictions by object and impermissible (with the exception of third-party online platform restrictions, see ECJ *Coty*).

3.5 Encroachment – are there any minimum obligations that a franchisor must observe when offering franchises in adjoining territories?

It is not permitted under EU and Dutch competition law to provide an exclusive area into which the franchisee may sell the contracted services and goods unless restrictions only concern active sales to an exclusive customer group or into an exclusive territory. Passive sales (responding to unsolicited requests from individual customers) outside a franchisee's allocated exclusive territory cannot be prohibited by the franchisor. For obvious reasons, under civil law, a franchisor must be careful not to license a new franchise to operate a franchise unit in the territory, radius or customer group that he or she already exclusively allocated to another franchisee. This can be regarded as a breach of contract and/or against reasonableness and fairness; internet sales are in principle considered 'passive sales' in this context (see answer under question 3.4).

3.6 Are in-term and post-term non-compete and non-solicitation of customers covenants enforceable?

Competition law. Non-compete provisions during the term of a franchise agreement are generally considered to fall outside EU and Dutch competition law if they are necessary to protect the know-how and goodwill of the franchisor that is licensed to the franchisee, and to maintain the common identity and reputation of the franchised network (the *Pronuptia* case). These in-term non-compete covenants are therefore generally enforceable. Franchisees often try to escape from non-compete obligations by arguing that the provision constitutes a restriction on competition and is therefore null and void. Dutch courts, however, appear to have adopted a reticent approach. In the *ANVR ex v. IATA-NL* case, the Supreme Court ruled that if the burden of proof is on the claimant and is high, it requires that the economic context is shown. Civil franchise cases such as *Yarden franchise v. X1* and *Top 1 Toys v. Vedes* show that it is essential that a plaintiff invoking competition law supports his or her arguments with a thorough market definition of the relevant product and geographic market and an in-depth analysis of the market shares of the parties to fulfil the burden of proof, otherwise he or she will not succeed with the claims; see also the VBER and Guidelines.

Franchise Act. The post-term non-compete provision is only valid if (i) it does not exceed a term of one year, and (ii) the geographical scope does not exceed the territory within which the franchisee could commercialise the franchise formula under the franchise agreement.

Principle of reasonableness and fairness. A franchisee can also argue that a non-compete provision is unenforceable because the effect of the provision is unacceptable on the basis of the principle of reasonableness and fairness. Relevant circumstances in relation to the enforceability of a post-term non-compete provision (or limitation of the duration thereof) are the duration of the franchise relationship, the territorial scope of the non-compete provision and the specific situation (knowledge, transfer of know-how, background and bargaining power) of the franchisee. The consequences of the non-compete provision for the franchisee may be taken into account when assessing the enforceability. The mere fact that the franchisee will not be able to generate revenues for some time is not sufficient to render the provision unenforceable. Moreover, if the franchisee has chosen

to terminate the franchise agreement, he or she is less likely to be protected against a contractual non-compete provision than in a case where the franchise agreement has been terminated by the franchisor, or the termination has been caused by the franchisor's behaviour. In general, and particularly if the clause does not violate competition law (for example, if the clause is block-exempted) and, in the future, meets the Franchise Act and the franchisor has a legitimate interest in demanding to enforce the clause, non-compete provisions are generally enforceable.

4 Protecting the Brand and Other Intellectual Property

4.1 How are trade marks protected?

Trademarks must be registered to receive trademark protection. In the Netherlands, there are no Dutch national trademarks, but one can apply, through the Benelux Office for IP ("BOIP"), for registration of a Benelux trademark, which is protected under the Benelux Treaty for Intellectual Property. If a trademark is registered in the Benelux trademark register, the registrant has exclusive trademark rights in the Netherlands, Luxembourg and Belgium. Moreover, a trademark can be registered as an EU trademark in the register of the European Union Intellectual Property Office. If the franchisor decides to do so, he or she has the exclusive right to the trademark in the EU. Both Benelux and EU trademarks can also be applied for by means of an International Registration as offered by the World Intellectual Property Organization ("WIPO").

A trade name does not have to be registered to be protected under the Dutch Trade Names Act; protection is granted to a trade name that is actually used. It is prohibited to use a trade name that is (nearly) identical to an older trade name, if this use can lead to a risk of confusion among the public. The greater the extent to which companies conduct different types of business or conduct business at different geographical locations, the less likely the risk that confusion will be established.

4.2 Are know-how, trade secrets and other business-critical confidential information (e.g. the Operations Manual) protected by local law?

Yes. The unauthorised use or disclosure of confidential information can be opposed under Dutch and EU law (Dutch Trade Secrets Act and Trade Secrets Directive). All information that is kept secret and resembles a certain trade value can be protected as a trade secret. It is important that reasonable measures (legal and/or practical) must be taken to keep the information secret. A confidentiality clause is not enforceable if the scope of confidential information is not clear or too broad.

4.3 Is copyright (in the Operations Manual or in proprietary software developed by the franchisor and licensed to the franchisee under the franchise agreement) protected by local law?

In the Netherlands, copyright protection is granted automatically to creations that qualify as work under Dutch copyright law. This is the case if the work is the expression of the intellectual creation of its author; formal registration is not required. Elements of a franchise formula can qualify as a work within the meaning of the Dutch Copyright Act if it meets the aforementioned criteria. In general, ideas or formats are not protected under Dutch copyright law unless they are worked out in a sufficiently concrete and detailed manner. If the franchise formula meets such final criteria, this specific elaboration of the franchise formula can be protected

on itself, but not the idea behind it. Any unauthorised publication or reproduction of the copyrighted work is an infringement unless a limitation of copyright (such as personal use) is applicable. The imitation of a copyright-protected franchise formula does not automatically mean that the similar formula infringes the imitated franchisor's copyright. To determine if there is an infringement, a judge will assess whether elements protected by copyright have been copied from the copyright-protected work.

5 Liability

5.1 What remedies can be enforced against a franchisor for failing to comply with mandatory disclosure obligations? Is a franchisee entitled to rescind the franchise agreement and/or claim damages?

See answer under question 1.8. The Franchise Act is of mandatory law and includes rules for the pre-contractual exchange of information and places a general obligation on both parties to inform each other in a timely manner of everything that is or could reasonably be in the interest of the other party. Based on the general rules of error, a franchisee can annul a franchise agreement if it was in error about relevant circumstances on the basis of a statement or information provided (or omission to provide the same) by the franchisor, and if it would not have concluded the agreement without that information. If the franchisor, for instance, provides the franchisee with a financial prognosis and is aware that the prognosis contains serious flaws but does not notify the franchisee of those flaws, the franchisor may be found to have acted wrongfully and be held liable for damages. The time limit for the annulment of the franchise agreement is three years (Section 3:52 DCC).

5.2 In the case of sub-franchising, how is liability for disclosure non-compliance or for pre-contractual misrepresentation allocated between franchisor and master franchisee? If the franchisor takes an indemnity from the master franchisee in the Master Franchise Agreement, are there any limitations on such an indemnity being enforceable against the master franchisee?

See answer under question 5.1. It follows from the principle of freedom of contract that a franchisor and franchisee can sue each other for damages caused by the other party. It is possible to limit such liability or to include indemnifications for third-party claims. Normally, such limitations of liability hold (unless the outcome is against reasonableness and fairness, which, for example, occurs in the case of wilful intent or gross negligence of the debtor or of the persons that are charged with the management of that company).

5.3 Can a franchisor successfully avoid liability for pre-contractual misrepresentation by including a disclaimer in the franchise agreement?

Parties can include such disclaimer clauses in a franchise agreement under the principle of freedom of contract, but whether or not parties can successfully avoid liability would depend on the circumstances of the case. Generally, disclaimers in a franchise agreement do not provide sufficient protection given the adoption of the Franchise Act (if the statutory obligations are not complied with, for example) and also in light of how case law has developed. Pre-contractual misinterpretation can lead to error, which provides a legal basis for the annulment of the franchise agreement. Further, under the Act on Acquisition

Fraud, which regulates misleading omission and advertising (Sections 6:194 and 6:195 DCC), a franchisee can seek remedy for such pre-contractual misinterpretation by stating that it is an unlawful act in the sense of the provisions on misleading omission and advertising (see answer under question 1.2). Whether or not certain omissions or acts are misleading, depend on several factors, such as the nature, composition, number, and capacity of the information provided, but also the (time of) provenance, used calculation methods and the purpose of the provision of the information (see answer under question 5.3). While the general starting point in Dutch civil law is that the burden of proof lies with the party making the claim, invoking Section 6:195 DCC reverses the burden of proof to the party omitting or advertising, i.e. places the burden on the franchisor to prove that the information provided was accurate and complete. In light of the above, it is advisable to provide clear information as to the factual basis for information provided to the franchisee, to include disclaimers, and in any case not to provide financial forecasts (such as specific numbers), unless these were the result of diligent and thorough research and investigation into the local situation.

5.4 Does local law permit class actions to be brought by a number of aggrieved franchisees and, if so, are class action waiver clauses enforceable?

The Act on Collective Damages in Class Actions ('WAMCA') enables franchisees to claim damages for or on behalf of a 'class' in case of a tort or breach of contract. However, it follows from the principle of freedom of contract that class action waiver clauses can exist in a franchise agreement. Under the WAMCA, foundations or associations with full legal capacity can institute a claim intended to protect similar interests of other persons to the extent that its articles promote such interests (Article 3:305a DCC). The proceedings are different from class actions that are known in the USA.

6 Governing Law

6.1 Is there a requirement for franchise documents to be governed by local law? If not, is there any generally accepted norm relating to choice of governing law, if it is not local law?

No. Parties are free to decide to submit the franchise relationship to Dutch or any other foreign law. This follows from the principle of freedom of contract. However, if the franchisee is established in the Netherlands, the Franchise Act is applicable regardless of the choice of law. If the franchise agreement is subject to Dutch law, and the franchisee is established outside the Netherlands, the applicability of the Franchise Act can be excluded.

6.2 Do the local courts provide a remedy, or will they enforce orders granted by other countries' courts, for interlocutory relief (injunction) against a franchisee to prevent damage to the brand or misuse of business-critical confidential information?

Yes. Under the EU Trade Secrets Directive and Dutch Trade Secrets Act, Dutch courts can take interim measures in preliminary relief proceedings, such as the prohibition of the use and disclosure of trade secrets, the prohibition of the production of infringing goods, offering, placing on the market or use of infringing goods, or the importation, export or storage of infringing goods for those purposes. The Trade Secrets Act also includes the right of trade secret holders to claim attachment and

destruction of items containing or applying trade secrets, such as substances, documents and electronic files. Preliminary relief can also entail requesting a court order for specific performance (for example, to comply with the franchise agreements and handbook) or to stop certain behaviour that is damaging the brand. It is also possible to place a conservatory attachment on bank accounts or other assets (to be followed by proceedings on the merits) of a rogue franchisee; for example, if he or she stopped paying franchise fees. Regarding the enforcement of judgments of foreign courts, international private law is applicable. As such, the Hague Conference on Private International Law ('*Excutieverdrag*') deals with the recognition and enforcement of judgments in civil and commercial matters within and outside of the EU. For countries that are not contracting states to the Hague Conference, the enforcement of judgments of foreign courts would depend on what is regulated in other bilateral execution treaties.

6.3 Is arbitration recognised as a viable means of dispute resolution and is your country a signatory to the New York Arbitration Convention on the Recognition and Enforcement of Foreign Arbitral Awards? Do businesses that accept arbitration as a form of dispute resolution procedure generally favour any particular set of arbitral rules?

Arbitration is recognised under Dutch law as a form of dispute resolution (see Article 1020 Dutch Code of Civil Procedure). The Netherlands is party to the New York Arbitration Convention on the Recognition and Enforcement of Foreign Arbitral Awards. The NFV, together with the Netherlands Arbitration Institute, has established a list of 'franchise arbitrators' from which parties can select an arbitrator to settle a franchise dispute (<https://www.nfv.nl/geschillen/>). In particular, arbitration can be a good option for disputes involving international franchise contracts where one of the parties resides in a country that is not bound to international treaties on the execution of foreign judgments, cases where specialised background knowledge is required to understand the legal framework, and cases where confidentiality is key. Arbitration is relatively expensive compared to the Dutch court system.

7 Real Estate

7.1 Generally speaking, is there a typical length of term for a commercial property lease?

In principle, leases for commercial properties (including stores, restaurants, hotels, cafés, take-away services) are entered into for a minimum first term of five years. At the end of this term, the lease will be extended by another five years and then extended for an indefinite period, unless parties agree otherwise. Although parties can agree to alter the duration of (the extension of) the lease agreement, the first period must be five years or more and both terms must be at least 10 years. Parties may give notice of termination before the end of each term or at any time during the indefinite period. The notice of termination must comply with mandatory law, which includes a period of notice of one year or longer, and a limited number of grounds for the lessor for giving notice of termination. An exception to the above is a lease agreement with a duration of less than two years, in which case the contract will end by operation of law, unless parties agree otherwise. If parties extend/continue the lease after the period of two years, the statutory duration (2× five years) and mandatory grounds for giving notice of termination will apply to these leases as well by operation of law.

7.2 Is the concept of an option/conditional lease assignment over the lease (under which a franchisor has the right to step into the franchisee/tenant's shoes under the lease, or direct that a third party (often a replacement franchisee) may do so upon the failure of the original tenant or the termination of the franchise agreement) understood and enforceable?

A provision in the lease agreement that stipulates a right for the franchisor or another third party to step into the franchisee's/lessee's position if the lessee/franchisee fails to comply with its obligations under the franchise agreement is, in essence, a disguised extension of the statutory semi-mandatory (limited) termination grounds for the lessor. The same applies for situations in which the franchise agreement has been terminated and the franchisor (who is often also the franchisee's lessor) wishes to terminate the lease agreement as well in order to be allowed to occupy the leased premises itself. Such clauses are considered derogating covenants, which are, in principle, not valid under Dutch retail lease law. As a general rule, parties are not permitted to derogate from the statutory semi-mandatory law provisions to the disadvantage of the lessee (the lessee of commercial retail premises enjoys additional protection regarding, amongst others, minimum terms for the lease, statutory notice periods and statutory termination grounds; see answer under question 7.1 for a brief outline), unless the court has granted approval for a derogation in advance. The approval will only be granted: (i) if the covenant does not, in any essential respect, restrict any rights of the lessee; and/or (ii) if the lessee's social position, as compared to that of the lessor, is such that he or she does not reasonably require the protection of the semi-mandatory lease provisions. Only if the interests of the lessee are sufficiently safeguarded will the court approve the proposed deviation. If a deviation is not approved by the court and a conflict arises, a lessee may set aside the derogating provision and revert to the original provisions of the law. It is possible for parties to agree on a lease under the condition precedent that the court will approve an intended deviation from mandatory law.

7.3 Are there any restrictions on non-national entities holding any interest in real estate, or being able to sub-lease property?

Under Dutch property law, there is no distinction made between national and non-national entities. Therefore, there is no specific legal restriction for non-national entities holding any interest in real estate under Dutch property law. Commercial leases are mostly 'ROZ'-based. The Dutch Council for Real Estate matters (in Dutch: 'Raad voor Onroerende Zaken' or 'ROZ') publishes standard agreements and corresponding general terms and conditions, which are formulated in favour of the lessor. These standard agreements, including corresponding general terms and conditions, are frequently used and have become the *de facto* standard for commercial leases in the Netherlands. Under these standard general terms and conditions, the lessee is not allowed to relinquish the leased property to third parties by leasing, subleasing or allowing the use thereof without prior written approval of the lessor. The same applies to the transfer of tenancy rights. However, deviating arrangements are allowed under Dutch law. In practice, it is sometimes stipulated that subleasing to affiliated parties of the lessee is allowed without prior approval of the lessor, or that the lessor at least may not reasonably withhold his or her approval if the proposed new (sub)lessee (affiliate)'s solvency, liquidity and creditworthiness are equal to the lessee. It is noted that parties are free to agree upon further conditions in that respect.

7.4 Give a general overview of the commercial real estate market. To what extent has the real estate market been affected by the Coronavirus pandemic? Specifically, can a tenant expect to secure an initial rent free period when entering into a new lease (and if so, for how long, generally), or are landlords demanding "key money" (a premium for a lease in a flagship location)?

Regularly, owners/lessors of commercial property may provide the lessee with an incentive when entering into a new lease agreement. The purpose of such an incentive is to stimulate the lessee to actually proceed to enter into the lease agreement for the commercial property offered by the lessor. Some practical examples of incentives are: a rent-free period; a contribution towards the fit-out costs for the furnishings and fittings; tenant improvements (alterations of the premises paid by the lessor on request of the lessee); and step-up rent or limitations (a cap) on the contractual right of indexation. A rent-free period is the most common incentive. Except for advance payments for service charges and turnover tax (VAT) (generally), the lessee is not obliged to pay any rent during the agreed rent-free period. However, there is no general (legal) principle that applies to the terms, conditions, duration or amount of the incentive. Generally, transaction-specific variables such as the scope of the transaction, the duration of the intended lease term(s), the economic cycle and market circumstances are decisive in most cases. It is obvious that when the real estate market is more owner/lessor-friendly, a lessor is less willing to provide the lessee with attractive incentives than in a tenant-friendly market.

8 Online Trading

8.1 If an online order for products or request for services is received from a potential customer located outside the franchisee's exclusive territory, can the franchise agreement impose a binding requirement for the request to be re-directed to the franchisee for the territory from which the sales request originated?

No. The requirement in a franchise agreement to refuse or redirect passive sales is considered a hardcore restriction under the VBER and the accompanying Guidelines. Passive selling, including online sales, may not be restricted. These arrangements are exempted by the VBER if the market shares of both franchisor and franchisee do not exceed 30% of the relevant market and the agreement does not contain any hardcore restrictions. It is important to note that internet sales are considered passive sales and thus cannot be restricted, even if they take place in the exclusive territory of another franchisee. However, offering an online webshop with a domain name or language options that vary from those commonly used in the franchisee's exclusive territory is regarded as active selling into another territory.

8.2 Are there any limitations on a franchisor being able to require a former franchisee to assign local domain names to the franchisor on the termination or expiry of the franchise agreement?

No. The principle of freedom of contract establishes that a franchise agreement can provide for a requirement to assign local domain names to the franchisor on the termination or expiry of the franchise agreement.

9 Termination

9.1 Are there any mandatory local laws that might override the termination rights one might typically expect to see in a franchise agreement?

No. Laws on termination can be found in general contract law in the DCC, but this is complementary and not mandatory law.

- (i) **Statutory provisions on termination for breach.** There are no specific statutory laws on termination of franchise agreements in the Netherlands (other than the obligations regarding goodwill stated above). The applicable legislative framework regarding termination thus mainly exists in general contract law. General contract law (Books 3, 6 and 7 DCC) contains statutory provisions regarding termination for breach. Each party can rescind an agreement if the counterparty is in default (Article 265 Book 6 DCC). An agreement cannot be terminated based on a breach if, given its special nature or minor importance, the breach does not justify the termination. These rules are of supplementary (non-mandatory) law, and the parties can deviate by agreement, which is generally enforceable.
- (ii) **Termination for convenience.** The Franchise Act and general contract law in the DCC do not provide specific provisions for termination for convenience. It follows from case law that agreements concluded for an indefinite term and where parties did not provide a contractual regime for termination, can, in principle, be terminated 'for convenience'. Contracts for a definite term can be terminated for convenience only if the agreement provides for this. Many franchise agreements in the Netherlands are concluded for a definite term of five or 10 years and this may depend on any lease agreements to which they are linked. Franchise agreements that are concluded for a definite term will end on expiry and can only be terminated unilaterally if the agreement stipulates this.

9.2 Are there local rules that impose a minimum notice period that must be given to bring a business relationship that has existed for a number of years to an end, which will apply irrespective of the length of the notice period set out in the franchise agreement?

It follows from case law that if the application of a clause in the agreement would lead to an outcome that is unacceptable according to the principle of reasonableness and fairness, a termination for convenience may require a certain notice period, the length of which depends on all relevant facts and circumstances. It is also possible that the contractual regime for termination leaves an ambiguity or a space, which can be complemented by applying reasonableness and fairness. It is therefore crucial to draft contractual termination clauses with great care and sufficient knowledge of Dutch law. Important indicators for the length of a notice period are the duration of the franchise agreement and the degree of dependency.

10 Joint Employer Risk and Vicarious Liability

10.1 Is there a risk that a franchisor may be regarded as a joint employer with the franchisee in respect of the franchisee's employees? If so, can anything be done to mitigate this risk?

The concept of 'joint employment', as developed in the context of

franchise in North America, does not exist in Dutch law. Regardless of the agreements between the franchisor and franchisee, a working relationship between the franchisor and the franchisee's employees may be considered an employment agreement if three requirements are met. The employee must: (1) perform work for a certain period; (2) be in the service of the employer (a relationship of authority); and (3) be in exchange for a salary. In practice, this often means that the more (direct) influence the franchisor has on the work (through specific work instructions, such as working hours, how the work should be carried out, etc.) and the way the work is executed (by means of authority and supervision, such as performance reviews), the bigger the risk that this working relationship may be considered an employment agreement. Published case law shows that it rarely occurs that an employee of the franchisee is considered to be an employee of the franchisor, because there is no (direct) contact with or authority over the employees of the franchisee and the franchisee is usually considered the employer. However, the smaller the franchisee (one-man businesses in particular), the higher the risk that the requirements stated above may be met, depending on all facts and circumstances of the case. Note that several legislation changes have been announced to make it more clear as to when there is an employment agreement. These changes have not (as of the time of writing) been included in a legislative proposal.

10.2 Is there a risk that a franchisor may be held to be vicariously liable for the acts or omissions of a franchisee's employees in the performance of the franchisee's franchised business? If so, can anything be done to mitigate this risk?

The existence of an employment agreement or other type of working relationship with the franchisee does not preclude liability of the franchisor for acts or omissions of a franchisee's employee. In general, if the franchisor has control and authority (for example, by prescribing specific rules and instructions) over the acts or omissions of the franchisee's employee constituting the fault, the franchisor may be held liable. In practice, this is not often the case because the control and authority usually lies with the franchisee. To mitigate the risk of liability, the franchisor may include a limitation of liability and express indemnification in the franchise agreement. In addition, a clause stating that: the franchisee is responsible for compliance with, for example, the local health and safety legislations; the franchisee should not solely rely on the franchisor's manual and guidelines; and the franchisee must take out adequate insurance against any risks connected to the work, can be included in the franchise agreement.

11 Currency Controls and Taxation

11.1 Are there any restrictions (for example exchange control restrictions) on the payment of royalties to an overseas franchisor?

In principle, there are no restrictions on the payment of royalties to an overseas franchisor from a tax perspective. However, the following tax matters should be taken into account:

- In case of royalties paid to affiliated entities, the royalty should be at arm's length. This suggests that the royalty paid between the affiliated entities should be similar to what independent third parties would have charged each other under the similar conditions.
- As of January 1, 2021, a conditional withholding tax may be due for the receiver of royalty payments. The conditional withholding tax applies to royalties paid by a Dutch tax resident entity or a Dutch permanent establishment to an

affiliated company in a designated low-tax jurisdictions, or in case of abuse. The conditional withholding tax is levied the moment a royalty is receivable – hence, also in case of no actual payment (for example, if the royalty payment is accrued or offset), the withholding tax is levied. The conditional withholding tax is levied by means of withholding by the Dutch franchisee (the withholding agent) on behalf of the receiver, at a rate of 25.8% (directly linked with the highest Dutch corporate income tax rate).

- Generally, abuse is considered to be likely, for Dutch tax purposes, if the main purpose, or one of the main purposes, is to avoid tax, and there is an artificial construction or series of constructions that do not have valid business reasons.
- Every year, the Dutch Ministry of Finance publishes a list of designated low-tax jurisdictions, as a supplement to the EU Blacklist. In 2023, the following countries were designated as low tax-jurisdictions: the American Virgin Islands; American Samoa; Anguilla; the Bahamas; Bahrain; Barbados; Bermuda; the British Virgin Islands; the Cayman Islands; Costa Rica; Fiji; Guam; Guernsey; the Isle of Man; Jersey; Marshall Islands; Palau; Panama; Turkmenistan; the Turks and Caicos Islands; Samoa; the Seychelles; Russia; Trinidad and Tobago; Vanuatu; and the United Arab Emirates.
- In some cases, a royalty payment may not be (fully) deductible for corporate income tax purposes at the level of the payer, at least in the following two situations. First, a deduction may be denied based on the EU Anti-Tax Avoidance Directive (ATAD 2). These regulations, implemented in Dutch legislation, aim to neutralise hybrid mismatches resulting from a difference in tax qualifications between various jurisdictions, resulting in ‘double deduction’ or ‘deduction without inclusion’. Second, in some cases a deduction is (partially) denied based on anti-mismatch regulations regarding the difference in application of the at arm’s length principle between the Netherlands and the recipient’s country of residence.
- In principle, VAT is due on royalty payments. However, this is not always the case. Whether VAT is due on a royalty payment should be assessed case-by-case.

11.2 Are there any mandatory withholding tax requirements applicable to the payment of royalties under a trade mark licence or in respect of the transfer of technology? Can any withholding tax be avoided by structuring payments due from the franchisee to the franchisor as a management services fee rather than a royalty for the use of a trade mark or technology?

As of January 1, 2021, a conditional withholding tax is due on royalty payments to certain jurisdictions, or in abusive situations (see answer under question 11.1). Furthermore, the royalty payment may be non-deductible for Dutch tax purposes (see answer under question 11.1). For Dutch tax purposes, a royalty is defined in line with the OECD Model Tax Convention. Whether a management services fee or a royalty fee is due needs to be considered on a case-by-case basis.

11.3 Are there any requirements for financial transactions, including the payment of franchise fees or royalties, to be conducted in local currency?

No. There is no requirement that a financial transaction between franchisors and franchisees should be conducted in the local currency. However, in case the conditional withholding tax is levied on the royalty payment, the tax return should be filed in Euro amounts in the Netherlands.

12 Commercial Agency

12.1 Is there a risk that a franchisee might be treated as the franchisor’s commercial agent? If so, is there anything that can be done to help mitigate this risk?

There is only a risk if the franchisee acts for the risk and account of the franchisor and, if contracts are concluded by the franchisee with customers (instead of just bringing leads to the franchisor), the franchisee concludes these contracts in the name of the franchisor. In such a situation, the franchise agreement qualifies as a commercial agency agreement under the applicable Dutch statutory law, which is based on the EU Directive on Commercial Agents, and would be subject to the mandatory rules under it. Such mandatory provisions are minimum notice periods in case of termination, particular rules on the commission to be paid in particular circumstances and, if there is a lasting benefit after the end of the agency relationship and it is otherwise fair, a goodwill compensation. Normally, franchisees are considered to operate as independent entrepreneurs and not in the name of or on behalf or risk of the franchisor because they operate at their own risk and expense. To avoid the risk that the relationship may be perceived as commercial agency, it is important that the franchisee clearly indicates on or in his or her premises both the franchisee’s identity (legal entity name) and that the franchisee operates the franchised business in his or her own name and for his or her own account and risk. Usually, a sign in the store and a clear indication on, for example, the receipts (and terms and conditions, if any) that the customer receives upon payment are sufficient.

13 Good Faith and Fair Dealings

13.1 Is there any overriding requirement for a franchisor to deal with a franchisee in good faith and to act fairly in its dealings with franchisees according to some objective test of fairness and reasonableness?

Yes. The Franchise Act introduces the principle that the parties must behave as a ‘good franchisor’ and a ‘good franchisee’ by acting reasonably both prior to forming and during the franchise relationship. What that means, in practice, depends on what can be expected and required from both parties, the type of franchise, the industry, and the size of the franchise chain. In addition, general contract law provides that a contractual relationship can be supplemented by the principle of reasonableness and fairness if there is a void or ambiguity. On special occasions, the contract or clause can be overruled by the principle of reasonableness and fairness if the outcome would otherwise be unacceptable (Article 6:248 DCC).

13.2 Is there any limitation on a good faith obligation being unenforceable if it only applies from franchisee to franchisor, rather than being mutual?

No (see answer under question 13.1). The provision in the Franchise Act that both the franchisor and franchisee must act in good faith should be interpreted as an open standard. The degree of protection of both parties is tailored to the legal relationship between the parties in question. The franchisee, which is often a more dependent party, must also act as a reasonable and fair party, irrespective of their legal relationship. Obviously, when there is an unequal bargaining position on the franchisee’s side, the norm to act in good faith shall be interpreted in a different way.

14 Ongoing Relationship Issues

14.1 Are there any specific laws regulating the relationship between franchisor and franchisee once the franchise agreement has been entered into?

Yes. The Franchise Act regulates the relationship between the franchisor and franchisee during the franchise relationship (see answers under question 1.7 on disclosure obligations during the term of the franchise relationship and question 13.1 for the principle of ‘good franchisor’ and ‘good franchisee’).

15 Franchise Renewal

15.1 What disclosure obligations apply in relation to a renewal of an existing franchise at the end of the franchise agreement term?

See answer under question 1.5. There are no specific statutory disclosure obligations in relation to a renewal of an existing franchise agreement.

15.2 Is there any overriding right for a franchisee to be automatically entitled to a renewal or extension of the franchise agreement at the end of the initial term irrespective of the wishes of the franchisor not to renew or extend?

No. There are no such specific statutory rights of renewal on the part of the franchisee under Dutch law. Some franchise agreements include a clause stating that the agreement can be automatically (tacitly) renewed after the expiry date, or that an explicit renewal process is in place that provides that both parties will have to agree in writing to the renewal.

15.3 Is a franchisee that is refused a renewal or extension of its franchise agreement entitled to any compensation or damages as a result of the non-renewal or refusal to extend?

There are no such specific statutory rights of compensation or damages as a result of the non-renewal or refusal to extend the franchise agreement, because franchise agreements for a definite term will end on expiry. However, the franchisor’s freedom to refuse renewal or extension of the franchise agreement can be limited under the principle of reasonableness and fairness, for example, in the circumstance where the franchisor has made promises already regarding an extension, the parties have negotiated to the point of no return and agreement in principle, or where prior agreements include a right of extension under particular circumstances. In addition, the franchisor may be liable if a franchisee makes investments shortly before the termination (i.e. expiration) of the franchise agreement that cannot be earned back. This may require that the franchisee be entitled to the award of damages (*Mattel/Borke* case). It is advisable to communicate, in a timely (this means as early as possible) manner, the intention to let the agreement expire, in particular if the agreement was renewed earlier.

16 Franchise Migration

16.1 Is a franchisor entitled to impose restrictions on a franchisee’s freedom to sell, transfer, assign or otherwise dispose of the franchised business?

Yes, it follows from the principle of freedom of contract that a franchisor is entitled to impose such restrictions in a franchise agreement. Please note the rules on goodwill in the Franchise Act explained above. In general, if such restrictions are not meeting the standard of what a good franchisor would do, e.g. reasonableness and fairness, the restrictions can be unenforceable.

16.2 If a franchisee is in breach and the franchise agreement is terminated by the franchisor, will a “step-in” right in the franchise agreement (whereby the franchisor may take over the ownership and management of the franchised business) be recognised by local law, and are there any registration requirements or other formalities that must be complied with to ensure that such a right will be enforceable?

A step-in right, generally used if the franchisor wishes to take over the lease contract, can be implemented in a franchise agreement through a clause in the franchise agreement (for example, a purchase option). This is governed by general contract law (see answer under question 1.2). There are no specific registration requirements or other formalities before such right is enforceable. It is advisable to carefully draft a purchase option clause (and its conditions).

16.3 If the franchise agreement contains a power of attorney in favour of the franchisor under which it may complete all necessary formalities required to complete a franchise migration under pre-emption or “step-in” rights, will such a power of attorney be recognised by the courts in the jurisdiction and be treated as valid? Are there any registration or other formalities that must be complied with to ensure that such a power of attorney will be valid and effective?

There are no specific registration or other formalities applicable to this situation under Dutch law. The power of attorney is valid and effective if it meets the requirements under general contract law (Article 60 Book 3 DCC). See the remarks made above about ‘good franchisor’, reasonableness and fairness and goodwill.

17 Electronic Signatures and Document Retention

17.1 Are there any specific requirements for applying an electronic signature to a franchise agreement (rather than physically signing a “wet ink” version of the agreement), and are electronic signatures recognised as a valid way of creating a binding and enforceable agreement?

Electronic signatures are recognised in EU and Dutch law and have legal effect and admissibility as evidence in legal proceedings

if they meet the requirements that the method for authentication of the electronic signature is sufficiently reliable in relation to (i) the purpose that the electronic signature is being used for, and (ii) all other circumstances.

17.2 If a signed/executed franchise agreement is stored electronically (either having been signed using e-signatures or a “wet ink” version having been scanned and saved as an electronic file), can the paper version of the agreement be destroyed?

See answer under question 17.1. It is not required to keep a ‘wet ink’ copy for the existence of the franchise agreement under Dutch law.

18 Current Developments

18.1 What is the biggest challenge franchising is facing in your jurisdiction and how are franchisors responding to that challenge?

The current Russia-Ukraine war has had a great (international) impact on supply chains in many franchise sectors. Companies are seeking new suppliers, points of manufacture, and shipment routes. Some companies have even closed local headquarters or stores, and credit and political risks have increased. Together

with geopolitics and global inflation, this may have triggered businesses to look for new suppliers or customers. Further, the emphasis is on building a sustainable, green and socially responsible supply chain that is futureproof for global risks and challenges, including environmental legislative reforms and climate commitments. The trend towards more sustainable and circular production and distribution is being accelerated by the multiple legislative initiatives by the European Commission that have been adopted or are being prepared (e.g. European Green Deal, European Climate Law and EU Circular Economy Action Plan). The EU and Dutch legislative developments in the area of sustainability and circularity trigger a need for more sustainable products, certification and quality control, and it turns a spotlight on product compliance, the labelling of products and waste management (including re-use and recycling). Product compliance and enforcement by authorities will increase as a result. The ongoing digitalisation of the global economy and the COVID-19 pandemic have accelerated the transition to online sales and services. E-commerce and innovation have become of crucial importance for survival. Businesses that did not make this a priority in past years must now scale up and innovate or lose their competitive advantage. Some of these parties will disappear sooner than could be anticipated in normal market circumstances. Other businesses may have profited from the global shift to internet platforms, while others are struggling to find a (commercial) strategy that is not loss-making.



Martine de Koning is an expert in franchise, distribution and agency transactions and litigation. She combines in-depth knowledge of EU and competition law with a deep understanding of commerce and trade. She is praised for her 'sharp strategic insight, knowledge and creativity in providing solutions'. She handles litigation and arbitration in a 'smart, assertive and effective' manner.

Martine structures complex international cooperation such as the setting up of franchise networks and channel agreements. She represents domestic franchisors in their international expansion plans and also assists foreign clients with establishing a presence in Europe, the Middle East and Africa. Martine is a 'shrewd contract drafter and negotiator'. Martine's interests include trade unions and treaties (EU, WTO, ASEAN, APEC, NAFTA, Caricom), customs and exports regulations and sanctions. The impact of Brexit on commercial agreements and disputes catches her special interest.

Martine is a thought leader on competition law and pricing matters, such as rebates, tying, excessive pricing, dynamic pricing, royalties, licence and franchise fees, for dominant and other parties. With her lifelong focus on the fashion, retail, restaurant and hospitality sectors, she acts for her clients on internet sales restrictions, third-party platform restrictions, geoblocking, omnichannel (seamless marketplace), e-commerce, inventory sharing, dual distribution, horizontal and vertical data sharing, licensing of know-how and technology, loyalty programmes and big data.

Kennedy Van der Laan
Molenwerf 16
1014 BG Amsterdam
Netherlands

Tel: +31 20 5506 666
Email: martine.de.koning@kvdl.com
URL: www.kvdl.com



Tosca Bokhove is an associate in the Commercial and International Trade practice group. Tosca specialises in EU law and policy, focusing on the broader regulatory framework applicable to economic activities in EU and Dutch markets. Tosca has a strong understanding of EU free movement law on goods and services, as well as EU competition and consumer law. Tosca often advises clients on topics related to vertical restraints and pricing matters, e-commerce, omnichannel, dual distribution, platform regulation, online restrictions and liability of service providers. More recently she particularly focuses on novel regulatory topics and transformative law deriving from EU strategies concerning digital markets, circularity and sustainability. Tosca combines her expertise of the legal frameworks on digital markets and ESG compliance to offer clients integrated and holistic advice. Both from an antitrust, consumer protection and product compliance angle, Tosca's main practice comprises compliance, sanctions and risk management advice, as well as assisting and representing companies in challenging matters from (EU) regulators and enforcement authorities.

Kennedy Van der Laan
Molenwerf 16
1014 BG Amsterdam
Netherlands

Tel: +31 20 5506 809
Email: tosca.bokhove@kvdl.com
URL: www.kvdl.com

We are an independent Dutch law firm that was established 25 years ago. We service multinationals, local companies and government bodies with specialist legal know-how and services. We offer a broad range of legal expertise (full-service). Together with our clients, and based on our industry knowledge, we reach solid and pragmatic solutions for disputes, transactions and strategic decision-making. Our advice is always concise, clear and guiding.

www.kvdl.com

Kennedy Van der Laan

New Zealand

Jackson Russell



Darryl King

1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

There are no laws specifically regulating franchising in New Zealand, and there is no generally applicable definition of “franchise” in New Zealand law.

1.2 What laws regulate the offer and sale of franchises?

There are no laws specifically regulating the offer and sale of franchises in New Zealand. The offer and sale of franchises is regulated by general contract and commercial law including the common law applying to contracts and trade practices, and legislation such as the Fair Trading Act 1986 (**Fair Trading Act**), the Contract and Commercial Law Act 2017 (**CCLA**) and New Zealand’s competition laws in the Commerce Act 1986 (the **Commerce Act**) (which deal with such things as misrepresentations, anti-competitive behaviour and cartel conduct).

1.3 If a franchisor is proposing to appoint only one franchisee/licensee in your jurisdiction, will this person be treated as a “franchisee” for purposes of any franchise disclosure or registration laws?

No, there are no franchise disclosure or registration laws in New Zealand. The appointment of only one franchisee/licensee in New Zealand does not have disclosure or registration implications.

1.4 Are there any registration requirements relating to the franchise system?

No, there are not.

1.5 Are there mandatory pre-sale disclosure obligations?

No, there are no mandatory pre-sale disclosure obligations (however, see question 1.6 for the disclosure obligations that apply to members of the Franchise Association of New Zealand Inc. (**FANZ**), New Zealand’s national franchise association).

1.6 Do pre-sale disclosure obligations apply to sales to sub-franchisees? Who is required to make the necessary disclosures?

There is no mandatory disclosure regime.

Franchisors and master franchisees who choose to become members of FANZ have pre-sale disclosure obligations that are contained in FANZ’s Code of Practice. In summary, the Code requires members to disclose specified information to prospective franchisees and sub-franchisees at least 14 days before signing a franchise agreement.

1.7 Is the format of disclosures prescribed by law or other regulation, and how often must disclosures be updated? Is there an obligation to make continuing disclosure to existing franchisees?

As set out above, there is no mandatory disclosure regime.

For FANZ members, the FANZ Code of Practice specifies the information that must be contained in a member’s disclosure document, and members are encouraged to show the information in the order contained in the Code. The disclosure document must be updated at least annually.

A disclosure document must be provided to an existing franchisee in conjunction with the renewal of the franchise agreement within one month of being requested by the franchisee. In addition, the financial disclosures contained in the disclosure document must be provided to any existing franchisee on request.

1.8 What are the consequences of not complying with mandatory pre-sale disclosure obligations?

As noted above, there are no mandatory pre-sale disclosure obligations except for franchisors who join FANZ.

Non-compliance with disclosure obligations by FANZ members would constitute a failure to comply with FANZ’s Code of Practice. The board of FANZ could, in theory, impose sanctions under the regulations of FANZ (FANZ is not responsible for policing pre-sale disclosure, however). Sanctions may include removal, or suspension of the member from membership of FANZ and the recovery of reasonable costs incurred by FANZ.

1.9 Are there any other requirements that must be met before a franchise may be offered or sold?

There are no specific laws governing the offer or sale of a franchise. This is governed by normal commercial laws.

1.10 Is membership of any national franchise association mandatory or commercially advisable?

Membership of the national franchise association (being FANZ) is voluntary. Joining FANZ brings a number of benefits. Membership demonstrates to prospective and existing franchisees a commitment to best practice in franchising. FANZ provides regular networking, learning and development opportunities by way of webinars, meetings, training and a national conference. FANZ runs an annual awards evening recognising franchising leaders. FANZ undertakes surveys on franchising in New Zealand. FANZ also provides members with marketing benefits by way of direct membership and strategic partnerships. Membership also supports FANZ's advocacy work.

1.11 Does membership of a national franchise association impose any additional obligations on franchisors?

In addition to the disclosure obligations discussed above, obligations on franchisor members of FANZ include:

- Franchisors must comply with the FANZ's Rules, Code of Practice and Code of Ethics.
- Franchisors must agree to comply with FANZ's prescribed standards of conduct.
- A seven-day cooling off period must be given to new franchisees.
- Franchise agreements must include certain provisions, including an obligation on both the franchisor and franchisee to comply with the New Zealand laws and specified alternative dispute resolution provisions.

1.12 Is there a requirement for franchise documents or disclosure documents to be translated into the local language?

There is no legal obligation for franchise documents or disclosure documents to be translated into local languages. From a commercial perspective, it is advisable for franchise documents and disclosure documents to be in English, as if they are not, they might attract only limited interest from potential franchisees.

2 Business Organisations Through Which a Franchised Business Can be Carried On

2.1 Are there any foreign investment laws that impose restrictions on non-nationals in respect of the ownership or control of a business in your jurisdiction?

The Overseas Investment Act 2005 (OIA) imposes restrictions on non-nationals in respect of the ownership or control of a New Zealand business and certain land. In practice, these restrictions are likely to be of limited impact in the franchising context. This is because, in general terms, the restrictions apply to non-nationals acquiring interests in high-value businesses (usually of NZ\$100 million or more) and so these do not typically capture franchise businesses. The OIA also imposes restrictions on non-nationals acquiring interests in land (including certain leases of land) but these will generally not form part of the ownership or operation of a franchise business.

The OIA is complex legislation, and we strongly recommend that non-nationals entering the New Zealand market obtain legal advice on how it applies to and may restrict their intended activities.

2.2 What forms of business entity are typically used by franchisors?

Typically, franchisors use a limited liability company as this offers the protection of limited liability to shareholders. There is nothing to prevent other entities being used (which could include a limited partnership). Foreign franchisors may issue franchises or a master franchise directly, or they may operate through a New Zealand branch or subsidiary (or other New Zealand entity).

2.3 Are there any registration requirements or other formalities applicable to a new business entity as a pre-condition to being able to trade in your jurisdiction?

In New Zealand, there is no general requirement for registration or a business licence to start a new New Zealand business but there may be registration requirements depending on the business structure. Before trading via a new New Zealand company, the company needs to be incorporated and registered with the New Zealand Companies Register. A foreign company intending to carry on business in New Zealand must either register as an "overseas company" with the New Zealand Companies Office (to operate through a New Zealand branch) or incorporate a New Zealand subsidiary.

All new businesses also need to register with New Zealand's revenue authority, Inland Revenue. The choice of business structure will have New Zealand tax consequences, and advice should be sought.

3 Competition Law

3.1 Provide an overview of the competition laws that apply to the offer and sale of franchises.

By way of an overview, New Zealand competition law (the Commerce Act) prohibits (among other things):

- agreements that substantially lessen competition in a market;
- agreements that fix, maintain or control prices, that restrict output or capacity, or allocate markets or customers (**cartel provisions**);
- a person or business taking advantage of their dominant position in a market for an anti-competitive purpose; and
- a supplier specifying a minimum price at which its goods or services can be sold by another (resale price maintenance).

The Commerce Act does not apply any special treatment to franchises. Franchisors and franchisees are treated as separate (potentially competing) businesses by the Commerce Act.

Cartel provisions

The Commerce Act's cartel provisions have particular application to franchising due to the limitations on the franchisee's market freedom that are inherent in franchising. A cartel provision is an agreement or arrangement between competitors that (in summary) has the purpose, effect or likely effect of:

- *Fixing prices* – including controlling or maintaining prices, discounts, rebates, etc.
- *Restricting output* – including restrictions as to supplying to certain persons (on the sell side) and approved supplier arrangements (on the buy side).
- *Allocating markets* – including as to areas, customers or channels.

It is generally safest to assume that a competitive relationship exists between a franchisor and a franchisee in New Zealand. A franchisor or one of its related companies is likely to compete

with one or more of its franchisees at some point and, if not, most franchise systems are likely to be considered competitors of their franchisees by way of the “hub and spoke” nature of the franchise system.

An exemption to the cartel provisions (the “collaborative activity” exemption) allows many franchise agreement provisions that would otherwise be an illegal cartel provision provided each provision is reasonably necessary for the purposes of the franchise.

It is important that a franchisor obtains advice to ensure that its franchise agreement is compliant with competition law.

3.2 Is there a maximum permitted term for a franchise agreement?

No, there is not.

3.3 Is there a maximum permitted term for any related product supply agreement?

No, there is not.

3.4 Are there restrictions on the ability of the franchisor to impose minimum resale prices?

Yes, this is illegal under the Commerce Act.

3.5 Encroachment – are there any minimum obligations that a franchisor must observe when offering franchises in adjoining territories?

No, there are not.

3.6 Are in-term and post-term non-compete and non-solicitation of customers covenants enforceable?

To be enforceable, in-term and post-term non-compete and non-solicitation of customer covenants must be justifiable, reasonable, and otherwise comply with New Zealand law.

Non-compete and non-solicitation of customer covenants are likely to be cartel provisions under the Commerce Act as they restrict output (as explained at question 3.1). Accordingly, they need to be assessed to ensure they fit under the collaborative activity exemption to the Commerce Act (broadly that the terms are reasonably necessary for the purposes of the collaborative activity).

In respect of enforcing post-term non-compete clauses, in addition to showing that the collaborative activity exception applies, the New Zealand competition regulator has said that it would need to consider whether the restraint is reasonable at common law. To enforce a restraint at common law, the franchisor must show:

- that it has a “protectable interest” to justify the non-compete; and
- the non-compete must be no wider than is necessary to protect that interest.

4 Protecting the Brand and Other Intellectual Property

4.1 How are trade marks protected?

New Zealand recognises many types of trade marks – these can include (amongst other signs) words, logos, shapes, colours,

sounds, or any combination of these. New Zealand law protects both registered and unregistered trade marks.

The protection of registered trade marks is governed by the Trade Marks Act 2002. Registration of a trade mark makes it easier for trade mark owners to enforce their rights and protect against infringing use (compared to if a trade mark is unregistered). To obtain registration for a trade mark, an application must be filed with the Intellectual Property Office of New Zealand (**IPONZ**). Trade mark registration lasts for 10 years in New Zealand, and can be renewed for further periods of 10 years following expiry. There are no interim filing requirements during the registration period.

Owners of unregistered trade marks may also enforce their trade marks rights if another party illegally uses or copies that trade mark. This will generally involve either a claim in passing off and/or a claim under the Fair Trading Act for misleading and deceptive conduct. These types of actions, however, require the trade mark owner to prove certain matters – for example, that their trade mark has generated sufficient goodwill, that the “passing off” has caused quantifiable damage to the trade mark owner, and/or that the other party’s conduct was misleading and deceptive. These legal requirements do not have to be proved if the infringement is of a registered trade mark.

Franchisors should consider conducting searches and applying to register their trade marks locally as soon as possible (preferably prior to commencing operations in New Zealand) to ensure that they get adequate protection, and to ensure that the trade mark does not infringe another business’s trade mark.

New Zealand is also party to the Madrid Protocol, which allows trade mark owners to apply for their trade mark in 130 participating countries. Franchisors may choose to extend their existing registration to New Zealand (assuming their local jurisdiction is also a member of the Madrid system) by submitting a request through the World Intellectual Property Organisation.

4.2 Are know-how, trade secrets and other business-critical confidential information (e.g. the Operations Manual) protected by local law?

New Zealand has a variety of common law rights that protect know-how, trade secrets and other business-critical confidential information, but there is no single piece of legislation that covers this type of information.

The obligations to keep such information confidential are also usually captured by the franchise agreement, confidentiality agreements, supply agreements, or employment/contractor agreements with staff, and the unauthorised dissemination of such information could give rise to a claim for breach of contract in addition to the other avenues available at common law.

4.3 Is copyright (in the Operations Manual or in proprietary software developed by the franchisor and licensed to the franchisee under the franchise agreement) protected by local law?

The Copyright Act 1994 offers copyright protection for original literary works, which can include computer programs or other documents like an Operations Manual. The owner of copyright in a work has certain exclusive rights in relation to that work, including the right to make copies of that work, to publish and sell that work to others, and to adapt that work (amongst other rights).

Copyright protection in New Zealand arises automatically when the original work is created, and there is no formal registration process for copyright in New Zealand. It is a good practice to use a © symbol to indicate that a work is subject to copyright, but this is not a legal requirement. Copyright for literary works lasts during and for 50 years from the end of the author’s life.

Franchise agreements and supply agreements will often specify the copyrighted information and material that is owned and licensed between the parties, including how the proprietary software or other copyright owned by the franchisor can be used, and any licensing fees that need to be paid. Any proprietary material of the franchisor should be carefully documented in these agreements to ensure clarity as to the ownership of this proprietary information and the permitted scope of its use. Having these terms clearly set out in a written agreement can also help minimise the risk of any unauthorised use (whether inadvertent or otherwise).

5 Liability

5.1 What remedies can be enforced against a franchisor for failing to comply with mandatory disclosure obligations? Is a franchisee entitled to rescind the franchise agreement and/or claim damages?

There is no mandatory disclosure regime that a franchisor must comply with under New Zealand law in respect of offering franchises for sale.

As set out at question 1.6, there is a disclosure regime that applies to franchisors who have chosen to join FANZ. Set out at question 1.8 are the possible consequences of failing to comply with the FANZ disclosure regime. These do not entitle a franchisee to rescind the franchise agreement and/or claim damages.

5.2 In the case of sub-franchising, how is liability for disclosure non-compliance or for pre-contractual misrepresentation allocated between franchisor and master franchisee? If the franchisor takes an indemnity from the master franchisee in the Master Franchise Agreement, are there any limitations on such an indemnity being enforceable against the master franchisee?

There are no franchise-specific laws that allocate liability in this manner, and general commercial laws will apply. As noted above, there is no mandatory disclosure regime applying to franchising. In respect of pre-contractual misrepresentation, liability will ordinarily sit with the master franchisee as the party who made the misrepresentation (unless, for example, the master franchisor actively participated in the misrepresentation or the misrepresentation was made on its behalf).

In practice, the master franchise agreement between the franchisor and master franchisee will usually specifically provide that the parties are not each other's agents and that they will not have liability for representations made by the other. The master franchise agreement is also likely to contain an indemnity from the master franchisee for such liability. There are no specific laws limiting the enforceability of an indemnity of this nature.

5.3 Can a franchisor successfully avoid liability for pre-contractual misrepresentation by including a disclaimer in the franchise agreement?

No, a disclaimer in itself is unlikely to be fully effective to exclude liability for a pre-contractual misrepresentation by the franchisor. There are no franchise-specific laws applying to this question and it must be considered under the general law. Whether a franchisor may be able to avoid liability will depend on the terms of the particular clause, the law that applies and the relevant facts. Set out below is a summary of some laws that may be applicable. Franchisors should ensure they have good systems in place to ensure misstatements do not occur, and to identify before the franchise agreement is signed any misstatements that may have occurred.

If a franchisor includes a clause in its franchise agreement that denies any pre-contract representations were made, or that they were terms of the contract, or that they were relied on by the other party, this clause could be challenged by a franchisee under section 50 of the CCLA. Section 50 provides that a court, in any legal proceedings in relation to the agreement, is not prevented from inquiring into and determining any question about an alleged pre-contractual misrepresentation, unless the court considers that it is fair and reasonable that the clause should be conclusive between the parties, having regard to specified matters.

In addition, unfair contract terms in "small trade contracts" can be declared to be unfair and unenforceable under the Fair Trading Act. A small trade contract includes standard form contracts between businesses operating in trade, where the expectation is that the value of the contract will be NZ\$250,000 or less in any 12-month period. Franchise agreements will potentially come within this definition and so be subject to the unfair contract terms rules. The test for unfairness is if the term:

1. would cause **significant imbalance** in the parties' rights and obligations;
2. is not reasonably necessary to protect the **legitimate interests** of the party who benefits from it; and
3. would cause **detriment** to the other party.

If a franchise agreement is a "small trade contract" under the Fair Trading Act, then a clause in it under which a franchisor purports to avoid liability for pre-contract misrepresentation might be an unfair term. As set out above, if the clause is declared by a court to be unfair, it will be unenforceable.

5.4 Does local law permit class actions to be brought by a number of aggrieved franchisees and, if so, are class action waiver clauses enforceable?

New Zealand law does not currently use the term "class actions". Claims that may be considered class actions in other jurisdictions can be brought as "representative actions" under New Zealand court rules. "Representative actions" allow a claim to be brought "on behalf of, or for the benefit of, all persons with the same interest in the subject matter of the proceeding". As there is no statutory framework, representative actions can be inefficient and expensive as the courts need to determine complex procedural issues. As New Zealand does not have a class actions regime, class action waiver clauses are not included in New Zealand franchise agreements.

The New Zealand Law Commission recently completed a review of class actions and litigation funding in New Zealand in response to an increasing number of large representative proceedings in New Zealand. The Law Commission released a report (May 2022) recommending the establishment of a class actions regime, including the enactment of legislation to regulate class actions and litigation funding. It remains to be seen whether the government will introduce legislation to give effect to the recommendation.

6 Governing Law

6.1 Is there a requirement for franchise documents to be governed by local law? If not, is there any generally accepted norm relating to choice of governing law, if it is not local law?

No, there is no requirement for franchise documents to be governed by local law. Generally, in practice the governing jurisdiction will be that of the franchisor, or master franchisee. For example, where the franchisor is based overseas, they are likely to choose their local jurisdiction to govern the agreement with their New Zealand master franchisee. The master franchisee

will choose New Zealand as the governing law for their agreements with the sub-franchisees.

6.2 Do the local courts provide a remedy, or will they enforce orders granted by other countries' courts, for interlocutory relief (injunction) against a franchisee to prevent damage to the brand or misuse of business-critical confidential information?

Enforceability of foreign judgments in New Zealand will depend on which country the order has been made in and the type of judgment. New Zealand has several statutes governing the enforcement of foreign judgments in New Zealand courts. Generally, these are based on reciprocity and/or common connection, such as membership of the Commonwealth.

6.3 Is arbitration recognised as a viable means of dispute resolution and is your country a signatory to the New York Arbitration Convention on the Recognition and Enforcement of Foreign Arbitral Awards? Do businesses that accept arbitration as a form of dispute resolution procedure generally favour any particular set of arbitral rules?

Arbitration is recognised as a viable means of dispute resolution in New Zealand, with statutory governance provided by the Arbitration Act 1996. New Zealand has ratified the New York Arbitration Convention on the Recognition and Enforcement of Foreign Arbitral Awards and incorporates the treaty in the Arbitration Act 1996. Businesses that accept arbitration in New Zealand often follow rules published by the New Zealand Dispute Resolution Centre.

7 Real Estate

7.1 Generally speaking, is there a typical length of term for a commercial property lease?

The term of a commercial lease varies according to the nature, quality and landlord of the premises, and the location. For example, retail spaces may range from three to five years, while a commercial office will often have a longer term of nine years or more (but there has been a growing trend in New Zealand for an increasing number of shorter office lease terms), and hotels will usually require a far longer term. In all cases, it is common to have an option to renew for one or more terms.

7.2 Is the concept of an option/conditional lease assignment over the lease (under which a franchisor has the right to step into the franchisee/tenant's shoes under the lease, or direct that a third party (often a replacement franchisee) may do so upon the failure of the original tenant or the termination of the franchise agreement) understood and enforceable?

Yes, these concepts are understood and enforceable. In practice, the franchisor would have a clause in its franchise agreement that obliges the franchisee to procure that its premises lease includes a right in favour of the franchisor to take an assignment of the lease in certain circumstances (such as termination of the franchise agreement or on the franchisee experiencing insolvency issues). The franchisee would need to get its landlord to agree to such right being included in its lease. This clause may be attractive to some landlords as it means the landlord has a readily available new tenant if something goes wrong with the franchisee.

7.3 Are there any restrictions on non-national entities holding any interest in real estate, or being able to sub-lease property?

Yes (in addition, see our answer at question 2.1). There are restrictions on having an interest in or leasing (for more than 10 years) "sensitive land" (which includes residential land, large rural blocks, land that borders land with special features and historic land).

7.4 Give a general overview of the commercial real estate market. To what extent has the real estate market been affected by the Coronavirus pandemic? Specifically, can a tenant expect to secure an initial rent free period when entering into a new lease (and if so, for how long, generally), or are landlords demanding "key money" (a premium for a lease in a flagship location)?

While there are regional variations in the New Zealand commercial real estate market, at the time of writing both retail and secondary office space demand remains relatively weak, while prime office markets are stronger. The industrial market has held up well.

The pandemic affected the commercial real estate market in several ways. During lockdown, retail businesses suffered as online shopping accelerated, alongside a discernible increase in retail vacancies as shops closed. Post-lockdown, retail spaces on the outer edges of city centres recovered much faster, as more people continued to work from home. Since the pandemic, there has been a shift into higher quality spaces. While the market has started to recover from the pandemic, rising interest rates, high inflation and challenging economic conditions have slowed such recovery.

Rent-free periods for new commercial leases are common, but are built into a higher face rent. The rent-free period may be implemented at the beginning of the lease or spread throughout the term. The amount of any rent-free period will vary depending on the lease term and type of property. An alternative to a rent-free period is a landlord payment towards tenant fitout works. Demands for "key money" are not common.

8 Online Trading

8.1 If an online order for products or request for services is received from a potential customer located outside the franchisee's exclusive territory, can the franchise agreement impose a binding requirement for the request to be re-directed to the franchisee for the territory from which the sales request originated?

Yes. However, this requirement will be a cartel provision and the franchisor would need to ensure the collaborative activity exception to the Commerce Act applies to the franchise agreement term (refer to question 3.6).

8.2 Are there any limitations on a franchisor being able to require a former franchisee to assign local domain names to the franchisor on the termination or expiry of the franchise agreement?

No, there are not.

9 Termination

9.1 Are there any mandatory local laws that might override the termination rights one might typically expect to see in a franchise agreement?

In simple terms, no. The CCLA does empower a contracting party to cancel a contract in circumstances of repudiation, breach, and misrepresentation but those rights are subject to any express provisions in the contract that provide remedies for those matters. The CCLA does not limit a franchisor's termination rights. Unfair contract terms rules in the Fair Trading Act require termination rights to be fair.

9.2 Are there local rules that impose a minimum notice period that must be given to bring a business relationship that has existed for a number of years to an end, which will apply irrespective of the length of the notice period set out in the franchise agreement?

No, there are no such local rules.

10 Joint Employer Risk and Vicarious Liability

10.1 Is there a risk that a franchisor may be regarded as a joint employer with the franchisee in respect of the franchisee's employees? If so, can anything be done to mitigate this risk?

Yes, but the risk is low. For a franchisor to have liability as an employer/joint employer, there would need to be a contract of service between the worker and the franchisor. In franchise scenarios, the franchisor does not pay the worker and usually the franchisee is incorporated, so will most likely be precluded from an employee classification. A joint employment scenario can arise where related entities provide or accept liability for obligations arising out of employment such as payroll or jointly receiving the benefit of work undertaken by the employee. These factors are unlikely in a franchise situation but should be avoided by franchisors not wishing to be categorised as employers for any purposes. Joint employment scenarios can also arise in cases of common control of a worker. In a typical franchise, work is usually performed for the franchisee and an employment agreement between the worker and franchisee exists in relation to that work. Unless the franchisor is exercising direct control over the work, the risk of a franchisor being found to be a joint employer is low.

Franchisors in New Zealand need to be aware of the possible application of the Employment Relations (Triangular Employment) Amendment Act 2019 (Act). While the Act does not create an employment relationship between franchisor and worker, a franchisor can potentially fall within the definition of "controlling third party" (CTP). The Act requires the CTP to have a contract or arrangement with an employer under which the employee of the employer performs work for the benefit of the CTP. It also requires the CTP to exercise control or direction over the employee (or entitlement to do this) that is similar to the control or direction an employer exercises in relation to an employee. Case law has yet to determine whether a franchisee's employee performs work for the benefit of a franchisor in terms of this legislation. However, the legislation has the additional requirement for control or direction over the employee or an entitlement to exercise such control, which is unlikely to exist in most franchise systems.

10.2 Is there a risk that a franchisor may be held to be vicariously liable for the acts or omissions of a franchisee's employees in the performance of the franchisee's franchised business? If so, can anything be done to mitigate this risk?

It is common for employers to be vicariously liable for the acts of employees in the course of their employment. In most cases a franchisor will not be held to be a joint employer of a franchisee's employees and therefore not vicariously liable for any wrongs they commit. Generally, an entity in an independent contractor relationship such as a franchisor/franchisee relationship would not be vicariously liable for the actions of the other contracting party. This would make it even less arguable that a franchisor might be vicariously liable for the acts or omissions of the franchisee's employees. However, in New Zealand the Supreme Court has recognised vicarious liability arising out of an agency relationship based on a principal asking an agent to perform a task where there was inherent risk for third parties. The potential implication of this case for the franchise sector is yet to be determined. The risks for franchisors can be mitigated by requiring franchisees to comply with relevant laws including health and safety laws, and by excluding a relationship of principal and agent in the terms of a franchise agreement (and ensuring franchisees do not purport to act as an agent of the franchisor).

11 Currency Controls and Taxation

11.1 Are there any restrictions (for example exchange control restrictions) on the payment of royalties to an overseas franchisor?

No, there are no such restrictions.

11.2 Are there any mandatory withholding tax requirements applicable to the payment of royalties under a trade mark licence or in respect of the transfer of technology? Can any withholding tax be avoided by structuring payments due from the franchisee to the franchisor as a management services fee rather than a royalty for the use of a trade mark or technology?

New Zealand imposes non-resident withholding tax on the payment of royalties to non-residents under a trade mark licence and a transfer of technology. This is subject to any limits under an applicable double tax agreement.

Structuring payments as a "management fee" will not avoid the application of appropriate withholding tax. However, franchise fees sometimes include a combination of a royalty for the use of intellectual property rights (which is potentially subject to withholding tax) and fees for goods and services (which are not subject to withholding tax). Advice should be taken in relation to tax implications of payments to and from New Zealand.

11.3 Are there any requirements for financial transactions, including the payment of franchise fees or royalties, to be conducted in local currency?

No, there are no such requirements.

12 Commercial Agency

12.1 Is there a risk that a franchisee might be treated as the franchisor's commercial agent? If so, is there anything that can be done to help mitigate this risk?

In New Zealand, unlike in some other jurisdictions, the law of agency exists primarily at common law. There is no commercial agency legislation that would apply to a franchise relationship. A franchisee could be found to be acting as an agent for the franchisor if the franchisee or the franchisor represents to other persons that the franchisee is a representative or agent of the franchisor.

The franchisor may mitigate this risk through the terms of the franchise agreement and the conduct of the franchisee, to clearly convey that the franchisee is an independent contractor and not the franchisor's agent.

13 Good Faith and Fair Dealings

13.1 Is there any overriding requirement for a franchisor to deal with a franchisee in good faith and to act fairly in its dealings with franchisees according to some objective test of fairness and reasonableness?

Under New Zealand law, there is no general obligation of good faith or fair dealing that applies to franchisors. In contract law generally, good faith is not an explicit and established doctrine in New Zealand. It may be that in the future a court implies an obligation of good faith into franchise agreements, as the courts have previously left this open. When exercising a contractual discretion, a franchisor may be obliged by common law to exercise the discretion in a manner that is not arbitrary, capricious or in bad faith, or unreasonable in the sense that no reasonable contracting party could have so acted. This requirement to act in good faith and reasonably can be excluded by the clear wording of the franchise agreement – subject to the overriding requirement that the term is not an unfair contract term (refer to question 5.3).

For members of FANZ, the FANZ Code contains obligations as to the high standard of behaviour expected of the franchisor when dealing with a franchisee.

13.2 Is there any limitation on a good faith obligation being unenforceable if it only applies from franchisee to franchisor, rather than being mutual?

There is no general limitation of this nature. However, as explained at our answer to question 5.3, a franchise agreement is subject to the Fair Trading Act's unfair contract terms provisions. A franchisor would need to ensure that a one-sided good faith clause was not "unfair" for the purposes of those provisions.

14 Ongoing Relationship Issues

14.1 Are there any specific laws regulating the relationship between franchisor and franchisee once the franchise agreement has been entered into?

No, there are no specific laws of this nature. There are laws of general application, including those mentioned above. And for members of FANZ, the FANZ Code contains conduct obligations.

15 Franchise Renewal

15.1 What disclosure obligations apply in relation to a renewal of an existing franchise at the end of the franchise agreement term?

Please see our answer to question 1.5.

15.2 Is there any overriding right for a franchisee to be automatically entitled to a renewal or extension of the franchise agreement at the end of the initial term irrespective of the wishes of the franchisor not to renew or extend?

No, there are no such requirements. The renewal and extension rights will be those set out in the franchise agreement.

15.3 Is a franchisee that is refused a renewal or extension of its franchise agreement entitled to any compensation or damages as a result of the non-renewal or refusal to extend?

No compensation or damages will be payable unless the franchise agreement provided a right to renew or extend such franchise agreement, and the franchisor refused to comply with those rights. In the latter case contractual remedies for franchisor breach may be available to the franchisee.

16 Franchise Migration

16.1 Is a franchisor entitled to impose restrictions on a franchisee's freedom to sell, transfer, assign or otherwise dispose of the franchised business?

Yes, a franchisor is entitled to impose restrictions of this nature. However, the restrictions (which are likely to be one-sided) would need to be reasonably necessary to protect the franchisor's interests if they are to comply with the unfair contract terms rules referred to at our answer to question 5.3.

16.2 If a franchisee is in breach and the franchise agreement is terminated by the franchisor, will a "step-in" right in the franchise agreement (whereby the franchisor may take over the ownership and management of the franchised business) be recognised by local law, and are there any registration requirements or other formalities that must be complied with to ensure that such a right will be enforceable?

Yes, express "step-in rights" will be recognised by New Zealand law. There are no registration requirements or other formalities.

16.3 If the franchise agreement contains a power of attorney in favour of the franchisor under which it may complete all necessary formalities required to complete a franchise migration under pre-emption or "step-in" rights, will such a power of attorney be recognised by the courts in the jurisdiction and be treated as valid? Are there any registration or other formalities that must be complied with to ensure that such a power of attorney will be valid and effective?

Yes, a power of attorney of this nature will be recognised by New Zealand courts. A power of attorney does not need to be

registered but does need to be in writing and drafted correctly to come into effect, and to provide the necessary powers to the attorney. The attorney may be a class of person, for example a director of the franchisor. If the franchisor wishes to be able to sign a deed under the power of attorney, the power of attorney needs to be signed by the franchisee as a deed.

17 Electronic Signatures and Document Retention

17.1 Are there any specific requirements for applying an electronic signature to a franchise agreement (rather than physically signing a “wet ink” version of the agreement), and are electronic signatures recognised as a valid way of creating a binding and enforceable agreement?

Electronic signatures are a valid way of creating a binding and enforceable agreement. Best practice is to use a reputable digital signing platform that generates a digital certificate. This will ensure that the electronic signature is presumed to be reliable under the digital signature provisions of the CCLA.

A franchise agreement can also be signed electronically, but not use a signing platform, for example, by pasting in PDF signatures to indicate acceptance of terms. However, these simple forms of electronic signature are much less secure than digital signatures and more vulnerable to being challenged.

17.2 If a signed/executed franchise agreement is stored electronically (either having been signed using e-signatures or a “wet ink” version having been scanned and saved as an electronic file), can the paper version of the agreement be destroyed?

Yes, it can be destroyed as there is no requirement for the paper version of the agreement to be retained. The electronic version should, of course, be safely stored and readily accessible in case it is needed.

18 Current Developments

18.1 What is the biggest challenge franchising is facing in your jurisdiction and how are franchisors responding to that challenge?

The biggest challenge for many franchise systems in New Zealand is a large shortage of skilled people to fill jobs, compounded by immigration restrictions and wage inflation. New Zealand closed its borders for an extended period in response to COVID-19, and then the government significantly tightened immigration policy to significantly reduce the number of immigrants working in New Zealand – with these restrictions, notably, only recently being partially unwound. In addition, immigration settings for franchisees have changed, and franchisees have additional hurdles they must satisfy to employ immigrant workers. Staff shortages and a low unemployment rate have also impacted the recruitment of new franchisees.

Franchisors are responding to staff shortages in a wide variety of ways, including:

- increasing wages;
- increasing efficiency and automation;
- being more sophisticated about staff retention and attraction, including ways to make the organisation more attractive to current and future employees;
- targeting staff of similar organisations;
- providing further support and guidance to franchisees about staff recruitment and retention; and
- temporarily reducing customer capacity in store (for example, reducing restaurant capacity where there are staff shortages).



Darryl King is a partner in Jackson Russell's Business Law team. Darryl has over 25 years' experience of advising on, structuring and negotiating commercial transactions across a range of industry sectors. Darryl has particular expertise and interest in franchising and licensing. Darryl leads Jackson Russell's franchise law team that helps established franchisors, master franchisees and businesses looking to franchise/license their business.

Darryl is an active member of the Franchise Association of New Zealand Inc. (**FANZ**). He is a member of both FANZ's Board and FANZ's Advocacy and Legislation committee.

Jackson Russell
Level 13, 41 Shortland Street
Auckland
New Zealand

Tel: +64 9 300 6935
Email: darryl.king@jacksonrussell.co.nz
URL: www.jacksonrussell.co.nz

Jackson Russell is one of New Zealand's leading law firms, with expertise in franchising. Our franchising experts help franchisors and licensors across a range of industry sectors to build, grow, manage and exit their franchise/licence businesses. We have extensive expertise in structuring, documenting and negotiating franchise transactions in New Zealand. We provide a full range of legal services to help existing franchisors/licensors, businesses looking to establish a system in New Zealand, and international franchisors looking to appoint a master franchisee in New Zealand. Our franchising experts are passionate about franchising and take a leading role in supporting FANZ and franchising in New Zealand.

www.jacksonrussell.co.nz

 **JACKSON RUSSELL**
LAWYERS
ESTD 1844

Nigeria

ÆLEX



Tiwalola Osazuwa



Ifeoluwa Ebiseni



Nenjom Asuk

1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

Nigeria does not have a specific franchise law and, as such, there is no legal definition of a franchise. However, the Nigerian International Franchising Association defines franchising as a business arrangement whereby the franchisor grants the franchise operator (the “franchisee”) the right to distribute certain products or services in a particular way, at a particular location and for specified periods of time. In return, the franchisee pays the franchisor fees and royalties.

1.2 What laws regulate the offer and sale of franchises?

There is currently no specific law in Nigeria that regulates the offer and sale of franchises.

However, the National Office for Technology Acquisition and Promotion Act, Chapter N62, Laws of the Federation of Nigeria, 2004 (“NOTAP Act”) regulates the transfer of foreign technology to Nigeria. A franchise arrangement is regarded as involving the transfer of technology and so is regulated by the provisions of the NOTAP Act. It is worth noting a Franchising Regulation Bill, 2022, which appeared before the National Assembly. The Bill scaled through second reading at the House of Representatives on 27 March 2023.

1.3 If a franchisor is proposing to appoint only one franchisee/licensee in your jurisdiction, will this person be treated as a “franchisee” for purposes of any franchise disclosure or registration laws?

Yes, the franchisee/licensee will be treated as a franchisee under these circumstances.

1.4 Are there any registration requirements relating to the franchise system?

By virtue of the provisions of the NOTAP Act, all agreements

for the transfer of technology between a foreign transferor and a Nigerian transferee must be registered with the National Office for Technology Acquisition and Promotion (“NOTAP”). More specifically, Section 4 of the NOTAP Act states that such agreements are registrable if their purpose or intent is, in the opinion of NOTAP, wholly or partially for or in connection with the following:

- use of trademarks;
- use of patented inventions;
- supply of technical expertise in the form of technical assistance of any description whatsoever;
- supply of detailed engineering drawings;
- supply of machinery and plant; and
- provision of operating staff, managerial assistance, and the training of personnel.

As a franchise arrangement involves the transfer of technology, it is required to be registered with NOTAP.

1.5 Are there mandatory pre-sale disclosure obligations?

As a result of the absence of a franchise-specific law, there are no pre-contract disclosure requirements or formalities that apply to a franchise arrangement. However, disclosure requirements under the laws of contract will apply. For instance, the principle of misrepresentation under the common law of contract will apply to a franchise relationship.

1.6 Do pre-sale disclosure obligations apply to sales to sub-franchisees? Who is required to make the necessary disclosures?

Please refer to our answer to question 1.5 above.

1.7 Is the format of disclosures prescribed by law or other regulation, and how often must disclosures be updated? Is there an obligation to make continuing disclosure to existing franchisees?

Please refer to our answer to question 1.5 above.

1.8 What are the consequences of not complying with mandatory pre-sale disclosure obligations?

Please refer to our answer to question 1.5 above.

1.9 Are there any other requirements that must be met before a franchise may be offered or sold?

There are no prescribed requirements that must be met.

1.10 Is membership of any national franchise association mandatory or commercially advisable?

No, membership of a national franchise association is not mandatory. There is also no commercial benefit derived from belonging to a national franchise association.

1.11 Does membership of a national franchise association impose any additional obligations on franchisors?

No, membership of a national franchise association does not impose any additional obligations on franchisors.

1.12 Is there a requirement for franchise documents or disclosure documents to be translated into the local language?

There is no legal requirement that mandates that documents should be translated into a local language. However, as the official language in Nigeria is English, in practice, all documents are required to be in the English language.

2 Business Organisations Through Which a Franchised Business Can be Carried On

2.1 Are there any foreign investment laws that impose restrictions on non-nationals in respect of the ownership or control of a business in your jurisdiction?

Yes, there are. Generally, under the Companies and Allied Matters Act, 2020, every person who intends to carry on business in Nigeria must, in the first instance, incorporate a local company for that purpose.

Furthermore, the Immigration Act 2015 and the Nigerian Investment Promotion Commission Act, Chapter N1, Laws of the Federation of Nigeria, 2004 provide that a company with non-nationals must ensure that it registers its business, and also obtains a business permit, to be able to carry on business in Nigeria.

2.2 What forms of business entity are typically used by franchisors?

In Nigeria, the business entities typically used by franchisors are limited liability companies, which may be either private or public.

2.3 Are there any registration requirements or other formalities applicable to a new business entity as a pre-condition to being able to trade in your jurisdiction?

To commence trading in Nigeria, a new business entity must fulfil the following requirements:

- register with the Nigerian Investment Promotion Commission (applies only to companies with foreign participation);
- register with the Federal Inland Revenue Service for tax purposes;
- open a corporate bank in a commercial bank in Nigeria and import capital; and
- obtain a business permit and expatriate quota from the Ministry of Interior (applies only to companies with foreign participation and in cases where foreigners are to be employed).

Certain sector-specific requirements could also apply, depending on the sector in which the new business entity intends to operate.

3 Competition Law

3.1 Provide an overview of the competition laws that apply to the offer and sale of franchises.

There are no competition laws that specifically regulate the offer and sale of franchises. However, the Federal Competition and Consumer Protection Act 2019 (the “FCCPA”), which applies to all undertakings and activities within Nigeria, prohibits persons from entering into agreements that have the effect of restraining or preventing competition. Any agreement entered into in violation of the FCCPA will be void and of no legal effect.

3.2 Is there a maximum permitted term for a franchise agreement?

Yes, the NOTAP Act stipulates that an agreement for the transfer of technology must not exceed a term of 10 years. In practice, however, NOTAP usually approves a franchise agreement for a period of three years and, upon its expiration, it may be renewed for further periods of three years.

3.3 Is there a maximum permitted term for any related product supply agreement?

No. There is no maximum permitted term and parties are generally at liberty to agree on a term. However, it should be noted that NOTAP has the power to refuse the registration of a franchise agreement that contains provisions that impose an obligation on the franchisee to acquire equipment, tools, parts or raw materials exclusively from the franchisor or any other person or given source.

3.4 Are there restrictions on the ability of the franchisor to impose minimum resale prices?

Yes, NOTAP has the power to refuse the registration of a franchise agreement that contains any provision on resale prices that are in contravention of the Price Control Act or any other enactment relating to prices imposed for domestic consumption or for exportation.

In addition, pursuant to the FCCPA, any term or provision in an agreement for the sale of goods will be void to the extent that it purports to establish minimum prices for the resale of goods in Nigeria.

3.5 Encroachment – are there any minimum obligations that a franchisor must observe when offering franchises in adjoining territories?

There are no such obligations.

3.6 Are in-term and post-term non-compete and non-solicitation of customers covenants enforceable?

Under Nigerian law, non-compete or non-solicitation clauses are regarded as covenants in restraint of trade and are generally *prima facie* unenforceable, unless they are reasonable with reference to the interest of the parties concerned and of the public.

4 Protecting the Brand and Other Intellectual Property

4.1 How are trade marks protected?

An invented word, device, label, ticket, brand, letter, numeral, company name or any combination of the above can be registered with the Trademarks Registry as a trademark in Nigeria. Marks that are deceptive or scandalous, generic and descriptive, geographical names in their ordinary signification, or chemical substances cannot be registered as trademarks.

Nigeria is a first-to-file jurisdiction; therefore, for a mark to enjoy statutory protection, it must be registered in Nigeria. An application to register a trademark must be made to the Registrar of Trademarks and must contain the specification of goods.

The registration process currently takes between 12 and 18 months. A trademark is registered for an initial period of seven years but can be renewed for further periods of 14 years.

An unregistered trademark can be protected in Nigeria under the common law tort of passing off. For this purpose, the owner of the unregistered mark must show that:

- The trademark has acquired goodwill.
- Use of the mark by the third party is likely to result in confusion or deception.
- Use of the trademark by the third party is likely to cause damage.

4.2 Are know-how, trade secrets and other business-critical confidential information (e.g. the Operations Manual) protected by local law?

Trade secrets and confidential information do not have statutory protection in Nigeria but may be protected by contract, law of tort and other basic legal principles.

4.3 Is copyright (in the Operations Manual or in proprietary software developed by the franchisor and licensed to the franchisee under the franchise agreement) protected by local law?

Yes, operations manuals and proprietary software are regarded as literary works, which are protected as copyrights.

An application may be made to the Nigerian Copyrights Commission to register a work that is eligible for protection under Nigerian law. However, this registration does not confer copyright, as copyright arises automatically upon the creation of a work. A work is not eligible for copyright protection unless

sufficient effort has been expended to give it an original character and it is fixed in a definite medium of expression. The registration/entry of the work into the copyright register only serves as evidence (at first instance) of the work and the particulars entered into the register.

5 Liability

5.1 What remedies can be enforced against a franchisor for failing to comply with mandatory disclosure obligations? Is a franchisee entitled to rescind the franchise agreement and/or claim damages?

As a result of the absence of a franchise-specific law, there are no mandatory disclosure requirements or formalities that apply to a franchise arrangement. Disclosure requirements under the laws of contract will, however, apply. For instance, the principle of misrepresentation under the common law of contract will apply to a franchise relationship. The franchisee may be entitled to rescind the agreement and/or claim damages, depending on the terms of the agreement and what amounts to a material breach, as agreed by the parties.

5.2 In the case of sub-franchising, how is liability for disclosure non-compliance or for pre-contractual misrepresentation allocated between franchisor and master franchisee? If the franchisor takes an indemnity from the master franchisee in the Master Franchise Agreement, are there any limitations on such an indemnity being enforceable against the master franchisee?

Please refer to our answer to question 5.1 above.

5.3 Can a franchisor successfully avoid liability for pre-contractual misrepresentation by including a disclaimer in the franchise agreement?

There are no statutory restrictions on the inclusion of a disclaimer in a franchise agreement, nor is there Nigerian case law on this specific point. Nigerian Courts, however, do not take a lenient approach towards pre-contractual misrepresentations. In *Kuforji & Anor v. V.Y.B Nig. Ltd* (1981) LPELR-1716(SC), the Supreme Court held that where pre-contractual misrepresentation induces the party to whom such representation is made to enter into a contract, a valid cause of action arises.

5.4 Does local law permit class actions to be brought by a number of aggrieved franchisees and, if so, are class action waiver clauses enforceable?

As a result of the absence of franchise-specific laws in Nigeria, there is no law that regulates the institution of class actions by aggrieved franchisees. Under Nigerian civil law, however, the institution of class actions by aggrieved persons is permitted.

A franchise agreement may, however, have specific dispute resolution clauses that would provide that any dispute that arises between the franchisor and the franchisee must be settled by arbitration or other alternative dispute resolution mechanisms. This may prevent the aggrieved franchisees from bringing a class action as they would all have to institute their respective suits against the franchisor.

6 Governing Law

6.1 Is there a requirement for franchise documents to be governed by local law? If not, is there any generally accepted norm relating to choice of governing law, if it is not local law?

Contracting parties generally have the freedom to choose the law that would regulate their transaction and the courts would generally uphold foreign choice of law clauses as long as these do not violate the provisions of any Nigerian law.

However, by virtue of Section 6 (2) of the NOTAP Act, NOTAP may refuse to register any agreement that compels the franchisee to submit to foreign jurisdiction in any controversy arising for a decision concerning the interpretation or enforcement in Nigeria of any such contract or agreement or any provisions thereof.

Though, in practice, NOTAP has a preference for the adoption of Nigerian law as the governing law of a franchise agreement, it is not unusual for the choice of law of a foreign jurisdiction to be accepted, particularly English law.

6.2 Do the local courts provide a remedy, or will they enforce orders granted by other countries' courts, for interlocutory relief (injunction) against a franchisee to prevent damage to the brand or misuse of business-critical confidential information?

Interim/interlocutory foreign orders/judgments are not enforceable in Nigeria. Nigerian courts will permit the registration and enforcement of a foreign order/judgment only if it is final and conclusive between the parties thereto and it is payable, thereunder, a sum of money, not being a sum payable in respect of taxes or other charges of a like nature or in respect of a fine or other penalty.

6.3 Is arbitration recognised as a viable means of dispute resolution and is your country a signatory to the New York Arbitration Convention on the Recognition and Enforcement of Foreign Arbitral Awards? Do businesses that accept arbitration as a form of dispute resolution procedure generally favour any particular set of arbitral rules?

Yes, arbitration is recognised as a viable means of dispute resolution and Nigeria is a signatory to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. Nigeria acceded to the convention on March 17, 1970 and it came into force on June 15, 1970. The convention is set out in the Schedule 2 to the Arbitration and Conciliation Act, Chapter A18, Laws of the Federation of Nigeria ("Arbitration Act"), pursuant to Section 54 (1) of the Arbitration Act.

The more commonly used arbitral rules include: the Arbitration Rules made pursuant to the Arbitration Act; the United Nations Commission on International Trade Law ("UNCITRAL") Rules; and the Rules of Arbitration of the International Chamber of Commerce.

7 Real Estate

7.1 Generally speaking, is there a typical length of term for a commercial property lease?

Typically, leases are granted for a term of three to five years and are made subject to renewal by the parties.

7.2 Is the concept of an option/conditional lease assignment over the lease (under which a franchisor has the right to step into the franchisee/tenant's shoes under the lease, or direct that a third party (often a replacement franchisee) may do so upon the failure of the original tenant or the termination of the franchise agreement) understood and enforceable?

While this is not a common arrangement in Nigeria, and can even be considered unusual, an agreement of the parties in relation to a conditional lease will be enforceable.

7.3 Are there any restrictions on non-national entities holding any interest in real estate, or being able to sub-lease property?

Yes, the Acquisition of Lands by Aliens Law of the various states in Nigeria contains restrictions on the right of non-national entities to acquire interest in real estate.

Under the Acquisition of Lands by Aliens Law of Lagos State, for instance, non-national entities are not permitted to acquire any interest or right (for more than three years) in or over any land from a Nigerian, unless the transaction under which such interest or right is being acquired has been previously acquired by the Governor.

7.4 Give a general overview of the commercial real estate market. To what extent has the real estate market been affected by the Coronavirus pandemic? Specifically, can a tenant expect to secure an initial rent free period when entering into a new lease (and if so, for how long, generally), or are landlords demanding "key money" (a premium for a lease in a flagship location)?

The real estate market in Nigeria has not been significantly affected by the Coronavirus pandemic.

It is possible for a tenant in Nigeria to enjoy rent-free periods or periods where lower rent may be paid, especially where the tenant intends to make significant renovations that will improve the value of the leased property. Rental value is generally dictated by a number of factors, including the location and state of a property.

8 Online Trading

8.1 If an online order for products or request for services is received from a potential customer located outside the franchisee's exclusive territory, can the franchise agreement impose a binding requirement for the request to be re-directed to the franchisee for the territory from which the sales request originated?

Yes, the franchise agreement may contain provisions to this effect.

8.2 Are there any limitations on a franchisor being able to require a former franchisee to assign local domain names to the franchisor on the termination or expiry of the franchise agreement?

No, there are no such specific limitations.

However, NOTAP has the power to refuse the registration of a franchise agreement that imposes an obligation on a franchisee to assign to the franchisor, or any other person designated by the

franchisor, patents, trademarks, technical information, innovations or improvements obtained by the franchisee with no assistance from the franchisor or such other person.

9 Termination

9.1 Are there any mandatory local laws that might override the termination rights one might typically expect to see in a franchise agreement?

There are no mandatory laws that might override the termination rights of the parties to a franchise agreement. The terms on which a franchise agreement will be terminated, and the consequences of such termination, will be as agreed by the parties in the franchise agreement.

9.2 Are there local rules that impose a minimum notice period that must be given to bring a business relationship that has existed for a number of years to an end, which will apply irrespective of the length of the notice period set out in the franchise agreement?

Please see our response to question 9.1 above.

10 Joint Employer Risk and Vicarious Liability

10.1 Is there a risk that a franchisor may be regarded as a joint employer with the franchisee in respect of the franchisee's employees? If so, can anything be done to mitigate this risk?

The risk that the franchisor may be regarded as a joint employer may arise if the franchisor performs, in respect of the franchisee's employees, certain duties of an employer, such as paying salaries, carrying out performance evaluations and appointing or terminating employees.

In view of the limited amount of control that a franchisor is permitted to exercise over the operations of a franchisee by NOTAP, this risk should be mitigated if the parties in their operations comply with the NOTAP Act and guidelines.

It is also common for clauses expressly stating that neither party is an employee, agent or partner of the other to be inserted into franchise agreements.

10.2 Is there a risk that a franchisor may be held to be vicariously liable for the acts or omissions of a franchisee's employees in the performance of the franchisee's franchised business? If so, can anything be done to mitigate this risk?

No, this risk will only arise where the franchisor and franchisee are regarded as co-employees.

11 Currency Controls and Taxation

11.1 Are there any restrictions (for example exchange control restrictions) on the payment of royalties to an overseas franchisor?

Yes, one of the consequences of a failure to obtain NOTAP's approval in respect of a franchise agreement is that the franchisee will be unable to make remittances to an overseas franchisor from funds obtained from the official foreign exchange market.

By virtue of the provisions of the Foreign Exchange Manual issued by the Central Bank of Nigeria, offshore franchise fee payments can only be made by a commercial bank, upon presentation of the prescribed documentation. These include:

- a duly completed Form "A";
- a certified copy of the franchise agreement registered by NOTAP;
- a certificate of registration issued by NOTAP;
- a demand note from the franchisor;
- evidence of payment of tax on the amount to be remitted;
- audited account for the relevant period; and
- confirmation of reasonableness of fees from NOTAP.

Payments to an overseas franchisor may be made in any convertible currency, including British Pounds, United States Dollars and Euros.

11.2 Are there any mandatory withholding tax requirements applicable to the payment of royalties under a trade mark licence or in respect of the transfer of technology? Can any withholding tax be avoided by structuring payments due from the franchisee to the franchisor as a management services fee rather than a royalty for the use of a trade mark or technology?

Yes, withholding tax at a rate of 10% will apply to royalty payments made to an overseas franchisor.

The tax exposure of the franchisor may be reduced if the franchisor is incorporated in a country with which Nigeria has a double taxation agreement. Some of the countries with which Nigeria currently has a double taxation agreement include: Belgium; Canada; China; the Czech Republic; France; Italy; the Netherlands; Pakistan; Romania; the Slovak Republic; South Africa; and the United Kingdom.

The withholding tax requirement will not be avoided by structuring royalty payments as a management services fee as the same withholding tax rate will apply.

11.3 Are there any requirements for financial transactions, including the payment of franchise fees or royalties, to be conducted in local currency?

Yes, all transactions conducted between a Nigerian franchisor and franchisee are to be denominated in Naira, which is the official currency in Nigeria. This will not apply to payments from a local franchisee to a foreign franchisee or any other foreign entity.

12 Commercial Agency

12.1 Is there a risk that a franchisee might be treated as the franchisor's commercial agent? If so, is there anything that can be done to help mitigate this risk?

Under the common law doctrine of privity, it is only the parties to a contract that can enforce the contract with the aim of seeking its benefits. The contract cannot bind a third party, and third parties cannot take or accept the benefits or liabilities under it. On this basis, a third party cannot seek to enforce a franchise agreement to which it is not a party; and neither can a third party sue a franchisor for business relations between itself and the franchisee.

An exception to this doctrine is where an agency relationship can be established, as between the franchisor and franchisee and, in which case, the franchisee is construed as being the franchisor's agent. In this case, the franchisor may be liable for the actions of the franchisee.

However, in many cases, the franchisee is a distinct business entity from the franchisor and it may be difficult for a third party to prove an agency relationship between the franchisor and the franchisee, i.e. it dealt with the franchisee under the impression that it was in fact dealing with the franchisor.

13 Good Faith and Fair Dealings

13.1 Is there any overriding requirement for a franchisor to deal with a franchisee in good faith and to act fairly in its dealings with franchisees according to some objective test of fairness and reasonableness?

There are no express or implied obligations imposed on a franchisor under Nigerian law. The obligations of the parties will be determined by the express provisions of the franchise agreement.

13.2 Is there any limitation on a good faith obligation being unenforceable if it only applies from franchisee to franchisor, rather than being mutual?

Please refer to our response to question 13.1 above.

14 Ongoing Relationship Issues

14.1 Are there any specific laws regulating the relationship between franchisor and franchisee once the franchise agreement has been entered into?

No, there are no specific laws. The laws of contract will operate to regulate the relationship between a franchisor and franchisee.

15 Franchise Renewal

15.1 What disclosure obligations apply in relation to a renewal of an existing franchise at the end of the franchise agreement term?

There is no law that imposes disclosure obligations in relation to the renewal of an existing franchise. However, the laws of contract will operate to enforce any contractual terms on renewal, which may be contained in a franchise agreement.

15.2 Is there any overriding right for a franchisee to be automatically entitled to a renewal or extension of the franchise agreement at the end of the initial term irrespective of the wishes of the franchisor not to renew or extend?

Please see our response to question 15.1 above.

15.3 Is a franchisee that is refused a renewal or extension of its franchise agreement entitled to any compensation or damages as a result of the non-renewal or refusal to extend?

Please see our response to question 15.1 above.

16 Franchise Migration

16.1 Is a franchisor entitled to impose restrictions on a franchisee's freedom to sell, transfer, assign or otherwise dispose of the franchised business?

Yes. This may be regulated by contract between the franchisor and franchisee.

16.2 If a franchisee is in breach and the franchise agreement is terminated by the franchisor, will a "step-in" right in the franchise agreement (whereby the franchisor may take over the ownership and management of the franchised business) be recognised by local law, and are there any registration requirements or other formalities that must be complied with to ensure that such a right will be enforceable?

Yes, a step-in right will be recognised under Nigerian law. The formalities for this will depend on how the parties intend for the step-in right to be exercised.

16.3 If the franchise agreement contains a power of attorney in favour of the franchisor under which it may complete all necessary formalities required to complete a franchise migration under pre-emption or "step-in" rights, will such a power of attorney be recognised by the courts in the jurisdiction and be treated as valid? Are there any registration or other formalities that must be complied with to ensure that such a power of attorney will be valid and effective?

Yes, such a power of attorney will be recognised by the courts. Note, however, that a power of attorney requiring the donee to execute a deed must be under seal.

Although attestation of a power of attorney is not a mandatory requirement, it is necessary that a power of attorney be attested to by a Notary Public, Judge or Magistrate for the presumption of due execution. Where the power of attorney is executed outside Nigeria, it may be witnessed by a Notary Public who attests or certifies deeds and other documents and has worldwide recognition.

17 Electronic Signatures and Document Retention

17.1 Are there any specific requirements for applying an electronic signature to a franchise agreement (rather than physically signing a "wet ink" version of the agreement), and are electronic signatures recognised as a valid way of creating a binding and enforceable agreement?

Generally, electronic signatures are acceptable and recognised as a valid way of creating a binding agreement. Statutory provisions in support of this are found in the Evidence Act 2011 and the Cybercrimes (Prohibition, Prevention, etc.) Act 2015. Note, however, that in Nigeria, many government agencies, and in particular, NOTAP, require "wet ink" signatures on documents submitted to them.

17.2 If a signed/executed franchise agreement is stored electronically (either having been signed using e-signatures or a “wet ink” version having been scanned and saved as an electronic file), can the paper version of the agreement be destroyed?

Yes. Under Nigerian evidence law, copies of a document made from the original by mechanical or electronic processes can be admitted as secondary evidence if the original has been lost.

It is, however, not advisable to destroy the hard copy of the agreement without cause. Please also take note of our response for question 17.1 above.

18 Current Developments

18.1 What is the biggest challenge franchising is facing in your jurisdiction and how are franchisors responding to that challenge?

A challenge franchising is currently facing in Nigeria is access to foreign currency, with which payments under franchise agreements are to be made, and the constant devaluation of the Naira in

relation to the United States Dollar, which has resulted in higher costs for franchises as Nigeria is largely import-dependent.

The increase of value-added tax from 5% to 7.5% has also led to an increase in the cost of goods and services required by franchises.

The recent government policy removing fuel subsidy is also likely to have a significant impact on the cost of doing business in general. Franchise systems will be impacted by this, since raw material costs, as well as transportation and employee costs, are likely to increase. It also remains to be seen if the resulting inflation will impact on customer purchasing behaviour, especially as it relates to inessential products or services.



Tiwalola Osazuwa is a Partner in the Corporate and Commercial, IP/TMT and Mergers and Acquisitions Practice Groups at AELEX. She has advised local and multinational companies on corporate structure, regulatory compliance and acquisitions. She has advised several reputable franchises on market entry in Nigeria, including Kahala (Cold Stone Creamery), Johnny Rockets, Hard Rock Café and Tutor Doctor. Within the intellectual property practice, she regularly advises clients on the protection of intellectual property rights, intellectual property portfolio management and proffering legal solutions for combating counterfeiting of products and parallel imports. She is a member of the Famous and Well-known Marks Committee of the International Trademark Association and an Officer in the International Franchising Committee of the International Bar Association.

AELEX

4th Floor, Marble House, 1 Kingsway Road
Falomo, Ikoyi, Lagos
Nigeria

Tel: +234 1 2793 3678
Email: tosazuwa@aelex.com
URL: www.aelex.com



Ifeoluwa Ebiseni is an Associate in the IP, TMT and Data Privacy practice groups at AELEX.

She advises clients on various intellectual property matters (both of a contentious and non-contentious nature) relating to trademarks, patents, copyright, franchising, licensing, distributorship arrangements and technology transfer. Her experience cuts across intellectual property advisory, cybersecurity, data protection compliance, corporate financing and investment in the TMT space.

She manages the intellectual property portfolios of several companies, such as Volvo Holdings, MTN Group Management Services, Total Energies SE, and Lenovo, and represents these clients in opposition matters.

She has advised several clients on the registration and renewal of their franchise and management service agreements with NOTAP and the registration of products with the National Agency for Food and Drug Administration ("NAFDAC"). She is a member of the INTA and the Intellectual Property and Technology Law Committee of the IBA.

AELEX

4th Floor, Marble House, 1 Kingsway Road
Falomo, Ikoyi, Lagos
Nigeria

Tel: +234 1 2793 3678
Email: iebiseni@aelex.com
URL: www.aelex.com



Nenjom Asuk is an Associate at AELEX. Her practice areas include IP and TMT. She advises clients on various intellectual property matters (both of a contentious and non-contentious nature) relating to trademarks, patents, copyright, franchising, licensing, distributorship arrangements and technology transfer.

She manages the trademark portfolio of several multi-national companies and has advised several clients on the registration of their franchise agreements with NOTAP. She is a member of the INTA and the International Bar Association.

AELEX

4th Floor, Marble House, 1 Kingsway Road
Falomo, Ikoyi, Lagos
Nigeria

Tel: +234 1 2793 3678
Email: nasuk@aelex.com
URL: www.aelex.com

AELEX is a full-service commercial and litigation law firm with one of the largest offices in West Africa. AELEX has offices in Lagos, Port Harcourt and Abuja in Nigeria and Accra, Ghana.

AELEX has earned a reputation for excellent work in various practice areas including Dispute Resolution, Intellectual Property, Franchising and Licensing, Corporate/Commercial, Telecommunications and Technology, Taxation, Banking and Finance, Mergers and Acquisitions, Infrastructure, Energy and Natural Resources, Foreign Direct Investment, Labour and Employment, and Transportation. Lawyers in the firm are admitted to practise in several jurisdictions including Nigeria, New York, Ghana, England and Wales, and are qualified in disciplines such as political science and engineering.

The quality of the firm's work has led to it receiving top rankings and being featured in *The Legal 500*, *Chambers Global Guide*, *IFLR1000's Guide to the World's Leading Law Firms* and *Who's Who Legal* as Nigerian "Firm of the Year".

www.aelex.com

AELEX

LEGAL PRACTITIONERS & ARBITRATORS

Norway

Advokatfirmaet Forsberg DA



Per Forsberg



Dag Thorstensen

1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

Franchise contracts are not regulated by statute in Norway. Consequently, there is no statutory Norwegian definition of a franchise. In order to define franchising, such definition in the DCFR (IV. E. – 4:101) is sometimes referred to in legal theory in connection with descriptions of the legal scope of franchise relationships:

“This Chapter applies to contracts under which one party (the franchisor) grants the other party (the franchisee), in exchange for remuneration, the right to conduct a business (franchise business) within the franchisor’s network for the purposes of supplying certain products on the franchisee’s behalf and in the franchisee’s name, and under which the franchisee has the right and the obligation to use the franchisor’s tradename or trademark or other intellectual property rights, know-how and business method.”

1.2 What laws regulate the offer and sale of franchises?

Since there is no Norwegian statute specifically governing franchise contracts, the offer and sale of franchises will be governed by the Agreements Act 1918, as well as the non-statutory general law of contracts and the principle of contractual freedom.

1.3 If a franchisor is proposing to appoint only one franchisee/licensee in your jurisdiction, will this person be treated as a “franchisee” for purposes of any franchise disclosure or registration laws?

In principle, yes. However, there are no franchise-specific registration or disclosure laws applicable to franchisees/licensees in Norway (see questions 1.4 and 1.5 below).

1.4 Are there any registration requirements relating to the franchise system?

No franchise-specific statutory registration requirements apply to franchise systems for franchisors or franchisees. However, all businesses must register with the national Brønnøysund Register Centre.

1.5 Are there mandatory pre-sale disclosure obligations?

Under Norwegian law, there are no statutory pre-sale disclosure obligations. Nonetheless, prior to entering into a franchise agreement, both franchisor and franchisee must observe the general non-statutory contractual duty to disclose relevant information to the other party. Furthermore, under the same general contractual rules, a party must not misrepresent information to the other party.

1.6 Do pre-sale disclosure obligations apply to sales to sub-franchisees? Who is required to make the necessary disclosures?

Again, no statutory pre-sale disclosure obligations apply. The non-statutory obligation to disclose relevant information and not misrepresent information in relation to the sub-franchisee will rest with the party that issues the sub-licence to the sub- licensee in question.

1.7 Is the format of disclosures prescribed by law or other regulation, and how often must disclosures be updated? Is there an obligation to make continuing disclosure to existing franchisees?

Under the non-statutory general rule of contractual loyalty, both parties must disclose relevant information to the other party to the extent necessary to enable performance of the rights and obligations of the contract, even if this is not explicitly agreed in the franchise agreement. No specific intervals apply, but information must be given when the other party has a relevant need for the information.

1.8 What are the consequences of not complying with mandatory pre-sale disclosure obligations?

The consequences of failing to comply with pre-sale disclosure requirements will be contractual remedies (see question 5.1 below).

1.9 Are there any other requirements that must be met before a franchise may be offered or sold?

No formal franchise-specific requirements must be met before a franchise may be offered or sold.

1.10 Is membership of any national franchise association mandatory or commercially advisable?

There are no mandatory rules concerning membership. A Norwegian franchise association was formed in 1973, but was dissolved after a few decades. A new national franchise association called Norges Franchiseforening was formed in February 2022. The purpose of the existing association is to act as a service body for both franchisors and franchisees, and to promote knowledge-based ethical use of franchises. So far, the new association has not been particularly visible in the public domain.

1.11 Does membership of a national franchise association impose any additional obligations on franchisors?

There are no such obligations, other than those that may follow from the statutes of the association.

1.12 Is there a requirement for franchise documents or disclosure documents to be translated into the local language?

There is no requirement for the use of Norwegian language in franchise documents or disclosure documents, either in original documents or as translated versions.

2 Business Organisations Through Which a Franchised Business Can be Carried On

2.1 Are there any foreign investment laws that impose restrictions on non-nationals in respect of the ownership or control of a business in your jurisdiction?

As a main rule, non-nationals are free to acquire ownership or control of a business in Norway.

2.2 What forms of business entity are typically used by franchisors?

The typical business entity used is a private limited liability company (Norwegian translation: *aksjeselskap*). The minimum share capital of a PLC is NOK 30,000, the company must have a Norwegian street address as its office address, there must be at least one owner, all participants must be at least 18 years of age and they must have a Norwegian personal identity number, or in the case of individuals residing outside Norway, a so-called D number.

2.3 Are there any registration requirements or other formalities applicable to a new business entity as a pre-condition to being able to trade in your jurisdiction?

For a business with the purpose of trading as franchisor or franchisee, there are no franchise-specific registration requirements or other formalities as a pre-condition for being able to trade in Norway. However, once an undertaking starts its business, it will be subject to a number of formalities, e.g. registration of the undertaking with the Brønnøysund Register Centre. Also, the undertaking will be required to register with the so-called Aa Registry if it has employees, as well as the VAT register once the turnover exceeds NOK 50,000.

3 Competition Law

3.1 Provide an overview of the competition laws that apply to the offer and sale of franchises.

The (Norwegian) Competition Act 2004 (*Lov om konkurranse mellom foretak og kontroll med foretakssammenslutninger (konkurranse-loven)*) applies to agreements, acts and concerted practices which have as their object or effect the prevention, restriction or distortion of competition with effect in the realm of Norway. The EEA Competition Act 2004 (*Lov om gjennomføring og kontroll av EOS-avtalens konkurranseregler mv. (EOS-konkurranseloven)*) applies to agreements, acts and concerted practices which have as their object or effect the prevention, restriction or distortion of competition with effect on trade between Norway and other EEA Member States.

3.2 Is there a maximum permitted term for a franchise agreement?

No, there is freedom of contract in this field.

3.3 Is there a maximum permitted term for any related product supply agreement?

No, there is freedom of contract related to this, and no maximum permitted term.

3.4 Are there restrictions on the ability of the franchisor to impose minimum resale prices?

The franchisor may give a guiding price and set a maximum price so long as each of the parties do not have a market share of more than 30%. Section 10 of the Norwegian Competition Act corresponds with Article 101 of the Treaty on the Functioning of the European Union (TFEU), which prohibits cooperation that prevents, restricts or distorts competition. Any agreed minimum resale price will be a breach of the Competition Act.

3.5 Encroachment – are there any minimum obligations that a franchisor must observe when offering franchises in adjoining territories?

The European Commission Vertical Block Exemption Regulation Restraints (VBER) is implemented into Norwegian law. A franchise agreement will be considered as a vertical cooperation and will be regulated by VBER. Exclusive supply is allowed as a main rule for a territory. Prohibition of online sales are not allowed for any territory.

3.6 Are in-term and post-term non-compete and non-solicitation of customers covenants enforceable?

As a starting point, this is subject to the principle of contractual freedom. Non-compete and non-solicitation clauses will be enforceable to the extent that they are necessary in order to protect against competition and do not unreasonably restrict the access of gainful activity, cf. the Agreements Act 1918 section 38. However, if such clauses are part of employment contracts, they will be regulated by the Working Environment Act (WEA) and may only be entered into and enforced on certain terms for a

maximum of up to one year after termination of the employment relationship. Any non-competition clause outside the area of WEA which contains a long duration period, and without remuneration provisions, may be subject to contractual censorship by the courts.

4 Protecting the Brand and Other Intellectual Property

4.1 How are trade marks protected?

Trademarks are protected by the Norwegian Trademarks Act 2010. Norway has implemented the EU Trademark Directive. Norway is not covered by a trademark registered in the EU. Use of the application guide on the Norwegian Industrial Property Office's website is the simplest way of applying for a trademark in Norway. Protection may also be obtained through extensive use on the Norwegian market (use-acquired rights). A trademark registration is valid for 10 years. The trademark registration will cease if the applicant fails to pay the renewal fee and the late payment fee before the final deadline.

4.2 Are know-how, trade secrets and other business-critical confidential information (e.g. the Operations Manual) protected by local law?

The Norwegian Marketing Control Act 2009 section 28 sets the framework for the protection of know-how and company secrets, stating that a person who has obtained knowledge or possession of a trade secret in connection with an employment, business relationship or a position of trust shall not exploit the secret unlawfully in the course of trade. Trade secrets are also protected by the Penal Code 2005 and the Trade Secrets Act 2020. The best way to protect trade secrets, etc., is to regulate this in the franchise agreement either by a non-compete clause and/or by a professional secrecy clause.

4.3 Is copyright (in the Operations Manual or in proprietary software developed by the franchisor and licensed to the franchisee under the franchise agreement) protected by local law?

Norway has several laws protecting intellectual property rights, including the Copyright Act 2018. As a general rule, products covered by an intellectual property right can only be used when the rights holder has agreed to such exploitation. Such exclusive rights are also protected by international conventions, which Norway has acceded to.

5 Liability

5.1 What remedies can be enforced against a franchisor for failing to comply with mandatory disclosure obligations? Is a franchisee entitled to rescind the franchise agreement and/or claim damages?

As pointed out under question 1.5 above, no statutory franchise-specific disclosure obligations apply in Norway, whether pre-sale or post-sale. However, breach by one party of the general contractual duty to disclose and not misrepresent relevant information may give the other party a right of remedies for breach of contract.

These may include not only the right of compensation or price reduction for the other party, but also a right to rescind if the breach of disclosure is material.

5.2 In the case of sub-franchising, how is liability for disclosure non-compliance or for pre-contractual misrepresentation allocated between franchisor and master franchisee? If the franchisor takes an indemnity from the master franchisee in the Master Franchise Agreement, are there any limitations on such an indemnity being enforceable against the master franchisee?

This is up to contractual freedom in the agreement(s) between the parties concerned. As long as the Master Franchise Agreement is not based on an invalidating defect in contractual assent, or the agreement has subsequently become invalid pursuant to the Agreements Act 1918 section 36, such indemnities will be enforceable.

5.3 Can a franchisor successfully avoid liability for pre-contractual misrepresentation by including a disclaimer in the franchise agreement?

Both franchisor and franchisee may to some extent avoid liability for pre-contractual misrepresentation by way of an agreed disclaimer. However, the courts will not respect such disclaimers if the misrepresentation is intentional. The courts will also likely not accept such a disclaimer if the misrepresentation is made with gross negligence.

5.4 Does local law permit class actions to be brought by a number of aggrieved franchisees and, if so, are class action waiver clauses enforceable?

The Norwegian Disputes Act 2005 allows for class actions to be brought by aggrieved franchisees on certain terms. The claims must be based on the same or essentially the same factual and legal basis, the same court must be competent to adjudicate all the claims under essentially the same procedural rules, class action must be the best procedure and there must be a basis for appointing a class representative.

A class action waiver clause generally blocking a potentially aggrieved party from the right to have a claim adjudicated by the courts will not be valid under Norwegian law. However, a voluntary agreed waiver clause settling a claim after the dispute has arisen will, generally speaking, be valid.

6 Governing Law

6.1 Is there a requirement for franchise documents to be governed by local law? If not, is there any generally accepted norm relating to choice of governing law, if it is not local law?

No, this is subject to contractual freedom and the parties may agree on the venue and choice of law. A typical wording relating to choice of venue, governing law, etc., could be the following:

"This Agreement shall be governed by the laws of (... e.g. Norway). Any dispute, controversy or claim arising out of or in connection with this Agreement, or the breach, termination or invalidity thereof, which is not settled by mutual agreement, shall be subject to the jurisdiction of (...) District Court."

6.2 Do the local courts provide a remedy, or will they enforce orders granted by other countries' courts, for interlocutory relief (injunction) against a franchisee to prevent damage to the brand or misuse of business-critical confidential information?

Local courts do provide remedies for a temporary injunction when urgency is involved, and the aggrieved party cannot wait for a judgment to be handed down. Norwegian law allows for the recognition and enforcement of certain foreign civil and commercial court decisions, and Norway has recognised the Lugano Convention (2007) on Jurisdiction and Enforcement of Decisions in Civil and Commercial Matters.

6.3 Is arbitration recognised as a viable means of dispute resolution and is your country a signatory to the New York Arbitration Convention on the Recognition and Enforcement of Foreign Arbitral Awards? Do businesses that accept arbitration as a form of dispute resolution procedure generally favour any particular set of arbitral rules?

Arbitration is recognised and subject to contractual freedom, irrespective of whether the parties are Norwegian or foreign. Under the Norwegian Arbitration Act 2004 (NAA) section 45, arbitration awards can be enforced in Norway no matter what country the award is from. The procedural rules can to a large degree be agreed between the parties as part of the arbitration agreement. Norway has also signed The New York Arbitration Convention. The parties may decide the arbitral rules, but details which are not covered by such agreement will be dealt with according to the NAA and in the manner the tribunal deems appropriate.

7 Real Estate

7.1 Generally speaking, is there a typical length of term for a commercial property lease?

The length of term for a commercial property lease is subject to contractual freedom. A typical lease period is often five years, with the right to renew for one or more periods.

7.2 Is the concept of an option/conditional lease assignment over the lease (under which a franchisor has the right to step into the franchisee/tenant's shoes under the lease, or direct that a third party (often a replacement franchisee) may do so upon the failure of the original tenant or the termination of the franchise agreement) understood and enforceable?

The concept mentioned is subject to contractual freedom between the franchisor and franchisee, and should be regulated in the franchise contract. However, such an arrangement would typically be dependent on approval from the landlord, and the lease agreement should hence reflect such rights. It is common to agree on an option to take over the tenancy with the consent of the landlord, whose consent cannot be unreasonably withheld.

7.3 Are there any restrictions on non-national entities holding any interest in real estate, or being able to sub-lease property?

As a main rule, there are no restrictions in place on non-national entities owning real estate or being able to sub-lease property.

7.4 Give a general overview of the commercial real estate market. To what extent has the real estate market been affected by the Coronavirus pandemic? Specifically, can a tenant expect to secure an initial rent free period when entering into a new lease (and if so, for how long, generally), or are landlords demanding "key money" (a premium for a lease in a flagship location)?

The COVID-19 pandemic brought an abrupt halt to the rental market in the second quarter of 2020. As society gradually reopened, activity also picked up in the office rental market. The office rental market is doing well, as of the time of publication, and we are still registering rental price growth. The estimates for inflation have been adjusted upwards, and the Bank of Norway now expects inflation to end at 6% on average for 2023. If this is the outcome, the CPI adjustment of leases from January 2024 is likely to end on approximately 5%. An initial rent-free period for a new lease, or "key money" for a premium location is not common. Premium location is reflected only in the rental price per square meter.

8 Online Trading

8.1 If an online order for products or request for services is received from a potential customer located outside the franchisee's exclusive territory, can the franchise agreement impose a binding requirement for the request to be re-directed to the franchisee for the territory from which the sales request originated?

No limitations of internet sales are allowed, as this is considered to be passive sales in relation to the customer.

8.2 Are there any limitations on a franchisor being able to require a former franchisee to assign local domain names to the franchisor on the termination or expiry of the franchise agreement?

This is subject to an agreement between the parties.

9 Termination

9.1 Are there any mandatory local laws that might override the termination rights one might typically expect to see in a franchise agreement?

No, there are no such mandatory local laws.

9.2 Are there local rules that impose a minimum notice period that must be given to bring a business relationship that has existed for a number of years to an end, which will apply irrespective of the length of the notice period set out in the franchise agreement?

No. In the (unlikely) event that the notice period should not be set in the franchise contract, then it follows from non-statutory law of contract that termination must be given with reasonable notice.

10 Joint Employer Risk and Vicarious Liability

10.1 Is there a risk that a franchisor may be regarded as a joint employer with the franchisee in respect of the franchisee's employees? If so, can anything be done to mitigate this risk?

Under Norwegian law, each employer entity is regarded as a separate unit. The fact that many franchisors perform various services for the franchisees within the franchise concept, e.g. calculation of salary and bookkeeping, will not mean that the franchisor may be regarded as joint employer. However, if the franchisor performs employer rights and obligations in relation to employees formally employed with the franchisee, such as supervising and instructing the employees on a daily basis or paying part of the employees' salary, then there is a risk that the franchisor could be regarded as joint employer. The franchisor and franchisee should have written employment agreements with their employees which state clearly who the employer is, and should not take on employer powers in relation to employees of the other party in the franchise relationship.

10.2 Is there a risk that a franchisor may be held to be vicariously liable for the acts or omissions of a franchisee's employees in the performance of the franchisee's franchised business? If so, can anything be done to mitigate this risk?

As long as the franchisor does not take on obligations or rights as an employer in relation to employees formally employed with the franchisee (see question 10.1 above), the franchisor will not be held vicariously liable for the acts or omissions of a franchisee's employees.

11 Currency Controls and Taxation

11.1 Are there any restrictions (for example exchange control restrictions) on the payment of royalties to an overseas franchisor?

No exchange control restrictions apply on the payment of royalties to an overseas franchisor (except in the event that the overseas franchisor is subject to inter-state trade sanctions).

11.2 Are there any mandatory withholding tax requirements applicable to the payment of royalties under a trade mark licence or in respect of the transfer of technology? Can any withholding tax be avoided by structuring payments due from the franchisee to the franchisor as a management services fee rather than a royalty for the use of a trade mark or technology?

Withholding tax may be imposed on franchise royalties, provided that the franchisor and franchisee are closely related companies, and the franchisor is a tax resident in a low tax jurisdiction, but then only for the part of the franchise royalties paid for the use of intellectual property. If the management service fee is set at a typical rate for services provided by the franchisor, and no particular fee is paid for the use of a trade mark or technology, withholding tax will likely not apply. However, if the management service fee is set at a rate which could indicate that a royalty for the use of a trade mark or technology is included in the management service fee, withholding tax could apply, depending on the circumstances.

11.3 Are there any requirements for financial transactions, including the payment of franchise fees or royalties, to be conducted in local currency?

No, there are no such requirements.

12 Commercial Agency

12.1 Is there a risk that a franchisee might be treated as the franchisor's commercial agent? If so, is there anything that can be done to help mitigate this risk?

If the relationship between the franchisor and franchisee is a true franchise relationship, in which the franchisee trades at his own expense and risk, there is no risk that the franchisee would be treated as the franchisor's commercial agent. The Norwegian Agency Act implements EU Council Directive 86/653/EEC relating to self-employed commercial agents. If, in effect, there is a high degree of similarity between the position of the franchisee and the position of a commercial agent, then there is a possibility that provisions of the Agency Act may be applied analogically to the franchise contract. The franchisor can mitigate the risk by describing clearly in the franchise agreement that the franchisee operates at his own expense and risk, and follow this up by, e.g. ensuring that the franchisee is able to set his own prices.

13 Good Faith and Fair Dealings

13.1 Is there any overriding requirement for a franchisor to deal with a franchisee in good faith and to act fairly in its dealings with franchisees according to some objective test of fairness and reasonableness?

No, not generally speaking. The principle of contractual freedom allows for imbalanced contracts, e.g. because one party is better at negotiating than the other, or because one party has a stronger bargaining position than the other. However, the general duty of contractual loyalty applies both under negotiation and performance of a contract. This means, for example, that the franchisor cannot misrepresent or fail to disclose relevant facts to the franchisee. Also, if the franchise agreement is unreasonable within the meaning of the Agreements Act 1918 section 36, for which the threshold is high, the agreement may be set aside or revised by the courts.

13.2 Is there any limitation on a good faith obligation being unenforceable if it only applies from franchisee to franchisor, rather than being mutual?

No, not generally speaking. However, a one-way obligation to act in good faith is a circumstance which could be taken into consideration by the courts if asked to decide whether that franchise agreement is so manifestly unjust that it is unreasonable within the meaning of the Agreements Act 1918 section 36 (see question 13.1 above).

14 Ongoing Relationship Issues

14.1 Are there any specific laws regulating the relationship between franchisor and franchisee once the franchise agreement has been entered into?

No, there are no such laws.

15 Franchise Renewal

15.1 What disclosure obligations apply in relation to a renewal of an existing franchise at the end of the franchise agreement term?

There are none, other than those that apply for renewals of existing contracts under general non-statutory law of contracts (see questions 1.5 and 1.6 above).

15.2 Is there any overriding right for a franchisee to be automatically entitled to a renewal or extension of the franchise agreement at the end of the initial term irrespective of the wishes of the franchisor not to renew or extend?

No, not unless otherwise agreed in the franchise agreement or in a separate agreement prior to renewal.

15.3 Is a franchisee that is refused a renewal or extension of its franchise agreement entitled to any compensation or damages as a result of the non-renewal or refusal to extend?

No, not unless otherwise agreed in the franchise agreement or in a separate agreement prior to renewal.

16 Franchise Migration

16.1 Is a franchisor entitled to impose restrictions on a franchisee's freedom to sell, transfer, assign or otherwise dispose of the franchised business?

Yes, this is subject to contractual freedom between the parties.

16.2 If a franchisee is in breach and the franchise agreement is terminated by the franchisor, will a "step-in" right in the franchise agreement (whereby the franchisor may take over the ownership and management of the franchised business) be recognised by local law, and are there any registration requirements or other formalities that must be complied with to ensure that such a right will be enforceable?

Provided that the agreement between the parties must be understood to give the franchisor a step-in right and there is a breach by the franchisee, Norwegian law will respect the agreed right. If the franchisor organises the franchise he takes over into a new entity, then that entity must be registered with the Brønnøysund Register Centre, and if the franchisor takes over the employees of the franchisee, the employees must be registered with the Aa Registry at the Brønnøysund Register Centre.

16.3 If the franchise agreement contains a power of attorney in favour of the franchisor under which it may complete all necessary formalities required to complete a franchise migration under pre-emption or "step-in" rights, will such a power of attorney be recognised by the courts in the jurisdiction and be treated as valid? Are there any registration or other formalities that must be complied with to ensure that such a power of attorney will be valid and effective?

There are no formal requirements for a power of attorney to be valid in relation to franchises under Norwegian law. Hence, a

power of attorney in favour of the franchisor regarding a franchise migration or "step-in" rights will in principle be respected by the courts. However, such a power of attorney will not prevent the franchisee from disputing the (alleged) rights of the franchisor under the power of attorney before the courts.

17 Electronic Signatures and Document Retention

17.1 Are there any specific requirements for applying an electronic signature to a franchise agreement (rather than physically signing a "wet ink" version of the agreement), and are electronic signatures recognised as a valid way of creating a binding and enforceable agreement?

Norwegian law does not have formal requirements for accepting or signing franchise agreements. Even an oral agreement would be binding, but it is of course advisable to secure written proof of the agreement. Electronic signatures are recognised as a valid way of creating a binding and enforceable franchise agreement.

17.2 If a signed/executed franchise agreement is stored electronically (either having been signed using e-signatures or a "wet ink" version having been scanned and saved as an electronic file), can the paper version of the agreement be destroyed?

Yes, since there are no formal requirements under Norwegian law necessary to make a franchise agreement binding (see question 17.1 above).

18 Current Developments

18.1 What is the biggest challenge franchising is facing in your jurisdiction and how are franchisors responding to that challenge?

The biggest challenge franchising is facing in the Norwegian market is likely the competition physical outlets face from internet sales. This challenge is not much different from the same challenge traditional principals and their retailers face. There are no particular legal obstacles or legal remedies preventing or helping franchisees and franchisors in meeting this challenge, and franchise players attempt to meet it in much the same way as other traditional players in the market.



Per Forsberg has a varied background, including experience as a financial journalist in leading daily newspaper *Aftenposten* alongside his legal studies at the University of Oslo. He also served one year as a scientific assistant at the University of Oslo, where he wrote a thesis on employment law. Following his law degree in 1993, Forsberg served as a deputy lawyer and senior deputy lawyer with law firm Wikborg, Rein & Co. from 1993 to 1999, working, *inter alia*, with agency contracts and labour law. Forsberg went on to work as a partner in law firm Seland from 1999 to 2010. Forsberg went on to co-found the Law firm Forsberg DA in 2010. He has broad experience in general business law, while distribution law, franchise law and commercial agency law remain key areas of his practice. Forsberg is also author of the Norway Chapter in *EU & International Employment Law*, published by Jordan Publishing/LexisLibrary.

Advokatfirmaet Forsberg DA
P.O. Box 1289 Vika
0111 Oslo (visiting address: Stortingsgt. 22, Oslo)
Norway

Tel: +47 917 55 179
Email: pf@forsberglaw.no
URL: www.forsberglaw.no



Dag Thorstensen was educated at the University of Oslo, and has worked as a commercial lawyer since 1984. He has 36 years' experience as a partner, of which 20 years took place in the law firm Haavind. Thorstensen has been a partner in Forsberg since 2017. He has experience in most business law areas, as well as extensive experience in dispute resolution and processes. Within the field of general business law, Thorstensen has particularly worked with intermediary positions (agent, commission and independent distributors, franchise, etc.), purchase and sale of businesses, company law (especially shareholder agreements, shareholder relations, foundations, etc.), intellectual property rights and GDPR. Thorstensen was nominated for *Who's Who Legal* from 2012–2016 in the Information Technology lawyers category, and nominated in *Who's Who Legal* "Thought Leaders – Data" for 2018, 2019, 2020, 2021, 2022 and 2023. Thorstensen has been ranked in *The Legal 500*, and has "a strong track record in IT-purchase litigation", while he has also been recommended in *PLC Which Lawyer* under outsourcing: "Specialised in the IT and Technology fields. Also has experience of outsourcing projects, with special focus on ITOs." Thorstensen has experience from national and international (ICC) arbitration related to agency and franchise relationships. He has extensive experience as a board member in various companies/organisations, including Board of Director member of the International Technology Law Association (ITECHLAW), chairman of the membership committee in the same organization 2015–2019, and chairman of Ultra Fast Charging Scandinavia from 2020.

Advokatfirmaet Forsberg DA
P.O. Box 1289 Vika
0111 Oslo (visiting address: Stortingsgt. 22, Oslo)
Norway

Tel: +47 907 46 714
Email: dt@forsberglaw.no
URL: www.forsberglaw.no

Law Firm Forsberg DA is a law partnership offering assistance within the entire field of business law. The firm was formed by a group of highly experienced lawyers in 2010, and is located at the city centre of Oslo. Forsberg DA has comprehensive experience with general business law. In addition to tax and excise law, agency, distribution and franchise law are also among the key practice areas for the firm. Forsberg DA also assists clients extensively with litigation, general law of contracts, corporate law, mergers, demergers, the purchase and sale of businesses, generational transfers, construction law and real estate law. In addition to assisting Norwegian clients, Forsberg DA is instructed regularly by foreign clients and international groups. Forsberg DA also gives lectures to Regnskap Norge (Accounting Norway, the trade organisation for authorised accountants). Furthermore, Forsberg DA is a supplier of services and templates to Gyldendal Rettsdata, Practical Law (Norway's leading legal database).

www.forsberglaw.no



Saudi Arabia

Hammad and Al-Mehdar Law Firm



Suhaib Hammad

1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

The Franchise Law, promulgated by Royal Decree No. M/22 dated 9/2/1441H (corresponding to 08/10/2019G), which came into effect on 28/08/1441H (corresponding to 22/04/2020G) (the “Franchise Law”), defines the term “franchise” as: the rights granted by the franchisor to the franchisee to carry out the franchise business under the franchisee’s own account, while undertaking the use of the IP and related trademarks of the franchisor, whether with or without monetary compensation, exclusive of the compensation paid by the franchisor to the franchisee.

Commercially, in the Saudi market, a franchise is considered as a type of licence obtained by a party to allow them to have access to a business’s processes, trademarks and proprietary knowledge to provide a service or sell a product under the party’s name (franchisor).

1.2 What laws regulate the offer and sale of franchises?

Franchises in Saudi Arabia are regulated by the Ministry of Commerce (“**MOC**”), and are subject to the Franchise Law. The implementing regulations of the Franchise Law were issued on 18/09/1441H (corresponding to 11/05/2020G) (the “Implementing Regulations”). In addition, there is the Gulf Cooperation Council (“**GCC**”) Trademark Law. This Law was approved by Royal Decree No. 51 on 16/07/1435H (corresponding to 05/05/2014G), and applies to the protection, registration and licensing of trademarks, which may be offered as part of the offer and sale of franchises.

1.3 If a franchisor is proposing to appoint only one franchisee/licensee in your jurisdiction, will this person be treated as a “franchisee” for purposes of any franchise disclosure or registration laws?

Yes, a single franchisee is considered a franchisee, and is required to register as such with the Small and Medium Enterprises General Authority (“**Monsha’at**”), and must commit to the franchisee requirements set out by the Franchise Law. Furthermore, a single franchisee can be appointed as a master franchisee in Saudi Arabia and then, in the capacity of a master franchisee, the master franchisee would sub-franchise to multiple sub-franchisees in Saudi Arabia.

1.4 Are there any registration requirements relating to the franchise system?

Yes, a franchisor is required to register:

- the franchise agreement (or the sub-franchise agreement, in the case of a master franchisee); and
- the trademark and any licensed intellectual property before the Saudi Authority on Intellectual Property (“**SAIP**”).

It should be noted that the franchisor shall register or apply to register any trademark used for introducing the business model in Saudi Arabia before applying to register the franchise agreement and the disclosure document with Monsha’at, which is the competent authority responsible for overseeing the registration of franchise agreements.

1.5 Are there mandatory pre-sale disclosure obligations?

Yes, the franchisor is under an obligation to register and submit a disclosure document to Monsha’at before execution of the franchise agreement.

Documents that shall be attached along with the form to the Monsha’at are as follows:

- a statement of disclosure;
- a copy of the draft franchise agreement;
- a copy of the certification or application for registration of the trademark; and
- other documents that may be requested by Monsha’at at its discretion.

1.6 Do pre-sale disclosure obligations apply to sales to sub-franchisees? Who is required to make the necessary disclosures?

Yes, it is applicable to sales to sub-franchisees, and in this case the master franchisee is required to make the disclosure to Monsha’at in accordance with the Franchise Law as if he were the franchisor for all intents and purposes.

1.7 Is the format of disclosures prescribed by law or other regulation, and how often must disclosures be updated? Is there an obligation to make continuing disclosure to existing franchisees?

Yes, it is prescribed by the Franchise Law under a separate provision. The Franchise Law makes it an obligation on the franchisor to inform Monsha’at of any major updates to the previously submitted disclosure document, which was submitted

during the disclosure to Monsha'at prior to execution of the franchise agreement. It is worth noting that the disclosure form issued by MOC has been further updated pursuant to Ministerial Resolution No. 339 on 14/08/1444H (06/03/2023G) removing the franchisor's requirement to disclose its financial position and to furnish audited financial statements of the last two years.

1.8 What are the consequences of not complying with mandatory pre-sale disclosure obligations?

If the franchisor did not comply with the mandatory disclosure as described in the Franchise Law, the Franchisor may be subject to the following consequences:

1. pursuant to Article 19 of the Franchise Law, the franchisee may claim damages for the franchisor's non-compliance but without terminating the franchise agreement; and
2. pursuant to Article 24 of the Franchise Agreement, the franchisor might be subject to a fine not exceeding 500,000 Saudi Riyals.

1.9 Are there any other requirements that must be met before a franchise may be offered or sold?

Yes, the franchise concept must already have been executed in markets for at least one year by two companies (one of which should be the franchisor), and the franchisor should have executed the franchise concept in at least two separate locations for a period of not less than one year each.

1.10 Is membership of any national franchise association mandatory or commercially advisable?

No, it is not mandatory under the Franchise Law. However, it is always commercially advisable to join the business associations and committees overseeing the franchise industry in Saudi Arabia to be informed of updates, and, recently, to be able to provide input on the new draft Franchise Law.

1.11 Does membership of a national franchise association impose any additional obligations on franchisors?

No such obligations exist on membership of a national franchise association.

1.12 Is there a requirement for franchise documents or disclosure documents to be translated into the local language?

Yes, all documents submitted to governmental authorities in Saudi Arabia for the purpose of registering and disclosing the franchise must be translated into Arabic by a local certified translator and must be attested by the Saudi embassy/consulate in the jurisdiction of the franchisor.

2 Business Organisations Through Which a Franchised Business Can be Carried On

2.1 Are there any foreign investment laws that impose restrictions on non-nationals in respect of the ownership or control of a business in your jurisdiction?

Yes, any business owned fully or partially by a foreign investor

will be subject to the foreign investment regulations issued by the Ministry of Investment of Saudi Arabia ("MISA"). Generally speaking, the restrictions imposed on non-nationals in respect of ownership and control are in relation to trading and wholesale activities.

While the Franchise Law does not specify a full Saudi ownership requirement to the franchisor, it does, however, require the franchisor to be performing in Saudi Arabia for not less than a year and to be providing the services directly by it to be able to sub-franchise. Foreign companies must fulfil the licence requirement by MISA and requirements set out under the Franchise Law, otherwise they cannot act as a franchisor in Saudi Arabia.

2.2 What forms of business entity are typically used by franchisors?

The most common form of business entity in Saudi Arabia is a limited liability company ("LLC"). The market is slowly moving towards establishing private joint-stock companies, which are similar to corporations in other jurisdictions. As it stands, most local Saudi franchisors or master franchisees are established as LLCs. There may be a new trend emerging in Saudi for franchisors or master franchisees to establish simplified joint stock companies, which offer flexibility in management, and no minimum capital requirement, which was recently recognised under the new Companies Law issued by Royal Decree No. M/132 on 01/12/1443H (30/06/2022G).

2.3 Are there any registration requirements or other formalities applicable to a new business entity as a pre-condition to being able to trade in your jurisdiction?

In relation to general trading, a foreign-owned entity carrying out trading activities will be subject to the Saudi Foreign Investment Law (promulgated by Royal Decree No. M/1 dated 05/01/1421H (10/04/2000G), as amended) and its implementing regulations.

3 Competition Law

3.1 Provide an overview of the competition laws that apply to the offer and sale of franchises.

The applicable Competition Law in Saudi Arabia was issued by Royal Decree No. M/25 dated 04/05/1425H, as amended by Royal Decree No. M/24 dated 11/04/1435H. Saudi Arabia recently issued, on 29/03/2019G and pursuant to Royal Decree No. M/75 dated 29/06/1440H (07/03/2019G), its reinvigorated Competition Law, which came into effect 20/07/1440H (27/03/2019G).

The Saudi Competition Law is designed to protect fair competition in the market and prevent dominant players from controlling the market and imposing unfair practices on consumers. The Competition Authority in Saudi Arabia is currently concerned with regulating the practices of manufacturers and distributors of products in their dealings with sale outlets and consumers. We have yet to see a crackdown on franchisors or franchisees by the Authority. However, in theory, dominant players in the franchise industry are subject to the Saudi Competition Law and their activities must be carried out in compliance with the Law.

3.2 Is there a maximum permitted term for a franchise agreement?

No, there are no limitations; however, terms are usually for a period of five years.

3.3 Is there a maximum permitted term for any related product supply agreement?

No, there are no limitations for any related product supply agreement.

3.4 Are there restrictions on the ability of the franchisor to impose minimum resale prices?

Generally, there are no restrictions imposed on the ability of a franchisor or master franchisee to impose minimum resale prices. It is commonly understood that franchisees need to provide a similar price range, in keeping with the franchise standards; unless, of course, that franchisor is considered a dominant entity as defined by the Competition Law, in which case such practice may be considered as price-fixing by a dominant entity and thus may subject the franchisor or master franchisee to fines. That being said, we have not seen an active pursuit by the Competition Authority against franchisors and therefore the market practice is that franchisors should be able to set the pricing for the products or services as they deem fit, so long as such arrangements are commercially sound and reasonable.

3.5 Encroachment – are there any minimum obligations that a franchisor must observe when offering franchises in adjoining territories?

No, the Franchise Law does not refer to any minimum obligations.

3.6 Are in-term and post-term non-compete and non-solicitation of customers covenants enforceable?

The courts accept non-compete and non-solicitation provisions as long as they are implemented in accordance with the applicable regulations. In practice, generally, the courts would not enforce unreasonable or burdensome covenants and the courts may, at their discretion, adjust the parameters of the covenant as they see fit. For example, periods may be reduced if they are in excess of five years. Courts in Saudi Arabia will take a case-by-case approach when enforcing an injunction granted by a foreign court but, subject to reciprocity agreements with other jurisdictions, the local courts may enforce such injunctions as they are without adjustment.

4 Protecting the Brand and Other Intellectual Property

4.1 How are trade marks protected?

Trademarks are protected under the GCC Trademark Law, which was approved by Royal Decree No. 51 dated 16/07/1435H (corresponding to 05/05/2014G) and came into effect in September 2016 in Saudi Arabia, along with the Trademark Law issued by Royal Decree No. M.21 dated 01/01/1423H (15/03/2002G). A trademark registration usually lasts for a period of 10 years and can be renewed by submitting a renewal application and satisfying the renewal requirements. Failure to protect a mark in

Saudi Arabia will deny the holder of the mark any rights under the applicable regulations.

4.2 Are know-how, trade secrets and other business-critical confidential information (e.g. the Operations Manual) protected by local law?

Under the Protection of Confidential Trade Secrets Regulations issued by MOC's Ministerial Resolution No. 3318 dated 25/03/1426H (04/05/2005G) and authorised by Council of Ministers Resolution No. 50 dated 25/02/1426H (05/04/2005G), know-how and trade secrets are protected from being illegally used by third parties. Most recently, Saudi Arabia rolled out the Personal Data Protection Law issued by Royal Decree No. M/19 dated 09/02/1443H (16/09/2021G) and its amendments issued by Royal Decree No. M/147 dated 05/09/1444H (27/03/2023G) ("PDPL"), which regulates data protection of individuals and comes into effect on 14/09/2023G. Further to the PDPL, under Sharia principles, anyone's right to privacy is protected and consent must be obtained for any disclosure of personal/confidential information, unless public interest requires its disclosure. Most recently, SAIP presented the draft Intellectual Property Law in 1444H (2023G) for public consultation, which introduces the concept of trade secrets and how to best protect it.

4.3 Is copyright (in the Operations Manual or in proprietary software developed by the franchisor and licensed to the franchisee under the franchise agreement) protected by local law?

Copyrights are protected by the Copyright Regulation promulgated by Royal Decree No. M/41 dated 02/07/1424H (corresponding to 30/08/2003G) which came into effect on 22/01/1425H (corresponding to 14/03/2004G) and its Rules of Implementation published on 16/04/1425H (corresponding to 04/06/2004G). There is no procedure in place for copyright registration, because the Law considers any published content protected once it is published in any media.

5 Liability

5.1 What remedies can be enforced against a franchisor for failing to comply with mandatory disclosure obligations? Is a franchisee entitled to rescind the franchise agreement and/or claim damages?

The franchisee can request damages from the franchisor for failure to commit to disclosure requirements in accordance with the Franchise Law.

5.2 In the case of sub-franchising, how is liability for disclosure non-compliance or for pre-contractual misrepresentation allocated between franchisor and master franchisee? If the franchisor takes an indemnity from the master franchisee in the Master Franchise Agreement, are there any limitations on such an indemnity being enforceable against the master franchisee?

The franchisor will need to comply with the disclosure requirements. There are no limitations on the indemnity under the applicable laws in Saudi Arabia, except under Sharia doctrines, which limit damages only to actual and proven suffered damages and losses. Parties seeking better protection and indemnity should consider making the agreement subject to a different governing law and jurisdiction.

5.3 Can a franchisor successfully avoid liability for pre-contractual misrepresentation by including a disclaimer in the franchise agreement?

Any disclaimer provisions not in line with the provisions of the Franchise Law are not acceptable.

5.4 Does local law permit class actions to be brought by a number of aggrieved franchisees and, if so, are class action waiver clauses enforceable?

The Franchise Law did not make reference to class action suits. Class action suits are not uncommon in Saudi Arabia, as we have seen such suits in commercial fields (not related to franchise).

6 Governing Law

6.1 Is there a requirement for franchise documents to be governed by local law? If not, is there any generally accepted norm relating to choice of governing law, if it is not local law?

Yes, the Franchise Law imposes an obligation on franchise agreements executed in Saudi Arabia to be in compliance with the Franchise Law. However, there is no obligation on subjecting the agreement to local law or local litigation/arbitration. The key requirement is that the franchise agreement adheres to the Franchise Law in stating its terms and conditions.

6.2 Do the local courts provide a remedy, or will they enforce orders granted by other countries' courts, for interlocutory relief (injunction) against a franchisee to prevent damage to the brand or misuse of business-critical confidential information?

It is possible to seek urgent injunctive relief from commercial courts in order to prevent a rogue franchise. The court will assess the claim on a case-by-case basis.

6.3 Is arbitration recognised as a viable means of dispute resolution and is your country a signatory to the New York Arbitration Convention on the Recognition and Enforcement of Foreign Arbitral Awards? Do businesses that accept arbitration as a form of dispute resolution procedure generally favour any particular set of arbitral rules?

Yes, arbitration is a viable means of dispute resolution. Saudi Arabia acceded to the New York Convention on 19/04/1994. It should be noted that Saudi Arabia submitted a reservation, to the New York Convention, that it will not recognise an arbitral award issued from another jurisdiction of a signatory party, unless that jurisdiction recognises awards issued by Saudi Arabia (the reciprocity principle). The most common arbitral rules in Saudi Arabia are the DIAC Arbitration Rules.

7 Real Estate

7.1 Generally speaking, is there a typical length of term for a commercial property lease?

No, it depends on agreement of the parties. The most common are one-year renewable lease agreements.

7.2 Is the concept of an option/conditional lease assignment over the lease (under which a franchisor has the right to step into the franchisee/tenant's shoes under the lease, or direct that a third party (often a replacement franchisee) may do so upon the failure of the original tenant or the termination of the franchise agreement) understood and enforceable?

The option/conditional lease assignment over the lease is not common but can be done by inserting the relevant assignment provisions in the lease agreement.

7.3 Are there any restrictions on non-national entities holding any interest in real estate, or being able to sub-lease property?

Yes, there are certain limitations and non-nationals must obtain a licence from MISA before owning any property. The Foreign Ownership of Real Estate Regulation (enacted by Royal Decree No. M/15 dated 17/04/1421H (19/07/2000G)) regulates foreign, non-GCC nationals' ownership of real estate in Saudi Arabia.

7.4 Give a general overview of the commercial real estate market. To what extent has the real estate market been affected by the Coronavirus pandemic? Specifically, can a tenant expect to secure an initial rent free period when entering into a new lease (and if so, for how long, generally), or are landlords demanding "key money" (a premium for a lease in a flagship location)?

The commercial real estate market is one of the main markets that has been generally affected by the Coronavirus pandemic. Due to the great impact of the pandemic on the Saudi market in general and, more specifically, the commercial real estate market, the Saudi government established special courts to resolve any disputes arise out of or in connection with pandemic's impact.

An initial rent-free period is sometimes granted by the landlords in certain situations to allow the tenant to prepare the premises for the business. Such periods usually range from one to six months.

8 Online Trading

8.1 If an online order for products or request for services is received from a potential customer located outside the franchisee's exclusive territory, can the franchise agreement impose a binding requirement for the request to be re-directed to the franchisee for the territory from which the sales request originated?

The Franchise Law does not cover antitrust issues. In the absence of regulation, the parties can agree on such language in the franchise agreement, and it is at the commercial courts' discretion to enforce such provisions in case of disputes.

8.2 Are there any limitations on a franchisor being able to require a former franchisee to assign local domain names to the franchisor on the termination or expiry of the franchise agreement?

No, ownership of domain names and trademarks can be transferred from one party to another. This can be either by acquisition of the entity holding ownership of the domain name or trademark, or by assignment of such domain name/trademark to another party.

9 Termination

9.1 Are there any mandatory local laws that might override the termination rights one might typically expect to see in a franchise agreement?

No, termination conditions of the franchise agreement are set forth in Articles 16–18 of the Franchise Law.

9.2 Are there local rules that impose a minimum notice period that must be given to bring a business relationship that has existed for a number of years to an end, which will apply irrespective of the length of the notice period set out in the franchise agreement?

No such local laws exist.

10 Joint Employer Risk and Vicarious Liability

10.1 Is there a risk that a franchisor may be regarded as a joint employer with the franchisee in respect of the franchisee's employees? If so, can anything be done to mitigate this risk?

No, franchisee's employees will be under the franchisee's sponsorship in accordance with the applicable labour law regulations and, therefore, the franchisor will not be regarded as a joint employer.

10.2 Is there a risk that a franchisor may be held to be vicariously liable for the acts or omissions of a franchisee's employees in the performance of the franchisee's franchised business? If so, can anything be done to mitigate this risk?

No, the franchisee will be liable for acts of employees under his sponsorship.

11 Currency Controls and Taxation

11.1 Are there any restrictions (for example exchange control restrictions) on the payment of royalties to an overseas franchisor?

There are no such restrictions.

11.2 Are there any mandatory withholding tax requirements applicable to the payment of royalties under a trade mark licence or in respect of the transfer of technology? Can any withholding tax be avoided by structuring payments due from the franchisee to the franchisor as a management services fee rather than a royalty for the use of a trade mark or technology?

Yes, withholding tax is applicable at a rate of 15% for the payment of royalties. It is possible to structure the payments but parties need to make sure they do not cause suspicion or violate the applicable Anti-Concealment Law in Saudi Arabia. Should a franchisor choose to structure the royalties in a different manner, they could offer the franchise royalty-free and charge management fees and training fees instead, which are subject to a 5% withholding tax.

11.3 Are there any requirements for financial transactions, including the payment of franchise fees or royalties, to be conducted in local currency?

Generally, transactions conducted in Saudi Arabia are settled in Saudi Riyals. The banks accept inbound and outbound payments in other major currencies. However, transactions could be conducted in any other currency to which the parties may agree.

12 Commercial Agency

12.1 Is there a risk that a franchisee might be treated as the franchisor's commercial agent? If so, is there anything that can be done to help mitigate this risk?

No, under the Franchise Law the franchisee will not be treated as the franchisor's commercial agent. The parties can also add clear terms in the franchise agreement that set out that the franchisee is not an agent or representative of the franchisor. This contractual protection would be sufficient.

13 Good Faith and Fair Dealings

13.1 Is there any overriding requirement for a franchisor to deal with a franchisee in good faith and to act fairly in its dealings with franchisees according to some objective test of fairness and reasonableness?

Yes, such obligation is imposed on the franchisor and franchisee in the Franchise Law. The language imposes an obligation on both parties to commit to their obligations in good faith. In addition, the good faith obligation is imposed on the parties of a contract by the general principles of Sharia.

13.2 Is there any limitation on a good faith obligation being unenforceable if it only applies from franchisee to franchisor, rather than being mutual?

There is no such limitation.

14 Ongoing Relationship Issues

14.1 Are there any specific laws regulating the relationship between franchisor and franchisee once the franchise agreement has been entered into?

Yes, generally all applicable regulations will indeed be applicable one way or another. The money laundering regulations, the Competition Law, the laws and regulations issued by SAIP, the Environment Law, and regulations issued by MOC will be the most relevant here to the franchise agreement.

15 Franchise Renewal

15.1 What disclosure obligations apply in relation to a renewal of an existing franchise at the end of the franchise agreement term?

The same disclosure obligation imposed by the Franchise Law applies.

15.2 Is there any overriding right for a franchisee to be automatically entitled to a renewal or extension of the franchise agreement at the end of the initial term irrespective of the wishes of the franchisor not to renew or extend?

Article 15 of the Franchise Law addressed renewal of the franchise agreement. This includes a written notice of at least 180 days by the franchisee to franchisor for its desire to renew the franchise agreement for a similar period and under the same terms. The Article also excludes incidents when such renewal is not applicable under the Franchise Law.

15.3 Is a franchisee that is refused a renewal or extension of its franchise agreement entitled to any compensation or damages as a result of the non-renewal or refusal to extend?

The franchisee is entitled to damages only in the case where the non-renewal is in violation of the provision of the franchise agreement.

16 Franchise Migration

16.1 Is a franchisor entitled to impose restrictions on a franchisee's freedom to sell, transfer, assign or otherwise dispose of the franchised business?

Yes, the franchisor is entitled to impose such restrictions in the franchise agreement.

16.2 If a franchisee is in breach and the franchise agreement is terminated by the franchisor, will a "step-in" right in the franchise agreement (whereby the franchisor may take over the ownership and management of the franchised business) be recognised by local law, and are there any registration requirements or other formalities that must be complied with to ensure that such a right will be enforceable?

The Franchise Law does not make any reference to a "step-in" right. Such right may be agreed to under the franchise agreement and can be enforced. In the case of a local franchisor, there should not be any legal restrictions that prevent the franchisor from stepping in; however, in the case of a foreign franchisor, there are restrictions.

16.3 If the franchise agreement contains a power of attorney in favour of the franchisor under which it may complete all necessary formalities required to complete a franchise migration under pre-emption or "step-in" rights, will such a power of attorney be recognised by the courts in the jurisdiction and be treated as valid? Are there any registration or other formalities that must be complied with to ensure that such a power of attorney will be valid and effective?

Yes, such power of attorney will be looked into seriously by the courts. If the power of attorney is issued outside Saudi Arabia, it needs to be attested at the Saudi Embassy in the place of execution before further being attested at the Ministry of Foreign Affairs in Saudi Arabia.

17 Electronic Signatures and Document Retention

17.1 Are there any specific requirements for applying an electronic signature to a franchise agreement (rather than physically signing a "wet ink" version of the agreement), and are electronic signatures recognised as a valid way of creating a binding and enforceable agreement?

Yes, electronic signatures are acceptable in Saudi Arabia. Saudi Arabia has issued its Electronic Transactions Law (promulgated by Royal Decree No. M/18 dated 08/03/1428H (26/03/2007G)). The Law is aimed at controlling, regulating and providing a legal framework for electronic transactions and signatures.

Requirements for applying e-signatures are provided for under Article 14(3) of the Electronic Transactions Law are as follows:

- The electronic signature is the signature of the person identified in the relevant digital certificate.
- The electronic signature was provided by the person identified in the relevant digital certificate for the purpose specified therein.
- The electronic transaction has not been altered since the electronic signature was affixed thereto.

17.2 If a signed/executed franchise agreement is stored electronically (either having been signed using e-signatures or a "wet ink" version having been scanned and saved as an electronic file), can the paper version of the agreement be destroyed?

While copies of electronically signed agreements are enforceable, it is always advisable that original agreements are not destroyed. This is because governmental entities or the courts might request the original during the course of an application/dispute. It is still the practice in Saudi Arabia that digital scanned copies of wet-signed agreements are not considered originals for the purpose of taking legal action and enforcing their terms. However, a duly e-signed document in compliance with the legal requirements for e-signatures, as described above, is considered an original and there is no need to have a "wet ink" version of the same duly e-signed agreement.

18 Current Developments

18.1 What is the biggest challenge franchising is facing in your jurisdiction and how are franchisors responding to that challenge?

As of the time of writing, it appears as though the biggest challenge that franchising is facing in Saudi Arabia is that under the Franchise Law it is a prerequisite for a franchisor to have sufficient experience in operating the business before being legally permitted to grant the franchise rights. In the event a franchisor sets up a business which he wishes to immediately franchise to others, they would need to enter general licensing agreements whereby they could grant the rights they would have under a franchise agreement. However, it would be a licensing agreement granting the use of the tradename and marks, etc. of the franchise, but it would not fall under the scope of application of the Franchise Law. In that sense, it would leave a franchisee to operate under general commercial terms rather than being subject to a statute which regulates and protects franchise arrangements.



Suhaib Hammad is a Saudi-licensed attorney who leads Hammad & Al-Mehdar's Corporate and Commercial practice focusing on Foreign Direct Investment, Corporate Structuring, Regulatory Advisory, Healthcare, Technology, and Media. His experience also includes advising major international and regional companies on Saudi regulations in relation to formation and operation, as well as structuring both on-shore and off-shore.

He joined the Firm in 2008 after earning his LL.B. from the International Islamic University Malaysia. After working for nearly a year in the interim, he then obtained an LL.M. from the University of Miami in 2010, specialising in International Business Law.

Suhaib was awarded a Client Choice award by Lexology in 2020, while his Corporate and Commercial Practice was ranked in *Chambers Global* 2022.

Suhaib has a vast array of international legal experience, gained by working with the Corporate and Commercial team at a prominent English law firm in their Dubai and London offices, where he worked on leading cross-border transactions of various types. He was also working and training for a brief period in the United States, and in Malaysia during his studies.

Hammad and Al-Mehdar Law Firm
Level 8, Fakhry Tower
Prince Saud Al-Faisal Street, Jeddah
Saudi Arabia

Tel: +966 920 004 626
Email: suhaib.hammad@hmco.com.sa
URL: www.hmco.com.sa

Hammad & Al-Mehdar Law Firm was founded in 1983 in Jeddah, Saudi Arabia, and has grown to become one of the most prominent private practice Saudi firms in the Kingdom and the GCC. The law firm boasts a leading local presence supported by international capabilities. Hammad & Al-Mehdar provides a full suite of business and corporate legal services in all major areas of Saudi law, working on cutting-edge, complex and high-value transactions and disputes.

Headquartered in Jeddah, Hammad & Al-Mehdar's growth story is one of trade, innovation and technology in the Kingdom's private sector. Hammad & Al-Mehdar maintains a strong specialisation in servicing privately held businesses, with unrivalled expertise in business and transaction structuring, private construction works, commercial matters, intellectual property, corporate governance, and regulatory advisory services.

www.hmco.com.sa

HAMMAD & AL-MEHDAR
LAW FIRM

South Africa

Fluxmans Inc.



Ian Jacobsberg

1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

Section 1 of the Consumer Protection Act, 68 of 2008 (CPA), defines a “franchise agreement” in the following terms:

“An agreement between two parties, being the franchisor and franchisee, respectively—

- (a) in which, for consideration paid, or to be paid, by the franchisee to the franchisor, the franchisor grants the franchisee the right to carry on business within all or a specific part of the Republic under a system or marketing plan substantially determined or controlled by the franchisor or an associate of the franchisor;
- (b) under which the operation of the business of the franchisee will be substantially or materially associated with advertising schemes or programmes or one or more trademarks, commercial symbols or logos or any similar marketing, branding, labelling or devices, or any combination of such schemes, programmes or devices, that are conducted, owned, used or licensed by the franchisor or an associate of the franchisor; and
- (c) that governs the business relationship between the franchisor and the franchisee, including the relationship between them with respect to the goods or services to be supplied to the franchisee by or at the direction of the franchisor or an associate of the franchisor.”

Any business relationship based on an agreement that complies with that definition would be regarded as a franchise, regardless of whether it is called a franchise agreement.

1.2 What laws regulate the offer and sale of franchises?

The CPA and the regulations promulgated in terms of it specify certain information that must be included in a franchise agreement and other information that must be included in a disclosure document, to be given to a prospective franchisee before the agreement is signed. The South African common law of contract will apply to the extent that a particular matter is not provided for in the CPA and regulations.

1.3 If a franchisor is proposing to appoint only one franchisee/licensee in your jurisdiction, will this person be treated as a “franchisee” for purposes of any franchise disclosure or registration laws?

If the agreement complies with the definition of a “franchise

agreement” in terms of the CPA (see question 1.1 above), the relationship will be regarded as a franchise and must comply with the applicable laws.

1.4 Are there any registration requirements relating to the franchise system?

No, there are no registration requirements relating to the franchise system.

1.5 Are there mandatory pre-sale disclosure obligations?

Yes. In terms of the regulations promulgated in terms of the CPA (CPA Regulations), a prospective franchisee must be provided with a disclosure document, setting out specified historical and financial information about the franchisor, and a copy of the franchise agreement, at least 14 days before the agreement is signed.

1.6 Do pre-sale disclosure obligations apply to sales to sub-franchisees? Who is required to make the necessary disclosures?

Yes. The disclosure obligations must be complied before any agreement that meets the definition of a “franchise agreement” set out in the CPA may be signed. This would include a sub-franchise agreement. If a master franchisee/sub-franchisor recruits sub-franchisees, it must observe the disclosure obligations before signing agreements with them.

1.7 Is the format of disclosures prescribed by law or other regulation, and how often must disclosures be updated? Is there an obligation to make continuing disclosure to existing franchisees?

The CPA Regulations prescribe detailed information that must be included in a franchise agreement and disclosure document. This disclosure must be made at least 14 days before the agreement is signed. There is no obligation to update it for existing franchisees, except in respect of renewals (see question 15.1 below).

1.8 What are the consequences of not complying with mandatory pre-sale disclosure obligations?

The CPA and the CPA Regulations do not specify the consequences of a failure to comply with the disclosure requirements,

either fully or at all, and there is no case law as yet on that point. It is suggested that, if the franchisee can prove that, as a result of the non-compliance, it did not have access to information which, if known to it, would have influenced its decision to enter into the agreement, it would be able to cancel the agreement and reclaim any money paid on account of the purchase or establishment of the business.

1.9 Are there any other requirements that must be met before a franchise may be offered or sold?

No, there are no other requirements that must be met before a franchise may be offered or sold.

1.10 Is membership of any national franchise association mandatory or commercially advisable?

The Franchise Association of South Africa (FASA) is a voluntary association for franchisors, franchisees, service providers and suppliers to the industry. Members are obliged to subscribe to FASA's Code of Ethics and Business Practices in addition to the basic legal requirements. Accordingly, prospective franchisees signing up with franchisors who are members of FASA have the benefit of knowing that they subscribe to a higher standard of ethical practices than the minimum required by law. This additional level of credibility may assist franchisors who are FASA members in attracting franchisees.

1.11 Does membership of a national franchise association impose any additional obligations on franchisors?

As stated in answer to question 1.10 above, FASA members are obliged to subscribe to FASA's Code of Ethics and Business Practices in addition to the basic legal requirements.

1.12 Is there a requirement for franchise documents or disclosure documents to be translated into the local language?

There is no express requirement for this in the CPA. However, section 22 requires that any document provided in terms of the CPA or any other law must be in "plain and understandable language". This implies, *inter alia*, that it should be in a language that is commonly understood in South Africa. English is an official language of South Africa and the most used language in business.

2 Business Organisations Through Which a Franchised Business Can be Carried On

2.1 Are there any foreign investment laws that impose restrictions on non-nationals in respect of the ownership or control of a business in your jurisdiction?

There is no general requirement of local ownership or control, although certain law requires that licences to operate in specified sectors (including aviation, broadcasting and mining) will only be granted to local applicants. In addition, broad-based black economic empowerment legislation, while not making local ownership compulsory, has the effect that businesses that do not comply with certain thresholds of local ownership and

control by black South African nationals may experience more difficulty in being awarded contracts than businesses that do meet the thresholds.

2.2 What forms of business entity are typically used by franchisors?

Most franchise businesses are operated through limited liability profit companies, incorporated in terms of the Companies Act, 71 of 2008. These may be public or private companies. Some social franchises, operated for public benefit and not for profit, are run through non-profit companies or trusts.

2.3 Are there any registration requirements or other formalities applicable to a new business entity as a pre-condition to being able to trade in your jurisdiction?

Companies must be registered with the Companies and Intellectual Property Commission (CIPC) before they can incur obligations and acquire rights in their own right. Before registration, the incorporators may incur obligations and acquire rights on behalf of the company but will be bound by them in their personal capacities unless and until the company is registered and passes a resolution to assume the rights and obligations concerned.

All businesses are also required to register with the South African Revenue Service (SARS) for payment of income tax, value-added tax and employees' taxes, and with the Department of Labour for payment of unemployment insurance fund and workmen's compensation fund contributions on behalf of their employees.

3 Competition Law

3.1 Provide an overview of the competition laws that apply to the offer and sale of franchises.

In terms of section 5(1) of the Competition Act, 89 of 1998 (Competition Act), provides that "an agreement between parties in a vertical relationship is prohibited if it has the effect of substantially preventing or lessening competition in a market". This may affect certain terms commonly found in franchise agreements. These include:

- grants of exclusive trading territories to franchisees and restrictions on their trading outside their own territories;
- "tying and bundling" restrictions, in terms of which franchisees are obliged to buy stock and supplies from the franchisor or its approved suppliers only; and
- terms restricting or prescribing the prices franchisees may charge their customers.

A party to an agreement that may appear to contravene section 5(1) may be able to justify the restriction if it can prove that "any technological, efficiency or other pro-competitive, gain resulting from that agreement outweighs [the anti-competitive] effect".

3.2 Is there a maximum permitted term for a franchise agreement?

No, but if the agreement contains restrictions that have an anti-competitive effect, the duration of the agreement may be a factor in determining whether it can be justified in terms of the Competition Act.

3.3 Is there a maximum permitted term for any related product supply agreement?

No, but if the agreement contains restrictions that have an anti-competitive effect, the duration of the agreement may be a factor in determining whether it can be justified in terms of the Competition Act.

3.4 Are there restrictions on the ability of the franchisor to impose minimum resale prices?

In terms of section 5(2) of the Competition Act, a franchisor may not impose a minimum resale price.

A franchisor may recommend a minimum resale price to a franchisee provided:

- the franchisor makes it clear to the franchisee that the recommended price is not obligatory; and
- if the product has its price stated on it, the words “recommended price” appear next to the stated price.

3.5 Encroachment – are there any minimum obligations that a franchisor must observe when offering franchises in adjoining territories?

If a franchise agreement allocates a territory to a specific franchisee, the franchisor may offer an adjacent territory to another franchisee. The franchisor must then be able to justify allocating territories to franchisees on the “technological, efficiency or other pro-competitive” grounds provided for in terms of section 5(1) of the Competition Act. This practice can usually be justified if it can prove that the allocation of exclusive territories is necessary to avoid “free-riding” (where a franchisee in a territory avoids investment on marketing and after-sales services, and relies on neighbouring franchisees, who have made those investments, to publicise the franchise and service customers), or that if franchisees are allowed to service unlimited geographical areas, their resources will be too thinly spread to service customers’ requirements properly.

3.6 Are in-term and post-term non-compete and non-solicitation of customers covenants enforceable?

This is not covered by the Competition Act, but by the common law of contract. Non-compete and non-solicitation (known in South Africa as “restraint of trade”) covenants are *prima facie* valid, unless the party subject to the restraint can prove that it is unreasonable. A restraint agreement is deemed to be unreasonable if the duration or the geographical area for which it applies is greater than necessary to protect the legitimate interests, such as intellectual property and customer relationships, of the party in whose favour it is given from being abused.

4 Protecting the Brand and Other Intellectual Property

4.1 How are trade marks protected?

A trademark may be registered in terms of the Trade Marks Act, 194 of 1993. Once a mark is registered, no one may, without the authority of the registered owner:

- use in the course of trade, in relation to goods or services in respect of which the mark is registered, an identical mark or a mark so nearly resembling the registered mark that it is likely to deceive or cause confusion;
- use in the course of trade a mark that is identical or similar to the registered mark, in relation to goods or services, which are so similar to the goods or services in respect of which the mark is registered, that such use creates the likelihood of deception or confusion; or
- use in the course of trade, in relation to any goods or services, a mark that is identical or similar to a trademark registered, if that mark is well-known in South Africa and the use of that mark would be likely to take unfair advantage of, or be detrimental to, the distinctive character or the repute of the registered trademark, even in the absence of confusion or deception.

4.2 Are know-how, trade secrets and other business-critical confidential information (e.g. the Operations Manual) protected by local law?

This material is not automatically protected. It is advisable to include clauses in the franchise agreement recording the franchisor’s rights in respect of the material and obliging the franchisee:

- only to use it for the purposes of the business contemplated in the agreement; and
- on termination of the franchise agreement, to cease using it, and, to the extent that it exists in a tangible form, to return it to the franchisor.

In the absence of a clause of this nature, in order for the franchisor to enforce its rights to the material, the franchisor would need to provide that it created the material, or acquired the rights to it from a third party, and that it clear from the circumstances in which it was shared with the franchisee that the franchisee was only authorised to use it for the purposes of the franchised business for as long as the agreement endured.

4.3 Is copyright (in the Operations Manual or in proprietary software developed by the franchisor and licensed to the franchisee under the franchise agreement) protected by local law?

Copyright in literary works and computer programmes is protected in terms of the Copyright Act, 98 of 1978. Ownership of copyright in either a literary work or a computer programme vests in the copyright owner the exclusive right to reproduce or make an adaptation of the work.

5 Liability

5.1 What remedies can be enforced against a franchisor for failing to comply with mandatory disclosure obligations? Is a franchisee entitled to rescind the franchise agreement and/or claim damages?

The CPA and the CPA Regulations do not set out the consequences of a failure to make disclosure and, as yet, there is no case law on that point. It is suggested that, if the franchisee can prove, as a result of its failure to make disclosure, information was withheld from them, which, if known, would have influenced their decision to enter into the agreement, they would be entitled to cancel the agreement and reclaim any money invested to purchase or establish the business.

5.2 In the case of sub-franchising, how is liability for disclosure non-compliance or for pre-contractual misrepresentation allocated between franchisor and master franchisee? If the franchisor takes an indemnity from the master franchisee in the Master Franchise Agreement, are there any limitations on such an indemnity being enforceable against the master franchisee?

In general, sub-franchisees will contract with the master franchisee, and any claims they may have will be against the master franchisee. The master franchisee may in turn claim from the franchisor if the master franchisee's failure to disclose or misrepresentation of the facts to the sub-franchisee was the result of the franchisor's misrepresentation or non-disclosure to the master franchisee. An indemnity by the master franchisee in favour of the franchisor will not be enforceable against the master franchisee if the franchisor has fraudulently misrepresented or concealed the facts, as a party cannot contract out of liability for its own fraud. In terms of section 48 of the CPA, a supplier (including a franchisor), may not require a consumer (including a franchisee) to waive any rights, assume any obligation or waive any liability of the supplier on terms that are unfair, unreasonable or unjust. There is no case law on this point as yet, but it is suggested that this provision of the CPA would prohibit a franchisor from contracting out of liability for a negligent misrepresentation or non-disclosure.

5.3 Can a franchisor successfully avoid liability for pre-contractual misrepresentation by including a disclaimer in the franchise agreement?

See the answer to question 5.2 above.

5.4 Does local law permit class actions to be brought by a number of aggrieved franchisees and, if so, are class action waiver clauses enforceable?

South African law does allow class actions, but it is a relatively new procedure and the law has not been developed in practice. However, in South African law a class action will generally only be permitted where, due to the number of potential claimants, it is not possible to identify all of them individually, and due to the fact that each of them has a relatively small claim against the defendant, it is not economical for each of them to bring their claims individually. It would therefore not be appropriate for a dispute between a franchisor and a group of franchisees. Where all the individual plaintiffs can be identified, they can all join individually as co-plaintiffs, as long as the disputes of fact and/or law between the franchisor and them are substantially the same.

For the reasons set out above, the types of matters likely to be litigated as class actions are unlikely to be based on formal agreements. For that reason, none of the class action suits before the courts have involved class action waivers, and it is uncertain whether such clauses will be recognised in South Africa.

6 Governing Law

6.1 Is there a requirement for franchise documents to be governed by local law? If not, is there any generally accepted norm relating to choice of governing law, if it is not local law?

As a general rule, parties are free to choose the governing law of their contracts. It is not unusual for a multinational franchisor

to insist that the agreement be governed by the law of its domicile, in order to ensure uniformity across the global network. However, the choice of a foreign governing law will not exclude the application of South African statutes, such as the CPA and Competition Act, to an agreement that is concluded and/or is to be implemented in South Africa. If any terms in an agreement that is subject to a foreign legal system conflict with any of these statutes, the statutory provisions will prevail.

6.2 Do the local courts provide a remedy, or will they enforce orders granted by other countries' courts, for interlocutory relief (injunction) against a franchisee to prevent damage to the brand or misuse of business-critical confidential information?

South African courts will grant interdicts (injunctions) against a franchisee who is conducting business in such a way as to damage the brand or who is misusing the franchisor's confidential information.

A South African court will generally enforce an order granted by a foreign court, provided the order was obtained through a fair process (the respondent must have received notice of the proceedings and been given an adequate opportunity to oppose the granting of the order) and the terms of the contract to be enforced are not contrary to public policy in South Africa.

6.3 Is arbitration recognised as a viable means of dispute resolution and is your country a signatory to the New York Arbitration Convention on the Recognition and Enforcement of Foreign Arbitral Awards? Do businesses that accept arbitration as a form of dispute resolution procedure generally favour any particular set of arbitral rules?

Arbitration is an accepted form of dispute resolution and many, if not most, franchise agreements provide for it. South Africa is a signatory to the New York Arbitration Convention on the Recognition and Enforcement of Foreign Arbitral Awards. Most agreements that provide for arbitration in South Africa state that the arbitration is to be conducted according to the arbitration rules of the Arbitration Foundation of South Africa.

7 Real Estate

7.1 Generally speaking, is there a typical length of term for a commercial property lease?

Commercial leases are usually for an initial period of three to five years, with the tenant often having a right to renew the lease for one or more further three- to five-year periods.

7.2 Is the concept of an option/conditional lease assignment over the lease (under which a franchisor has the right to step into the franchisee/tenant's shoes under the lease, or direct that a third party (often a replacement franchisee) may do so upon the failure of the original tenant or the termination of the franchise agreement) understood and enforceable?

It is a common term in franchise agreements and enforceable in law, but in practice can only be given effect if the landlord consents to the assignment.

7.3 Are there any restrictions on non-national entities holding any interest in real estate, or being able to sub-lease property?

No, there are not.

7.4 Give a general overview of the commercial real estate market. To what extent has the real estate market been affected by the Coronavirus pandemic? Specifically, can a tenant expect to secure an initial rent free period when entering into a new lease (and if so, for how long, generally), or are landlords demanding “key money” (a premium for a lease in a flagship location)?

According to various reports, the commercial real estate property market was severely damaged by the COVID-19 pandemic. Office space occupancy was most seriously affected, as more businesses adopted remote working. Retail space was also adversely affected by the pandemic. A spate of riots and widespread looting in two of the country’s major economic hubs, following political protests in July 2021, exacerbated the problem, as many shopping malls were attacked and large numbers of retail businesses were damaged or destroyed. Many of these smaller businesses have not been able to reopen.

While it is not common for landlords to offer rent-free periods (except perhaps for a “fitting out period” before commencement of trading), the reduced levels of occupancy in both high and lower value locations have forced landlords to reduce rentals in most areas.

8 Online Trading

8.1 If an online order for products or request for services is received from a potential customer located outside the franchisee’s exclusive territory, can the franchise agreement impose a binding requirement for the request to be re-directed to the franchisee for the territory from which the sales request originated?

It is permissible, subject to the competition law concerns mentioned in the answers in section 3 above.

8.2 Are there any limitations on a franchisor being able to require a former franchisee to assign local domain names to the franchisor on the termination or expiry of the franchise agreement?

No, it is permissible.

9 Termination

9.1 Are there any mandatory local laws that might override the termination rights one might typically expect to see in a franchise agreement?

No, there are not.

9.2 Are there local rules that impose a minimum notice period that must be given to bring a business relationship that has existed for a number of years to an end, which will apply irrespective of the length of the notice period set out in the franchise agreement?

The notice period set out in the agreement will generally govern termination. It is possible that a very short notice period may

be considered to be an unfair contract term in terms of section 48 of the CPA, and declared invalid, but there is no case law on this point as yet.

10 Joint Employer Risk and Vicarious Liability

10.1 Is there a risk that a franchisor may be regarded as a joint employer with the franchisee in respect of the franchisee’s employees? If so, can anything be done to mitigate this risk?

As the franchisee and franchisor are separate legal entities, the franchisor will not be regarded as a joint employer.

10.2 Is there a risk that a franchisor may be held to be vicariously liable for the acts or omissions of a franchisee’s employees in the performance of the franchisee’s franchised business? If so, can anything be done to mitigate this risk?

There is always a risk that members of the public who suffer losses as a result of an act committed by a franchisee or its employees may not appreciate that the franchisor and franchisee are separate legal entities and may claim from the franchisor. The franchisor would be fully entitled to disavow liability. It is not uncommon for franchise agreements to contain clauses in terms of which the franchisee is required to indemnify the franchisor against such claims, although this is merely a precautionary measure, as the franchisor will not be liable for the franchisee’s obligations.

11 Currency Controls and Taxation

11.1 Are there any restrictions (for example exchange control restrictions) on the payment of royalties to an overseas franchisor?

In terms of the Exchange Control Regulations, any payment by a South African resident to an offshore creditor from funds held in South Africa requires the approval of the South African Reserve Bank (SARB). In the case of royalties paid for the use of intellectual property, the SARB may require proof that the amount of the royalty represents fair value for the rights acquired.

11.2 Are there any mandatory withholding tax requirements applicable to the payment of royalties under a trade mark licence or in respect of the transfer of technology? Can any withholding tax be avoided by structuring payments due from the franchisee to the franchisor as a management services fee rather than a royalty for the use of a trade mark or technology?

A withholding tax (WHT) of 15% is payable on any royalties or consideration for the use of technology, paid to or for the benefit of any person not resident in South Africa for tax purposes, to the extent that the amount was received by or accrued to that person from a source in South Africa. This is subject to applicable double taxation agreement relief. The transfer of technology (intellectual property) itself is not subject to WHT, but may be subject to capital gains tax amongst other things. Payment of management fees to a non-resident for tax purposes is currently not subject to WHT. With respect to any structuring of the payment of a royalty as a management fee, due regard must be had for South Africa’s General Anti Avoidance Rule and “substance over form” rules taking into account all surrounding facts and business purposes.

11.3 Are there any requirements for financial transactions, including the payment of franchise fees or royalties, to be conducted in local currency?

The amount payable may be expressed in any currency. However, South African residents may only receive and hold funds in South African Rand (ZAR). Therefore, if a South African resident is required to pay an amount expressed in a foreign currency, it will have to use ZAR to purchase the equivalent amount in the relevant currency in order to remit it to the offshore recipient. If a South African resident receives an amount expressed in a foreign currency, the amount will be converted into ZAR at the prevailing exchange rate on the day it is credited to the recipient's bank account.

12 Commercial Agency

12.1 Is there a risk that a franchisee might be treated as the franchisor's commercial agent? If so, is there anything that can be done to help mitigate this risk?

The franchisee will only be regarded as an agent of the franchisor if the franchisor has expressly appointed the franchisee as such, or has conducted itself in such a way as to lead a third party, acting reasonably, to conclude that the franchisee is the franchisor's agent. It is general practice for franchise agreements to contain clauses prohibiting the franchisee from holding out that it is the franchisor's agent and indemnifying the franchisor from any claims arising from a contravention of the prohibition.

13 Good Faith and Fair Dealings

13.1 Is there any overriding requirement for a franchisor to deal with a franchisee in good faith and to act fairly in its dealings with franchisees according to some objective test of fairness and reasonableness?

Good faith is recognised not as a self-standing rule, but as an underlying value that is given expression through other rules of contract law, in particular the principle of reciprocity, in terms of which each party must be prepared to fulfil its obligations and may demand the same of the other. The CPA and the regulations promulgated in terms of it contain various provisions requiring the franchisor to deal fairly and reasonably with its franchisees. For example:

- (1) as mentioned with regard to question 5.2 above, in terms of section 48 of the CPA, a supplier (including a franchisor) may not require a consumer (including a franchisee) to waive any rights, assume any obligation or waive any liability of the supplier on terms that are unfair, unreasonable or unjust; and
- (2) in terms of regulation 2 of the regulations, a franchise agreement must contain provisions that prevent:
 - (i) unreasonable or overvaluation of fees, prices or other direct or indirect consideration;
 - (ii) conduct that is unnecessary or unreasonable in relation to the risks to be incurred by a party; and
 - (iii) conduct that is not reasonably necessary for the protection of the legitimate business interests of the franchisor, franchisee or franchise system.

13.2 Is there any limitation on a good faith obligation being unenforceable if it only applies from franchisee to franchisor, rather than being mutual?

As there is no general requirement of good faith, as set out

above, this question is not applicable to franchise agreements in South Africa.

14 Ongoing Relationship Issues

14.1 Are there any specific laws regulating the relationship between franchisor and franchisee once the franchise agreement has been entered into?

The CPA contains provisions dealing with transactions for the sale of products and provision of services by supplier to consumer. Included within the definition of "transactions between a supplier and a consumer" are:

- (a) a solicitation of offers to enter into a franchise agreement;
- (b) an offer by a potential franchisor to enter into a franchise agreement with a potential franchisee;
- (c) a franchise agreement or an agreement supplementary to a franchise agreement; and
- (d) the supply of any goods or services to a franchisee in terms of a franchise agreement.

Accordingly, most of the provisions of the CPA that protect the rights of a consumer in a contract for the supply of goods and services apply in respect of goods and services supplied in terms of or in relation to a franchise agreement.

15 Franchise Renewal

15.1 What disclosure obligations apply in relation to a renewal of an existing franchise at the end of the franchise agreement term?

In terms of regulation 2(4) of the CPA Regulations, a franchise agreement that is renewed is considered to be a new franchise agreement, and all of the requirements of the CPA Regulations with regard to the content of a franchise agreement and pre-signature disclosure that apply to a new franchise agreement also apply to the renewal.

15.2 Is there any overriding right for a franchisee to be automatically entitled to a renewal or extension of the franchise agreement at the end of the initial term irrespective of the wishes of the franchisor not to renew or extend?

No, unless the agreement itself, expressly or by implication, provides that right.

15.3 Is a franchisee that is refused a renewal or extension of its franchise agreement entitled to any compensation or damages as a result of the non-renewal or refusal to extend?

As there is no automatic right of renewal by operation of law, independent of the terms of the agreement, there is no right to compensation if the franchisor refuses to agree to a renewal in accordance with the agreement.

16 Franchise Migration

16.1 Is a franchisor entitled to impose restrictions on a franchisee's freedom to sell, transfer, assign or otherwise dispose of the franchised business?

Yes. It is common for franchisors to include clauses in the

agreement that provides the franchisor with a right of first refusal to purchase the business if the franchisee wishes to sell, and requiring the franchisee to obtain the franchisor's approval to any sale.

16.2 If a franchisee is in breach and the franchise agreement is terminated by the franchisor, will a "step-in" right in the franchise agreement (whereby the franchisor may take over the ownership and management of the franchised business) be recognised by local law, and are there any registration requirements or other formalities that must be complied with to ensure that such a right will be enforceable?

Such rights are valid and enforceable. No registration or other formalities are required. It may be necessary to obtain the consent of third-party suppliers to the franchisee, in particular the landlord, if the contracts between the franchisee and the suppliers require it.

16.3 If the franchise agreement contains a power of attorney in favour of the franchisor under which it may complete all necessary formalities required to complete a franchise migration under pre-emption or "step-in" rights, will such a power of attorney be recognised by the courts in the jurisdiction and be treated as valid? Are there any registration or other formalities that must be complied with to ensure that such a power of attorney will be valid and effective?

A "*pactum commissorium*" (i.e., an agreement in terms of which a creditor may take over property of the debtor if the debtor is in default) will generally not be valid. In the absence of a voluntary handover of the business by the franchisee, the franchisor would have to obtain a court order authorising it to take possession of the franchisee's business and ordering the franchisee to hand it over.

17 Electronic Signatures and Document Retention

17.1 Are there any specific requirements for applying an electronic signature to a franchise agreement (rather than physically signing a "wet ink" version of the agreement), and are electronic signatures recognised as a valid way of creating a binding and enforceable agreement?

In terms of section 7(1) of the CPA, a franchise agreement must be in writing and signed by or on behalf of the franchisee.

Section 12 of the Electronic Communications and Transactions Act, 25 of 2002 (ECTA) provides that a requirement in

law that a document or information must be in writing is met if the document or information is in the form of a data message and accessible in a manner usable for subsequent reference. In terms of section 13(1) of the ECTA, where the signature of a person is required by law and that law does not specify the type of signature, the signature requirement is met only if an advanced electronic signature is used. An "advanced electronic signature" is defined as one that has been generated by a process accredited by the .za Domain Name Authority.

The cumulative effect of these provisions is that a franchise agreement may be concluded in electronic form, provided that the franchisee signs it by way of an "advanced electronic signature".

17.2 If a signed/executed franchise agreement is stored electronically (either having been signed using e-signatures or a "wet ink" version having been scanned and saved as an electronic file), can the paper version of the agreement be destroyed?

If the agreement was originally signed in a "wet ink" version, it is advisable to retain it, as that is the true original version and, if there is a dispute as to the authenticity of an electronic version, the most effective way of settling the dispute would be by producing the original.

18 Current Developments

18.1 What is the biggest challenge franchising is facing in your jurisdiction and how are franchisors responding to that challenge?

Franchised businesses share a number of challenges that are common to small and medium-sized enterprises outside the franchise sector. These include the regulatory "red tape" with which businesses need to comply, such as complicated tax legislation and employee-biased labour laws, which increase the costs of operating a business. A longstanding issue that has also beset small- and medium-sized enterprises, including franchised businesses, are the challenges facing the national electricity grid, resulting in electricity not being available from the state-owned supplier for several hours daily.

Franchisors have responded in various ways, using their influence and resources as larger businesses. Apart from, in many cases, granting franchisees "royalty breaks", they have used their bargaining power with landlords, banks and suppliers to obtain concessions and more favourable terms for their franchisees, and assisting with the procurement of alternative power supplies such as inverters, generators and solar power.



Ian Jacobsberg is a corporate and commercial lawyer with over 30 years' experience. His expertise and experience in all aspects of running a successful business means that clients benefit from his extensive knowledge and skill, no matter their size or business sector.

His substantial legal offering includes assistance in data protection and processing, mergers and acquisitions, competition law, economic regulation, commercial exploitation of intellectual property, franchising and licensing.

Ian is acknowledged as one of South Africa's leading experts in franchise law. He is a Director of the Franchise Association of South Africa and also acted as its Chairman in 2014/2015.

Ian's interest in business law and focus on entrepreneurs and innovators has led to him being a mentor and panellist for Endeavor South Africa, a mission-driven, global organisation leading the high-impact entrepreneurship movement in the country. He is listed in international *Who's Who of Franchise Lawyers* in their 2012–2019 editions and in international peer review guide *Best Lawyers* for 2022 in their Mergers and Acquisitions and Franchise Law categories.

Ian has been a Commissioner of the Small Claims Court since 1997 and joined Fluxmans as a Director in 2022.

He obtained his B.A. LL.B. at the University of the Witwatersrand in 1983 and the University of South Africa and World Intellectual Property Organisation Certificates in Essential Trademark Law and Essential Copyright Law, University of South Africa in 2001.

Expertise

Corporate law | Consumer law | Commercial law | Regulatory law | Competition | Data protection | Mergers and Acquisitions | Sales of Business | International trade | Life sciences | Food and beverage | Franchising | Licensing | Commercial exploitation of intellectual property.

Professional memberships

Franchise Association of South Africa.

Awards

Best Lawyers 2022, Mergers and Acquisitions and Franchise Law.

Fluxmans Inc.

24 Fricker Rd, Illovo
Johannesburg, 2196
South Africa

Tel: +27 11 328 1700
Email: ijacobsberg@fluxmans.com
URL: www.fluxmans.com

Fluxmans Attorneys is one of South Africa's leading law firms, and offers an extensive range of legal services to a diverse client base, including individuals and large corporates across all sectors. Our passion, knowledge and understanding within our service offering, as well as our ability to simplify complexities, ensures our clients receive the best personal service, support, and solutions to their varied legal matters.

Fluxmans traces its origins to the 1890's and while we are cognisant of our entrenched history and successes, our way of doing business and our client satisfaction is what we are most proud of.

Taking advantage of our smaller size means that even though we offer a broad range of practice areas, we are more agile and dynamic ensuring our clients receive the best personal service, support, and solutions to their varied needs. Our practice areas include commercial and completion law, estates, exchange, insolvency and business rescue, labour, litigation, matrimonial and family law, mining, property, tax, technology, media and communications.

We are committed to transferring knowledge and expertise through mentoring and skills development thereby retaining and rewarding talent while ensuring our principles and fundamental values are retained.

www.fluxmans.com

Spain

ELZABURU



Javier Fernández-Lasquetty Quintana



Jorge Parada Chacón

1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

Franchising activity is defined in Spain as that which is carried out by virtue of a contract whereby a (i) company (the franchisor), (ii) assigns to another (the franchisee), (iii) in a given market, (iv) in exchange for a direct or indirect financial consideration or both, (v) the right to operate a franchise, on a business or commercial activity that the former has previously carried out with sufficient experience and success, (vi) in order to market certain types of products or services, and which includes at least:

- The use of a common name or sign or other intellectual or industrial property rights and a uniform presentation of the premises or means of transport covered by the contract.
- The communication by the franchisor to the franchisee of know-how or technical knowledge, which must be his own, substantial and unique.
- The franchisor's continuous provision of commercial and/or technical assistance to the franchisee during the term of the agreement, without prejudice to any supervisory powers that may be contractually established.

A commercial concession or exclusive distribution contract, whereby an entrepreneur undertakes to acquire, under certain conditions, normally branded products from another that grants him a certain exclusivity in an area, and to resell them also under certain conditions, as well as to provide assistance to the buyers of these products after the sale has been made, will not necessarily be considered as franchising, neither shall any of the following legal relationships be considered franchising:

- The grant of a manufacturing licence.
- The cession of a registered trademark for use in a certain area.
- The transfer of technology.
- The assignment of the use of an ensign or commercial label.

1.2 What laws regulate the offer and sale of franchises?

- Act 7/1996, of 15th January, on the Retail Trade Act, which dedicates Article 62 to franchising (hereinafter, Act 7/1996).
- Royal Decree 201/2010, regulating the exercise of commercial activity under the franchise system (hereinafter, RD 201/2010).

- The offer and sale of franchises is affected by the common or general rules that regulate contracting and commercial activity (Civil Code, Commercial Code, Trademark Law, corporate and tax legislation, etc.).

European legislation includes:

- Treaty on the Functioning of the European Union, in particular Article 101(3).
- Guidelines on Vertical Restraints (2022/C 248/01).
- Commission Regulation (EU) 2022/720 of 10 May 2022 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices (hereinafter, EU Regulation 2022/720).

1.3 If a franchisor is proposing to appoint only one franchisee/licensee in your jurisdiction, will this person be treated as a "franchisee" for purposes of any franchise disclosure or registration laws?

Yes. It is not necessary to generate a national franchisee network for the franchise legislation to apply. It is sufficient that the franchisee acquires the right to operate the business model according to the above-mentioned legal definition.

1.4 Are there any registration requirements relating to the franchise system?

No. Previously, there were registration obligations, but this rule was repealed. Currently, there are no registration requirements.

1.5 Are there mandatory pre-sale disclosure obligations?

Yes. Article 3 of RD 201/2010 regulates the pre-contractual information to the potential franchisee.

At least 20 working days prior to the signing of the franchise contract or pre-contract or to the delivery by the future franchisee to the franchisor of any payment, the franchisor or main franchisee must provide the potential franchisee with the following truthful and non-deceptive information in writing:

- identity details of the franchisor;
- proof of having been granted for Spain, and in force, the title of ownership or licence to use the trademark and distinctive signs of the franchising entity, and of any judicial appeals lodged that may affect the ownership or use of the trademark, if any, with an expression, in any event, of the duration of the licence;

- (c) a general description of the sector of activity that is the subject of the franchise business, including the most important data relating thereto;
- (d) the experience of the franchising undertaking, which shall include, among other data, the date of creation of the undertaking, the main stages of its evolution and the development of the franchised network;
- (e) content and characteristics of the franchise and its operation;
- (f) structure and extent of the network in Spain; and
- (g) essential elements of the franchise agreement.

1.6 Do pre-sale disclosure obligations apply to sales to sub-franchisees? Who is required to make the necessary disclosures?

Yes, as we have seen, in accordance with Article 3 of RD 201/2010, the signing party must provide the information, whether it is the franchisor or the master franchisee, to the potential franchisee, with the content and in the advance period indicated above.

1.7 Is the format of disclosures prescribed by law or other regulation, and how often must disclosures be updated? Is there an obligation to make continuing disclosure to existing franchisees?

The minimum pre-contractual disclosure to the potential franchisee must be carried in writing, as set under Article 3 of RD 201/2010. The information must be accurate at the moment of disclosure, but there is no obligation to further update the information.

There is also no obligation of mandatory post-contractual disclosure of periodical information to the franchisees.

1.8 What are the consequences of not complying with mandatory pre-sale disclosure obligations?

An utter lack of pre-sale disclosure of information shall cause the agreement to be void if challenged by the franchisee. Incomplete or misleading information may allow the agreement to be rescinded if it caused an error in the franchisor that motivated entering into the franchise scheme, and the error and the causality can be reasonably proven in Court. Damages can be sought by the franchisee (see question 5.1).

Moreover, incomplete pre-sale disclosure of information to the franchisee shall incur in a violation of Article 62 of Act 7/1996, which, in connection with Articles 65.1(s) and 68, may lead to fines of up to 30,000 euros, or up to 900,000 euros for repeated offences.

1.9 Are there any other requirements that must be met before a franchise may be offered or sold?

No, the only requirement is pre-contractual information in accordance with Article 62.3 of Act 7/1996 and Article 3 of RD 201/2010.

1.10 Is membership of any national franchise association mandatory or commercially advisable?

It is not mandatory, although association with the national franchise association (Asociación Española de Franquicias (AEF)) may be advisable, as the Code of Conduct imposed to its

members is a guarantee of high standards that can improve the trust of suppliers, contractors and consumers. The AEF also provides services to its members and has agreements with other institutions, associations and administrations that may make affiliation commercially advisable.

1.11 Does membership of a national franchise association impose any additional obligations on franchisors?

There is an obligation to comply with the Code of Conduct, in addition to the obligation to pay the membership fee.

1.12 Is there a requirement for franchise documents or disclosure documents to be translated into the local language?

No. However, the documents are very frequently translated, in order to ensure that the franchisee is fully aware of terms and conditions. This could be relevant in the case of litigation or alternative dispute resolution.

2 Business Organisations Through Which a Franchised Business Can be Carried On

2.1 Are there any foreign investment laws that impose restrictions on non-nationals in respect of the ownership or control of a business in your jurisdiction?

Yes. The liberalisation regime for certain foreign direct investments in Spain has been suspended by Royal Decree 8/2020, of 17th March (hereinafter, RD 8/2020) and Royal Decree 11/2020, of 31st March (hereinafter, RD 11/2020), amending the regime established by Act 29/2003 on the legal regime of capital movements and foreign economic transactions (hereinafter, Act 29/2003).

There are currently restrictions on foreign direct investments by non-EU and EFTA residents that involve a shareholding equal to or greater than 10% of the share capital of a Spanish company or where, as a result of the corporate operation, legal act or business, the investor effectively participates in the management or control of the company, and the company is in a strategic sector. These strategic sectors are critical infrastructure, critical technologies, supply of critical inputs, including raw materials and food safety, sectors with access to sensitive information and, in particular, personal data and the media.

Investment in these cases requires prior governmental authorisation.

In the event of non-compliance with the restrictions introduced, investment operations without prior authorisation will lack validity and legal effects until they are legalised, without prejudice of eventual fines imposed.

2.2 What forms of business entity are typically used by franchisors?

In the case of franchisors, the most commonly used options are the limited company and the public limited company. The former makes it easier to maintain control within a closed group of partners, while the latter makes it easier to obtain financing from multiple investors. Specifically, when a foreign company generates a master franchisee subsidiary in Spain, it is usually a single-person limited company, in which the parent company is the sole shareholder.

In Spain, the formula used by franchisees most is the limited company, whether sole proprietorship or not, due to its low initial capital requirements and limited personal liability. In certain types of business, it is common for franchisees to operate as self-employed professionals.

2.3 Are there any registration requirements or other formalities applicable to a new business entity as a pre-condition to being able to trade in your jurisdiction?

Although a business can trade without registration, shareholders' personal limitation of liability does not apply if the company is not registered as per Royal Decree 1/2010, of 2nd July (hereinafter, RD 1/2010), enacting the revised text of the Capital Companies Act.

3 Competition Law

3.1 Provide an overview of the competition laws that apply to the offer and sale of franchises.

The applicable laws are:

- Act 15/2007, of 3rd July, on Competition.
- Royal Decree 261/2008, of 22nd February, of the Antitrust Regulation.
- Treaty on the Functioning of the European Union, in particular Article 101(3) thereof.
- EU Regulation 2022/720.

3.2 Is there a maximum permitted term for a franchise agreement?

No. The AEF's Code of Conduct does, however, provide for a minimum duration, which is the duration that allows the franchisee to amortise its investment.

3.3 Is there a maximum permitted term for any related product supply agreement?

No, there is not.

3.4 Are there restrictions on the ability of the franchisor to impose minimum resale prices?

Yes, including EU Regulation 2022/720, on the application of Article 101(3) of the Treaty on the Functioning of the European Union to certain categories of vertical agreements and concerted practices.

This regulation prohibits the franchisor from imposing the resale prices of the product or service on the dealer, although he may recommend them to the dealer, or set maximum sale prices. If, *de facto*, maximum or recommended prices do not allow the dealer real freedom to set a different price, such a limitation would be void (STS 18.02.2015, RJ 2015/577, which reiterates consolidated criteria in EU and Spanish case law).

3.5 Encroachment – are there any minimum obligations that a franchisor must observe when offering franchises in adjoining territories?

Spanish regulations impose on the franchisor pre-sale disclosure information obligations regarding adjoining territories. As per Article 3(f) of RD 201/2010, the franchisor must provide the potential franchisee with information relating to the structure

and extent of the network in Spain, which shall include the form of organisation of the franchise network and the number of establishments in Spain, distinguishing those operated directly by the franchisor from those operating under the franchise assignment regime, with an indication of the town in which they are located and the number of franchisees who have ceased to belong to the network in Spain in the last two years, stating whether the termination occurred due to expiry of the contractual term or other causes of termination.

3.6 Are in-term and post-term non-compete and non-solicitation of customers covenants enforceable?

Yes, although EU Regulation 2022/720 limits non-competition to the following time limits: no more than five years of non-competition, from the signature of the contract, is permitted.

Express renewal is permitted, but tacit renewal is not.

In the case of lease or transfer of premises where the activity is carried out:

- (a) The non-compete covenant shall not be longer than the duration of the lease or assignment of the premises or land.
- (b) The non-compete covenant can be extended longer (up to one year after the expiry of the franchise agreement) if the non-compete covenant meets the following requirements:
 - (i) It relates to goods or services that compete with the franchise goods or services.
 - (ii) It is limited to the premises and land from which it has operated during the franchise agreement period.
 - (iii) It is indispensable to protect know-how transferred by the franchisor to the franchisee.

It should be noted that the obligations arising from a contract are only binding on the signatory parties, so that the franchisee's relatives cannot be prevented from entering into the contract, directly or indirectly, or carry out activities that may fall within the scope of the franchise.

4 Protecting the Brand and Other Intellectual Property

4.1 How are trade marks protected?

Trademarks that provide protection in Spanish territory can be either Spanish Trademarks or EU Trademarks. As the latter have unitary character, they can only be applied for and, if applicable, granted for the entire territory of the EU.

EU Trademarks can be applied for at the European Union Intellectual Property Office (EUIPO) in Alicante. Application can also be submitted to the Spanish Patent and Trademark Office in Madrid (SPTO). Spanish Trademarks must be requested before the SPTO.

4.2 Are know-how, trade secrets and other business-critical confidential information (e.g. the Operations Manual) protected by local law?

As long as they meet the requirements to be considered trade secrets, they will be protected in accordance with the Trade Secrets Act 1/2019. This Act's requisites to provide protection to confidential information are:

- (a) the information is secret;
- (b) the information has business value, either actual or potential, precisely because it is secret; and
- (c) the information has been the subject of reasonable steps by the holder to keep it secret.

Unfortunately, lack of proper legal counsel often causes franchisees to omit actions that would ensure information is protected as a valuable trade secret under Spanish legislation.

4.3 Is copyright (in the Operations Manual or in proprietary software developed by the franchisor and licensed to the franchisee under the franchise agreement) protected by local law?

Yes. Protection from the Civil Courts may be sought against infringements of copyright. Particularly severe cases can be addressed also by Criminal Courts.

Although registration is not necessary to obtain rights and judiciary protection on the former, it is advisable to register or deposit works particularly important to the company before the Intellectual Property Registry or a Notary Public, in order to generate evidence of the existence of the copyrighted works at a moment in time.

5 Liability

5.1 What remedies can be enforced against a franchisor for failing to comply with mandatory disclosure obligations? Is a franchisee entitled to rescind the franchise agreement and/or claim damages?

Case law has construed that the franchisor can rescind the franchise agreement if the obligation to disclose information was fully omitted or if the information provided was false. Incomplete information does not allow the franchise agreement to be rescinded, unless it can be proven that the lack of information caused an essential and excusable or non-avoidable error about the key elements that motivated the franchisee to enter into the franchise agreement, and as long as without such error the franchisee would not have entered into the franchise agreement.

Moreover, a lack of mandatory disclosure of information allows the franchisee to claim damages if the cause and effect between the former and the latter can be proven.

Relevant Court decisions on the matter are, *inter alia*, Supreme Court ruling 62/2012 of 27th February, Section 19 of the Provincial Court of Barcelona ruling 502/2018b of 29th November, and Section 2 of the Provincial Court of León ruling 147/2018 of 3rd May.

5.2 In the case of sub-franchising, how is liability for disclosure non-compliance or for pre-contractual misrepresentation allocated between franchisor and master franchisee? If the franchisor takes an indemnity from the master franchisee in the Master Franchise Agreement, are there any limitations on such an indemnity being enforceable against the master franchisee?

Due to the lack of a particular provision, liability shall be placed on the party to the agreement with the franchisee. Therefore, franchisors that do not enter into the agreements with franchisees due to a master franchisee scheme would not be directly liable. A master franchisee can, nevertheless, claim damages against the franchisor if the liability was caused due to false or insufficient information provided by the franchisor to the master franchisee in order to comply with the pre-sale disclosure obligations. The franchisor can take an indemnity from

the master franchisee, as long as infringement of information duties is not carried in bad faith, in which case the indemnity would be void.

5.3 Can a franchisor successfully avoid liability for pre-contractual misrepresentation by including a disclaimer in the franchise agreement?

No. This would be a provision in fraud of law and would be void, as it would seek to avoid the obligations set under RD 201/2010.

5.4 Does local law permit class actions to be brought by a number of aggrieved franchisees and, if so, are class action waiver clauses enforceable?

No. Although franchisees may file actions jointly as co-plaintiffs, they cannot represent the collective of the franchisees and only franchisees that are party to the lawsuit will be affected by the ruling.

6 Governing Law

6.1 Is there a requirement for franchise documents to be governed by local law? If not, is there any generally accepted norm relating to choice of governing law, if it is not local law?

No, there is no such requirement. Usually, Spanish law is chosen as competent Courts in the case of infringement of the franchisee would be the Spanish Courts due to the residence of the franchisee, and, when applicable, location of the real estate involved, consumers affected, trademarks registered at the SPTO or the EUIPO and similar circumstances.

The exception is when the franchisor is overseas and considers it pertinent to apply a uniform legal scheme worldwide, in which case, the franchisor's national law may be chosen, even if this implies that such law must be proven before the Spanish Courts.

6.2 Do the local courts provide a remedy, or will they enforce orders granted by other countries' courts, for interlocutory relief (injunction) against a franchisee to prevent damage to the brand or misuse of business-critical confidential information?

Yes. This is regulated in Act 29/2015 on international legal cooperation in civil matters (hereinafter, Act 29/2015). Orders enforceable in the State of origin shall be enforceable in Spain once the exequatur proceeding is complete.

The exequatur proceedings, in which the parties must be represented by a procurator at Court and assisted by a lawyer, can be performed at the request of any person demonstrating a legitimate interest. The request for enforcement may be joined in the same brief.

Local Courts shall enforce foreign provisional or precautionary measures pursuant to Act 29/2015, subject to two cumulative conditions: (i) that they have been adopted after hearing the opposing party; and (ii) that the refusal to enforce them would entail a violation of effective judicial protection (Article 41(4) of Act 29/2015).

6.3 Is arbitration recognised as a viable means of dispute resolution and is your country a signatory to the New York Arbitration Convention on the Recognition and Enforcement of Foreign Arbitral Awards? Do businesses that accept arbitration as a form of dispute resolution procedure generally favour any particular set of arbitral rules?

In relation to international arbitration, Spain favours the so-called ‘conflict autonomy’, by which choosing the legislation applicable to the franchise or submitting to an arbitration is valid.

Indeed, Spain is a signatory to the New York Convention and, since the approval of Act 60/2003 on Arbitration, arbitration is increasingly recognised in Spain as an agile dispute resolution mechanism and the main Bar Associations, as well as other institutions, have arbitration centres.

In particular, arbitration is applied when the parties to an agreement decide to be subject to the laws of jurisdiction other than Spanish laws, as it allows the appointment of arbitrators who are familiar with such foreign laws, which the national Courts would not be familiar with.

7 Real Estate

7.1 Generally speaking, is there a typical length of term for a commercial property lease?

With regard to the duration of the lease of premises, Act 29/1994, of 24th November, of urban leases (hereinafter, Act 29/1994) grants the parties full freedom on the matter. Nevertheless, if we follow the guidelines of the AEF’s Code of Conduct, the minimum duration of the franchise contract will be that which allows the amortisation of the investment, and it may be construed that this will also be the minimum initial duration of the lease of the premises where the activity is carried out.

7.2 Is the concept of an option/conditional lease assignment over the lease (under which a franchisor has the right to step into the franchisee/tenant’s shoes under the lease, or direct that a third party (often a replacement franchisee) may do so upon the failure of the original tenant or the termination of the franchise agreement) understood and enforceable?

Yes, such provision is valid and enforceable. Nevertheless, Article 34 of Act 29/1994 establishes a compensation right for the franchisee/tenant for customer base generated for the business, from which the franchisor or the awarded third party could benefit. Compensation is applicable if a commercial activity of sale to the public has been carried on for the last five years, and the tenant/franchisee has offered a renewal four months prior to termination, for (at least) five years, and at a market rent, and either:

- (a) the tenant/franchisee, within six months of the expiry of the lease, starts performing the same or a similar activity in the same municipality; or
- (b) the tenant/franchisee starts a different activity within the six months following the termination of the lease or does not start any activity at all, and the franchisor or a third party carries out the same activity or one similar to that carried out by the tenant/franchisee on the rented property.

7.3 Are there any restrictions on non-national entities holding any interest in real estate, or being able to sub-lease property?

We have referred to restrictions to non-national investments in question 2.1. Commercial venues are not deemed strategic, and therefore restrictions do not apply in this case.

7.4 Give a general overview of the commercial real estate market. To what extent has the real estate market been affected by the Coronavirus pandemic? Specifically, can a tenant expect to secure an initial rent free period when entering into a new lease (and if so, for how long, generally), or are landlords demanding “key money” (a premium for a lease in a flagship location)?

The COVID-19 pandemic and doubts about economic recovery caused real estate investment in Spain to plummet in 2020. The volume of transactions dropped by 28% that year, according to figures released by BNP Paribas Real Estate. There were exceptions, as investment in premium locations on premium cities was on the rise in 2020.

Even so, the number of operations completed in the Iberian Peninsula (Spain and Portugal) throughout 2022 represented an annual growth of 67% in the number of transactions and a 33% increase in the capital invested compared to year 2021. In this regard, Spain represented a share of capital of 84%, while Portugal attracted the remaining 16%.

Premium locations kept the pace and did not lose their gained advantage. CBRE, on its “Real Estate Market Outlook 2022, Spain” stated the COVID-19 pandemic had further polarised the market, with a chasm between premium assets and the rest.

Despite the growth explained above, the franchise sector closed 2022 with a turnover figure that grew by only 2.9% from the previous year.

Likewise, and in relation to the rent, in premium locations, it is common for landlords to demand key money, as demand is much greater than supply. In the rest of the country, where supply and offer do not differ strongly, landlords tend not to request key money, but to negotiate rent-free terms when entering in a new lease is not frequent either.

8 Online Trading

8.1 If an online order for products or request for services is received from a potential customer located outside the franchisee’s exclusive territory, can the franchise agreement impose a binding requirement for the request to be re-directed to the franchisee for the territory from which the sales request originated?

Assuming the online order comes from a passive sale and is not coming from active sales, such as marketing advertisements in social networks targeted to outside the franchisee’s exclusive territory, the answer would be **no**. As per Article 4 of EU Regulation 2022/720, the restriction of competence can only limit active sales to the territory of the franchisee or limit active sales to an exclusive customer group reserved to the franchisee, but may not impose restrictions to passive online sales, or any other form of passive sale.

8.2 Are there any limitations on a franchisor being able to require a former franchisee to assign local domain names to the franchisor on the termination or expiry of the franchise agreement?

No, there are no direct limitations.

9 Termination

9.1 Are there any mandatory local laws that might override the termination rights one might typically expect to see in a franchise agreement?

No. The provisions on termination set under the franchise agreement shall apply.

9.2 Are there local rules that impose a minimum notice period that must be given to bring a business relationship that has existed for a number of years to an end, which will apply irrespective of the length of the notice period set out in the franchise agreement?

No, there is no concrete minimum notice period established by law. It is sufficient to provide a reasonable previous notice of termination. Otherwise, the exercise of the termination would be abusive or not in accordance with good faith, as construed by, *inter alia*, Supreme Court ruling of 28th January 2002, in case 2767/1996.

10 Joint Employer Risk and Vicarious Liability

10.1 Is there a risk that a franchisor may be regarded as a joint employer with the franchisee in respect of the franchisee's employees? If so, can anything be done to mitigate this risk?

It may occur if the franchisor's control goes so far as to directly take over the management of the work process, the instructions to the employees and the outcome of the work process. Case law is consistent in considering that, if the franchisor provides instructions on the work process to the franchisees' employees, the franchisor is to be considered jointly liable.

Also, other forms that may cause such liability include clauses in the franchise agreement that provide control over the workflow to the franchisor, such as intervention in the choice of employees, and the possibility of granting bonuses or incentives.

We suggest never providing direct instructions to a franchisee's employees on how to perform their work and, instead, sending instructions to the franchisee itself and being extremely cautious in order to avoid including clauses in the agreement that may cause such vicarious liabilities.

10.2 Is there a risk that a franchisor may be held to be vicariously liable for the acts or omissions of a franchisee's employees in the performance of the franchisee's franchised business? If so, can anything be done to mitigate this risk?

The scenario is the same as in the previous question: joint liability may arise if the franchisor exerts control over the workflow of the franchisee.

11 Currency Controls and Taxation

11.1 Are there any restrictions (for example exchange control restrictions) on the payment of royalties to an overseas franchisor?

No, there are not.

11.2 Are there any mandatory withholding tax requirements applicable to the payment of royalties under a trade mark licence or in respect of the transfer of technology? Can any withholding tax be avoided by structuring payments due from the franchisee to the franchisor as a management services fee rather than a royalty for the use of a trade mark or technology?

Yes. Income from royalties is deemed earnings derived from movable capital and is subject to the applicable tax scheme to such revenues. Nevertheless, multiple double taxation treaties apply, which may reduce the withholding to around 5%–10%.

11.3 Are there any requirements for financial transactions, including the payment of franchise fees or royalties, to be conducted in local currency?

There is no restriction on the currency to be used. Nevertheless, the compensation shall be translated to euros for tax purposes, such as the amount to be withheld.

12 Commercial Agency

12.1 Is there a risk that a franchisee might be treated as the franchisor's commercial agent? If so, is there anything that can be done to help mitigate this risk?

Article 1 of Act 12/1992 defines an agency contract as a contract whereby a natural or legal person, known as an agent: (i) undertakes to another person on a continuous or stable basis; (ii) in exchange for remuneration; (iii) to promote acts or transactions of commerce on behalf of others, or to promote and conclude them on behalf of and in the name of others; (iv) as independent intermediaries, without assuming, unless otherwise agreed, the risks and rewards of such transactions.

On the contrary, the franchise contract is characterised by the fact that the franchisee enters into contracts with third parties in its own name, on its own account and assuming its own risks. Therefore, despite certain similarities, they are different concepts. To avoid the possible risk of a franchisee being considered a commercial agent, the contractual relationship must clearly establish that the franchisee operates assuming commercial risks.

13 Good Faith and Fair Dealings

13.1 Is there any overriding requirement for a franchisor to deal with a franchisee in good faith and to act fairly in its dealings with franchisees according to some objective test of fairness and reasonableness?

This needs to be looked at on a case-by-case basis. In Spain, there is no objective test as such to check the requirements of good faith. Good faith is regulated in a broad sense in Articles 7 and 1.258 of the Civil Code.

13.2 Is there any limitation on a good faith obligation being unenforceable if it only applies from franchisee to franchisor, rather than being mutual?

The obligation to act in good faith is a general mandatory principle imposed by law and is therefore always mutual and implicit to any contractual relationship. A provision excluding the obligation to act in good faith would be void.

14 Ongoing Relationship Issues

14.1 Are there any specific laws regulating the relationship between franchisor and franchisee once the franchise agreement has been entered into?

There is an obligation to provide continued commercial and/or technical assistance during the term of the agreement, without prejudice to any supervisory powers that may be contractually established, as it is one of the three criteria for a franchising scheme to exist, as per Article 2 of RD 201/2010. Nevertheless, this obligation for commercial and/or technical assistance is to be defined in the franchise agreement and does not require a particular complexity.

There is no other particular law regulating ongoing relationship issues between franchisor and franchisee.

15 Franchise Renewal

15.1 What disclosure obligations apply in relation to a renewal of an existing franchise at the end of the franchise agreement term?

There are no mandatory disclosure obligations applying to the renewal of an existing agreement.

15.2 Is there any overriding right for a franchisee to be automatically entitled to a renewal or extension of the franchise agreement at the end of the initial term irrespective of the wishes of the franchisor not to renew or extend?

No, unless such right is set under the franchise agreement.

15.3 Is a franchisee that is refused a renewal or extension of its franchise agreement entitled to any compensation or damages as a result of the non-renewal or refusal to extend?

As seen in question 9.2, the franchisee may seek to enforce a renewal or seek damages caused if the termination was not notified reasonably in advance.

Also, as seen in question 7.2, compensation for the customers is generated in a commercial venue when, after requesting a renewal for the lease of the real estate, the franchisor decides not

to provide such renewal and afterwards, directly or by a third party, operates the same or a similar business that profits from the previously generated customer base.

16 Franchise Migration

16.1 Is a franchisor entitled to impose restrictions on a franchisee's freedom to sell, transfer, assign or otherwise dispose of the franchised business?

The franchisor is able to impose contractual restrictions on the transfer of the franchised business to a third party or the means by which the business is conducted, as there are no legal limitations to the contractual freedom of the parties.

However, franchisors cannot impose upon franchisees the selling prices at which they must sell their products or offer their services. In fact, as the Spanish Supreme Court has recalled, the franchisor may make a recommendation or imposition of a maximum price, insofar as there is a margin, but not a price fixing in the strict sense.

16.2 If a franchisee is in breach and the franchise agreement is terminated by the franchisor, will a "step-in" right in the franchise agreement (whereby the franchisor may take over the ownership and management of the franchised business) be recognised by local law, and are there any registration requirements or other formalities that must be complied with to ensure that such a right will be enforceable?

Yes, the franchisor is able to impose a contractual resolutive condition in the franchise agreement by means of which it may 'step-in' in the management of the franchise, as set out under the franchise agreement. Nevertheless, the step-in may be complicated if the venue where the business is placed is not owned by the franchisor. If the franchisee is either leasing the venue on a separate agreement or from a third party, or conducts the business on its own venue, the invasion of such venue by a step-in right may not be feasible.

16.3 If the franchise agreement contains a power of attorney in favour of the franchisor under which it may complete all necessary formalities required to complete a franchise migration under pre-emption or "step-in" rights, will such a power of attorney be recognised by the courts in the jurisdiction and be treated as valid? Are there any registration or other formalities that must be complied with to ensure that such a power of attorney will be valid and effective?

Although the power of attorney can be granted, there is a high risk that it may not be enforceable, due to self-contracting by the franchisor, as self-contracting against the interests of the represented party is void. Moreover, power of attorney rights can be withdrawn, even if there is an agreement to make such power of attorney not withdrawable.

17 Electronic Signatures and Document Retention

17.1 Are there any specific requirements for applying an electronic signature to a franchise agreement (rather than physically signing a “wet ink” version of the agreement), and are electronic signatures recognised as a valid way of creating a binding and enforceable agreement?

An electronic contractual document has the same legal validity as a document signed in the traditional way, provided that the electronic signature requirements of Law 6/2020 on the legal effects of electronic documents are met.

17.2 If a signed/executed franchise agreement is stored electronically (either having been signed using e-signatures or a “wet ink” version having been scanned and saved as an electronic file), can the paper version of the agreement be destroyed?

If it has been executed digitally, through a valid e-signature, there is no need for a paper version. Nevertheless, if the original

signature is physical, it is advisable that the original executed version is conserved, in order to allow for certification of the original signature if conflicts arise.

18 Current Developments

18.1 What is the biggest challenge franchising is facing in your jurisdiction and how are franchisors responding to that challenge?

Franchising lacks a comprehensive regulation in Spain, which causes some uncertainties. Although a Spanish regulation may solve such issues, there is an added challenge on top of that, which is the lack of legal harmonisation on franchising in Europe. Due to the existence of a unitary EU market without the existence of unified franchising regulations, EU franchises find it difficult to generate a unitary framework and are forced to rely on national experts in each jurisdiction in order to avoid operating risks.

Nevertheless, the ongoing success of the franchising model, which has been increasing in prevalence for the last few years in the EU, motivates us to be optimistic on the probability of the EU Parliament and Commission taking the steps necessary to solve such issues.



Javier Fernández-Lasquetty Quintana is a Partner at ELZABURU, and the Head of the Legal and Business Department of our Firm. Javier provides counsel in licensing agreements, joint ventures, franchise agreements, R&D projects and IT projects. He also litigates in trademarks, copyright, IT and unfair competition matters. A panellist of WIPO Arbitration and Mediation Centre and member of its Advisory Board, he participates in international mediation and arbitration proceedings.

He has been a Legal Counsel at Secoinsa, S.A., a Spanish computer company (1982–1986), a Legal Counsel at Fujitsu España (1986–1990), a Legal Department and Consultancy Director in TGI, S.A., an IT and R&D company (1993–1997), and IP/IT Partner at Baker & McKenzie Madrid (1997–2004).

Associated Professor at IE Law School and invited professor in other universities, he speaks at international conferences and seminars on intellectual property, IT, mediation, etc. Javier is listed in the world's leading legal rankings, including *The Legal 500*, *IAM Patent 1000*, *The World's Leading Patent Professionals*, *Chambers Europe*, *Chambers Global*, etc.

ELZABURU

Paseo de la Castellana 259C
Torre Cristal Floor 28
Madrid, 28046
Spain

Tel: +34 917 00 94 00
Email: jfl@elzaburu.es
URL: www.elzaburu.es



Jorge Parada Chacón is an Attorney in ELZABURU's Legal and Business Group. His practice is focused on providing counsel to companies operating in the fields of technology, research, innovation and development, with a particular expertise in corporate law, technology transfer processes, investment processes and commercial agreements.

ELZABURU

Paseo de la Castellana 259C
Torre Cristal Floor 28
Madrid, 28046
Spain

Tel: +34 917 00 94 00
Email: jpc@elzaburu.es
URL: www.elzaburu.es

ELZABURU is a multidisciplinary Spanish professional Firm established in 1865, made up of lawyers, industrial property attorneys, engineers, and graduates in chemistry, biology, and physics.

In its capacity as a Law Firm, our Firm offers full-service advice in the areas of industrial property, intellectual property, licensing, technology transfer, unfair competition, domain names and general litigation relating to industrial and intellectual property rights in all pertinent Courts at all levels and in all jurisdictions, including international arbitration Courts.

In its capacity as a Firm of Industrial Property Attorneys, our Firm acts directly before the SPTO in Madrid, the WIPO in Geneva, the EPO in Munich, and the EUIPO in Alicante, and handles legal actions and litigation in industrial property matters before the Spanish Courts, the General Court of the European Union and the Court of Justice of the European Union.

The Firm of ELZABURU S.L.P. currently comprises 57 Professionals. The Firm has approximately 150 employees working under the leadership of Ignacio Díez de Rivera, who represents the fifth generation of family. ELZABURU's main office is located in Madrid, and we also operate branch offices in Alicante, Valencia and Beijing.

www.elzaburu.es



Sweden

Sagell & Co. Advokatbyrå



Dan-Michael Sagell

1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

Since 2006, there has been a disclosure law entitled the Act on Franchisor's Information Obligation (2006:484), which regulates the information a franchisor must disclose both within a reasonable time, and before a potential franchisee signs the franchise agreement. This law contains the following legal definition of a franchise agreement:

"A franchise agreement is an agreement by which an enterprise agrees with a party that the party against consideration shall use the specific business model of the enterprise regarding the marketing and selling of products or services, and shall use the trade marks and the proprietary rights of the enterprise, and accepts regular controls that the franchise agreement adheres to."

1.2 What laws regulate the offer and sale of franchises?

There is no particular law that regulates the offer and sale of a franchise. Such offer and sale are covered by the general commercial laws that govern business contracts.

1.3 If a franchisor is proposing to appoint only one franchisee/licensee in your jurisdiction, will this person be treated as a "franchisee" for purposes of any franchise disclosure or registration laws?

Yes, this person will be treated as such.

1.4 Are there any registration requirements relating to the franchise system?

There are no particular registration requirements, regarding a certain business, simply because the business is operating under a franchise system.

1.5 Are there mandatory pre-sale disclosure obligations?

The Swedish disclosure law states that the franchisor shall provide information about the implication of the franchise agreement, and about any other conditions that are needed concerning the

circumstances in question, in good time before the signing of the franchise agreement.

The information shall be in writing, clear and understandable and shall, as a minimum, contain the following:

1. A description of the franchise business model that is to be operated by the franchisee.
2. Information about the other franchisees in the franchise chain and the size of their businesses.
3. Information about the payments the franchisee shall make to the franchisor and about the other financial conditions in the franchise agreement.
4. Information about the intellectual and proprietary rights that are to be licensed to the franchisee.
5. Information about the products and services that the franchisee is obligated to buy or lease.
6. Information about any non-competition clause that is to be valid during the term of the franchise agreement or after the expiration of the agreement.
7. Information about the term of the franchise agreement, the conditions for amendments, prolongation and termination of the franchise agreement and about the financial consequences connected with the termination of the franchise agreement.
8. Information about the dispute resolution rules in the franchise agreement and how the costs for such dispute resolution shall finally be distributed between the parties.

Said information shall also be handed over when the franchise agreement is to be transferred with the consent of the franchisor from the present franchisee to a new franchisee.

However, the list above is only a minimum requirement. The law also requires that if there is a clause in the franchise agreement that can be seen as particularly financially onerous upon the franchisee, such clause must also be disclosed beforehand.

1.6 Do pre-sale disclosure obligations apply to sales to sub-franchisees? Who is required to make the necessary disclosures?

The pre-sale disclosure obligations are also applicable to a sub-franchise, and it is the master franchisee that must hand over the information in question to its potential sub-franchisees.

1.7 Is the format of disclosures prescribed by law or other regulation, and how often must disclosures be updated? Is there an obligation to make continuing disclosure to existing franchisees?

The only format of disclosure that is prescribed by the law is that the information is handed over in writing and in understandable language.

Since it is the franchisor who has the burden of proof in a dispute as to whether the franchisee has been informed according to the law or not, it is advisable that the franchisor sees to it that franchisee signs a receipt confirming that the information has been received in good time before the signing of the franchise agreement.

There is no obligation to make continuing disclosure to existing franchisees.

1.8 What are the consequences of not complying with mandatory pre-sale disclosure obligations?

See answer under question 5.1 below.

1.9 Are there any other requirements that must be met before a franchise may be offered or sold?

No, there are no such other requirements that must be met just because it is a franchise.

1.10 Is membership of any national franchise association mandatory or commercially advisable?

No, membership of a national franchise association is not mandatory, but could be commercially advisable because such membership says to the potential franchisee that the franchisor is prepared to follow not only the disclosure law but also the ethical rules of the national franchise association.

1.11 Does membership of a national franchise association impose any additional obligations on franchisors?

Yes, membership of the Swedish Franchise Association (*Svenska Franchise Föreningen*) means that the franchisor must comply with the ethical rules of that association. These ethical rules are identical to the ethical code of the European Franchise Federation (EFF), titled the European Code of Ethics for Franchising (<https://eff-franchise.com/>).

1.12 Is there a requirement for franchise documents or disclosure documents to be translated into the local language?

No, the legal requirement in the disclosure law is that such a document shall be understandable for the potential franchisee in question. However, the European ethical code requires that the franchise agreement be translated into the official language of the country in which the franchisee is established. However, as many business people in Sweden understand English today, it is fairly common for franchise agreements and disclosure documents written in plain English to be considered acceptable.

2 Business Organisations Through Which a Franchised Business Can be Carried On

2.1 Are there any foreign investment laws that impose restrictions on non-nationals in respect of the ownership or control of a business in your jurisdiction?

No, a company or person that is registered in or is a citizen of a country within the EU Common Market or the European

Economic Area (EEA) can start or buy a business in Sweden without any restrictions. The same can be said with regard to companies or persons from outside the EU Common Market or the EEA; however, a Swedish company, for instance, owned by such a company/person must have a person on its board of directors who is domiciled within the EU or EEA.

However, at the end of the year of 2023, a law will be implemented in order to protect businesses that are deemed to be valid for the Swedish national security. However, it will certainly not affect business concepts that are or can be franchised.

2.2 What forms of business entity are typically used by franchisors?

A franchisor is typically a limited liability company (*Aktiebolag*) with no personal liability for its owners.

2.3 Are there any registration requirements or other formalities applicable to a new business entity as a pre-condition to being able to trade in your jurisdiction?

No, there are no such general formalities, except for the formalities required to form a company if trade is to be made through the company, the tax formalities, and the formalities required for the particular trade in question, for instance with respect to health issues. However, there are very few kinds of trade in Sweden that need a licence or a permit from the authorities before they start being conducted.

3 Competition Law

3.1 Provide an overview of the competition laws that apply to the offer and sale of franchises.

There are no competition laws that apply to the offer and sale of franchises. With regard to Swedish competition laws, these are identical to the competition laws applied by the EU Common Market.

3.2 Is there a maximum permitted term for a franchise agreement?

No, but the common term for a franchise agreement in Sweden is five years, with the option for the franchisee to sign a new franchise agreement for an additional five-year period. The reason for the five-year period is that there are competition laws that say you cannot, for a period longer than five years, restrict a business (a franchisee) in a contract to only buying from suppliers appointed by the franchisor and/or only selling certain products in its business to a third party.

3.3 Is there a maximum permitted term for any related product supply agreement?

No, there is not. If there is not a fixed end date in the agreement, either party has the right at any time during the life of the agreement to terminate the agreement within a reasonable notification period. The longer the time such an agreement has existed, the longer the notification period must be.

3.4 Are there restrictions on the ability of the franchisor to impose minimum resale prices?

Yes, a franchisor cannot impose upon the franchisee, or by other means determine, the minimum price at which the franchisee sells its product or service to its customers. The franchisor is entitled to have recommended resale prices, but it must be clear that the franchisee is free to deviate from the recommended prices. However, there is one exemption to this rule; that the franchisor is allowed to determine the maximum resale prices.

3.5 Encroachment – are there any minimum obligations that a franchisor must observe when offering franchises in adjoining territories?

No, there are not.

3.6 Are in-term and post-term non-compete and non-solicitation of customers covenants enforceable?

Yes, in-term non-compete and non-solicitation of customers covenants are enforceable, as long as the agreement is in force. Such covenants are also valid for a time period of six months, but sometimes also up to two years after the termination of the agreement. The length of this time period depends on the type of business in question. If a longer time period is needed post the agreement, the ex-franchisee must then be compensated in some form for this restriction upon its business, to avoid the longer time period being deemed unreasonable and thus null and void.

4 Protecting the Brand and Other Intellectual Property

4.1 How are trade marks protected?

A trade mark is protected by registration, or by the use of the fact that the trade mark owner can prove that the trade mark in question is well-known within the majority of its market. However, since the latter can be difficult to prove in a court dispute against an infringer, the recommendation is that the trade mark should be registered in order to get protection.

Trade mark registration is made at the Swedish Patent and Registration Office, is valid for a period of 10 years, and can be renewed for additional 10-year periods. Sweden has ratified the Protocol Relating to the Madrid Agreement on the International Registration of Marks, and recognises European Community Trademarks.

4.2 Are know-how, trade secrets and other business-critical confidential information (e.g. the Operations Manual) protected by local law?

Yes, they are protected by law and by non-disclosure agreements or non-disclosure clauses in agreements, but it is very important to also treat this information as confidential by protecting the information physically, by having the information accessible only within restricted areas and/or by only granting a limited group of persons access to the information, and finally by using visible signs to brand the documents (e.g. the Operations Manual) as trade secrets and confidential information.

4.3 Is copyright (in the Operations Manual or in proprietary software developed by the franchisor and licensed to the franchisee under the franchise agreement) protected by local law?

Yes, the Operations Manual and the software are automatically protected under copyright law. There is no need for registration.

5 Liability

5.1 What remedies can be enforced against a franchisor for failing to comply with mandatory disclosure obligations? Is a franchisee entitled to rescind the franchise agreement and/or claim damages?

The only remedy provided by the Swedish disclosure law is that a franchisor failing to provide information that should be disclosed can: be ordered by the court to provide this information and to amend its disclosure document accordingly for its future usage; and, if not complying with this order, be ordered by the court to pay a penalty sum to the government. Unfortunately, the franchisee that has not received the information is not entitled to rescind the franchise agreement and/or claim damages.

Furthermore, the absence of such information could, according to the preparatory work behind the disclosure law, give a franchisee a good argument for pleading that an onerous clause in his agreement should be declared by the court or the arbitrator to be unreasonable and thus null and void under section 36 of the Swedish Contract Act, because he or she had not been informed about this clause. If the court then rules in favour of this franchisee, the clause in question can no longer be enforced by the franchisor, but the franchise agreement will still be valid except for this clause. However, this argument and such a case have yet to be tested before a district court, and eventually the Swedish Supreme Court, in order to establish a precedent for such an argument and ruling.

5.2 In the case of sub-franchising, how is liability for disclosure non-compliance or for pre-contractual misrepresentation allocated between franchisor and master franchisee? If the franchisor takes an indemnity from the master franchisee in the Master Franchise Agreement, are there any limitations on such an indemnity being enforceable against the master franchisee?

If there are clauses – and there should be – in the master franchise agreement stating that the master franchisee must comply with local laws, including local disclosure laws, and the master franchisee fails to do so in relation to its sub-franchisee, the franchisor has the right to indemnify the master franchisee. However, if this failure is due to actions or omissions by the franchisor, then it can be seen as unreasonable to indemnify the master franchisee.

The sub-franchisee has no case against the franchisor under the disclosure law, and by the fact that they are not bound to each other by an agreement between them.

5.3 Can a franchisor successfully avoid liability for pre-contractual misrepresentation by including a disclaimer in the franchise agreement?

No. A party to a contract cannot be free from liability for any false statements that have misled the other party to enter into the contract in question. Such an agreement will be rescinded

by the court, provided that the other party has proved that it decided to enter into the contract based on a representation that has turned out to be a misrepresentation.

5.4 Does local law permit class actions to be brought by a number of aggrieved franchisees and, if so, are class action waiver clauses enforceable?

Yes, class actions can be initiated, but are so far rare in Sweden. The validity of a clause in a franchise agreement preventing the franchisee to be part of a class action has not yet been tried by a court in Sweden.

6 Governing Law

6.1 Is there a requirement for franchise documents to be governed by local law? If not, is there any generally accepted norm relating to choice of governing law, if it is not local law?

The franchisor and the franchisee are, under the freedom of contract principle, free to decide the law that shall govern the franchise agreement, and shall be applicable when solving a dispute between them. They can also decide whether the trial shall take place in Sweden or somewhere else.

6.2 Do the local courts provide a remedy, or will they enforce orders granted by other countries' courts, for interlocutory relief (injunction) against a franchisee to prevent damage to the brand or misuse of business-critical confidential information?

Yes, the Swedish courts can do that if the decision of the other country's court is not against *ordre public*.

A court injunction in Sweden does generally demand that the party seeking an injunction put forward a security before the court in order to protect the party being stopped by the injunction, if the following lawsuit and trial regarding the main issue ends with a ruling that this party has not done anything wrong, and subsequently has the right to be compensated for the stoppage of its business. The security shall cover such compensation sum. Additionally, an injunction in Sweden must be followed by a lawsuit within a few weeks following the injunction. If not, the injunction will be lifted.

6.3 Is arbitration recognised as a viable means of dispute resolution and is your country a signatory to the New York Arbitration Convention on the Recognition and Enforcement of Foreign Arbitral Awards? Do businesses that accept arbitration as a form of dispute resolution procedure generally favour any particular set of arbitral rules?

The answer is yes. The arbitral rules commonly used are the rules of the SCC Arbitration Institute.

7 Real Estate

7.1 Generally speaking, is there a typical length of term for a commercial property lease?

The typical length of term for a commercial property lease is three or five years with an automatic extension for three or five years, respectively, each time, if none of the parties have

notified their termination of the lease agreement at the latest nine months prior to the expiration of the then current lease period of three or five years.

If the tenant has been notified properly, it has to move out of the premises when the lease agreement expires, but the tenant is then: entitled to a compensation sum from the landlord that is, at the minimum, equal to the rent the tenant paid during the last year of the lease; or entitled to a new location, provided by the landlord, which shall be similar to the existing premises. This is only the case provided that the termination is not due to the tenant's breach of contract, or the landlord has a reasonable cause for the termination. However, the tenant can, in a separate written document, waive these rights of compensation and of relocation to other premises.

7.2 Is the concept of an option/conditional lease assignment over the lease (under which a franchisor has the right to step into the franchisee/tenant's shoes under the lease, or direct that a third party (often a replacement franchisee) may do so upon the failure of the original tenant or the termination of the franchise agreement) understood and enforceable?

This concept is enforceable between the franchisor and the franchisee/tenant; however, with regard to the landlord, it is not enforceable. The landlord must give its consent to this change of tenants in order for the concept to be enforceable against the landlord.

Only under certain circumstances can the landlord be overruled by a government body with the competence to rule over disputes between landlord and tenant (*Hyses- och arrendenämnden*) if the present tenant has had the lease for at least three years and the incoming tenant takes over the business from the outgoing tenant that has been conducted on the premises in question.

7.3 Are there any restrictions on non-national entities holding any interest in real estate, or being able to sub-lease property?

No; see the answer under question 2.1 above.

7.4 Give a general overview of the commercial real estate market. To what extent has the real estate market been affected by the Coronavirus pandemic? Specifically, can a tenant expect to secure an initial rent free period when entering into a new lease (and if so, for how long, generally), or are landlords demanding "key money" (a premium for a lease in a flagship location)?

Under the principle of freedom of contract, a landlord and a tenant are free to negotiate the terms of the lease agreement, including a rent-free period and key money.

8 Online Trading

8.1 If an online order for products or request for services is received from a potential customer located outside the franchisee's exclusive territory, can the franchise agreement impose a binding requirement for the request to be re-directed to the franchisee for the territory from which the sales request originated?

No, the franchise agreement can state that the franchisee cannot actively solicit business outside its exclusive territory, but the agreement cannot state that the franchisee is prohibited from selling to

a customer outside the exclusive territory, if the customer in question wants to do business with this franchisee.

8.2 Are there any limitations on a franchisor being able to require a former franchisee to assign local domain names to the franchisor on the termination or expiry of the franchise agreement?

No, there are no such limitations in Sweden.

9 Termination

9.1 Are there any mandatory local laws that might override the termination rights one might typically expect to see in a franchise agreement?

No, there are no such laws in Sweden.

9.2 Are there local rules that impose a minimum notice period that must be given to bring a business relationship that has existed for a number of years to an end, which will apply irrespective of the length of the notice period set out in the franchise agreement?

No, there are no such laws in Sweden.

10 Joint Employer Risk and Vicarious Liability

10.1 Is there a risk that a franchisor may be regarded as a joint employer with the franchisee in respect of the franchisee's employees? If so, can anything be done to mitigate this risk?

If a franchisor passes by the franchisee and gives instructions and orders directly to the employees of the franchisee, there is such a risk. Consequently, if the franchisor will communicate with these employees, the franchisor must communicate with the franchisee and instruct the franchisee to forward this communication to its employees.

10.2 Is there a risk that a franchisor may be held to be vicariously liable for the acts or omissions of a franchisee's employees in the performance of the franchisee's franchised business? If so, can anything be done to mitigate this risk?

No, such a risk is minimal. It must first be established that the franchisor actually is the employer of the employee in question; see the answer under question 10.1. above.

11 Currency Controls and Taxation

11.1 Are there any restrictions (for example exchange control restrictions) on the payment of royalties to an overseas franchisor?

No, there are no such restrictions.

11.2 Are there any mandatory withholding tax requirements applicable to the payment of royalties under a trade mark licence or in respect of the transfer of technology? Can any withholding tax be avoided by structuring payments due from the franchisee to the franchisor as a management services fee rather than a royalty for the use of a trade mark or technology?

No, there is only a withholding tax regarding dividends that are paid to shareowners domiciled abroad.

11.3 Are there any requirements for financial transactions, including the payment of franchise fees or royalties, to be conducted in local currency?

No, there are no such requirements.

12 Commercial Agency

12.1 Is there a risk that a franchisee might be treated as the franchisor's commercial agent? If so, is there anything that can be done to help mitigate this risk?

No, only if the franchise agreement has clauses that fall under the Agency Act (1991:351). This act is based on EU law. The court disregards what the agreement is called by the parties. The court looks at the real character of the agreement.

13 Good Faith and Fair Dealings

13.1 Is there any overriding requirement for a franchisor to deal with a franchisee in good faith and to act fairly in its dealings with franchisees according to some objective test of fairness and reasonableness?

There is no such objective test, but a franchisor shall deal with a franchisee in good faith and act fairly by following the general principles that are embedded in all commercial agreements, meaning that each party must be loyal to the other and make its best efforts to meet its obligations. If not, that could be seen as a material breach of the contract, giving the other party the right to terminate the contract prematurely and claim damages.

13.2 Is there any limitation on a good faith obligation being unenforceable if it only applies from franchisee to franchisor, rather than being mutual?

No, there are no such limitations.

14 Ongoing Relationship Issues

14.1 Are there any specific laws regulating the relationship between franchisor and franchisee once the franchise agreement has been entered into?

No. This relationship is governed by general commercial laws and precedents.

15 Franchise Renewal

15.1 What disclosure obligations apply in relation to a renewal of an existing franchise at the end of the franchise agreement term?

No, there are no such obligations.

15.2 Is there any overriding right for a franchisee to be automatically entitled to a renewal or extension of the franchise agreement at the end of the initial term irrespective of the wishes of the franchisor not to renew or extend?

No, there is no such right.

15.3 Is a franchisee that is refused a renewal or extension of its franchise agreement entitled to any compensation or damages as a result of the non-renewal or refusal to extend?

No, it is not.

16 Franchise Migration

16.1 Is a franchisor entitled to impose restrictions on a franchisee's freedom to sell, transfer, assign or otherwise dispose of the franchised business?

Yes, a franchisor is entitled to impose such restrictions.

16.2 If a franchisee is in breach and the franchise agreement is terminated by the franchisor, will a "step-in" right in the franchise agreement (whereby the franchisor may take over the ownership and management of the franchised business) be recognised by local law, and are there any registration requirements or other formalities that must be complied with to ensure that such a right will be enforceable?

This remedy is recognised by Swedish law if it is stated clearly in the franchise agreement. It does not require any registration or other formalities beforehand, although such a "step-in" can be seen as unreasonable if the franchisee's franchised business is wealthy. The "step-in" clause should therefore be connected with some kind of compensation for the takeover, equal to an objective value of the franchised business at the time of this takeover.

16.3 If the franchise agreement contains a power of attorney in favour of the franchisor under which it may complete all necessary formalities required to complete a franchise migration under pre-emption or "step-in" rights, will such a power of attorney be recognised by the courts in the jurisdiction and be treated as valid? Are there any registration or other formalities that must be complied with to ensure that such a power of attorney will be valid and effective?

This power of attorney is recognised and does not need any registration or other formalities. A power of attorney can be given to a company. However, in order to not have it deemed unreasonable in a certain case, this power of attorney should be on a separate document appended to the franchise agreement, instead of being hidden among all the sections and paragraphs of the franchise agreement.

17 Electronic Signatures and Document Retention

17.1 Are there any specific requirements for applying an electronic signature to a franchise agreement (rather than physically signing a "wet ink" version of the agreement), and are electronic signatures recognised as a valid way of creating a binding and enforceable agreement?

Yes, an electronic signature is a valid way of creating a binding and enforceable agreement.

17.2 If a signed/executed franchise agreement is stored electronically (either having been signed using e-signatures or a "wet ink" version having been scanned and saved as an electronic file), can the paper version of the agreement be destroyed?

Yes, it can.

18 Current Developments

18.1 What is the biggest challenge franchising is facing in your jurisdiction and how are franchisors responding to that challenge?

There is no specific challenge facing the concept of franchising in Sweden today.



Dan-Michael Sagell was admitted to the Swedish Bar Association in 1993.

Education

- University of Stockholm (*juris kandidat*, LL.M.) 1984.
- University of Stockholm, a degree in Business Administration regarding accounting and auditing 1988–1989.
- University of Stockholm, a degree in English 1988–1989.

Professional Experience

- Junior Judge, District Court Huddinge County 1984–1987.
- Legal Counsel, The Stockholm House Property Owners Association 1987–1988.
- Legal Counsel, Foreningsbankernas Bank 1989–1990.
- Associate with Hedberg & Co. Advokatbyrå 1990–1992.
- Associate with Bjorn A Marklund Advokatbyrå 1992–1996.
- Partner at Sagell & Angsmark Advokatbyrå 1997–2001.
- Partner at Sagell Angsmark Anell Advokatbyrå 2001–2006.
- Partner at Sagell & Co. Advokatbyrå 2006–present.

Member

- Member of the Swedish Franchise Association.
- International Franchise Lawyers Association (IFLA).

Publications

- Author of the book "*Handbok i franchisejuridik*" (translation: "*The Handbook on Franchise Laws*"), 1st edition, 2016, Publisher Wolters Kluwer.
- Contributor with chapters to the book "*Finansiering – En handbok i hur du finansierar ditt företag – från start till notering*" (translation: "*Funding – a handbook on how you fund your company from the start up to the first IPO*"), 1st edition, 2008, Publisher Björn Lundén Information AB.
- Author of the book "*Franchisegivarens informationsskyldighet*" (translation: "*The Franchisor's obligation to disclose*"), 1st edition, 2006, Publisher BDO Nordic AB.
- Author of the book "*Franchise - Praktisk handbok för franchisegivare och franchisetagare*" (translation: "*Franchise - Guide for franchisor and franchisee*"), 1st edition, 2005, Publisher Björn Lundén Information AB.
- Co-author of the book "*Starta Eget - med framgång*", (translation: "*Start your own business with success*"), 4th edition, 2002, Publisher Wahlström.
- Co-author of the book "*UppfinnarPraktika – vision och verklighet – en handbok för innovatörer*", (translation: "*The Inventor's Manual – vision and reality – a handbook for inventors*"), 1st edition, 1999, Publisher Nordstedts.
- Co-author of the publication "*Att starta och driva tillväxtföretag – några råd på vägen*" (translation: "*Starting and Running a High Growth Company*"), 1st edition, 1999, Publisher Royal Swedish Academy of Engineering Sciences (IVA) and Connect Sweden.
- Co-author of the publication "*Finansieringsmöjligheter för tillväxtföretag – några råd på vägen*" (translation: "*Financing a High Growth Company*"), 1st edition, 1999, Publisher Royal Swedish Academy of Engineering Sciences (IVA) and Connect Sweden.
- Author of several articles about franchising, licensing and distribution law in papers and magazines.

Sagell & Co. Advokatbyrå

Saltmätargaten 5
SE-113 59, Stockholm
Sweden

Tel: +46 707 952 733

Email: dms@saglaw.se

URL: www.saglaw.se

Sagell & Co. Advokatbyrå has developed first-rate know-how on franchise laws and on such laws that a franchise system has to deal with in its daily operations. We provide legal services to several franchise networks in Sweden. The law firm also assists franchisees in their negotiations with the franchisor. Our services include the drafting of or the vetting of the written disclosure documents that a franchisor under Swedish laws must present to a potential franchisee in good time before the signing of the franchise agreement. Sagell & Co. Advokatbyrå has good relations with franchise consultants and accountants; therefore, we can quickly form a team of advisors to set up a new franchise system, establish a foreign franchise system in Sweden, or convert an existing joint venture into franchise.

www.saglaw.se

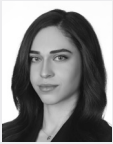


Türkiye/Turkey

Pehlivan & Güner



Haşmet Ozan Güner



Nilgün Gonca Deveci



İpek Açıkgöz

1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

There is no specific definition of franchise under Turkish law. The Turkish High Court of Appeals defines franchise as a “long-term continuous contractual relationship between two independent parties, whereby a party, which owns the rights of a product or service, grants the second party the right to conduct the commercial business subject to the said rights by providing information and support with regard to the management and organisation of the business for a certain duration and under certain conditions and restrictions”.

1.2 What laws regulate the offer and sale of franchises?

There is no legislation in Turkey that specifically deals with franchising. However, the below laws, among others, particularly apply to franchising in Turkey:

- Turkish Code of Obligations.
- Turkish Commercial Code.
- Turkish Industrial Property Law.
- Intellectual Property Rights Law.
- Law on the Protection of Competition.
- Tax Procedure Law.
- Stamp Tax Law.
- Corporate Tax Law.

Additionally, other industry-specific laws and regulations may apply.

1.3 If a franchisor is proposing to appoint only one franchisee/licensee in your jurisdiction, will this person be treated as a “franchisee” for purposes of any franchise disclosure or registration laws?

There are no registration or disclosure requirements to be met for franchising in Turkey. There is also no distinction between a sole franchisee and multiple franchisees in this regard.

1.4 Are there any registration requirements relating to the franchise system?

No, there are not any registration requirements in relation to the franchise system.

1.5 Are there mandatory pre-sale disclosure obligations?

No, there are no pre-sale disclosure obligations.

1.6 Do pre-sale disclosure obligations apply to sales to sub-franchisees? Who is required to make the necessary disclosures?

This is not applicable in Turkey.

1.7 Is the format of disclosures prescribed by law or other regulation, and how often must disclosures be updated? Is there an obligation to make continuing disclosure to existing franchisees?

This is not applicable in Turkey.

1.8 What are the consequences of not complying with mandatory pre-sale disclosure obligations?

This is not applicable in Turkey.

1.9 Are there any other requirements that must be met before a franchise may be offered or sold?

There are no other requirements.

1.10 Is membership of any national franchise association mandatory or commercially advisable?

Membership of a franchise association is not mandatory. Franchisors and franchisees may voluntarily choose to join general franchise or industry-specific associations.

1.11 Does membership of a national franchise association impose any additional obligations on franchisors?

As explained above, there is no mandatory membership of any national franchise association. Each franchise association, however, may impose additional rules by its by-laws.

1.12 Is there a requirement for franchise documents or disclosure documents to be translated into the local language?

There is no such requirement, but it is recommended.

In a recent case, a foreign supplier and a Turkish distributor had executed an English language contract, including foreign arbitration and foreign governing law clauses. The foreign supplier then sued the Turkish distributor for breach of contract, and the Turkish distributor raised a plea of arbitration. The Turkish High Court of Appeals refused the Turkish distributor's plea of arbitration, on the grounds that Turkish entities must execute contracts in Turkish language (due to Law no. 805 on the Compulsory Use of Turkish Language in Commercial Businesses), thus the Turkish distributor cannot rely on the English language arbitration clause.

Although it is unclear whether the Turkish High Court of Appeals opines the whole contract invalid or that solely the Turkish distributor cannot rely thereon, we recommend contracts between foreign and Turkish nationals/entities to be executed in Turkish to avoid discussions of validity.

2 Business Organisations Through Which a Franchised Business Can be Carried On

2.1 Are there any foreign investment laws that impose restrictions on non-nationals in respect of the ownership or control of a business in your jurisdiction?

Generally speaking, there is no restriction on non-nationals in respect of the ownership or control of a business in Turkey. Foreign nationals or legal entities are generally subject to the same legal regime with respect to ownership and control of business. For the company incorporation, however, additional documentation is required from foreign nationals and legal entities (such as apostilled versions of the documents which are required for Turkish nationals and legal entities). Additionally, while opening a bank account in Turkey, companies with foreign shareholding are subject to relatively heavier know-your-customer requirements. Generally, however, these do not create significant obstacles.

Conducting activities in some industries, however, requires a majority Turkish shareholding and control. These industries include weapons and defence, private schools (except for international schools), internal aviation and maritime transportation for commercial purposes.

2.2 What forms of business entity are typically used by franchisors?

Joint-stock companies and limited companies are the most commonly used company forms in Turkey. There are no restrictions or requirements as to which model or form may be used, but as these two company types differ in various aspects, a detailed analysis is required in order to choose the appropriate form.

2.3 Are there any registration requirements or other formalities applicable to a new business entity as a pre-condition to being able to trade in your jurisdiction?

In order to operate a business in Turkey, registration with the Trade Register is required. Further, there may be additional industry-specific registration requirements. Product approvals or registrations may also be required for certain industries.

3 Competition Law

3.1 Provide an overview of the competition laws that apply to the offer and sale of franchises.

In Turkey, Law no. 4054 on the Protection of Competition is the primary legislation dealing with competition law, including anti-competitive agreements and abuse of dominance. It prohibits the agreements and concerted practices between undertakings, and decisions and practices of associations of undertakings which have as their object or effect, or likely effect, the prevention, distortion or restriction of competition directly or indirectly in a particular market for goods or services. The Turkish Competition Authority is the general regulatory authority with regard to competition law, and the Turkish Competition Board is its management body. The Turkish Competition Board's Block Exemption Communiqué on Vertical Agreements provides a block exemption for vertical agreements fulfilling certain conditions. Furthermore, the Turkish Competition Authority's Guidelines on Vertical Agreements provide details on their interpretation of the law and the Block Exemption Communiqué.

3.2 Is there a maximum permitted term for a franchise agreement?

There is no maximum permitted term for a franchise agreement.

3.3 Is there a maximum permitted term for any related product supply agreement?

There is no maximum permitted term for any related product supply agreement.

3.4 Are there restrictions on the ability of the franchisor to impose minimum resale prices?

Yes. Resale price maintenance is prohibited under Turkish Competition Law.

3.5 Encroachment – are there any minimum obligations that a franchisor must observe when offering franchises in adjoining territories?

There are no minimum obligations.

3.6 Are in-term and post-term non-compete and non-solicitation of customers covenants enforceable?

In-term non-compete covenants are enforceable as long as the franchise agreement carries the conditions for block exemption (e.g. the franchisor's market share does not exceed 30%).

Post-term non-compete covenants of a maximum term of one year are enforceable as long as the franchise agreement carries

the conditions for block exemption, and provided that the non-compete obligation is (i) limited to the competing goods or services, (ii) limited to the facilities or land where the franchisee has operated during the agreement, and (iii) necessary to protect the know-how transferred by the franchisor to the franchisee.

Non-solicitation covenants are also deemed a type of non-compete covenant, therefore the above rules apply thereto.

4 Protecting the Brand and Other Intellectual Property

4.1 How are trade marks protected?

Trade marks are protected under Turkish Industrial Property Law. This law confers territorial protection for marks which are registered in Turkey. Although infringement of an unregistered mark is actionable under the Turkish Commercial Code's unfair competition law rules, trade mark registration provides a stronger protection in terms of available legal actions and their speed. Therefore, it is recommended that all marks are registered in Turkey.

4.2 Are know-how, trade secrets and other business-critical confidential information (e.g. the Operations Manual) protected by local law?

From a civil law perspective, know-how, trade secrets and other business-critical confidential information are protected within the framework of the Turkish Commercial Code's unfair competition law rules. Those who face an act of unfair competition may request from the court certain remedies, including, but not limited to, the prevention of the unfair competition and indemnification.

First, from a criminal law perspective, acts of unfair competition that are listed under the Turkish Commercial Code are subject to imprisonment of up to two years, or a monetary fine. Note that the imprisonment can be postponed under certain conditions. Moreover, those who illegally disclose trade secrets that he knows due to his title, duty or profession are subject to imprisonment of one to three years.

4.3 Is copyright (in the Operations Manual or in proprietary software developed by the franchisor and licensed to the franchisee under the franchise agreement) protected by local law?

Copyright is protected under Law no. 5846 on Intellectual and Artistic Works. In order to have protection under said Law, the Operation Manual and/or software should have the qualification of a work as defined in the Law. Additionally, there are provisions in Turkish Penal Law; unauthorised access to informatics systems or their distortion is regulated as a criminal offence (Article 243 and 244). These penal law provisions may apply for proprietary software.

5 Liability

5.1 What remedies can be enforced against a franchisor for failing to comply with mandatory disclosure obligations? Is a franchisee entitled to rescind the franchise agreement and/or claim damages?

As stated earlier, Turkish law does not impose any mandatory disclosure obligation on the franchisor. As a result, no specific remedy is available to the franchisee.

5.2 In the case of sub-franchising, how is liability for disclosure non-compliance or for pre-contractual misrepresentation allocated between franchisor and master franchisee? If the franchisor takes an indemnity from the master franchisee in the Master Franchise Agreement, are there any limitations on such an indemnity being enforceable against the master franchisee?

As stated earlier, Turkish law does not impose any mandatory disclosure obligation on the franchisor. In terms of contractual liability, however, liability for pre-contractual misrepresentation in terms of data disclosed being incomplete, inaccurate or misleading belongs to the party which misrepresents such data, provided that such misrepresentation is due to such party's fault.

5.3 Can a franchisor successfully avoid liability for pre-contractual misrepresentation by including a disclaimer in the franchise agreement?

Under Turkish law, limitation of liability provisions are valid only for liability due to slight fault. In other words, contractual liability cannot be limited or avoided for wilful misconduct or gross fault. Avoiding liability for pre-contractual misrepresentation by disclaimer clauses is only possible for slight faults.

In addition, note that limitation of liability clauses are also invalid for slight faults if the relevant party's services or operations require expertise and are conducted under a governmental permit.

5.4 Does local law permit class actions to be brought by a number of aggrieved franchisees and, if so, are class action waiver clauses enforceable?

No, class action is not available in Turkey.

6 Governing Law

6.1 Is there a requirement for franchise documents to be governed by local law? If not, is there any generally accepted norm relating to choice of governing law, if it is not local law?

Under Turkish law, contractual relationships that include a foreign element are permitted to be governed by foreign law. Turkish law does not directly define the "foreign element", but it is generally accepted that agreements carry a foreign element if, for example, at least one party is a non-Turkish individual or entity and/or the goods and services are supplied to, or from, abroad.

6.2 Do the local courts provide a remedy, or will they enforce orders granted by other countries' courts, for interlocutory relief (injunction) against a franchisee to prevent damage to the brand or misuse of business-critical confidential information?

If parties have chosen Turkish courts' jurisdiction in the agreement (or another mutually executed document), or if the parties have not chosen any court or arbitration to have jurisdiction over the disputes, and Turkish courts are, according to Turkish international private law rules, competent in terms of the disputes, it is possible to apply to Turkish courts for interlocutory relief (injunction) against a rogue franchisee to prevent damage to the brand or misuse of business-critical confidential information.

To enforce orders granted by other countries' courts or arbitral tribunals for interlocutory relief (injunction), a recognition or enforcement decision from Turkish courts must be obtained. Obtaining a recognition or enforcement decision from Turkish courts requires a number of conditions to be met, the most significant being reciprocity, in terms of enforcement, of foreign court rulings or arbitral awards (as the case may be). The reciprocity may be established by an international treaty, by law or by practice.

6.3 Is arbitration recognised as a viable means of dispute resolution and is your country a signatory to the New York Arbitration Convention on the Recognition and Enforcement of Foreign Arbitral Awards? Do businesses that accept arbitration as a form of dispute resolution procedure generally favour any particular set of arbitral rules?

Turkey is party to the 1958 New York Convention on the Recognition and Enforcement of Arbitral Awards (the "New York Convention"). Therefore, the conditions under the New York Convention apply for the recognition and enforcement of foreign arbitral awards in Turkey. Note, however, that Turkey has ratified the New York Convention with the reservation that, for a foreign arbitral award to be recognised or enforced in Turkey, it must be made in the territory of another contracting state.

The businesses that accept arbitration as a form of dispute resolution procedure do not favour any particular set of arbitral rules.

7 Real Estate

7.1 Generally speaking, is there a typical length of term for a commercial property lease?

Under Turkish law, there is no mandatory minimum or maximum term for a commercial property lease. However, in particular, the shopping mall management companies generally prefer to execute lease agreements for shops for five years.

7.2 Is the concept of an option/conditional lease assignment over the lease (under which a franchisor has the right to step into the franchisee/tenant's shoes under the lease, or direct that a third party (often a replacement franchisee) may do so upon the failure of the original tenant or the termination of the franchise agreement) understood and enforceable?

Under Turkish law, the assignment of a lease to a third party is only possible when there is a provision authorising such assignment in the lease agreement. In other words, unless otherwise provided in the lease agreement, a tenant cannot assign the lease to a third party, including the franchisor, without the landlord's consent, unless the agreement explicitly permits such assignment. Therefore, the failure of the original tenant or termination of the franchise agreement shall not suffice for a lease assignment to the franchisor.

7.3 Are there any restrictions on non-national entities holding any interest in real estate, or being able to sub-lease property?

Under Turkish law, non-national entities can only own real estate in Turkey within the scope of specific laws. These specific laws are the Tourism Incentives Law (Law no. 2634), Industrial Zones Law (Law no. 4737) and Petroleum Law (Law no. 6326).

Furthermore, Turkish entities with a foreign shareholding of 50% or more are permitted to own real estate in Turkey with an approval of the military authorities or the governorships, which examine whether the real estate is in a prohibited military zone, military security zone or special security zone.

Leasing or sub-leasing commercial real estate in Turkey would be deemed a commercial activity, which is possible only by establishing a legal presence in Turkey (e.g., a liaison office, branch or legal entity, depending on the type of commercial activity).

7.4 Give a general overview of the commercial real estate market. To what extent has the real estate market been affected by the Coronavirus pandemic? Specifically, can a tenant expect to secure an initial rent free period when entering into a new lease (and if so, for how long, generally), or are landlords demanding "key money" (a premium for a lease in a flagship location)?

Although there is no obligation to provide such securities under Turkish law, tenants are generally expected to deposit cash or a bank letter of guarantee in an amount equal to two to six month's rental fee.

Throughout the pandemic, the popularisation of practices such as remote working and remote education has affected not only the sales trend and housing preferences in the housing market in Turkey, but also working offices becoming smaller. Most corporate firms, mainly multinationals, are moving to smaller office spaces.

On the other side, the current inflationist environment in Turkey is resulting in a significant increase in real estate prices in terms of Turkish Lira. Price increases in commodities, including construction materials in terms of USD, also result in an increase in real estate prices in terms of USD. These price increases are further boosted by the lack of new zoned locations and immigration into Turkey.

Increased real estate prices, both residential and commercial, also reflect onto the rental market. These factors balanced the narrowing down of office spaces due to the increase in remote working.

Landlords in Turkey generally do not demand "key money" for leases in particular locations. In some cases, however, the former lessees demand key money to terminate their lease agreement and exit the leased premises. This is also common if the former lessee has made non-removable investments in the leased property.

Legislative changes in September 2018 prohibited rental fees to be agreed in foreign currency. Lease agreements are exempt from this restriction, however, if (i) the lessee is an office, branch, representation office or liaison office of a foreign resident, (ii) 50% or more of its shares are owned, directly or indirectly, by a foreign resident, or (iii) the lessee is under sole or joint control of a foreign resident.

8 Online Trading

8.1 If an online order for products or request for services is received from a potential customer located outside the franchisee's exclusive territory, can the franchise agreement impose a binding requirement for the request to be re-directed to the franchisee for the territory from which the sales request originated?

No. Online orders for products or request for services from a potential customer outside the franchisee's exclusive territory are deemed passive sales. A contractual obligation on the franchisee to re-direct such orders are deemed a ban on passive sales.

The prohibition of passive sales in vertical agreements is generally prohibited.

8.2 Are there any limitations on a franchisor being able to require a former franchisee to assign local domain names to the franchisor on the termination or expiry of the franchise agreement?

No, there is no limitation on a franchisor to require a former franchisee to assign local domain names to the franchisor on the termination or expiry of the franchise agreement. It is, however, recommended to regulate the assignment of domain names upon expiry or termination in the agreement.

9 Termination

9.1 Are there any mandatory local laws that might override the termination rights one might typically expect to see in a franchise agreement?

No. However, franchisors are recommended to observe the following Turkish law formalities on the termination of agreements, irrespective of the contractual choice of law. Turkish law requires the termination notices between merchants to be served via: a (Turkish) notary public; registered mail; or telegraph or registered email using secure e-signature. Among these, the recommended method, due to its practicality and power of proof, is notary public. Although it is not clear whether the foregoing is mandatory under Turkish law rule, parties are recommended to observe it to avoid any discussion on the validity of the termination.

9.2 Are there local rules that impose a minimum notice period that must be given to bring a business relationship that has existed for a number of years to an end, which will apply irrespective of the length of the notice period set out in the franchise agreement?

No. However, in light of the good faith rules, it is recommended to grant notice periods that would enable the other party to reorganise its business due to termination. For a franchise agreement, such notice period is recommended to be three to nine months, depending on the particulars of the case.

10 Joint Employer Risk and Vicarious Liability

10.1 Is there a risk that a franchisor may be regarded as a joint employer with the franchisee in respect of the franchisee's employees? If so, can anything be done to mitigate this risk?

Under Turkish law, the franchisor is not deemed a sub-employer or joint-employer in respect of the franchisee's employees. In order to avoid doubts, it is recommended to include provisions in the franchise agreement setting out the parties' relations with and obligations to, *vis-à-vis*, the franchisee's employees. For instance, a franchisor, having a right to hire, instruct and fire the franchisee's employers, may be deemed to be their joint-employer.

10.2 Is there a risk that a franchisor may be held to be vicariously liable for the acts or omissions of a franchisee's employees in the performance of the franchisee's franchised business? If so, can anything be done to mitigate this risk?

In a typical franchisor-franchisee relationship, the franchisor would not be considered as a sub-employer or joint-employer in respect of the franchisee's employees. As a result, a franchisor may not be held vicariously liable for the acts or omissions of the franchisee's employees in the performance of the franchisee's franchised business. As noted above, in order to mitigate the risk, it is recommended to include provisions in the franchise agreement setting out the parties' relations with and obligations to, *vis-à-vis*, the franchisee's employees.

11 Currency Controls and Taxation

11.1 Are there any restrictions (for example exchange control restrictions) on the payment of royalties to an overseas franchisor?

There are no such restrictions.

Legislative changes in September 2018 prohibited certain types of contracts to include payment obligations in a foreign currency. These contract types include movable and immovable sales and leases, leasing, employment, service and work contracts. Franchise agreements, however, are not among these contract types. Therefore there are no exchange control or currency restrictions for royalty fees under franchise agreements.

11.2 Are there any mandatory withholding tax requirements applicable to the payment of royalties under a trade mark licence or in respect of the transfer of technology? Can any withholding tax be avoided by structuring payments due from the franchisee to the franchisor as a management services fee rather than a royalty for the use of a trade mark or technology?

Royalty payments from a resident franchisee to a non-resident franchisor operating without a permanent establishment in Turkey are subject to withholding tax. The withholding tax ratio may change depending on the double-tax avoidance treaty between the countries of the parties.

As regards the option of structuring payments as a management service fee, this is in principle possible, but the franchisee would, in a tax inspection, be required to demonstrate that the services have actually been rendered. Otherwise, tax authorities may treat these payments as royalty fees and claim the difference between the tax due on royalty payments and the tax actually paid, with applicable interest and penalties.

11.3 Are there any requirements for financial transactions, including the payment of franchise fees or royalties, to be conducted in local currency?

In Turkey, conducting financial transactions, including the payment of franchise fees or royalties, might involve certain regulations regarding the use of local currency (Turkish Lira) due to foreign exchange regulations and financial stability concerns.

Turkey had previously experienced fluctuations in its currency value, and the government had taken measures to regulate foreign currency transactions in order to stabilise the economy. This might have implications for transactions involving foreign currencies, such as franchise fees or royalties.

12 Commercial Agency

12.1 Is there a risk that a franchisee might be treated as the franchisor's commercial agent? If so, is there anything that can be done to help mitigate this risk?

No. However, certain Turkish law provisions on commercial agency apply to franchise agreements, too. Among these, the goodwill compensation rules are the most significant:

Turkish law generally entitles commercial agents to a goodwill compensation when the relationship expires or is terminated, provided that the principal would continue to benefit from the customer base and market reputation developed by the agent even after the agreement's end, unless (i) the agent terminates the agreement without legitimate cause attributable to the principal, or (ii) the principal terminates the agreement with legitimate cause due to the agent's fault.

Turkish law also stipulates that this rule applies to other continuous contractual relations where exclusive rights are granted, such as exclusive distribution and franchise.

Turkish law sets out the upper limit of the goodwill compensation for the agents. The amount of goodwill compensation awarded may not exceed the average annual commission paid to the agent for the previous five years. If the agency relationship existed for less than five years, the average of the entire term serves as the basis for calculation. By way of analogy, it is generally accepted that the upper limit for an exclusive franchisee's goodwill compensation entitlements may be the average annual profits of the distributor. It is, however, unclear whether this profit is the gross or net profit.

Court precedent, moreover, indicates that calculation of an "appropriate" amount, as determined by a court-appointed expert, should take into consideration: (i) the term of the contractual relationship; (ii) the franchisee's market share; (iii) the franchisee's efforts to market the goods or services; (iv) the nature of the goods or services; and (v) the quality and reliability of the goods or services and trade marks.

In Turkish law and court precedent, there is no clarity on whether the goodwill compensation rules override mandatory law rules or not. The Turkish High Court of Appeals, however, decided in one case in 2002 that it is not competent over the goodwill compensation dispute due to a contractual choice of foreign courts. Some scholars, however, argue that goodwill compensation rules are of Turkish public order and apply mandatorily, irrespective of the contractual choice of law.

To avoid mitigating this risk for the franchisors, we generally advise (i) not appointing the franchisees on an exclusive basis and making direct sales into or appointing other franchisees in the territory, (ii) including a choice of foreign law and foreign forum provision in the agreement, and (iii) when terminating the agreement, doing it with legitimate cause due to the agent's fault.

13 Good Faith and Fair Dealings

13.1 Is there any overriding requirement for a franchisor to deal with a franchisee in good faith and to act fairly in its dealings with franchisees according to some objective test of fairness and reasonableness?

No, unless the franchisor is in a dominant position in the

market. If the franchisor is in a dominant position, it is under a no-discrimination obligation.

13.2 Is there any limitation on a good faith obligation being unenforceable if it only applies from franchisee to franchisor, rather than being mutual?

Under Turkish law, the principle of good faith obligation is often recognised and has implications for various contractual relationships, including franchise agreements. Good faith obligation imposes an obligation on both parties to act fairly, honestly, and in a manner that respects the legitimate interests of the other party.

Regarding the enforceability of a good faith obligation that only applies from the franchisee to the franchisor, rather than being mutual, it is important to consider that the enforceability of contractual terms can be influenced by various factors, including the specific language used in the agreement, the nature of the relationship, and courts may consider it when interpreting and enforcing contracts.

On the other hand, the franchising agreement establishes a continuous contractual relationship and is based on a special relationship of trust between the parties due to its function and nature. The primary obligations of the franchisee to carry out activities for the promotion and increase of the goods or services subject to the agreement, and to use the intangible goods offered to it within the scope of this purpose, in a sense, results in leaving the future of the franchisor's image in the market in the hands of the franchisee.

Moreover, the franchisee becomes economically dependent on the franchisor for a long period. Considering these consequences, a good faith obligation arises even if it is not expressly agreed in the agreement. Therefore, the good faith obligation also imposes on the franchisee such obligations as non-competition, confidentiality, personal fulfilment of contractual obligations, and on the franchisor such obligations as information and accountability.

14 Ongoing Relationship Issues

14.1 Are there any specific laws regulating the relationship between franchisor and franchisee once the franchise agreement has been entered into?

The relationship between a franchisor and a franchisee is primarily governed by the franchise agreement. Additionally, the relationship between them would be regulated as per various laws and regulations which are specific to the business being undertaken. Please also refer to our response under question 1.2.

15 Franchise Renewal

15.1 What disclosure obligations apply in relation to a renewal of an existing franchise at the end of the franchise agreement term?

No, disclosure requirements exist in relation to a renewal of an existing franchise at the end of its term.

15.2 Is there any overriding right for a franchisee to be automatically entitled to a renewal or extension of the franchise agreement at the end of the initial term irrespective of the wishes of the franchisor not to renew or extend?

There is no such right.

15.3 Is a franchisee that is refused a renewal or extension of its franchise agreement entitled to any compensation or damages as a result of the non-renewal or refusal to extend?

Goodwill compensation rules apply at the end of expiry, too. Please see our response to question 12.1 above in this regard.

16 Franchise Migration

16.1 Is a franchisor entitled to impose restrictions on a franchisee's freedom to sell, transfer, assign or otherwise dispose of the franchised business?

Under Turkish law, assignment of agreement (or an obligation) is subject to the other party's consent. Therefore, unless otherwise stipulated in the franchise agreement, franchisees are not entitled to assign the franchise agreement or their obligations thereunder to a third party. It is, however, recommended to include a provision in the agreement prohibiting such transfers without the franchisor's prior written consent.

If stipulated under the franchise agreement, a franchisor may also restrict a franchisee's ability to sell, transfer, assign or otherwise dispose of the franchised business, even if such acts are not deemed assignment of agreement or obligations. Even if such provisions exist under the agreement, however, the franchisor may not be able to prevent the franchisee from doing so, but rather may solely claim damages due to breach of contract, depending on the type of the restriction.

16.2 If a franchisee is in breach and the franchise agreement is terminated by the franchisor, will a "step-in" right in the franchise agreement (whereby the franchisor may take over the ownership and management of the franchised business) be recognised by local law, and are there any registration requirements or other formalities that must be complied with to ensure that such a right will be enforceable?

Generally speaking, a franchisor can step into the shoes of a franchisee if stipulated in the franchise agreement. The franchisor, to be able to conduct the franchised business on its own, would be required to incorporate a subsidiary in Turkey. Further, taking over some rights or assets may be subject to the third parties' consent, such as a lease agreement.

16.3 If the franchise agreement contains a power of attorney in favour of the franchisor under which it may complete all necessary formalities required to complete a franchise migration under pre-emption or "step-in" rights, will such a power of attorney be recognised by the courts in the jurisdiction and be treated as valid? Are there any registration or other formalities that must be complied with to ensure that such a power of attorney will be valid and effective?

Under Turkish law, powers of attorney are subject to strict formal and content requirements. These include the power of attorney certified – and for some powers, prepared – by a notary public. Further, some representation rights need explicit and detailed formulation of these rights in the power of attorney. Furthermore, powers of attorney can be withdrawn at any time. Therefore, a power of attorney in the franchise agreement is unlikely to be enforceable in terms of pre-emption or "step-in" rights.

17 Electronic Signatures and Document Retention

17.1 Are there any specific requirements for applying an electronic signature to a franchise agreement (rather than physically signing a "wet ink" version of the agreement), and are electronic signatures recognised as a valid way of creating a binding and enforceable agreement?

Under Turkish law, "secure electronic signatures" supported by government-accredited secure electronic signature service providers are deemed valid and binding as wet ink signatures, apart from for legal transactions subject to other formal requirements. Franchise agreements, not being subject to any specific formal requirements, may theoretically be executed through a "secure electronic signature". The secure electronic signature, however, has not become a common practice in Turkey.

17.2 If a signed/executed franchise agreement is stored electronically (either having been signed using e-signatures or a "wet ink" version having been scanned and saved as an electronic file), can the paper version of the agreement be destroyed?

A franchise agreement signed/executed by secure electronic signatures can be stored electronically and used as evidence when necessary. Therefore, their paper version may be destroyed.

With regards to the wet ink version of franchise agreements, the originals should be kept and stored; storing solely their electronic versions should be avoided. Electronic copies of wet ink documents are not deemed as evidence before the courts, particularly if the other party claims that the signatures are fake.

18 Current Developments

18.1 What is the biggest challenge franchising is facing in your jurisdiction and how are franchisors responding to that challenge?

From the perspective of Turkish Law, one of the major challenges encountered during franchise agreements is ensuring the principle of "Commercial Stability and Equality". This principle is enshrined in the Constitution and the Turkish Code of Obligations, aiming to establish a fair balance between the parties. Since franchise agreements often involve larger national or international companies and smaller franchisees, there can be an economic and power imbalance between the parties. Given that the franchising sector in Turkey faces both advantages and challenges, it is important to address potential economic imbalances and power differentials between larger franchisors and smaller franchisees.

In Turkey, the franchising sector faces several challenges alongside its numerous advantages. One of the prominent factors is economic fluctuations and financial uncertainties. Especially during periods like the COVID-19 pandemic, a decrease in consumer spending and economic instability can impact franchising brands.

In response, franchisors can develop various strategies to address such challenges. For instance, they can provide flexibility in franchise fees during crisis periods, optimise marketing and advertising expenses, and even diversify their portfolios by introducing new business models or services. Additionally, franchisors can collaborate closely with franchisees to offer support and guidance during tough times, presenting solutions to enhance operational efficiency.

Although franchising in Turkey encounters challenges, it remains a dynamic and promising field. Franchisors, by embracing flexibility and innovation to adapt swiftly to changing conditions, can continue to sustainably support the sector's growth.

In light of these challenges, it is important to establish the terms of the franchise agreement fairly between the parties. Larger brands might have a stronger negotiating position compared to smaller franchisees. Franchisors could aim to reach an agreement on more equal terms by offering fair and reasonable contract conditions and engaging in negotiations. This not only supports the principle of "Commercial Stability and Equality", but also contributes to the overall health and growth of the franchising sector in Turkey.



Haşmet Ozan Güner is one of the two founding partners of Pehlivan & Güner. He advises and represents many local and multinational companies, particularly on structuring commercial partnerships, distributorship, franchise and agency agreements, preparing their contracts, conduct and termination of these relationships and disputes in these fields. Haşmet Ozan Güner has particularly worked in competition law compliance, Turkish Competition Board investigations, clearance filings for mergers and acquisitions and individual exemption applications in the competition law field. He has managed the contract drafting and legal processes of mergers and acquisitions. He also advises on regulations and contracts regarding, particularly, pharmaceuticals, medical devices, animal drugs and food supplements.

Pehlivan & Güner
Levent Cad. Lale Sok. No: 18
34330 Levent, Beşiktaş, İstanbul
Türkiye/Turkey

Tel: +90 212 282 6025
Email: ozanguner@pehlivanguner.com
URL: www.pehlivanguner.com/en-us



Nilgün Gonca Deveci graduated from Başkent University Faculty of Law in 2019. She completed her master's degree in health law at Galatasaray University in 2023. Gonca has been primarily engaged in providing litigation and advisory services across a range of legal domains, including labour law, commercial law, consumer law, and corporate law. Her specialised focus extends to pharmaceutical and healthcare law, personal data protection law, contract drafting and review, along with delivering legal consultancy services to a variety of companies.

Pehlivan & Güner
Levent Cad. Lale Sok. No: 18
34330 Levent, Beşiktaş, İstanbul
Türkiye/Turkey

Tel: +90 212 282 6025
Email: goncadeveci@pehlivanguner.com
URL: www.pehlivanguner.com/en-us



İpek Açıkgoz, in 2021, earned her LL.B. degree from Yeditepe University Faculty of Law. Her experience centres around corporate law, contract law, pharmaceuticals and health law, as well as mergers and acquisitions. As a legal professional, she provides legal advice and representation to multinational corporations spanning various sectors. Her capabilities extend to encompass e-commerce, commercial law, data privacy, and health law.

Pehlivan & Güner
Levent Cad. Lale Sok. No: 18
34330 Levent, Beşiktaş, İstanbul
Türkiye/Turkey

Tel: +90 212 282 6025
Email: ipekacikgoz@pehlivanguner.com
URL: www.pehlivanguner.com/en-us

Pehlivan & Güner is a young and dynamic law Firm based in İstanbul. The Firm has a team of nine lawyers and a good network of of counsels. The Firm provides wide-range legal services with a client-oriented approach. It prioritises saving the clients' business, time and funds through dispute-preventive advisory services, and develops resolutions for disputes in a legal framework. Pehlivan & Güner works with a dynamic team of successful lawyers and of counsels, having expertise in various fields. The Firm also invests in new team members by attracting and training young talent. Closely following the legal environment, legal changes and new technology in order to keep up with needs of contemporary business life is among the Firm's priorities. The Firm has Turkey-wide operational abilities and provides qualified, practical and solution-oriented services to both local and multinational clients. Pehlivan & Güner continues to be a business partner of its clients with

its dispute-preventive advisory, legal consultancy and dispute resolution services, particularly in the areas of commercial law, real estate law, pharmaceuticals and healthcare regulations, and competition and anti-trust law. Pehlivan & Güner's clients include Turkey's largest companies in their industries, as well as multinational healthcare, construction, e-commerce and food and beverages companies.

www.pehlivanguner.com/en-us



United Arab Emirates



Munir Suboh



Amala Atieh



Felicity Hammond

BSA Ahmad Bin Hezeem & Associates

1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

“Franchise” as standalone terminology is not defined in the internal regulations, as the concept of franchise does not have a separate legislative framework under UAE national law. However, under Federal Law No. 3/2022 (the “New Commercial Agencies Law”), a “Commercial Agency” is defined as the “Representation of the Principal by an Agent under an agreement of agency, distribution, sale, offer, franchise, or the provision of a commodity or service, within the State, in return for a commission or profit”.

The definition under the New Commercial Agencies Law extends to “franchising”, and the practice reveals this. In the past, many franchisees in the UAE opted to register themselves as commercial agents, so long as they fulfil the statutory criteria. The registry is organised and managed federally by the Ministry of Economy.

1.2 What laws regulate the offer and sale of franchises?

There is no standalone legislation that specifically regulates franchising in the UAE. Instead, franchising falls within the scope of different laws, such as the New Commercial Agencies Law (which was effective as of 15 June 2023), Commercial Transactions and Civil Transactions Law, trademarks and other intellectual property (IP) regulations. Some of those applicable laws include the following:

1. *Federal Law No. 3/2022 on the Regulation of Commercial Agencies (the “New Commercial Agencies Law”).*
2. *Federal Law No. 5 of 1985 on Civil Transactions (“Civil Code”), amended by Federal Decree-Law No. 30/2020 dated 27/9/2020.*
3. *Federal Decree-Law No. 50/2022 on the Promulgation of the Commercial Transactions Law (“Commercial Code”).*
4. *Federal Decree-Law No. 42/2022 on the Promulgation of the Civil Procedure Law.*
5. *Federal Decree-Law No. 36/2021 (“Trademark Law”).*
6. *Federal Decree-Law No. 38/2021 on Copyrights and Neighbouring Rights.*

7. *Federal Law No. 11 of 2021 on the Regulation and Protection of Industrial Property Rights (the “Industrial Property Law”).*

1.3 If a franchisor is proposing to appoint only one franchisee/licensee in your jurisdiction, will this person be treated as a “franchisee” for purposes of any franchise disclosure or registration laws?

There is no concept of a “franchisee” defined in UAE law, and no relevant disclosure or registration laws *per se*. Therefore, whether a licensee (or commercial agent) should be treated as a “franchisee” will only be relevant from a commercial perspective and under other situations, such as a registered user or licensee of trademarks, and this will have a different implication than those assumed in a franchise system in countries where franchise laws or systems exist. No registration of its rights or disclosure of the same is required in light of current regulations.

If a franchisee meets the requirements of a commercial agent, they can opt to register the franchise agreement with the Ministry of Economy and become a commercial agent of the Principal under the New Commercial Agencies Law. As per Article 7.1 of the New Commercial Agencies Law:

“The original Principal may appoint one Agent in the State as one area, and he may also appoint one Agent in each emirate, or in a number of emirates, provided that the distribution of the goods and services subject-matter of the Commercial Agency is limited to him within the Agency area.”

This means that the agreement – to be considered as commercial agencies – must grant the agent/franchisee exclusivity to operate in a defined territory, and the agent/franchisee shall have exclusivity over the products or services in the defined territory. Further, the Principal may appoint a separate agent/franchisee for each Emirate provided the products or services according to the agreement are restricted to the specific agent/franchisee for each Emirate.

1.4 Are there any registration requirements relating to the franchise system?

There are no franchise registration requirements in the UAE. However, if the franchisee wished to register as a commercial agent, an application for registration in the commercial agent’s registry will need to be submitted alongside a written and

notarised contract (with Arabic translation), and legalised before the UAE diplomatic channel if it is executed outside the UAE.

The application shall be accompanied by supporting documents (commercial licence copy and copy of the Commercial Agency Contract that is notarised and certified by the official authorities), and shall include the name of the agent and Principal, the nationality and address of each, the assets, commodities and service relevant to the trade agency, the activity area of the agent and the commencement and expiry dates of the agent.

Trademark licences, within a franchise scope, can also be recorded at the UAE Trademark Office. Most franchise agreements include this authorisation of brand use, and parties opt to complete the recordal formalities. This helps to prove trademark use and entitles parties to claim some limited rights. However, no direct reference to franchise rights or recordal is required to be included.

1.5 Are there mandatory pre-sale disclosure obligations?

There are no applicable pre-sale disclosure obligations apart from what parties agree contractually.

1.6 Do pre-sale disclosure obligations apply to sales to sub-franchisees? Who is required to make the necessary disclosures?

There are no mandatory disclosure obligations applicable to sales to sub-franchisees apart from what parties agree contractually.

1.7 Is the format of disclosures prescribed by law or other regulation, and how often must disclosures be updated? Is there an obligation to make continuing disclosure to existing franchisees?

There are no disclosure obligations in the initial stages of the franchise relationship nor throughout the duration of the agreement apart from what parties agree contractually.

1.8 What are the consequences of not complying with mandatory pre-sale disclosure obligations?

No disclosures are required and, accordingly, there are no consequences. Parties, however, should fulfil what they agree contractually.

1.9 Are there any other requirements that must be met before a franchise may be offered or sold?

There are no specific statutory requirements that must be met by parties of a franchise, except for the general or relevant requirements for conducting business.

1.10 Is membership of any national franchise association mandatory or commercially advisable?

This is not applicable in the UAE as there are no official national franchise associations. Membership with local associations is also generally not mandatory.

1.11 Does membership of a national franchise association impose any additional obligations on franchisors?

This is not applicable in the UAE; please see the answer to question 1.10.

1.12 Is there a requirement for franchise documents or disclosure documents to be translated into the local language?

If the franchise agreement is to be registered with the Ministry of Economy, the agreement will need to be translated into Arabic along with the application form specifying the terms of the relationship.

In the case of any governmental dealings or courts, a properly legal translation of any relevant documents into Arabic will be required in order to be considered.

2 Business Organisations Through Which a Franchised Business Can be Carried On

2.1 Are there any foreign investment laws that impose restrictions on non-nationals in respect of the ownership or control of a business in your jurisdiction?

Until 1 June 2021, the UAE Commercial Companies Law required a UAE national to own at least 51% of the shares in the capital of onshore companies in the UAE. However, following the introduction of Federal Decree-Law No. 26 of 2020, this requirement was removed from Article 10, permitting 100% foreign ownership for dozens of commercial activities, subject to some restrictions.

The activities that are excluded from 100% foreign ownership include, but are not limited to, commercial agencies activities and strategic activities such as banking, insurance and telecommunications and others.

That said, under the New Commercial Agencies Law, it remains that commercial agency activities can only be carried out by one of the following:

- A UAE National.
- A UAE Public Joint-Stock company ("PJSC") owned at least 51% by UAE nationals.
- A UAE private entity owned by a PJSC meeting the above requirements.
- A UAE private entity that is 100% owned by UAE nationals.

Further, the New Commercial Agencies Law permits international companies/foreign Principal to act as agents in selling their own products directly in the UAE – even if not owned in whole or in part to UAE nationals – provided that (1) there is no agent already appointed for the products in the UAE, and (2) the commercial agency must be new and not subject of any existing registered agency in the UAE. However, and in order to be registered as commercial agent, international company/foreign Principal must obtain the UAE Cabinet's permit, acting under the recommendation of the Minister of Economy.

For those companies incorporated in a free zone, they continue to be capable of having a 100% foreign ownership according to the applicable regulations and requirements.

2.2 What forms of business entity are typically used by franchisors?

The most common form of business entity used by franchisors in the UAE is a limited liability company. There are many cases of franchisors entering into joint ventures with a locally-based entity in order to gain easy access and insight into the local market, and in order to have control of the use of the know-how that will be transferred to the franchisee; however, such joint venture structures are uncommon and are also selected by parties commercialising the luxury goods sector. In addition, foreign franchisors are generally reluctant to fully participate in joint ventures through capital investment to exploit franchise rights.

2.3 Are there any registration requirements or other formalities applicable to a new business entity as a pre-condition to being able to trade in your jurisdiction?

All business entities are required to obtain and issue a commercial licence in the UAE whereby they will be licensed to trade or provide services for designated activities as intended under the entity.

3 Competition Law

3.1 Provide an overview of the competition laws that apply to the offer and sale of franchises.

The main Federal laws and regulations governing competition in the UAE are as follows:

- The Federal Law No. 4 of 2012 on the Regulation of Competition (“UAE Competition Law”).
- Cabinet Resolution No. 37 of 2014 concerning the Implementing Regulation of the UAE Competition Law (“Implementing Regulation”).
- Cabinet Resolution No. 13 of 2016 (“Ratio Decision”), which provides the ratios and controls related to the application of the UAE Competition Law.
- Cabinet Resolution No. 22 of 2016 (“SME Decision”) in respect of small and medium projects and enterprises.

The UAE Competition Law applies to activities carried out by entities in the UAE and the exploitation of IP rights inside the UAE or abroad and, further, the law applies to activities that are practised abroad but affect competition in the UAE.

The main aim of the UAE Competition Law and Implementing Regulation is to protect and promote competition and anti-monopoly practices through maintaining a competitive market governed by market mechanisms, in accordance with the principle of economic freedom, by regulating the following areas:

1. Restrictive Agreements:

The UAE Competition Law and Implementing Regulation prohibit the restrictive agreements that restrict and prevent competition in the relevant market. *Therefore, and when drafting the franchise agreement, the parties need to ensure that the provisions of the agreement are not in breach of the UAE Competition Law and Implementing Regulation, noting that the agreements that include the following provisions are prohibited:*

- Agreements that specify directly or indirectly the purchase or sale prices of goods or services.
- Agreements that freeze or limit production, development, distribution, marketing and other investment aspects.
- Agreements that restrict the freedom of supply of goods or services in the relevant market.

- Agreements that collude in refusing to deal with certain entities or limiting the sale or supply to certain organisations, etc.

The prohibitions stipulated under the UAE Competition Law and Implementing Regulation exclude “low-impact restrictive agreements” in which the total share of the parties to the agreements do not exceed 10% of the total transactions in the relevant market.

Further, franchise agreements that are registered as “commercial agencies” under the Commercial Agencies Law are expressly exempted from the application of the UAE Competition Law and Implementing Regulation. The Competition Law expressly states that certain restrictions cannot be included in agreements except to the extent they are included under the Commercial Agencies Law, such as the following:

- Agreements that are aimed at market sharing or allocation of clients on the basis of geographical areas, distribution centres, customer quality, seasons, periods of time or any other basis that affects competition.
- Agreements that are taking any measures to hinder the entry of other entities into the market.

2. Abuse of Dominant Position:

The UAE Competition Law and Regulation prohibits companies with a dominant position in the relevant market, or in a substantial or influential part thereof, from carrying out any acts or actions that lead to the abuse of the position to prejudice, restrict or prevent competition. Therefore, while having a dominant position is not in itself prohibited under the UAE Competition Law, using a dominant position for anti-competitive purposes is prohibited, such as in the following cases:

- Imposing – whether directly or indirectly – prices or conditions for resale of goods or services.
- Selling goods or services at below cost price with the aim of hindering the entry of competitive entities to the market.
- Forcing customers not to deal with a competitive entity as well as unjustified discrimination of customers of identical contracts in terms of prices of goods or services or the terms of sale or purchase of contracts.
- Disseminating false information about the products or services and their prices and other activities.

However, the UAE Competition Law provides that a certain minimum threshold must be met, which is calculated by reference to the total market share of the parties to the agreement and whether the same exceeds a percentage specified by the UAE Cabinet.

3.2 Is there a maximum permitted term for a franchise agreement?

There is no maximum permitted term; however, the New Commercial Agencies Law has provided for a minimum contract term of five years if the agent/franchisee is required under the contract to establish showrooms, buildings, commodity stores or maintenance/repair facilities, unless agreed otherwise between the parties.

3.3 Is there a maximum permitted term for any related product supply agreement?

There is no maximum permitted term prescribed by law for any related product supply agreement.

3.4 Are there restrictions on the ability of the franchisor to impose minimum resale prices?

Generally, there are no restrictions imposed on the ability of the franchisor to impose a minimum resale price in order to comply with the franchise standards. The main concern would be the competition law and whether the local entity, i.e. franchisor or franchisee, is considered a dominant entity as defined under the UAE Competition Law, as in such case such act would potentially be an issue that is considered as price-fixing by a dominant entity and, accordingly, would be subject to the sanctions stipulated under the UAE Competition Law.

In light of this, the franchisor shall be able to set the prices for the products or services, subject to the franchise agreements, as long as the franchisor and/or franchisee are not in a dominant position. The nature of product/service can trigger the Competition Law issue and potentially be a factor, i.e. whether the product is substantial, a luxury, or pertains to consumers' direct needs.

3.5 Encroachment – are there any minimum obligations that a franchisor must observe when offering franchises in adjoining territories?

There are no laws or regulations that govern competing franchisees that are granted franchise in neighbouring territories (encroachment). However, the main principle under the applicable UAE laws is that contractual matters are subject to the agreement of the parties, which will be enforceable to the extent that it does not violate UAE public policy or morality. Further, the UAE Civil Code provides that all contracts must be performed in a manner consistent with the requirements of good faith, accepted industry practice and honourable dealings.

Therefore, and as the franchise rights can be granted to franchisees on an exclusive and non-exclusive basis, the franchisor shall be clear regarding the territory or geographical limits granted to each franchisee when drafting the franchise agreement. The non-exclusive franchise agreement shall include sufficient provisions that expressly state that the franchisor will reserve the right to grant franchises to third parties within the territory in order to mitigate any risks in this regard, while the exclusive franchise agreement shall include provisions that expressly state that the franchisor will reserve the rights to grant franchises to third parties outside the exclusive territory or even to grant franchises for similar concepts that do not incorporate the licensed or franchised IP rights within the exclusive territory.

As for the exclusive franchise agreements that are registered as a commercial agency agreement with the Ministry of Economy under the UAE Federal Law No. 187 of 1981, the same grants exclusivity to the franchisee in relation to the franchised territory (whether in respect of one Emirate or number of Emirates or the entire UAE).

The franchisee that is recorded as a commercial agent will be able to prevent third parties – including the franchisor – from importing any commodity, product, material or any other merchandise that is the subject matter of a franchise agreement registered at the Ministry of Economy within the scope of the franchised territory.

3.6 Are in-term and post-term non-compete and non-solicitation of customers covenants enforceable?

Non-compete and non-solicitation clauses during the term and post termination are legally enforceable under UAE law but,

in practice, they face serious practical challenges to prove and pursue, including remedies and claimed compensation.

Provided such clauses are reasonably drafted and included, they can be enforced. In practice, generally, the courts in the UAE take into consideration the following factors when determining the reasonableness of a non-compete or non-solicitation restrictions:

1. **Duration of the restriction:** The period of non-compete and non-solicitation clauses will be subject to challenge in case the same are considered too long by the court.
2. **Geographical scope of the restriction:** The geographical scope of non-compete and non-solicitation clauses will be subject to challenge in case the same are considered too large by the court.
3. **Position and status of the person or entity against whom the restrictions are imposed, as well as the restricted activities.**

Therefore, non-compete and non-solicitation clauses, in which the franchisees agree not to be involved in any similar or competing business and not to solicit any employees from the franchised business, are enforceable in the UAE, provided they are reasonable in respect of the period, the geographical area and the activity restricted.

As for the franchisor's know-how, it is possible to include standard indefinite restrictions or clauses on using any of the franchisor's know-how in any other similar or competing business.

4 Protecting the Brand and Other Intellectual Property

4.1 How are trade marks protected?

In the UAE, trademarks are protected under the Trademark Law and may be registered before the UAE Trademark Office.

A trademark registration lasts for a duration of 10 years from the date of application and can be renewed for further periods of 10 years.

In terms of process, an application must be made to the Trademark Office (in Arabic). The officials will then examine the trademark on both absolute and relative grounds, as per the prescribed conditions in Articles 2 and 3 of the Trademark Law.

Providing no objections are made, the trademark will be published in the *Official Gazette* and two local newspapers for a period of 30 days. If no opposition is lodged by a concerned third party within the requisite time period, the trademark will be eligible for registration, which will be secured upon payment of the associated fee.

The owner of a registered trademark maintains the exclusive right to use its trademark and may bring action against any party which uses the trademark without its consent.

4.2 Are know-how, trade secrets and other business-critical confidential information (e.g. the Operations Manual) protected by local law?

The UAE is party to the TRIPS Agreement and, accordingly, the concept of trade secrets and confidential information is provided for in the UAE Federal laws under several different provisions. Under the Penal Code, it is a criminal offence for an individual who “... *by virtue of his profession, craft, position or art is entrusted with a secret and divulges it in cases other than those allowed by law or if used for his own personal interest or for the interest of another person, unless authorized by the confiding person to disclose or use it*”.

Under the Civil Transactions Law, employees must “safeguard the industrial or commercial secrets of their work, even after the expiration of the contract, as required by the agreement or customarily practiced”.

The labour regulations give some protection for trade secrets; for instance, the employer's right to take disciplinary measures if the employee “divulges any of the secrets of the establishment where he works”.

The UAE Companies Law that came into force on 1 July 2015 contains a provision in Article 369 titled “Disclosure of company secrets”, which penalises the following:

“1. Anyone who takes advantage of data or information that he obtained from the incorporation committee at any stage of incorporation of the company and who is a legal or financial consultant or a subscription director or covering sponsor or the parties participating in the incorporation procedures or any of their representatives.

2. the chairman, a board member or an employee who uses or discloses a company secret or intentionally tries to damage the company's activity.”

Further, the Industrial Property Law – which apply to patents, industrial designs, integrated circuits, utility certificates and undisclosed information – recognises the right of confidentiality in relation to undisclosed information and/or know-how. The confidential information will be protected as long as they meet the requirements to be considered confidential information. The Law's requirements to provide protection to confidential information are:

1. the information shall be confidential and not known or circulated generally to those engaged in the industrial art within whose scope the information falls;
2. the information has business value and such value is derived from being a secret; and
3. the information has been the subject of reasonable measures by its holder to keep it secret.

The Industrial Property Law requires that steps are taken to preserve the secrecy of that undisclosed information. In accordance with the provisions of Chapter 6 of the Law and Article (71) of the Cabinet Decision No. 6 of 2022 on the Implementing Regulations of the Industrial Property Law, the party asserting confidentiality must demonstrate that positive steps have been taken to keep the information confidential and that the nature of the information as such was communicated.

Also, Article 71 of the Implementing Regulation contains detailed measures to be taken by the legal owner of undisclosed information to maintain the confidentiality of undisclosed information, including but not limited to:

- Keeping documents or any other items containing undisclosed information in a way that ensures that they are not viewed by others without permission and managing the workplace so that employees do not view such undisclosed information.
- Preventing third parties from visiting the workplace, except with the prior permission of the owner and in his personal presence or his authorised representative.
- Prohibiting any programme that would allow the visitor to view undisclosed information.
- Ensuring that any type of agreement concluded with employees or third parties – which may allow the employees or third parties to view some elements of the undisclosed information – includes provisions and clauses that impose on the employees or third parties not to disclose any element of undisclosed information obtained during the term of the agreement, and not to use or exploit the information for their benefit or the interest of any third party, either directly or indirectly, during the term of the agreement or after its termination for any reason, without the prior permission of the owner of the undisclosed information.

Therefore, it is the best practice to include obligations relating to trade secrets and confidential information in any franchise

agreement that set out the circumstances of the disclosure of confidential information.

If the concerned contract is governed under the laws of the DIFC free zone, the relevant provisions can be found in the DIFC IP Law, which was implemented in 2020. This defines the concept of a trade secret as “all forms and types of financial, business, scientific, technical, economic or engineering information, including patterns, plans, compilations, programs, devices, formulas, designs, prototypes, methods, techniques, processes, procedures, or codes, whether tangible or intangible, and whether or how stored, compiled, or memorialised physically, electronically, graphically, photographically, or in writing”. However, it must meet the following requirements:

- “(1) the information involved constitutes a trade secret, or part thereof;
- (2) the information derives actual or potential economic value from not being generally known to other persons who may obtain economic value from its disclosure or use; and
- (3) the person lawfully in control of the information has taken reasonable measures to keep the information a secret.”

4.3 Is copyright (in the Operations Manual or in proprietary software developed by the franchisor and licensed to the franchisee under the franchise agreement) protected by local law?

Yes, copyright protection in the UAE is applicable to any original work in the areas of literature, arts or science, whatever its description, mode of expression, significance or purpose of creation. The copyrighted work includes: smart applications; computer programs and applications; databases; and similar works. This is provided for under Federal Decree-Law No. 38/2021 On Copyrights and Neighbouring Rights. The UAE is also a signatory to several copyright treaties, such as the Berne Convention, WTO TRIPS Agreement, WIPO Copyright Treaty and the Rome Convention.

Although registration is not necessary to obtain rights and copyright protection, it is advisable to register or deposit works that are important to the company before the Copyright Department at the Ministry of Economy, in order to generate evidence of the existence of such copyrighted work.

5 Liability

5.1 What remedies can be enforced against a franchisor for failing to comply with mandatory disclosure obligations? Is a franchisee entitled to rescind the franchise agreement and/or claim damages?

There are no mandatory disclosure obligations under the applicable UAE laws. However, and if such disclosure is agreed between the parties in the franchise agreement, then the franchisee may have the right to terminate the agreement or claim for damages if the provisions of the agreement grant the franchisee such rights.

5.2 In the case of sub-franchising, how is liability for disclosure non-compliance or for pre-contractual misrepresentation allocated between franchisor and master franchisee? If the franchisor takes an indemnity from the master franchisee in the Master Franchise Agreement, are there any limitations on such an indemnity being enforceable against the master franchisee?

Any liability for misrepresentation under the sub-franchise agreement that is made between the master franchisee and

sub-franchisee would rest with the master franchisee, as the parties must have a contractual relationship to bring a claim of misrepresentation in the UAE. The franchisor or its officers and directors will not be liable for a breach by the master franchisee of its obligations.

In general, the provisions in a franchise agreement that provide for indemnification of a party against liability arising in a contract are enforceable under UAE law, provided that the losses are not the result of the fraud, wilful default or gross fault or negligence of the party seeking to be indemnified. Therefore, the parties of the franchise agreement may include any indemnity clauses; however, if the master franchise agreement between the franchisor and master franchisee contains a wide obligation for the latter to indemnify the franchisor for all the master franchisee's acts or omissions, the courts would have the right to assess, revise and, at their, sole discretion decide to hold or strike out the indemnity provision for being "unreasonable" in case the acts or omissions are caused by the franchisor's own negligence.

5.3 Can a franchisor successfully avoid liability for pre-contractual misrepresentation by including a disclaimer in the franchise agreement?

It is best practice to include entire agreement and non-reliance clauses to prevent either party from bringing a misrepresentation action, and disclaimers of this nature would generally be sufficient to avoid civil liability. However, disclaimers do not always continue to exempt the parties from liabilities and courts will carefully assess the enforceability of pre-contractual liability based on the facts, contractual terms and parties' expectation of liabilities. In addition, third parties will not be automatically restricted from pursuing their rights against franchise parties because of having such disclaimers.

5.4 Does local law permit class actions to be brought by a number of aggrieved franchisees and, if so, are class action waiver clauses enforceable?

The applicable UAE laws do not legislate for class-action lawsuits; however, in practice, a group of claimants may collectively commence legal proceedings against one or a number of defendants in some cases. The courts will review the opening statement claims carefully and, if the cause of action is unified among all claimants, the case could be approved. In particular, the class action may work in claims where various claimants suffered harm as a result of the acts of one or a number of defendants, but may be difficult to pursue in cases related to franchise.

6 Governing Law

6.1 Is there a requirement for franchise documents to be governed by local law? If not, is there any generally accepted norm relating to choice of governing law, if it is not local law?

There is no requirement for franchise documents to be governed by local law, and generally the parties to any agreement are free to choose the governing law and forum within the contract. However, if the franchise agreement is registered with the Ministry of Economy at the Commercial Agencies Department, it will be subject to UAE internal laws, such as the New Commercial Agencies Law.

Under the Old Commercial Agencies Law, the Commercial Agencies Committee ("Committee") had exclusive jurisdiction

to hear any dispute between the parties, and the UAE courts had exclusive jurisdiction to hear and determine any appeals over the Committee's decisions.

The New Commercial Agencies Law confirms the exclusive jurisdiction of the Committee to hear any dispute that arise between the parties **in the first instance**. However, the New Commercial Agencies Law has allowed the parties for the first time to agree to refer any dispute to arbitration in relation to a registered commercial agency agreement, after the issuance of a decision from the Committee, meaning that the parties shall – at the first instance – refer any dispute to the Committee, but thereafter refer the dispute to arbitration as a next step, in which case the Committee's decision will neither be binding on the parties nor the arbitrators.

The default seat for arbitration is the UAE, unless otherwise agreed between the parties. However, the arbitration clause will not apply to a commercial agency in relation to a dispute that has arisen or is already being heard by a UAE court before the publication of the New Commercial Agencies Law (15 December 2022).

6.2 Do the local courts provide a remedy, or will they enforce orders granted by other countries' courts, for interlocutory relief (injunction) against a franchisee to prevent damage to the brand or misuse of business-critical confidential information?

The UAE courts may enforce orders granted by other courts if the foreign judgments fulfil the conditions stipulated in UAE laws and/or treaties. The foreign judgments can be enforced in the UAE either:

1. under a bilateral treaty signed between the UAE and a foreign country;
2. under the provisions of the Executive Regulations of the Civil Procedure Law No. 11 for the year 1992 as amended in 2018; or
3. through the DIFC or ADGM courts.

6.3 Is arbitration recognised as a viable means of dispute resolution and is your country a signatory to the New York Arbitration Convention on the Recognition and Enforcement of Foreign Arbitral Awards? Do businesses that accept arbitration as a form of dispute resolution procedure generally favour any particular set of arbitral rules?

Yes, arbitration is readily available and widely used in the UAE as a form of dispute resolution. The UAE is a signatory to the New York Arbitration Convention. The arbitration award will be enforceable, provided the same is issued in accordance with the UAE arbitration regulations and also covers matters that can be referred to arbitration.

As mentioned at question 6.1 above, arbitration is specifically mentioned in the New Commercial Agencies Law as a dispute resolution mechanism. In fact, Article 26.1 states:

"The provisions of this Law shall not prejudice any agreement between the Agent and the Principal to refer any dispute arising between them to arbitration."

7 Real Estate

7.1 Generally speaking, is there a typical length of term for a commercial property lease?

This is generally a minimum of a year, with most commercial leases being either three or five years.

7.2 Is the concept of an option/conditional lease assignment over the lease (under which a franchisor has the right to step into the franchisee/tenant's shoes under the lease, or direct that a third party (often a replacement franchisee) may do so upon the failure of the original tenant or the termination of the franchise agreement) understood and enforceable?

Whilst it is possible to include a term of this nature into the franchise agreement, the tenant (franchisee) would need to have express permission from the landlord in order to assign the lease to another party. If this was not obtained beforehand, any assignment would fail unless the landlord approves the same when such right is exercised.

7.3 Are there any restrictions on non-national entities holding any interest in real estate, or being able to sub-lease property?

There are no legal restrictions that prohibit a non-national to lease or sub-lease a property due to the nationality. However, non-nationals may own property only in certain allowable territories in the UAE, namely called "freeholds".

7.4 Give a general overview of the commercial real estate market. To what extent has the real estate market been affected by the Coronavirus pandemic? Specifically, can a tenant expect to secure an initial rent free period when entering into a new lease (and if so, for how long, generally), or are landlords demanding "key money" (a premium for a lease in a flagship location)?

The COVID-19 pandemic initially led to a temporary reduction in rental prices for commercial properties in 2020 and 2021, with many landlords becoming more flexible in respect of payment terms and the requirement for post-dated cheques, permitting bank transfers instead. The parties entered into amicable negotiations to review their commercial contracts, and a large number of deals were resolved without escalation to disputes. This assured confidence in the market by foreign investors, and demonstrated the flexibility and dynamic of the UAE market in dealing with global crisis.

Since COVID-19, the UAE real estate market has had a dramatic recovery, and even hit a "record high" according to a report published by CBRE in early 2023. In respect of the Commercial Real Estate market, particularly, reports indicate that there was significant growth throughout 2022 with demand for offices, retail, and warehouses. The growing demand has led to shortages of available office space in particular prime areas, which has in turn drove up both the purchase and rental markets.

Some landlords were willing to provide rent-free periods when entering into a new lease, but the availability of this can depend on the area and the relevant level of demand. Given the significant increase in demand generally, this is likely to be confined to "up and coming" areas. Key money is not usually demanded by landlords.

8 Online Trading

8.1 If an online order for products or request for services is received from a potential customer located outside the franchisee's exclusive territory, can the

franchise agreement impose a binding requirement for the request to be re-directed to the franchisee for the territory from which the sales request originated?

Yes, the franchise agreement can impose a binding requirement for the request to be re-directed.

8.2 Are there any limitations on a franchisor being able to require a former franchisee to assign local domain names to the franchisor on the termination or expiry of the franchise agreement?

There are no formal limitations. However, if the domain name is inclusive of the trademark of the franchisor, the franchisor will be able to claim that the domain name is their property and accordingly should be transferred. It is best practice to include provisions relating to any domain names within the franchise agreement.

9 Termination

9.1 Are there any mandatory local laws that might override the termination rights one might typically expect to see in a franchise agreement?

Generally, the provisions on the termination that are set under the franchise agreement shall apply. However, if the franchisee is registered as a commercial agent, the contract may only be terminated for the following reasons:

- a) Expiry of the contract term, unless said term is renewed by agreement of the contracting parties.
- b) By the will of either the Principal or the Agent based on the terms and conditions of the Commercial Agency Contract.
- c) By agreement of the contracting parties before the end of the contract term (early termination).
- d) Issuance of a final court judgment terminating the Commercial Agency.
- e) Any other case mentioned in the New Commercial Agencies Law.

The implementation of the above termination provision gives parties an enhanced flexibility in agreeing and supervising agency contracts.

The New Commercial Agencies Law also provides for statutory notice periods for early termination or non-renewal of a contract upon expiry. As per the law, unless the parties have specifically agreed otherwise, the terminating party will be required to provide notice to the other party either one year before the date of expiry/termination, or before the lapse of half of the contract term, whichever is less.

It should be noted that the New Commercial Agencies Law (and the changes to termination procedures) will not immediately apply to all existing commercial agency relationships. Instead, Article 30 of the New Commercial Agencies Law sets out transitional implementation periods.

Parties in existing commercial agencies will not benefit from the changes to the termination and/or non-renewal provisions, which will not apply to existing relationships, except:

- after the lapse of two years after the New Commercial Agencies Law is in force (15 June 2025); or
- after the lapse of 10 years after the New Commercial Agencies Law is in force (15 June 2025, in the case of commercial agencies which have been registered for more

than 10 years with an agent, or where the agent has invested more than AED 100,000,000 into the commercial agency.

Instead, the position of the old law will be applicable, wherein a contract could only be terminated for “fundamental or material reasons”. This was generally interpreted narrowly by the local courts and was often considered a deterrent in engaging in commercial agency in the UAE. This was viewed by some as a mechanism which prevented international parties from enforcing termination procedures and holding their local agents accountable for agreed performance targets and objectives.

9.2 Are there local rules that impose a minimum notice period that must be given to bring a business relationship that has existed for a number of years to an end, which will apply irrespective of the length of the notice period set out in the franchise agreement?

There are no local laws that impose a minimum notice period in the UAE for commercial contracts or franchise agreements. However, under the New Commercial Agencies Law, a statutory notice period has been implemented (mentioned at question 9.1 above).

10 Joint Employer Risk and Vicarious Liability

10.1 Is there a risk that a franchisor may be regarded as a joint employer with the franchisee in respect of the franchisee's employees? If so, can anything be done to mitigate this risk?

No, UAE employment law requires all employees to be sponsored by a legal entity in the UAE for work and residency purposes. It would not be possible to suggest that an employee of a franchisee be regarded as an employee of the franchisor, unless the franchisor was based in the UAE and the franchisor sponsored the employees. Nevertheless, it is recommended to disclaim any relationship of partnership, employment or agency within the agreement in order to mitigate any risk.

In 2021, the UAE in 2021 introduced a new employment law (i.e. Law No. 33/2021) that offered and proposed new types of employment contracts, such as part-time, temporary and/or flexible contracts, which can be explored by the appointed staff or teams in franchise transactions.

10.2 Is there a risk that a franchisor may be held to be vicariously liable for the acts or omissions of a franchisee's employees in the performance of the franchisee's franchised business? If so, can anything be done to mitigate this risk?

Generally, the franchisor will not be held liable for the acts or omissions of the franchisee's employees unless the franchisor has contributed to or validated such acts, or caused any omissions or misconduct due to its direct control over the franchisee's employees and works, including the day-to-day operations, or due to common ownership of the franchisor and franchisee.

11 Currency Controls and Taxation

11.1 Are there any restrictions (for example exchange control restrictions) on the payment of royalties to an overseas franchisor?

There are no restrictions of this kind in the UAE.

11.2 Are there any mandatory withholding tax requirements applicable to the payment of royalties under a trade mark licence or in respect of the transfer of technology? Can any withholding tax be avoided by structuring payments due from the franchisee to the franchisor as a management services fee rather than a royalty for the use of a trade mark or technology?

No, this is not applicable within the UAE.

11.3 Are there any requirements for financial transactions, including the payment of franchise fees or royalties, to be conducted in local currency?

There are no such requirements in the UAE.

12 Commercial Agency

12.1 Is there a risk that a franchisee might be treated as the franchisor's commercial agent? If so, is there anything that can be done to help mitigate this risk?

Yes, there is a risk, especially if the franchise agreement is registered with the Ministry of Economy or, explicitly or implicitly, allows such registration for the franchisee.

It is important to set out the rights of the franchisee within the franchise agreement, and specifically mention whether the franchisee is a commercial agent or not, and determine whether it can or cannot be registered thereof. A disclaimer to this effect being included within the agreement is recommended. Parties are strongly advised to obtain a proper consultation from local counsel who is an expert in this area.

13 Good Faith and Fair Dealings

13.1 Is there any overriding requirement for a franchisor to deal with a franchisee in good faith and to act fairly in its dealings with franchisees according to some objective test of fairness and reasonableness?

Yes, a duty to act in good faith is implied into any agreement which is subject to UAE law. As per Article 246 of the UAE Civil Code, “a contract must be performed in accordance with its contents, and in a manner consistent with the requirements of good faith”.

13.2 Is there any limitation on a good faith obligation being unenforceable if it only applies from franchisee to franchisor, rather than being mutual?

The obligation to act in good faith applies to all contracts and is an obligation on both contracting parties, irrespective of the terms in the agreement.

14 Ongoing Relationship Issues

14.1 Are there any specific laws regulating the relationship between franchisor and franchisee once the franchise agreement has been entered into?

No, there are no specific laws that regulate the franchise relationship once the franchise agreement comes into effect. However, the parties shall not contravene any of the general principles of law in relation to the ongoing dealings between them.

Further, there are specific policies and regulations established for certain industries and certain categories of products or services and, therefore, the parties shall ensure the requirements imposed for the industry subject of the franchise business, such as the franchises related to educational institutions or pharmacies, etc. are established.

15 Franchise Renewal

15.1 What disclosure obligations apply in relation to a renewal of an existing franchise at the end of the franchise agreement term?

No disclosure obligations are specified by the applicable laws in the UAE.

When franchise rights are covered in trademark licence agreements, the recordal of licence agreements are published in the *Official Gazette*.

15.2 Is there any overriding right for a franchisee to be automatically entitled to a renewal or extension of the franchise agreement at the end of the initial term irrespective of the wishes of the franchisor not to renew or extend?

There are no mandatory imposed rights in relation to automatic renewals of the franchise agreement at the end of the initial or subsequent term. However, and in case the franchise agreement is recorded as a commercial agency under the Old Commercial Agencies Law, the franchisor will be liable for compensation if non-renewal occurs by the franchisor's decision without a legitimate cause, even if the franchise agreement term is fixed.

The position has changed under the New Commercial Agencies Law, wherein the franchisor (or Principal) is able to terminate the relationship for several reasons (detailed at question 9.1), and this explicitly includes "the expiry of a limited term of agency contract".

15.3 Is a franchisee that is refused a renewal or extension of its franchise agreement entitled to any compensation or damages as a result of the non-renewal or refusal to extend?

No, the franchisor and franchisee are free to agree the terms of the franchise agreement, and no compensation or damages will be payable unless the contract provided for this.

However, and in case the franchise agreement is recorded as a commercial agency agreement (before 15 June 2023), under the Old Commercial Agencies Law, the franchisee will be entitled to compensation on failure to renew an agreement, even if the non-renewal is made in accordance with the terms of the franchise agreement. The amount of the compensation is decided on a case-by-case basis; however, the courts in the UAE take into account different factors when determining the amount of compensation, such as the duration of the franchise agreement, the net profit generated by the franchisee and its efforts in promoting the franchisor, as well as the targets reached by the franchisee in accordance with the terms of the franchise agreement.

As Article 30 of the New Commercial Agencies Law provides a transition period for existing commercial agency contracts, the above would still apply for existing agency relationships, and compensation is likely to be due.

The New Commercial Agencies Law provides, also, for the right to claim for compensation for any damages suffered as a result of non-renewal or termination of the agency contract as follows:

1. **Expiration of any agency contract (non-renewal) by way of a legal notice being issued by either of the parties:** The agent may claim from the Principal a compensation for the damages it has suffered as a result of non-renewal of the contract, unless the contract expressly stipulates otherwise (Article 11/1).
2. **Termination of the contract term by the will of either of the parties based on the terms and conditions of the contract:** The affected party can claim from the other party a compensation for damages it has suffered (Article 11/2).
3. **Termination of the contract term by the will of either of the parties based on the terms and conditions of the contract:** The agent can challenge the termination before the Commercial Agencies Committee in addition to claiming compensation for damages it has suffered if the agent proves that its efforts have contributed to the success of the products and have led to the increase of customers or clients for such products, as well as have led to the loss of profit as a result of the termination (Article 11/2).

The New Commercial Agencies Law does not provide any clarification or criteria for the assessment of such compensation.

16 Franchise Migration

16.1 Is a franchisor entitled to impose restrictions on a franchisee's freedom to sell, transfer, assign or otherwise dispose of the franchised business?

Yes, this can be set out in the franchise agreement and the same should be enforceable.

16.2 If a franchisee is in breach and the franchise agreement is terminated by the franchisor, will a "step-in" right in the franchise agreement (whereby the franchisor may take over the ownership and management of the franchised business) be recognised by local law, and are there any registration requirements or other formalities that must be complied with to ensure that such a right will be enforceable?

A step-in clause in the franchise agreement will be recognised; however, there may be limitations on the enforceability in respect of the franchisee's own contracts with third parties, such as the landlord of the franchisee's premises.

With respect to assets related to franchised business, the New Commercial Agencies Law introduced new provisions that oblige the agent to transfer to the Principal or the new agent any assets (such as commodities, merchandise, materials, spare parts, machinery and others) which are held by the agent at the date of termination, and which are subject to the Commercial Agency Contract in return of a fair value, provided that there are no restrictions on the transfer of the ownership of the assets at the time of the termination of the contract, unless otherwise agreed between the parties (Article 9/2).

16.3 If the franchise agreement contains a power of attorney in favour of the franchisor under which it may complete all necessary formalities required to complete a franchise migration under pre-emption or "step-in" rights, will such a power of attorney be recognised by the courts in the jurisdiction and be treated as valid? Are there any registration or other formalities that must be complied with to ensure that such a power of attorney will be valid and effective?

In order to use a Power of Attorney ("POA") in the UAE, it must be executed in the presence of a notary and legalised at the UAE

embassy in the country of execution. Once it reaches the UAE, it will require local authentication before it can be relied upon.

For a POA from a UAE-based entity, only execution in the presence of a notary is required.

As a POA lacks certain formalities, it may be considered “useless” and cannot be presented or used before third parties and/or governmental authorities.

17 Electronic Signatures and Document Retention

17.1 Are there any specific requirements for applying an electronic signature to a franchise agreement (rather than physically signing a “wet ink” version of the agreement), and are electronic signatures recognised as a valid way of creating a binding and enforceable agreement?

There are no specific requirements in respect of using electronic signatures and the UAE recognises electronic signatures as a valid form of signature, which are increasingly used in cross-border transactions. Whilst an electronically signed document will still form a binding and enforceable agreement, one practice is to execute the document in the presence of a notary in the UAE. As mentioned, if the franchise agreement is to be registered with the Ministry of Economy, it will require notarisation.

However, we are aware that the vast majority of franchise agreements are simply signed and exchanged in emails or e-communications.

17.2 If a signed/executed franchise agreement is stored electronically (either having been signed using e-signatures or a “wet ink” version having been scanned and saved as an electronic file), can the paper version of the agreement be destroyed?

No, in the UAE it is common for the court to request the original contract and/or supporting documents as evidence of the agreements, signed using wet ink. Failure to provide the originals may not be sufficient to convince the courts a valid agreement exists unless parties can show the signature of agreements in electronic means.

As for the agreements signed using e-signatures, the parties would be required to present copies of the emails exchanged by them containing the e-signed agreement in order to prove that the parties confirm the agreement.

18 Current Developments

18.1 What is the biggest challenge franchising is facing in your jurisdiction and how are franchisors responding to that challenge?

The UAE is considered a mature franchise market where franchising is common and has been used for several years as a method for business growth. However, foreign franchisors may still face certain challenges with their expansion to the UAE, such as the following:

(1) Finding the right franchisee

Finding the right candidate is one of the main challenges, since most franchisors tend to contract with franchisees who meet financial requirements, while the right approach is to consider franchisees that (1) have good management skills, (2) understand the market situation, and (3) work hard and adopt the latest technology, taking into account that the right franchisee is vital for the success of the franchised business and failure to find the proper franchisee would negatively affect the brand image, as well as the customers’ perception of the franchisor’s company.

(2) Inflation

The current worldwide inflation arising out of different crises and wars may impact the profitability of the franchised business, and consequently may lead to the early termination of the franchise agreements.

(3) Termination of franchise agreements registered as commercial agency

The termination of a registered franchisee in the UAE commercial agencies registrar is another challenge, irrespective of the terms of the franchise agreement. Although the New Commercial Agencies Law provides some relief to parties, there are still many challenges, particularly for those involved in existing commercial agency relationships who will not immediately benefit from any changes.

(4) The registration of the franchisor’s brand as a trade name by the Franchisee

A further practical challenge for franchisors is that the franchisee is likely to register a trade name in the UAE, and this may include the name or trademark of the business. Having this trade name revoked once the relationship has dissolved can present a further challenge to franchisors. In order to overcome this, franchisors should include specific terms of termination within the franchise agreement that sets out the assignment of any trade names if registered in the name of the franchisor.



Munir Suboh is a Partner and Head of the Intellectual Property Team at BSA Ahmad Bin Hezeem & Associates, working in the Dubai office. Recognised by *Chambers and Partners*, *The Legal 500*, *Best Lawyers* and *WTR*, amongst others, as a leading IP lawyer in the region. Most recently, the *World Trademark Review* highlighted him as “a standout professional in the region” who is “innovative and seasoned”, and ranked as one of the *Reuters ALB* Top 50 Lawyers in the MENA region with a “gift for problem solving and quick thinking”. Munir Suboh leads the firm’s Intellectual Property Department and is in fact cited by peers as “the key behind BSA’s success” according to *WTR*. *Chambers and Partners* cites his professionalism and pragmatism, further commenting that he is “very thorough and thoughtful in everything he does”. Munir is an experienced lawyer, consistently recognised by his peers, in-house counsel and client’s as amongst the top lawyers for both commercial and contentious IP work. Munir is highly sought after, particularly “by significant media and broadcasting companies” for his legal knowledge and “astute understanding of commercial realities”, in addition to his established track record across a multitude of IP disciplines, including licensing, global brand launches, high value litigation, asset acquisitions and transactions.

BSA Ahmad Bin Hezeem & Associates
Level 6, Building 3, The Gate Precinct
Dubai International Financial Centre, Dubai,
United Arab Emirates

Tel: +971 4 528 5555
Email: munir.suboh@bsabh.com
URL: www.bsabh.com



Amala Atieh is Of Counsel in the Intellectual Property Team at BSA Ahmad Bin Hezeem & Associates, and is well recognised for her capabilities that “span the whole gamut of IP services, including licensing and transactions” according to *WTR*, who also notes her high level of experience in the region. This is echoed by *The Legal 500*, who note that Amala possesses “outstanding knowledge of law and excellent communication skills”. Amala assists clients across industries to protect and commercialise their intangible assets, and to navigate the IP and tech-related aspects of transactions, including large, complex carve-outs. She advises clients at various stages of their development on a cross-section of commercial, IP, general litigation and technological matters with a particular focus on matters pertaining to media, branding strategy and development, e-commerce, consumer protection, IP and IT, franchising and commercial licensing of IP, false advertising and unfair competition. Amala is extremely knowledgeable and adept in the intricacies and ever-changing legal landscape of the GCC countries. She has an extensive experience in commercial agencies and comprehensive IP legal services such as IP strategy and enforcement, IP portfolio management, anti-counterfeiting strategic planning, infringement, complex unfair competition and IP litigation, online enforcement and domain names disputes.

BSA Ahmad Bin Hezeem & Associates
Level 6, Building 3, The Gate Precinct
Dubai International Financial Centre, Dubai
United Arab Emirates

Tel: +971 4 528 5555
Email: amala.atieh@bsabh.com
URL: www.bsabh.com



Felicity Hammond is an Associate in the Intellectual Property Team at BSA Ahmad Bin Hezeem & Associates LLP. Felicity focuses her practice in the areas of trademarks and copyrights, counselling her clients on management of their IP rights in the UAE and abroad. In addition to assisting clients with the selection, clearance, prosecution, policing and enforcement of their trademarks, she negotiates and drafts a wide variety of IP agreements. Her work also includes assisting clients with domain name, social media (such as Facebook and Instagram) and YouTube disputes. She advises on all aspects of brand protection, with a particular interest in NFT and Metaverse projects. Felicity is an experienced litigator, and deals with intricate cross-border claims. She has led counterfeit operations and cancellation actions in Europe, in addition to managing the prosecution side of the practice, bringing a wealth of skills and practices from her international law firm experience. Felicity has authored articles for *The Patent Lawyer* and *Chambers and Partners*, and co-authored many articles and publications with the head of practice.

BSA Ahmad Bin Hezeem & Associates
Level 6, Building 3, The Gate Precinct
Dubai International Financial Centre, Dubai
United Arab Emirates

Tel: +971 4 528 5555
Email: felicity.hammond@bsabh.com
URL: www.bsabh.com

BSA is home to a “full-service department with a compelling IP offering”. Our top-ranked Intellectual Property team is renowned for its “tailored, reliable solutions” and diverse strengths across the full spectrum of IP services, particularly including IP litigation, complex copyright claims and expertise in patent and trademark prosecution. According to *The Legal 500*, the BSA team has a “profound knowledge of intellectual property law”. BSA’s Intellectual Property Team is “able to leverage its impressive regional footprint to great effect on multi-jurisdictional instructions”. Notably, two members of the team are among a select group of the UAE’s top trademark professionals, as cited by *WTR*. Over the past year, the team has seen a marked growth in the number of advisory tasks, managing cases in the field of anti-counterfeiting, anti-piracy and digital infringement in not only

the Middle East but globally, particularly online. Copyright claims and issues are also extremely prevalent in the GCC region, with many claims successfully defended for our clients.

www.bsabh.com

BSA
BSA Ahmad Bin Hezeem
& Associates LLP

USA

Rosen Karol Salis, PLLC



Richard L. Rosen



Leonard S. Salis



John A. Karol

1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

The U.S. Federal Trade Commission (“FTC”) promulgated 16 C.F.R. Part 436 (the “FTC Franchise Rule”) to regulate the offer and sale of franchises in the U.S. Under the FTC Franchise Rule, a commercial business arrangement or relationship will be deemed a “franchise” if the terms of the contract (whether oral or written) satisfies the following three elements:

- (i) the franchisee will obtain the right to operate a business that is identified or associated with the franchisor’s trademark, or to offer, sell, or distribute goods, services, or commodities that are identified or associated with the franchisor’s trademark;
- (ii) the franchisor will exert or has authority to exert a significant degree of control over the franchisee’s method of operation, or provides significant assistance in the franchisee’s method of operation; and
- (iii) as a condition of obtaining or commencing operation of the franchise, the franchisee will either make a required payment or commit to make a required payment to the franchisor or its affiliate. The FTC’s Compliance Guide provides that the required payment must be a “minimum of at least \$500 during the first six months of operations”.

While many states have franchise-related laws, there is no uniform legal definition of a “franchise”. Various states’ laws mirror the FTC Franchise Rule’s definition of a franchise. For example, the laws of California, Illinois, Indiana, Iowa, Maryland, Michigan, North Dakota, Oregon, Rhode Island, Virginia, Washington, and Wisconsin provide that a “franchise” exists if, under the terms of the contract:

- (i) a franchisee is granted the right to offer, sell, or distribute goods or services under a marketing plan or system prescribed or suggested in substantial part by a franchisor;
- (ii) the operation of the franchisee’s business pursuant to such plan or system is substantially associated with the franchisor’s trademark, service mark, trade name, logotype, advertising, or other commercial symbol designating the franchisor or its affiliate; and

- (iii) the person granted the right to engage in such business is required to pay to the franchisor or an affiliate of the franchisor, directly or indirectly, a franchise fee of \$500 or more.

The laws of Hawaii, Minnesota, Mississippi, Nebraska and South Dakota vary from the FTC Franchise Rule model by identifying a “community of interest” rather than a “marketing plan” as an element of a “franchise”. A “community of interest” means a continuing financial interest between the franchisor and a franchisee in the operation of the franchised business.

Connecticut, Missouri, New York and New Jersey provide a “two-pronged” definition of a “franchise”. For example, New Jersey law provides that a franchise exists where:

- (i) there is a written agreement in which one person grants another a licence to use a trade name, trademark, service mark, or related characteristic; and
- (ii) there is a community of interest in the marketing of the goods and services being offered.

The New York’s Franchise Sales Act’s (“NYFSA”) “two-pronged” approach provides for a more expansive definition of a franchise. A franchise exists under the NYFSA where: (i) the franchisee pays a franchise fee (the “First Prong”); and (ii) the franchisee *either*: (a) operates under a marketing plan; or (b) is granted the use of a trademark (the “Second Prong”).

1.2 What laws regulate the offer and sale of franchises?

The FTC Franchise Rule imposes a pre-sale disclosure requirement that applies to all states, obligating franchisors to furnish prospective franchisees with information and data regarding the material terms of the franchise relationship prior to consummating the sale of a franchise. Franchisors disclose this material information in a prescribed format commonly referred to as a Franchise Disclosure Document (“FDD”). In addition, 15 states have registration and/or disclosure requirements that must be met before a franchise can be offered and sold in that state. 11 of these states require that, before franchisors may commence franchise sales activities in their states: (i) there must be a state agency review and approval of the FDD; and (ii) the franchisor must register its franchise programme with the state. 25 states have Business Opportunity Laws, which extend the disclosure

protections afforded to franchisees as well as to consumers who purchase business opportunities, including franchises. Under Business Opportunity Laws, franchise sellers are typically obligated to prepare and disclose certain information to prospective franchisees prior to the consummation of a sale of a franchise. Typically, the information required to be disclosed by franchise sellers under Business Opportunity Laws is less extensive than what is required to be disclosed under the FTC Franchise Rule or applicable state franchise laws. Franchisors may be provided with an “exemption” or “exclusion” from Business Opportunity Laws, provided that they are in compliance with the FTC Franchise Rule. Obtaining the exemption or exclusion, in some cases, may require the filing of a notice to qualify for the exemption (e.g., Florida, Kentucky, Nebraska, Texas and Utah).

1.3 If a franchisor is proposing to appoint only one franchisee/licensee in your jurisdiction, will this person be treated as a “franchisee” for purposes of any franchise disclosure or registration laws?

Yes. Business format franchising is the primary method by which franchisors elect to expand their brand in different domestic consumer markets. However, “direct franchising” is not the typical method of franchising for U.S.-based franchisors looking to establish their presence internationally. Franchisors seeking global expansion of their brand are more likely to partner with a single franchisee/licensee (“Master Franchisee/Sub-Franchisor”) to develop, market and operate units under the franchisor’s brand within a specified geographic region outside of the U.S. Notwithstanding this approach, this form of expansion is more commonly referred to as “master franchising”. A Master Franchisee/Sub-Franchisor is treated as a franchisee for the purposes of franchise disclosure and registration laws. The Master Franchisee/Sub-Franchisor is afforded the same franchise disclosure and registration protections as if it was a “typical” franchisee for various reasons, including the fact that it makes a substantial investment in the franchisor’s system. However, because the Master Franchisee/Sub-Franchisor typically “steps into the shoes” of the Franchisor and assumes many of the duties of the franchisor by selling and offering franchises in its territory, the Master Franchisee/Sub-Franchisor will be required to provide appropriate disclosure to its “Sub-Franchisees”.

1.4 Are there any registration requirements relating to the franchise system?

The FTC Franchise Rule does not require franchisors to register their FDDs with a federal administrative or governmental agency. It only imposes a pre-sale disclosure requirement on franchisors. However, as noted in the response to question 1.2 above, there are 15 states that require a franchisor to either: (i) register their FDD; or (ii) file a notice of intent with the appropriate regulatory authority prior to commencing the offer or sale of franchise or multi-unit development rights within the state. Notwithstanding this lack of requirement under the FTC Franchise Rule, most franchisors will require their franchisees or Master Franchisees/Sub-Franchisors to comply with all local laws.

1.5 Are there mandatory pre-sale disclosure obligations?

Any violation of the FTC Franchise Rule’s disclosure requirement is a violation of the U.S. Federal Trade Commission Act, and grants the FTC the right to sue franchisors in federal court

and to seek any or all of the following remedies: (i) civil penalties of up to \$11,000 per violation; (ii) injunctive relief with respect to violations of the FTC Franchise Rule, including barring franchise sales in the U.S.; and (iii) restitution, rescission, or damages on behalf of the affected franchisees. While the FTC can bring an action against franchisors who violate the FTC Franchise Rule, no such private right of action is granted to aggrieved franchisees. Although franchisees do not have a private right of action under federal law, state franchise disclosure laws permit an aggrieved franchisee to bring an action against the franchisor for violations of state registration and disclosure laws. These claims typically include actions for rescission of the franchise agreement and/or actions for actual damages (including reasonable attorneys’ fees and expenses). There has been a great deal of criticism over the lack of a private right of action under the FTC Franchise Rule and, as of February 1, 2022, a bill was introduced in the United States Congress (H.R. 6551) to introduce a private right of action under the FTC Franchise Rule.

With respect to pre-sale disclosure requirements, franchisors may look to the Franchise Registration and Disclosure Guidelines (the “Guidelines”) promulgated by the North American Securities Administrators Association, Inc. (“NASAA”) as a resource (along with other NASAA publications). NASAA is a voluntary association with a membership consisting of 67 state and territorial securities administrators in the 50 U.S. states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands, Canada and Mexico. NASAA facilitates multi-state enforcement actions, information sharing and education (including the publication of new materials). The Guidelines provide an item-by-item breakdown of the information required to be disclosed in FDDs.

On May 19, 2019, NASAA adopted three new cover pages that were to be incorporated into FDDs as of on January 1, 2020. These new pages include: “How to Use this Franchise Disclosure Document”, “What You Need to Know About Franchising” and “Special Risks to Consider about This Franchise”. The NASAA website provides instructions for use of the new cover pages (<https://www.nasaa.org/industry-resources/franchise-resources/>). On June 10, 2020, NASAA’s Franchise Project Group circulated guidelines to state franchise administrators for the review of Financial Representations after most businesses had been significantly impacted by the COVID-19 pandemic (see the response to question 1.7 below).

On September 18, 2022, NASAA adopted a Statement of Policy regarding the use of Franchise Questionnaires and Acknowledgments, generally finding them to run against public policy regarding the protection of franchisees and, at times, violative of state anti-waiver provisions. Several registration states, including Maryland and California, have adopted NASAA’s Statement of Policy into law, thereby requiring Franchisors to delete questionnaires and acknowledges which contravene the Statement of Policy.

In addition to the above, franchisors may also consult the FTC’s Franchise Rule Compliance Guide for an interpretation of the various disclosure requirements of the FTC Franchise Rule (<https://www.ftc.gov/system/files/documents/plain-language/bus70-franchise-rule-compliance-guide.pdf>).

1.6 Do pre-sale disclosure obligations apply to sales to sub-franchisees? Who is required to make the necessary disclosures?

The FTC Franchise Rule imposes a pre-sale disclosure requirement on franchisors selling franchises, but no such pre-sale disclosure requirement applies to sub-franchisees. While the FTC Franchise Rule does not directly address master franchising,

NASAA has adopted a Multi-Unit Commentary (as of September 16, 2014) that provides franchisors with practical guidance concerning their disclosure obligations with respect to certain multi-unit franchising arrangements, including master franchising. Under the NASAA guidelines, Master Franchisors are required to prepare a separate FDD (from the FDD the franchisor provides to area developers and unit franchisees) for offering and selling sub-franchise rights to prospective franchisees, because the relationships and agreements for sub-franchise rights are very different than those offered in a unit franchisee's FDD; combining them in the same FDD would lead to confusion. This pre-sale disclosure requirement is not only imposed on Master Franchisees offering and selling sub-franchise rights to prospective franchisees and multi-unit developers, but also upon Master Franchisees/Sub-Franchisors who "step-into" the franchisor's shoes and engage in franchise sales activities and provide training and support to sub-franchisees. Therefore, under the NASAA guidelines, Master Franchisees/Sub-Franchisors are responsible for preparing and providing their own FDD in connection with their offer and sale of sub-franchises and, where applicable, complying with state registration requirements.

1.7 Is the format of disclosures prescribed by law or other regulation, and how often must disclosures be updated? Is there an obligation to make continuing disclosure to existing franchisees?

Under the FTC Franchise Rule, franchisors are obligated to furnish prospective franchisees and multi-unit developers with certain material information through the prescribed format of an FDD. The purpose of the FDD is to provide prospective franchisees and multi-unit developers with the information they need to make an informed decision about investing in the franchisor's franchise system. The FDDs, which are the most essential component of the pre-sale due diligence process, are uniform in structure and are comprised of 23 categories ("Items") (which are laid out in the FTC Franchise Rule) of detailed information and accompanying exhibits regarding, among other things: (i) the history of the franchisor (and any parent or affiliate), including any history of bankruptcy or litigation; (ii) the business experience of the franchisor's principals; (iii) the recurring or occasional fees associated with operating the franchised business; (iv) an estimate of the franchisee's initial investment in order to commence operations; (v) the products (and sources for those products) that the franchisor requires the franchisee to use and/or purchase in connection with the operation of the franchised business; (vi) any direct or indirect financing (along with the terms of such financing) being offered by the franchisor; (vii) a list of all of the franchisor's word marks, service marks, trademarks, slogans, designs, and patents that will be used in connection with the operation of the franchised business; (viii) the territory in which the franchisee will operate, along with any rights retained by the franchisor to operate or cause a third party to operate in such territory; (ix) the exit strategies available to the franchisee and franchisor; (x) a description of how disputes are resolved; and (xi) the franchisor's financial performance, etc.

One of the Items that prospective franchisees and multi-unit developers usually deem to be amongst the most vital in analysing the franchise opportunity are financial performance representations concerning existing franchised and company-owned units. Such financial performance representations reflect past or projected revenues or sales, gross income and net income or profits. Franchisors are not required by federal or state law to provide prospective franchisees with this information. However, if they choose to do so, they may provide the information in FDD

Item 19, provided that there is a reasonable basis for the information and such information is properly and accurately disclosed. Improper or misleading financial performance representations can (and have, in many instances) give rise to a governmental or private cause of action under federal, state and/or common law (although there is no private right of action under the FTC Franchise Rule although there has been significant public interest in providing for a private right of action under the FTC Rule. The NASAA provides commentary (adopted May 2017) on certain aspects of the financial performance representations that may be disclosed under Item 19.

The FTC Franchise Rule requires new annual information (including updated audited financial information) to be made within 120 days of the end of each fiscal year. In addition, at the end of each fiscal quarter, a franchisor must prepare and include in "Item 22" an attachment reflecting any "material" changes to its FDD (e.g., bankruptcy filings or pending litigation filed against the franchisor).

In addition to the federal requirement to update an FDD, certain states require the franchisor to update the FDD and submit amendment filings (e.g., in New York, California, Maryland, Michigan, North Dakota and Rhode Island, a franchisor must "promptly" update its FDD and file an amendment with the state agency whenever there is a material change to the disclosed information).

Notably, in the aftermath of the COVID-19 pandemic and in an effort to streamline franchise filing generally, various states have begun to require the online filing of franchise registrations and renewals (e.g., the New York State Attorney General's Office and several other state agencies have recently adopted NASAA's Electronic Filing System; California's Department of Financial Protection and Innovation maintains its own system).

1.8 What are the consequences of not complying with mandatory pre-sale disclosure obligations?

Non-compliance with either federal or state disclosure laws, can result in very significant consequences. Because of the overlapping federal and state regulatory frameworks, each with its own set of repercussions for non-compliance, franchisors are strongly cautioned to engage competent franchise counsel to guide them through the sales process.

Under federal law, violations of the FTC Franchise Rule are deemed "unfair or deceptive acts or practices" in violation of Section 5 of the FTC Act. When such a violation occurs, the FTC can initiate enforcement actions against franchisors using its broad investigatory powers, including the ability to take testimony, examine witnesses, issue civil investigatory demands ("CIDs"), and issue federal subpoenas. *See, e.g.,* 15 USC 46, 49, 57, and 16 CFR Sec. 2.5. If a violation is found, the FTC may seek an administrative enforcement proceeding before an administrative law judge ("ALJ"), whose decision is enforceable in federal court. Consequences of franchisor's violation of the disclosure rule can include civil penalties, restitution of aggrieved parties, preliminary and permanent injunctive relief, including potentially barring a franchisor from conducting business or engaging in certain conduct (15 USC Sec. 56(b)), and other equitable relief. Enforcement actions by the FTC are relatively uncommon in the franchise context, although recently regulators have shown interest in enhancing enforcement. The federal FTC Act does not provide for a private right of action (although there has been recent discussion that Congress may re-address that issue).

Many states also have their own independent franchise sales and disclosure regulatory enforcement guidelines, typically through a state's Attorney General's ("AG") office. These state statutes,

depending upon the state, independently allow state regulators a variety of remedies, including the ability to impose fines, obtain preliminary and permanent injunctive relief, including potentially barring a franchisor from conducting business within the state, along with providing relief for aggrieved parties, such as damages, restitution, or rescission. Some state violations are independently punishable as crimes. Since a state's regulatory authority generally operates independently from federal regulatory schemes, state law, and its requirements must be independently reviewed, and complied with, in addition to any federal requirements. State regulatory actions are also relatively rare.

Perhaps the most commonplace risk to franchisors for non-compliance with disclosure and sales regulations, presently comes from private actions. Under state law, franchisors may be directly civilly liable to franchisees, and franchisees may bring their own private actions in court directly against the franchisor. As discussed herein, many states have unfair trade practices and consumer protection acts (often called "Little FTC Acts"), which provide franchisees with private rights of action for violations of the federal FTC Act's Franchise Rule. Many of these state acts grant significantly augmented damages, including in some cases, multiples of damages, punitive damages, and attorney fee-shifting.

In addition to state Little FTC Acts, there are currently 13 states that have their own state-specific franchise registration or disclosure obligations that require a franchisor to register a FDD (or similar state document). Other states require some form of registration or notice, and many states have general Business Opportunity Laws, which apply to franchise transactions. Each of these state laws not only provide state regulators with enforcement powers, but many also often permit aggrieved parties to maintain private rights of action for disclosure violations (See, e.g., N.Y. GBL 691; CA Corp Code. 31300). Further, even where disclosure requirements don't give rise to a right of action, disclosure violations can lead to a greater risk of liability for common law claims, including fraud and misrepresentation, or even for violations of the implied covenant of good faith and fair dealing.

Importantly, some of these state statutes allow actions against not just the franchisor, but also impose individual liability on officers, directors, control persons, or principals of franchisors engaging in prohibited activity, including sales agents who were involved in the sale (See, e.g., NY GBL 681(13), 691(3); CA 31302). See also *Sea Tow Servs. Int'l, Inc. v. Tampa Bay Marine Recovery, Inc.*, 2022 U.S. Dist. LEXIS 181658, *38–39, ___ F.Supp.3d ___, 2022 WL 5122728 (U.S.D.C. E.D.N.Y. Sept. 30, 2022) (NY Franchise Sales Act can impose joint and severable liability directly upon the General Counsel and the President of a franchisor as "persons" covered under the act). Franchisors should engage knowledgeable counsel that are aware of these liability risks, and ensure compliance, as liability can reach not just the corporate entity, but also individuals in certain states.

Therefore, an FDD (with its many protective disclosures and disclaimers) is really a tool to protect a franchisor, and franchisors should take care to show that a prospective franchisee properly received a compliant FDD. In ensuring that an FDD is compliant, franchisors should be mindful of the potential need to update their disclosures, as both federal and state law often require franchisors to provide interim disclosures or amendments if circumstances have materially changed. "Material changes" to a franchised system's operations may be triggered by material changes to financial conditions, or a franchised business model. These issues have been brought to the forefront in recent years, as the COVID-19 pandemic (and related government shut-downs and re-openings) caused material changes in operations in many franchised systems. More recently, global

and regional disruptions in supply chains, the War in Ukraine, and the availability of energy, fuel, required goods and services (or lack thereof), all have the potential to cause material impacts upon disclosures, and how accurate they are. Conflict-related sanctions, like those imposed because of the War in Ukraine, may also significantly impact overseas operations, particularly for international franchise systems operating in, or relying upon, targeted regions. All this should be potentially "disclosed" as being caused by unusual external factors, or changes as a result of price swings, significant fuel costs or supply chain issues, and these changes can occur even in the middle of a disclosure cycle. Franchisors should also be mindful that external factors can also cause financial disclosures to be misleading, as significant changes in revenues, or closures of units and abnormal financial declines, or conversely, abnormal growth in a "rebound" following a steep decline, can be aberrations and unrepresentative without additional information. All these may all call for amendments (e.g., FTC Act; Item 8: Restrictions on Sources of Products and Services), and franchisors should be flexible and reasonable under the circumstances, and protectively provide augmented disclosures with the assistance of knowledgeable counsel. These types of adverse changes may require a franchisor to amend and redisclose the amendment to an FDD to prospective franchisees (or even recently disclosed franchisees), under federal law and state law (as applicable) and the failure to do so may result in a violation that could lead to substantial civil liability. Here, even where it may not be technically required, amended and up to date, disclosure certainly may be advisable to avoid litigation, and provide a full picture of a franchisor's operations and financial situation.

1.9 Are there any other requirements that must be met before a franchise may be offered or sold?

In addition to franchisors' obligations to comply with the aforementioned franchise disclosure and registration laws, there are other business and legal elements of franchising that the franchisor must address prior to engaging in franchise sales activities.

Trademark registration

As noted in the response to question 1.1 above, the definition of a franchise includes the franchisee's operation of its business under the franchisor's trademark. Therefore, franchisors should pursue the federal registration of all trademarks, service marks, trade names, logos, domain names, and other commercial symbols that will be used in connection with the franchise programme with the United States Patent and Trademark Office. Federal trademark registration confers many benefits on the Franchisor, including but without limitation: (i) protection against infringement in the federal courts; (ii) a presumption of the trademark's validity; (iii) a valuable, transferrable asset; (iv) notice to potential infringers of the Franchisor's ownership of the trademark; and (v) prevention of the registration of similar trademarks.

Assumed business name registration

Franchisors should register any assumed or fictitious business names under which they operate with the proper administrative agency, prior to offering and selling franchises, in order to protect their rights to use that particular assumed name.

Copyright protection

Under the 1976 Copyright Act (the "Copyright Act") (17 U.S.C. §§101 *et seq.*) copyright protection is available for "original works of authorship fixed in any tangible medium of expression". The Copyright Act broadly protects literary works, musical works,

dramatic works, pictorial, graphic and sculptural works, sound recordings, motion pictures and audio-visual works, and architectural works. These categories may be viewed broadly, but also carefully. For example, software code may be registerable even if it is not a “literary work” in the literal sense. On the other hand, a recipe consisting of a mere list of ingredients is not protectable under the Copyright Act. Tradenames, slogans, phrases and logos, all of which are crucial to the franchise model, are generally protected under trademark law but not under the Copyright Act. It is advisable for franchisors to pursue copyright protection where appropriate, because of the relatively low cost of registering copyrights, and the valuable rights provided under the Act, including, but without limitation, the right to pursue statutory damages and attorneys’ fees in federal court.

Advertising materials related to the sale of franchises

Certain registration states, including New York and California, require franchisors to file any materials that advertise the sale of franchises (e.g., brochures and websites) prior to the advertisement’s first publication in that state. New York State in particular requires the franchisor to receive approval from the New York State Attorney General’s Office prior to publishing the advertisement.

Registration of franchise brokers and sellers

Certain states require franchisors to register their franchise sellers with the appropriate regulatory agency before that person is permitted to sell franchises or multi-unit development rights in that state. In these states, franchisors must file a Franchise Seller Disclosure Form for each franchise seller, which includes the seller’s name, business address and phone number, his or her employer, title, five-year employment history and information about certain relevant litigation and bankruptcy matters. Two states (e.g., New York and Washington) require franchise brokers to file a separate registration form that provides the state with more detailed information about the broker. A Franchise Seller Disclosure Form and/or Franchise Broker Registration Form must be submitted with each initial registration application, annual renewal application and any post-amendments to a franchisor’s FDD.

1.10 Is membership of any national franchise association mandatory or commercially advisable?

No. While membership in a national franchise association is not mandatory, it is strongly advisable. Many franchisors, individual franchisees and businesses that service the franchising industry are members of the International Franchise Association (“IFA”), which is the largest and oldest global franchising organisation. The IFA provides its members with a wealth of valuable information (including, but not limited to, the latest legal developments affecting the franchising industry, networking platforms and franchise opportunity information) relating to the franchising industry. For information about the IFA, visit their website at: <https://www.franchise.org>. In addition to holding membership in the IFA, many franchisees and franchisee associations are members of the American Association of Franchisees and Dealers (“AAFD”). The AAFD has promulgated a code of Fair Franchising Standards, which sets forth the AAFD’s view of requirements for a more “level playing field” between franchisors and franchisees. Visit <https://www.aafd.org> for more information about the AAFD. Both the IFA and the AAFD engage in “lobbying” activities before Congress, with respect to matters such as the FTC Franchise Rule and other franchise-related legislative matters.

1.11 Does membership of a national franchise association impose any additional obligations on franchisors?

The IFA has a Code of Ethics that can be found at <https://www.franchise.org/mission-statement/vision/code-of-ethics>. While it does not have the force or effect of law, this Code of Ethics provides IFA’s members with a framework for the manner in which they are to act in their franchise relationships. As mentioned in question 1.10 above, the AAFD has promulgated its code of Fair Franchising Standards, which addresses relationships between franchisors and franchisees and regarding franchising, generally.

1.12 Is there a requirement for franchise documents or disclosure documents to be translated into the local language?

No. Federal and state law only require that the FDD be written in “plain English”.

2 Business Organisations Through Which a Franchised Business Can be Carried On

2.1 Are there any foreign investment laws that impose restrictions on non-nationals in respect of the ownership or control of a business in your jurisdiction?

Generally, there are no restrictions relating to foreign investment in a business in the United States. Such restrictions are contrary to the general approach to free trade. Typically, countries with developing markets are more likely to impose such “foreign investment” restrictions and regulations. However, the U.S. federal government imposes certain restrictions, including, for example, disclosure filing requirements and/or actual limits on foreign investment that may apply to certain highly regulated sectors and/or sensitive industries or businesses (e.g., communications and broadcasting), especially those which may have a potential impact on national security (e.g., banking, technology, weapons manufacture, maritime, aircraft, energy, etc.). As franchise opportunities in the United States do not typically involve these industries or businesses, it is not likely that franchisors will be affected by such restrictions.

2.2 What forms of business entity are typically used by franchisors?

As is frequently the case with other businesses, franchisors operating in the United States will typically utilise either a corporation or limited liability company (“LLC”) as their preferred form of business entity. While each of these entity types offers “limited liability” to its owners, choosing between the two will depend on the legal, financial and tax needs of the franchisor and its principals. If a franchisor chooses to use the corporate form of entity, typically a “C corporation” is used, as opposed to an “S corporation” which is most often used in connection with small, closely held businesses, such as those formed by franchisees. It is important to note that foreign investors are prohibited from being owners of S corporations. In a C corporation, income which is received by the company is taxed at the entity level. Then, the company’s profits are taxed (again), to the company’s shareholders when distributions are made. However, over the last 20 years many franchisors have chosen to use the LLC as their preferred type of business entity for their business

structure, rather than utilising a corporate structure. LLCs offer franchisors greater flexibility in certain areas, including with respect to internal governance requirements (e.g., fewer “corporate” formalities in management structure and activities, and fewer ownership restrictions), income allocation and the ability to transfer assets out of the entity. Since LLCs are usually treated as “pass through” entities for tax purposes, the entity’s profits are not taxed at the business level. Rather, the profits typically flow through to the company’s owners in proportion to their ownership percentage so that the owners pay taxes on this income as part of their taxable income. An LLC may, however, elect to be treated as a C corporation for tax purposes.

While foreign franchisors are permitted to sell directly to prospective franchisees located within the United States, foreign franchisors typically use one or more affiliate or subsidiary entities to conduct their U.S. operations. However, if a U.S. franchisor is a wholly-owned subsidiary of a foreign parent, then certain financial disclosures regarding the foreign parent also have to be included in the U.S. franchisor’s “offering prospectus” (the FDD) which must be given to all prospective franchisees. Usually, franchisors (including foreign franchisors) find it useful to utilise a tiered “corporate” structure comprising a holding company or “parent” company at the “top” and several subsidiary operating entities, “below” the holding company. (This “corporate” structure approach may be used for LLCs as well as corporations.) For example, one subsidiary may own the intellectual property rights (typically, trademarks or service marks) associated with the franchise system; another subsidiary might be the “franchisor entity” which would enter into the franchise agreement (and other agreements) with franchisees; another subsidiary might be a management company which would provide the various “franchisor services” to the franchisees; and yet another subsidiary could purchase, sell or lease equipment to franchised or company owned units. Typically, separate entities are also formed in order to hold title to each parcel of real estate that is owned by the franchisor or its affiliates. Where the franchisor subleases the various premises to its franchisees, the franchisor may choose to form separate entities to enter into each “master-lease” with the landlord rather than have one real estate “leasing entity”. This provides the franchisor (and its affiliates) with greater asset protection and additional flexibility in the event that it wanted to sell or transfer a particular parcel of real estate.

Many franchisors, including foreign franchisors, do not rely solely on selling single unit franchises. In international franchising, franchisors typically establish a franchise network by utilising either (or sometimes both) the master franchise (or sub-franchisor) method and/or the area development method. The more common approach in international franchising in the United States is the master franchise method, where the master franchisee is granted the right to either develop the assigned territory itself or to sub-franchise the territory to other franchisees, with the master franchisee usually taking on “franchisor” obligations (e.g., providing initial training and ongoing support and guidance) and typically receiving a significant share of the initial franchise fees and ongoing royalty payments paid by the franchisees within the territory. Alternatively, some franchisors, who wish to retain greater control over their franchise network and do not wish to share their initial franchise fees and ongoing royalty fees with a master franchisee, will grant territories to “area developers” who obligate themselves to develop their territory, but have no rights to offer sub-franchises to other franchisees. Since the U.S. is a large country with varying demographics and diverse cultures, franchisors often utilise a combination of the master franchise and area development franchise arrangements to expand their franchise network. Another option is for the franchisor to enter into a “joint venture” with an independent company, presumably, a joint venture partner located in the U.S. Such a partner may have significant experience in

operating franchises or the ability to provide significant financial resources to the franchise system, or perhaps both. However, the “joint venture” approach has not been frequently utilised by franchisors (including foreign franchisors) as they have potential disadvantages which include, among others: (i) the risk of ineffective management and/or disagreements with the partner; (ii) requiring a large investment; and (iii) the sharing of initial and ongoing fees, profits and other benefits.

Shifting away from franchisors for the moment, some franchise systems have franchisee associations (membership associations for franchisees that are independent from the franchisor). Franchisee associations offer a group of individual franchisees the ability to have a collective voice in their communications and interactions with the franchisor. Franchisee associations, like other entities, are formed and governed under state law, and are typically formed as “not for profit” corporations. This provides the entity with limited liability and ensures its compliance with the FTC’s Amended Franchise Rule’s requirement for inclusion in Item 20 of the franchisor’s FDD as an independent franchisee association.

2.3 Are there any registration requirements or other formalities applicable to a new business entity as a pre-condition to being able to trade in your jurisdiction?

In the United States, new business entities are formed under state law and their formation documents (e.g., for corporations: the Certificate of Incorporation; and for LLCs: the Articles of Organisation) are filed with the Secretary of State (or similar agency) in the state of formation. (In a small number of states, there are publication requirements for new business entities, most notably, in New York, with respect to LLCs, limited liability partnerships (“LLPs”) and limited partnerships (“LPs”).) Any new business entity formed in the United States is required to obtain a federal taxpayer identification number by filing Form SS-4 with the Internal Revenue Service. Pursuant to said form, a “responsible party” must be identified, who is required to be a natural person (and not another entity), who is the person that exercises ultimate effective control over the entity. If the new entity will be conducting business in multiple states, it will likely have to file an application in each state (other than the state of formation) in order to qualify to “do business”. In each state where the entity is authorised to “do business”, it must list a designated “registered agent” (who resides in the state, in the case of an individual; or which has a physical location in the state, in the case of a business entity), upon whom service of process (e.g., lawsuit documents) may be served.

New entities must also register as an employer with the department of labour of the formation state and must withhold proper amounts of certain taxes including, for example, income taxes and Federal Insurance Contribution Act (“FICA”) taxes (which include contributions to federal Social Security and Medicare programmes). A handful of states require the filing of initial reports and tax forms rather than waiting to file an annual report. Finally, entities which are involved in certain specific industries or types of businesses (e.g., education/school based, childcare based businesses, or businesses selling alcohol to the public) may have to obtain one or more licences or permits in order to comply with state or local laws.

3 Competition Law

3.1 Provide an overview of the competition laws that apply to the offer and sale of franchises.

In the United States the concept of “competition law” is generally referred to as “antitrust law”. In contrast to other jurisdictions like the European Union, “antitrust” laws do not directly

regulate the offer and sale of franchises. The offer and sale of franchises are governed by the FTC Franchise Rule (16 C.F.R. 436 *et seq.*) and certain state statutes (e.g., N.Y. G.B.L. § 680 *et seq.*; CA Corp. Code §31000 *et seq.*). These State and Federal statutes directly regulate the required disclosures and sales practices with respect to the offer and sale of franchises (*see* Section 1 *supra*) and are not considered “antitrust” or “competition” laws. There may be circumstances where an offer or sale of a franchise constitutes an “unfair” or “deceptive” act or practice, under either federal law or an analogous state law. The FTC is responsible for consumer protection enforcement for over 70 different laws, including the FTC Act, which contains a broad prohibition against “unfair and deceptive acts or practices”. *See*, e.g., §15 U.S.C. 45. In addition, many states have also enacted similar statutory schemes prohibiting unfair or deceptive trade practices (sometimes called “Little FTC Acts”), many of which provide for a private right of action. However, these are not generally considered “competition” laws.

Nonetheless, in the U.S., “anti-trust” laws exist, which are analogous to “anticompetition” laws in the E.U., and they can impact the franchise relationship (even if franchise laws are not considered antitrust laws in and of themselves). At the federal level, the major antitrust statutes that may apply to franchising are the Sherman Act, (15 U.S.C. §1 *et seq.* generally prohibiting anti-competitive or monopolistic conduct) and the Robinson-Patman Act (at 15 U.S.C. §13 generally prohibiting anti-competitive price discrimination, exclusive dealing, and tying) which the Antitrust Division of the U.S. Dept. of Justice (“DOJ”) and the FTC cooperate to enforce, as well as the Clayton Antitrust Act (15 U.S.C. §§12 *et seq.*) that authorises private rights of action. At the state level, nearly all states have enacted anti-trust laws, which are usually based upon, but may differ from, the federal antitrust statutes and usually look to federal law for guidance. As a result, practitioners need to examine both the federal and state laws in the applicable jurisdiction, particularly where an issue concerning potentially monopolistic conduct, or price-determination, exclusive dealing, or tying is involved.

Fortunately for franchisors, many state and federal courts have significantly limited the applicability of antitrust laws in the franchise context, recognising that franchising is generally a specialised industry, and one where mandated disclosure provided some level of protection to the public. Antitrust claims declined in the last two decades after court decisions curtailed the applicability of antitrust laws in the franchise context by narrowly restricting the definition of the applicable “market” for antitrust analysis in ways that effectively exclude franchise relationships and franchise related claims such as price-fixing (like franchisee complaints where franchisors set maximum or minimum prices), exclusive dealing requirements (like requiring franchisees to deal only with particular designated vendors or suppliers), or tying (like requiring franchisees to purchase products or services not directly related to the trademarked franchised product or service). Additionally, courts now generally employ the “rule of reason” test (if it results in an unreasonable restraint of trade concerning competitors, based upon economic factors) in circumstances that would once have been *per se* violations of antitrust laws. As such, in most franchise circumstances, a franchise agreement that clearly provides for (and an FDD that adequately discloses) contractual requirements to purchase certain goods or services, restraints on a franchisee’s ability to freely conduct business, or requirements that franchisees deal only with specific vendors, will defeat most antitrust claims. It currently remains the case that franchisors who comply with all applicable disclosure requirements, and properly detail any potentially anti-competitive aspects of the franchise relationship within the FDD (like specific suppliers that must be used), can significantly lessen any potential liability for antitrust issues with their franchisees in the context of the offer or sale of the franchise.

However, more recently there has been increased regulation and activity as federal regulators scrutinise “no-poach” provisions (*see* Section 3.6 *infra*), and now may be interested in regulating post-term restrictive covenants in franchise agreements generally. Additionally, several legislative initiatives could dramatically alter the antitrust landscape, including franchising. If one or more of the proposed federal bills aimed at competition and antitrust law enforcement reform pass, not only will that potentially provide additional funding for increased enforcement and regulatory resources (including the FTC and DOJ), but also potentially alter some of the factors considered by courts and add legislation to curb “exclusionary conduct” by “dominant companies”.

Simultaneously, State Attorneys General are also aggressively reviewing “anti-poach” provisions, and other post-term restrictive covenants, and state-specific antitrust legislative action could impact franchises. If such prospective legislation is not carefully crafted, or does not contain sufficient carve-outs for franchising, it could upset traditionally permitted contractual terms, including: (1) restrictive covenants and other employee restrictions, which arguably are actually protective of franchisees in many ways; (2) permissible and disclosed price setting; and (3) tying and the required use of approved vendors or suppliers, which is often necessary to maintain franchise system standards, or create uniformity in a franchise system.

The uncertainty regarding what type of legislation may pass makes it difficult to predict how franchised system models will be impacted. And, if consideration of the benefits of franchising are stripped from a court’s analysis, any prospective legislation could have a disproportionate impact on franchised businesses.

3.2 Is there a maximum permitted term for a franchise agreement?

There is no federal regulation of the maximum permitted term for a franchise agreement; however, some states may be reluctant to enforce franchise agreements without a limited term. Some states may limit franchise agreements without a specified duration, or automatic renewal agreements that continue in perpetuity, for example, an agreement that renews automatically every 10 years without any limit. Other states may require a franchisor to automatically renew a franchise agreement, regardless of the stated term in the agreement, so long as a franchisee is in substantial compliance with the franchise agreement.

3.3 Is there a maximum permitted term for any related product supply agreement?

As noted above, there is no antitrust federal statutory restriction but there are some states that may be hostile to enforcing agreements without any stated term. The FDD must adequately disclose, and the franchise agreement must clearly provide for any required related product supply agreements. In addition, there may be circumstances where, for example, a supply agreement becomes so onerous that it may excuse performance, violate a state statute, or give rise to a claim, so that its enforcement becomes unreasonable, for example, the New Jersey Franchise Practices Act, makes it unlawful “to impose unreasonable standards of performance upon a franchisee”. *See* NJ Stat. §56:10-7(e).

3.4 Are there restrictions on the ability of the franchisor to impose minimum resale prices?

Federal antitrust law prohibits a minimum resale price (“MRP”) if the MRP causes an adverse effect on inter-brand competition

under a “rule of reason” test – if it results in an unreasonable restraint of trade concerning competitors, based upon economic factors. The “rule of reason” test is relatively permissive and, therefore, under federal law, courts have been reluctant to find violations where there is an economic justification, resulting in most cases being dismissed. However, some state statutes differ from the federal standard and prohibit the use of MRPs and may consider MRPs to be *per se* unreasonable restraints of trade.

In addition, while not an “antitrust” issue, MRPs may give rise to other claims by franchisees, such as common law claims for violation of the implied covenant of “good faith and fair dealing”, or prohibitions against imposing “unreasonable standards of performance” upon franchisees. *See* NJ Stat. §56:10-7(e). Federally, the Robinson-Patman Act can impact a franchisor’s ability to set pricing, causing a franchisor to be wary of differentiating between certain franchisees, or groups of franchisees, in its pricing of required goods or services, as favouritism to certain franchisees. *See* 15 U.S.C. §13 (anti-competitive price discrimination).

3.5 Encroachment – are there any minimum obligations that a franchisor must observe when offering franchises in adjoining territories?

Federal antitrust laws do not require a franchisor to observe any minimum obligations when offering franchises in adjoining territories (or when a franchisor itself operates in an adjoining territory). The antitrust laws will not consider the applicable “market” for antitrust analysis to be competing franchise locations, but the market for franchises more generally when the franchisee purchased the franchise. And under federal antitrust laws’ “rule of reason” analysis there will generally be sufficient justification for “territory” competition to avoid liability. Nonetheless, anti-competitive misconduct on the part of a franchisor that impacts inter-brand competitors could still result in liability under federal law and more restrictive state antitrust statutes may also impose liability for anti-competitive conduct.

The FTC Franchise Rule mandates that an FDD includes a detailed disclosure of the rights conferred in any territorial grant, but there are no mandated obligations. Although there is no specific federal minimum obligation with respect to the territorial rights of franchisees, encroachment or the unfair allocation of territories could lead to liability outside of antitrust law (discussed *infra*), as for violation of the implied covenant of “good faith and fair dealing” and some state franchising statutes may restrict or prohibit unfair encroachment activity.

The provisions in the franchise agreement (and the disclosures in the FDD) that address and define the franchisor’s right to sell franchises (or operate so-called “company owned” units) in a franchisee’s “protected territory” must be crafted with great care not merely considering geographical limits, but also to the applicable “market” of customers to which a franchisee will be selling its goods and services. Encroachment issues also encompass non-traditional methods of providing products and services that may compete with a franchisee, like through e-commerce, or the use of non-traditional sales-points, including food trucks, kiosks, or promotional activity within a territory of a franchisee.

3.6 Are in-term and post-term non-compete and non-solicitation of customers covenants enforceable?

Under federal antitrust law, in-term and post-term non-compete clauses (with respect to franchisees) and non-solicitation of customer provisions are generally enforceable. However, the FTC and federal regulators have shown increased interest in potentially regulating post-term restrictive covenants within franchise

agreements, are actively soliciting comment on the issue of restrictive covenants, and “no poach” provisions, and it remains to be seen if significant regulation may be forthcoming in the near future. The FTC has shown particular concern with in-term and post-term non-compete covenants “no-poach” agreements, which are non-compete clauses that apply to a franchisee’s employees, generally prohibiting one franchisee’s employees from being “recruited” to be employed by another franchisee. There are legislative efforts at both the federal and state levels to pass laws prohibiting restraints upon employment and poaching.

In April 2023, the FTC closed a comments period for a proposed rule, *inter alia*, banning non-compete clauses that would prevent employers from entering into non-compete clauses with their workers, require employers to rescind their existing non-compete provisions, and actively inform their employees that they were no longer bound by such provisions. The FTC’s proposed § 910.1(f) does not include the franchisor-franchisee relationship (since the franchisee is not an employee) but includes workers employed by the franchisee or franchisor, and non-compete clauses between franchisors and franchisees would remain subject to federal antitrust law (as well as all other applicable law). These laws include state laws that apply to non-compete clauses in the franchise context. As a potential window into the FTC’s thinking, the FTC sought comment on whether non-compete clauses between franchisors and franchisees should be included in the rule and why, and specifically cited matters involving franchises, including 7-Eleven’s acquisition of Speedway that violated federal antitrust laws with an order prohibiting 7-Eleven from “enforcing any non-compete clauses against any franchisees or employees working at or doing business with the divested assets”, and another franchise case where the FTC issued a final consent order in which a company and its subsidiary “agreed to roll back a sweeping non-compete clause they imposed on a company to which they sold 60 gas stations”. REGULATIONS.GOV, <https://www.regulations.gov/document/FTC-2023-0007-0001> (last visited July 10, 2023).

More broadly, in July 2021, the Biden Administration issued an Executive Order “Promoting Competition in the American Economy”, which, *inter alia*, targeted employment restrictive covenants, including anti-poaching clauses. And, prior to the Executive Order, in April 2018, the DOJ issued a policy update specifically warning the public of its intent to aggressively enforce antitrust laws in relation to labour markets and “no-poach” provisions and has been engaged in that activity under the Biden Administration. The DOJ is clearly engaged in increased resource allocation and scrutiny, as well as a policy shift as to the applicable legal standard (advocating for no-poach provisions to be considered “*per se*” violations as opposed to being analysed under a “rule of reason” analysis).

At present, the enforceability of these contract terms still depends largely on state law. Some states may prohibit or severely restrict post-termination non-competition clauses. In states that restrict non-solicitation and non-compete clauses, enforceability often depends on the reasonableness of the restriction, including factors like the scope of business activity being restricted, the duration of the restriction, whether it is necessary to protect legitimate business interests, whether the restriction is contrary to the public interest, and whether it is reasonable in geographic scope. And many states do not allow their non-competition statutory provisions to be waived regardless of what a “choice of law” clause may state in an agreement.

State statutes and state regulators vary in their approaches to this issue. More aggressive state regulators have been prosecuting cases under state law arguing a “*per se*” rule should be applied, independent of the federal anti-competition laws. Further, several states’ AG’s Offices have aggressively pursued

state “no-poach” regulations under state anti-trust laws (notably CA under its Cartwright Act, and WA under its Consumer Protection Act), also generally seeking to take a “*per se*” violation approach. Indeed, there is a decided momentum to void such restrictive covenants. For example, in May 2023, Minnesota enacted amendments to its law to prohibit and void employment restrictive covenants in the franchise context, and requires all prior agreements to be voided and notice be provided to all franchisees that such provisions are no longer effective (“no franchisor may restrict, restrain, or prohibit in any way a franchisee from soliciting or hiring an employee of a franchisee of the same franchisor...[or] an employee of the franchisor”) (See MN Stat. 181.99).

Most cases will depend on whether restraints are deemed to be “vertical” or “horizontal” and the standard utilised by the court. Within the context of franchises, “vertical” agreements are imposed by franchisors on franchisees to prohibit them from hiring employees of another franchisee within the system, while “horizontal” agreements are between franchisors within a single industry. “Horizontal” agreements are clearly violative of federal and state law and may even impose criminal penalties. A case is likely to turn upon whether under the circumstances, precedent, or statute involved, a strict “*per se*” standard, a “rule of reason” standard, or a “quick look” (a truncated “rule of reason” test) is used.

Previously, the use of broad restrictive covenants was relatively commonplace in franchise agreements. However, now, with the increased scrutiny of regulators, and more regulation potentially on the horizon, franchisors are well-advised to ask whether such clauses are necessary to protect their system. Many franchisors have decided that such restrictive covenants are not worth the risk. Franchisors should examine whether their systems really need to have such protections, whether they are justified, and consult with knowledgeable counsel prior to their inclusion in a standard franchise agreement.

4 Protecting the Brand and Other Intellectual Property

4.1 How are trade marks protected?

At the international level, the United States is a party to the Paris Convention and Madrid Protocol (administered by the World Intellectual Property Organization (“WIPO”)), which allow a trademark to be registered internationally with member nations through a uniform process (an “International Application”). Generally, under the Madrid Protocol, a trademark must first be registered and approved “locally” in a member nation (the “Office of Origin”), and then submitted to the WIPO for international approval and registration (within 12 or 18 months). Once approved at the WIPO level, the mark may be submitted to the other member nations in which the mark holder seeks to obtain trademark protection. When an international mark holder seeks approval of an international trademark within the U.S. through the Madrid Protocol (often called a “Madrid application” or “Section 66(a) Application”), the application is submitted to the United States Patent and Trademark Office (“USPTO”). The application will then be examined by the USPTO, in the same manner, and subject to the same standards, as a mark seeking approval within the U.S., and must be approved by the USPTO before it is allowed to be registered within the U.S. Notably, the WIPO also provides for ADR through its WIPO “Arbitration and Mediation Center”, and franchisors are well-advised to consider that forum for dispute resolution, should a dispute arise.

At the federal level, the USPTO is the agency responsible for registering trademarks. Unique logos or designs, including “trade dress” that a franchisor wishes to use in connection with their mark can, and should, also be registered with the USPTO. The USPTO will initially determine if the application has met the minimum filing requirements. If it has, then the USPTO will assign an examining attorney to review the application and determine if any conflicting marks or other defects in the application prevent the application from being granted (this review by the examining attorney generally takes several months). If an issue with the application arises, and the examining attorney decides the mark should not be registered, the USPTO will issue a letter explaining the reason for refusal or deficiency (an “Office Action”), and the applicant must respond (a “Response to an Office Action”) within six months, or the mark will be deemed to have been “abandoned”. If the examining attorney approves the mark, or the application overcomes an Office Action, the USPTO will “publish” the mark in the USPTO’s weekly “*Official Gazette*”, and anyone wishing to challenge it will have 30 days from the date of publication to do so. Any objection will be heard by an administrative tribunal within the USPTO called the Trademark Trial and Appeal Board (“TTAB”). If an application is refused by the examining attorney, or fails to overcome any objections, there is an appeals process to the TTAB. If no objection is filed, or none are successful, the registration process (which differs slightly if the mark is currently “in use” or not) then continues to formal “registration”, which can take several more months. If the mark is not actively “in use”, the registrant must, after receiving a “notice of allowance”, use the mark in commerce and submit a “Statement of Use” to the USPTO (or request an extension). Franchisors should take care to avoid having another party cancel, and even acquire, the mark they wanted to use. Further, the issue of what constitutes “use” or “use in commerce”, for foreign trademark holders to qualify for protection, can be particularly tricky to navigate, and mere “spillover” of international business operations into the U.S., or occasional use, may not be sufficiently protective, if a properly registered mark is not being used actively in U.S.-based Operations (within the U.S.). After a federal trademark is registered, the registrant must, periodically, take steps to renew the mark, and file “maintenance” documents, or risk cancellation. Significantly, a “declaration of use” must be filed between five and six years after registration, and a renewal application must be filed 10 years after registration, and every 10 years thereafter (internationally filed marks under the Madrid Protocol follow a slightly different process). Specific acts or affirmative steps may need to be undertaken by an internationally-based franchisor to further protect that mark (such as to affirmatively utilise a U.S.-based agent to promote or provide services connected with a mark). Knowledgeable counsel should be consulted if this is a significant risk.

Recently, the Trademark Modernization Act (“TMA”) expedited and simplified the process for removal of unused (or abandoned) trademarks, even by *ex parte* practice (both for expungement, and for re-examination). The TMA further codified the “letter of protest practice” whereby interested third parties could challenge a registration, making it easier to challenge an unused mark. The TMA also expedites the registration process (e.g., by shortening the response period for office actions (effective since December 27, 2021). With the passage of the TMA, mark holders must remember to be vigilant, as the process for removal or expungement of an “unused” mark, has been simplified, and even well-intending franchisors who have suffered a delay in implementation of a new mark or system (e.g., due to COVID-19 or supply chain-related issues), may need to take steps to ensure timely “use” of their mark.

At the state level, individual states also have their own trademark registration offices (with their own registration process) that register trademarks within their individual states, which is better than no registration at all or relying on common law trademark rights (discussed *infra*) but inferior to federal registration that would protect their marks throughout the United States.

In the U.S., unlike in many jurisdictions, a party can also establish and acquire “common law” trademark rights through the usage of a mark in commerce. Common law rights to a mark may be superior to another party’s attempt to subsequently register the same or a similar mark, especially if the common law mark is in use before the other party files for registration, and the holder of the common law mark objects properly. However, common law rights are not well defined and are often limited by geographic scope and specific industries or markets. Indeed, recent decisions, as well as established jurisprudence, tend to significantly limit such common law marks to the specific geographic market in which they are known or “famous” – meaning that reliance on a common law mark may limit the first-in-time mark holder to a small geographic territory (such as a city), while a later, federal USPTO registrant, may have the rest of the country to operate in.

Therefore, while trademarks do not have to be registered to obtain “common law” rights, franchisors are well advised to proceed with, and complete, the federal trademark registration process with the USPTO (outlined above), as a federally registered trademark acts as a “notice to the public” of the franchisor’s claim on the mark and creates a legal presumption of nationwide ownership and the exclusive right to use the mark (in connection with the goods or services in the registration). Additionally, federal law grants significant legal remedies for federally registered marks (including, under certain circumstances, injunctive relief, treble damages and attorneys’ fees). Further, once registered, the federal mark holder has a presumptive argument that it was “first in time” as of its registration (since all objections will either have been rejected or deemed untimely). After federal trademark protection is granted, an adverse “common law” mark holder will be extremely unlikely to overcome the protection of the federal registration and the TMA resolved an unsettled trademark issue caused by the U.S. Supreme Court decision *eBay Inc. v. MercExchange*. 547 U.S. 388 (2006), by codifying that mark holders have been presumptively irreparably harmed by a violation, removing a significant barrier to obtaining an injunction. Trademark infringement actions can also be brought to address online violations, including unauthorised usage of a trademark in a domain name (or “cybersquatting”), by initiating actions under the Lanham Act (as amended by the Anti-Cybersquatting Piracy Act), or initiating an arbitration proceeding to seize the offending domain under the Internet Corporation for Assigned Names and Numbers (“ICANN”) Uniform Domain-Name Dispute-Resolution Policy (“UDRP”) procedure, or, if applicable, ICANN’s newly adopted Uniform Rapid Suspension (“URS”) domain name suspension procedure for “top down” domain names.

However, trademark holders in the U.S. are cautioned that they are generally required to “police” their marks, by actively monitoring the market in order to discover infringement, and then taking action against infringers so as to protect the mark. A franchisor who fails to take timely action against infringers may lose its right to obtain any relief (due to, *inter alia*, affirmative defences of laches, acquiescence or waiver, a finding of abandonment, or where usage of the mark by others causes the mark to lose its distinctive significance). Once it has been established that a franchisor has not properly policed its mark in one instance, subsequent attempts to enforce a mark may become much more difficult, or impossible.

Unfortunately, a franchisor must also constantly “police” its mark and brand reputation, not just to protect against infringement, but also to ensure that consumers see it in a positive light. The franchisor must remain apprised of online and social media commentary on the mark, and aggressively work with its franchisees to address negative comments and adverse online postings. The U.S. is culturally diverse, and regional and political differences vary significantly from market to market. It may be necessary for a franchisor to be flexible in its political positioning (or neutrality) to facilitate operations for individual franchisee’s local political environments, and Franchisors may need to tailor their approach on a regional level to avoid negative impacts upon brand image based on region. Franchisors must stay ahead of any potentially concerning situation with effective PR, so the brand can protect its marks from any negative social media, and such services are often relatively inexpensive compared to the potential costs of failing to properly handle a PR issue. Even smaller franchisors should have contingency plans and systems for addressing PR problems in place, so they will be able to identify any threat, respond properly, and recognise that regional differences may necessitate a nuanced approach. The ability for any negative situation to rapidly reach large segments of the population through non-traditional media, means that franchisors must be able to maintain a presence on a wide variety of social media platforms, and be prepared to react swiftly and adeptly to threats as they manifest.

4.2 Are know-how, trade secrets and other business-critical confidential information (e.g. the Operations Manual) protected by local law?

Confidential information, which can include know-how, trade secrets, and other business-critical information, may be protected by federal and state statutes, as well as common law.

At the federal level, the Defend Trade Secrets Act of 2016, 18 U.S.C. §1831 *et seq.* (the “DTSA”) provides a private civil right of action for theft or misappropriation of trade secrets (which may be brought in federal court), under which an aggrieved party can seek damages, and in instances of wilful and malicious violation, double damages and attorneys’ fees. To utilise the DTSA, a party must have provided “notice” (under 18 U.S.C. §1833(b)(3)) to any person it wishes to prohibit from disclosing the trade secret(s), including employees, agents, or franchisees. Therefore franchisors (and franchisees) should incorporate into their agreements, policy manuals, confidentiality agreements, and other confidentiality provisions, such “notice”. Additionally, the DTSA, provides for injunctive relief, including an *ex parte* expedited seizure of the trade secret under certain circumstances. See 18 U.S.C. §1836. Importantly for foreign parties (or in connection with agreements with foreign parties), the DTSA also may provide for extra-jurisdictional liability (reaching violators outside of the U.S.). See 18 U.S.C. §1837. Franchisors may use this legislation to restrain former franchisees from misappropriating trade secrets, and to protect the franchisor’s intellectual property. See, e.g., *Panera, LLC v. Nettles and Papa John’s Int’l, Inc.*, 4:16-cv-1181-JAR, 2016 WL 4124144 (E.D. Mo. 2016) (franchisor successfully obtained a temporary restraining order against a former employee to prevent dissemination of trade secrets under the DTSA); *Bambu Franchising v. Nguyen*, 5:21-cv-00512-EJD, 2021 US Dist. LEXIS 88030 (ND Cal May 7, 2021) (franchisor granted injunctive relief for, *inter alia*, violation of the DTSA). However, simply stating in a franchise agreement that something is a trade secret does not make it one and courts will examine carefully whether a franchisor has taken reasonable measures to keep an

alleged trade secret “confidential”, and whether the information really is a trade secret not readily ascertainable through independent means, or available as general knowledge in the industry. *See, e.g., Oakwood Labs. LLC v. Thanoo*, 999 F.3d 892 (3d Cir. 2021). However, overly protective contractual draftsmanship may lead to definitions of a “trade secret” or “confidential information” within a FA that exceeds what is actually protectable under the DTSA. And franchisors should be aware that contractual breaches for what constitutes protected information, does not necessarily equate to statutory violations of the DTSA, and they should only bring suit under the DTSA statute when there is a viable claim. Therefore, while utilising the DTSA may protect franchisors against former franchisees absconding with secrets, it may also harm franchisors by inadvertently having a court declare that its intellectual property is not sufficiently protected as a “trade secret” (which could have system-wide implications).

At the state level, almost every state (New York being a notable exception) has adopted some form of the Uniform Trade Secret Act (“UTSA”). Additionally, each state (including New York) has its own common law trade secret protection operating in tandem with the federal level protections. While there is variation between states, typically, a party must show that information it seeks to protect is “secret”, not in the public sphere or known by others. Furthermore, a party must also demonstrate that it has undertaken significant efforts to maintain the secrecy of its trade secrets to be afforded common law or statutory protection.

To protect themselves from the acts of franchisees, franchisors should implement policies and procedures designed to protect against the dissemination of confidential information. From the start of a relationship with a potential franchisee, franchisors should be wary in their sales processes (e.g., Zoom calls or even “discovery days”) to adequately define the line between a pitch to prospective franchisees, and inadvertently disclosing intellectual property that they want to protect, as prospective franchisees are generally not bound by NDAs, and such conduct by a franchisor will likely result in the information being unprotected. *See, e.g., Smash Franchise Partners, LLC v. Kanda Holdings, Inc.*, 2020 Del. Ch. LEXIS 263, No. 2020-0302-JTL (Ch August 13, 2020) (information was freely shared with prospective franchisees, including on phone calls with prospective franchisees, in pitch-decks, in group calls (without security measures or non-disclosure agreements (“NDAs”)) and in the FDD, and therefore was not protectable as a “trade secret”, and was not properly protected as “confidential” information by the franchisor). Where applicable, franchisors should require franchisees to agree to non-disclosure agreements and should include strong and inclusive confidentiality provisions in their franchise agreements. Further, franchisors should mandate that their franchisees require that their own respective agents or employees agree to confidentiality prior to disseminating any of the franchisor’s trade secrets.

Courts will generally enforce confidentiality agreements and grant injunctive relief in appropriate circumstances to prevent the theft or misuse of confidential information. Well-crafted franchise agreements will often include injunctive relief provisions designed to facilitate the protection of confidential information in court. New or prospective franchisors should be extremely mindful of confidentiality issues before discussing their “new concept”, their “secret sauce”, or other intellectual property with anyone (including potential investors or prospective business partners). Non-disclosure agreements should be entered into prior to having discussions in which a prospective franchisor has disclosed a trade secret or idea that is unique and worth protecting. In addition, a well-crafted franchise agreement will ensure any “inventions” by a franchisee belong to the franchisor. This may be a trap for the unwary in some states, as for example, in New York, franchisors may not require execution of an NDA prior to providing a

prospective franchisee with an approved and registered prospectus (*See* NY GBL 693(8) (no “other agreement” concerning the franchise may be entered into prior to disclosure and a 10 business-day period). While each situation is different, it may be the prudent course of action to avoid any disclosure of truly confidential information prior to execution of a FA.

Franchisors often employ restrictive covenants within their franchise agreements to prevent a former franchisee (after termination or execution of the franchise agreement) or any person who had access to confidential information or trade secrets from subsequently competing with the franchise (e.g., working for a competitor). However, restrictive covenants may not be enforceable, or the extent of enforceability may be limited. Some states will find them void or unenforceable as a matter of law, and many will not enforce them unless they are truly necessary to protect IP or a brand, and the person(s) being restrained have been adequately compensated. Recently, federal and state regulators have been “cracking down” on over-reaching franchisor’s post-employment restrictive covenants as violating anti-competition laws or restraints of trade. Therefore, franchisors should be cautious when relying upon restrictive covenants to protect their IP.

Publications by the franchisor, including operations manuals and policy and procedure manuals, may also be protected by federal copyright law (discussed below). In addition, a franchisor might consider applying for a federal patent with the USPTO if a franchisor has a unique invention or product, process, or design. However, confidential trade secrets can be kept in perpetuity, while patents expire. Further, in applying for a patent, a company risks publication of its intellectual property, as patents are public; and, if a patent application is rejected, it is typically publicly available within 18 months. Therefore, it may be better to protect certain IP as a “trade secret”, depending upon the nature of the IP. If an operations manual or other publication is to contain “trade secrets”, franchisors are well advised to so state on the document itself and require their franchisees to take steps to guard it (and its employees), such as insisting that only certain of the franchisees’ employees have access to it, and that each franchisee maintains it in a secure place with limited access to others.

Furthermore, franchisors should consider utilising other security measures, including password-protected computer systems, to maintain the “confidentiality” of information (such as client or customer lists and information) that the franchisor may wish to keep “confidential”.

Franchisors should also be vigilant after termination of a franchise and ensure that not only physical (paper) manuals and trade secrets are returned or destroyed, but also all online access to trade secrets or confidential information is terminated. *See, e.g., Neighborhood Networks Publishing, Inc. v. Lyles*, 19-cv-89-BO (EDNC January 31, 2021) (franchisor failed to take reasonable steps to protect trade secrets by continuing to allow terminated franchisee access to web-portal months after termination, making misappropriation claim unviable).

Additionally, as artificial intelligence continues to develop and be utilised by different actors in different ways, franchisors need to take steps to protect their intellectual property and themselves from infringing on others’ IP. First, franchisors need to be vigilant about the dissemination of their protected materials and remain aware of the various ways in which it might be used both to train AI and to create new content that may infringe on their rights. Second, in using AI themselves (as in creating marketing campaigns), franchisors must be sure to review all materials produced before dissemination to ensure that they are not infringing on another company’s protected IP, or as discussed herein, ensure that they are not generating erroneous, improper, or potentially damaging content. Human involvement is necessary in both situations.

Finally, as discussed *supra*, the reputation associated with a brand must be protected from (increasingly all-too-common) online assaults. Franchisors must not only remain vigilant in protecting their trademark or intellectual property from being stolen or usurped, but also from unfairly disparaging commentary or defamatory material on online social media, third-party product or service reviews, or other online commentary or postings. Traditional common law defamation, based upon the relevant state law, may be utilised when false claims are made concerning a brand or service. In addition, the Lanham Act may also be utilised to protect a federal trademark from statements that might be misleading to consumers, even if such statements are not literally false (which may open the door to bringing claims under the Lanham Act to protect a mark from statements that might not be literally false, but which may be misleading).

Furthermore, the FTC Act may allow a franchisor to seek assistance from the FTC due to a third-party utilising “unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce...”. 15 U.S.C. §45(a)(1). States’ “Little FTC Acts” may also apply, including what are often called unfair and deceptive trade practices acts allowing a franchisor to bring an action to protect its branding from unfair online competition or commentary. Finally, most online service providers have terms of service that prohibit defamatory or unfairly disparaging speech. Often, it may be sufficient (and cost effective) to directly contact a service provider and attempt to have the offending material removed under the terms of service, at least in the first instance, rather than resort to litigation. However, prior to bringing any action, a franchisor should be mindful that the U.S. has particularly strong public policy rights associated with freedom of speech. The franchisor should consider whether the potentially offending content is protected opinion, or otherwise qualifies for protection as free speech. There are implications (such as “Anti-SLAPP” statutes) that may punish overly litigious franchisors who bring lawsuits that improperly infringe upon someone’s right to freedom of speech. If a franchisor wishes to engage in litigation to address potentially defamatory misconduct, it is highly recommended that knowledgeable counsel be retained, as ill-advised litigation can backfire.

4.3 Is copyright (in the Operations Manual or in proprietary software developed by the franchisor and licensed to the franchisee under the franchise agreement) protected by local law?

As detailed above, the United States is a signatory to many treaties and conventions concerning copyrights, including those overseen by the WIPO. Within the U.S., federal law protects both registered and unregistered copyrighted material. Furthermore, common law rights and statutory rights conferred by states, such as claims for misappropriation or unfair competition, may overlap with copyright law to protect information within publications. Nonetheless, there are exceptions to copyright (such as “Fair Usage”), and a franchisor should carefully consider which exceptions it may encounter before it seeks to protect its copyright through litigation.

A wide variety of publications and media, including operations manuals, websites and online content, social media pages and content, advertisements, menus, or computer programs may be protectable by copyright. In distributing such materials, franchisors should be careful to draft clear agreements covering employees, agents or vendors that designate “work for hire” copyright ownership to the franchisor for materials that are created for the franchisor to ensure that it does not inadvertently grant “ownership” of expensive, custom resources to outside parties.

The culture of the U.S. tilts decidedly towards protecting intellectual property rights and punishing those who would misappropriate or engage in unauthorised usage or plagiarism of another’s intellectual property. For example, the Federal Digital Millennium Copyright Act (“DMCA”) also provides a mechanism whereby copyright holders can directly notify third-party online service providers that an infringement is occurring (like a user posting a confidential portion of an operations manual) and ask that the provider remove or disable access to the infringing material. Most third-party internet service providers also have terms of service that prohibit infringement and will remove offending material on that basis once notified of unauthorised use of copyrighted material. And federal law often provides for the assessment of additional damages, including exemplary (sometimes treble) damages, and attorney fees, against those who violate the law through unauthorised usage or plagiarism. Many of these protections are now in tension with the greatly accelerated usage of AI to cull available information, process it, and generate similar content. While material and content may be available online, and therefore available for AI to emulate and process, the legality of then utilising copyrighted or protected content to generate output is murky at best. Courts will need to adapt to this emerging technology, and the legal landscape here is likely to develop and change rapidly in the coming years. Franchisors should think twice about allowing public or online access to copyrighted or protected work if they fear emulation through AI usage by competitors.

In addition, generic and commonly known information may not be protectable. Copyrighted materials that courts may characterise as basic, common, and generic, including those in “confidential” proprietary franchise operation manuals, even if copied verbatim, may not necessarily qualify for protection. *See, e.g., Civility Experts Worldwide v. Molly Manners, LLC*, 15-cv-0521-WJM-MJW, 2016 WL 865689 (D. Colo. 2016). Practically, even if a copyrighted work is protected, a franchisor must be prepared to explain to a court how its unauthorised use truly harms the franchisor. Franchisors must diligently police any information that they want to protect as confidential or as trade secrets, regardless of what is set forth in its contracts, or what statutory remedies may or may not apply. Therefore, it is not prudent for a franchisor to rely upon statutory protection alone to protect its IP and should have clear and enforceable provisions within its franchise agreements protecting the IP and declaring it a material breach for any failure to do so (in addition to any regulatory or statutory protections). Such provisions should make it clear that any IP or manuals are the property of the franchisor and are only being *temporarily* licensed. Furthermore, the dispute resolution provisions should provide a “carve out” for a franchisor to go to court to obtain injunctive or other relief to protect its IP. And, upon termination of a franchise, a franchisor should require destruction or return of any and all property and IP that a franchisor wishes to protect, so at the minimum, breach of contract may be employed in addition to statutory or other rights. In these matters, it is essential to act quickly, and a well-timed “cease and desist” letter may not only serve to avoid litigation, but also evince to a court that a franchisor is taking its rights seriously, and diligently acting to protect its intellectual property.

5 Liability

5.1 What remedies can be enforced against a franchisor for failing to comply with mandatory disclosure obligations? Is a franchisee entitled to rescind the franchise agreement and/or claim damages?

Under federal law, the FTC’s Franchise Rule does not provide a private right of action for franchisees to sue their franchisors for

disclosure violations. As such, a franchisee's only recourse is to refer disclosure violations to the FTC for enforcement. Such a referral was, historically speaking, unlikely to yield any results for the wronged franchisees because, until recently, the FTC rarely directly sued franchisors for violating the FTC Franchise Rule, perhaps due to the lack of the allocation of resources to enforcement personnel. However, in a dramatic shift from past decades of lax enforcement policy, the FTC filed an enforcement action against a certain burger franchisor in February 2022 for alleged pre-contract misrepresentations, and appears to be increasing its activity in this area. Additionally, the FTC launched a new fraud reporting tool in 2022, in an effort to further hold franchisors accountable for FTC Franchise Rule violations. Whether the FTC will maintain this increase in enforcement, and increased scrutiny and potential additional regulation of business practices in the franchise arena, remains to be seen.

Like the FTC, state enforcement agencies can seek to impose civil and criminal penalties or obtain an injunction against a non-compliant franchisor. Unlike the FTC, individual states allow for a private right of action for a franchisee to sue its franchisor under applicable statutes that afford protection to franchisees, including, *inter alia*, under a state's unfair trade practices act ("Little FTC Act"), franchise statute, and/or business opportunity law.

In some states, a franchisee may even be able to directly sue not just a franchisor entity, but also potentially a franchisor's owners, directors, agents, or other "persons" covered under a statutory definition of those liable for violations. Such individual liability may come as a surprise to unwary franchisors, their owners, officers, key personnel, and even salespersons, and it highlights the need to have competent counsel advise franchisors concerning their sales process. It also behoves franchisors and salespersons to have appropriate insurance to cover individual liability if sales are potentially covered by such statutes. For example, recently the Eastern District of New York ruled that a Chief Executive Officer and a General Counsel could individually qualify as "persons" jointly and severally liable under two independent sections of the New York franchise Sales Act. The court found these "persons" could be liable under NY GBL 681(13) (definition of "person" liable), or alternatively, as a "control person" that "materially aids in the act or transaction constituting the violation" under NY GBL 691(3). *See Sea Tow Servs. Int'l, Inc. v. Tampa Bay Marine Recovery, Inc.*, 2022 WL 5122728 at 27–28*; 38–39*, ___ F.Supp.3d ___ (S.D.N.Y. Dist. 2022). It is a cautionary tale. In states with broad definitions of "person(s)" that may be liable, franchisors, and key personnel, including individuals in the sales process, should be mindful of the need to navigate the applicable state statutes. Fortunately, most state statutes are not overly burdensome to comply with, particularly if a franchisor is already complying with federal law, and competent counsel is timely sought.

If a franchisee prevails in an action, the franchisee may be entitled to various forms of relief, including rescission, damages, costs, reasonable attorneys' fees, and statutory interest. Rescission, which restores the parties to the "*status quo ante*" (the condition they were in before the violations occurred), provides for the restitution of any money previously paid by the franchisee to the franchisor, including the franchise fee and royalty payments. Additionally, in some states, it may also entitle a franchisee to recover its initial investment costs and operational losses. However, rescission may only be available under limited circumstances (e.g., for wilful and material violations). Some states allow for the recovery of treble damages for plaintiffs that prevail on their franchise claims. However, what is important to keep in mind is that the rights and potential remedies available to a franchisee will vary by state. As such, it is generally advisable for a franchisee to retain counsel knowledgeable in the applicable state's franchise law.

5.2 In the case of sub-franchising, how is liability for disclosure non-compliance or for pre-contractual misrepresentation allocated between franchisor and master franchisee? If the franchisor takes an indemnity from the master franchisee in the Master Franchise Agreement, are there any limitations on such an indemnity being enforceable against the master franchisee?

To sub-franchise a franchise, the franchisee must be considered a "Master Franchisee". In other words, a Master Franchisee must: (a) enter into unit or sub-franchise agreements with franchisees; and (b) provide ongoing business support to the franchisees after signing in accordance with those sub-franchise agreements. Master Franchisees are considered "Sub-Franchisors" and, as such, must comply with its disclosure obligations under the FTC's Franchise Rule and any applicable state disclosure laws. Franchisors and franchisees should be mindful that these "master franchise" agreements have their own, often independent, disclosure and sales requirements.

In an action against a Master Franchisee, the FTC's Franchise Rule and most state franchise statutes consider the Master Franchisee and the franchisor to be jointly and severally liable for their violation(s) of the disclosure laws. As such, it is common for a Master Franchisee and franchisor to include a mutual indemnification clause in the Master Franchise Agreement. Such clauses are generally enforceable, except, in states where an indemnification clause covering the intentional misconduct of the indemnitee is void as a matter of public policy.

5.3 Can a franchisor successfully avoid liability for pre-contractual misrepresentation by including a disclaimer in the franchise agreement?

Under the FTC's Franchise Rule, a franchisor cannot disclaim, or require a prospective franchisee to waive reliance on representations contained within the FDD. Such actions are deemed as unfair or deceptive trade practices. Therefore, disclaimers are ineffective with respect to representations within the FDD. Disclaimers are also ineffective against protecting a franchisor from liability for material omissions in the pre-contract disclosures. Disclaimers are only an effective form of protection with respect to misrepresentations that are extraneous to the FDD, and still may not fully inoculate a franchisor from liability.

In addition to the FTC's Franchise Rule, several states' franchise laws contain anti-waiver provisions. In other words, some states protect franchisees by voiding any contractual term that attempts to waive a franchisee's right to sue under the statute for, *inter alia*, pre-contractual misrepresentations. In other jurisdictions, merger and integration clauses may not be able to defeat a claim for fraudulent inducement based on the theory that fraud is extraneous to the contract.

Typically, specific disclaimers are more effective than broad disclaimers or integration clauses. Such disclaimers can be effective against common law claims, and undermine a franchisee's "reliance" upon extra-contractual representations. It still is relatively commonplace for franchisors to require a franchisee to sign a separate questionnaire detailing what representations were, and were not made, prior to execution of the franchise agreement, although the efficacy and propriety of such questionnaires are increasingly being challenged by courts and regulators. As such, disclaimers generally still have some utility, depending upon the jurisdiction, but are not going to function as liability shields, particularly where franchise statutory remedies are present that operate independently of contractual language.

While disclaimers do not wholly protect a franchisor from claims of pre-contract misrepresentations, at the very least a

franchisor can point to the disclaimer clauses as evidence that the franchisee did not reasonably rely on the misrepresentation.

5.4 Does local law permit class actions to be brought by a number of aggrieved franchisees and, if so, are class action waiver clauses enforceable?

Yes, franchisees can join together to file a class action lawsuit so long as the designated class meets the applicable federal or state law requirements for class certification. Generally, separate franchisees may be able to sue the same franchisor within the same action or arbitration (or join multiple claims together), depending upon the jurisdiction or forum. Additionally, franchisee associations can sue on behalf of their members if the associations can show they have standing to sue, which is available in certain jurisdictions. Alternatively, a franchisee association can create a litigation fund, and sponsor a lawsuit by one of its franchisee members. Therefore, there are a variety of mechanisms that multiple franchisees can employ to bring a joint, class, or collective action, and potentially pool their resources.

Although franchisees can join together for a class action lawsuit, it is common practice for franchisors to include both general class action waiver provisions within franchise agreements as well as waiver clauses in the arbitration provisions preventing class or group arbitrations. The U.S. Supreme Court has long held that such provisions are generally enforceable. In addition, where arbitration forums are utilised, such class or collective action waivers tend to be more effective, depending upon the jurisdiction. Notably, general class action waivers within a franchise agreement are still subject to normal contractual defences, and still may not be enforced under certain state laws (e.g. if they are found to be against public policy, unconscionable, or not a knowing and voluntary waiver of a right).

6 Governing Law

6.1 Is there a requirement for franchise documents to be governed by local law? If not, is there any generally accepted norm relating to choice of governing law, if it is not local law?

There is no requirement for a franchise to be governed by local law, except for non-waivable state statutory provisions, or when there are statutes mandating that the local law overrides any choice of law provision. Choice-of-law provisions are generally enforceable if: (1) there is a substantial nexus between the selected state and the parties or the transaction, or some other reasonable basis for the parties' choice exists; and (2) the selection does not violate the public policy of the state having the predominant interest. Choice of law provisions will likely be ineffective in avoiding liability under a state franchise law that is otherwise applicable. Indeed, most state franchise statutes contain non-waiver provisions.

Typically, franchisors include in their franchise agreements a choice of law provision preventing their non-applicability that requires application of the law of the franchisor's home state to the contract, and to any related disputes. This allows for uniformity in application of the forum state's law across the franchised system, at least as far as the interpretation of the franchise agreement is concerned, and to the extent that common law claims are asserted in connection with any disputes that arise. While, as noted above, choice of law provisions are generally unable to override a local statute, they can do much to ensure that a more advantageous forum state's substantive contract law, and potentially its tort and common law, will apply to any potential dispute.

6.2 Do the local courts provide a remedy, or will they enforce orders granted by other countries' courts, for interlocutory relief (injunction) against a franchisee to prevent damage to the brand or misuse of business-critical confidential information?

A franchisor has the right under federal and state law to seek an injunction against a franchisee. To obtain such an injunction, the franchisor will typically seek recourse by filing a court action. Even franchise agreements with arbitration provisions will typically preserve or "carve out" the right to seek injunctive relief in court. Even where there is no such carve out, injunctive relief may be available under the rules of certain arbitration organisations (including the American Arbitration Association ("AAA") and JAMS), arbitrators have the authority to grant interim relief is sought in an arbitration proceeding.

The U.S. is not a signatory to any treaty or convention that specifically requires its courts to recognise or enforce injunctive orders or judgments issued by any foreign courts. However, out of "international comity", U.S. courts typically recognise and enforce final and valid foreign judgments. While some U.S. courts have enforced foreign court orders for permanent injunctive relief, they have been less willing to enforce preliminary injunctions (as they are not final and conclusive judgments).

6.3 Is arbitration recognised as a viable means of dispute resolution and is your country a signatory to the New York Arbitration Convention on the Recognition and Enforcement of Foreign Arbitral Awards? Do businesses that accept arbitration as a form of dispute resolution procedure generally favour any particular set of arbitral rules?

Arbitration is clearly a favoured means of dispute resolution under federal law, as codified in the Federal Arbitration Act ("FAA"). Furthermore, the FAA pre-empts any state law that attempts to deny or even limit the right of contracting parties to arbitrate disputes involving interstate commerce.

The U.S. adopted the New York Convention and ratified the Inter-American Convention on International Commercial Arbitration (Panama Convention), which requires the U.S. and most South American nations to enforce arbitration agreements and awards originating in members' countries. The New York Convention and Panama Convention have been codified as U.S. law in Chapters 2 and 3, respectively, of the FAA.

Ad hoc (self-administered) arbitrations often proceed in accordance with the UNCITRAL Arbitration Rules or the CPR's Non-Administered Arbitration Rules. The International Centre for Dispute Resolution ("ICDR") (the AAA's international division) and the International Institute for Conflict Prevention & Resolution ("CPR") are two of the most well-established international arbitration forums located in the U.S. Additionally, the International Chamber of Commerce ("ICC") administers arbitrations from its New York City office and some international organisations, like the London Court of International Arbitration ("LCIA"), can conduct U.S.-seated arbitrations from their foreign offices.

7 Real Estate

7.1 Generally speaking, is there a typical length of term for a commercial property lease?

The U.S. represents a huge real estate market with urban, suburban and rural areas. It is not one homogenous market, but rather it is

comprised of diverse areas within which there are wide differences with respect to commercial leasing conditions. As such, there is no typical length of term for a commercial lease in the U.S. The term may vary depending on a variety of factors including, for example, the area type and specifics of the local market, the premises (e.g., retail, office or industrial), general economic and market conditions, the landlord, lender requirements, franchisor requirements, etc. In major metropolitan areas and in shopping centres, it is common to have leases for retail spaces that are for 10 years or more. While, perhaps, this may not be as prevalent in smaller communities, even there, leases of 10 years (or more) can usually be negotiated for well-known franchise brands. (While there is no standard length of franchise agreement in the U.S., many franchise agreements have an initial term of 10 years.) Some landlords offer “specialty leasing” arrangements in which tenants are offered the option of leasing retail spaces in malls, shopping centres, and storefronts on a short-term basis. This option is especially advantageous for businesses that sell merchandise that is either seasonal or related to a specific holiday. Tenants often seek to incorporate one or more option terms into their leases. Some franchisors, and franchisees (if they are represented by knowledgeable counsel) will prefer to have the term of the franchise agreement (with any renewals) coincide with or be “coterminous” with the term of the lease being entered into (including any options). Generally, there are no statutory rights regarding a commercial tenant’s or franchisee’s right to “hold over” at the end of the lease’s contractual term. In most instances, commercial leases contain provisions requiring the tenant to pay anywhere between 125% and 200% of the Base Rent and Additional Rent during any holdover period(s), although the amount of the overage, as is the case with most lease provisions, is usually subject to negotiation.

7.2 Is the concept of an option/conditional lease assignment over the lease (under which a franchisor has the right to step into the franchisee/tenant’s shoes under the lease, or direct that a third party (often a replacement franchisee) may do so upon the failure of the original tenant or the termination of the franchise agreement) understood and enforceable?

Yes, this is a well-established concept that serves to protect both the franchisor’s brand and revenue stream derived from a particular location and is often addressed by contractual agreement, both in the franchise agreement and, if properly negotiated, in the lease, as well. Sophisticated landlords are generally aware that franchisors often reserve rights in their franchise agreements which will enable the franchisor, an affiliated entity or another approved franchisee, to “step-into” the franchisee/tenant’s shoes, either to temporarily operate the franchisee’s business (*see* commentary at question 16.2), or to take an assignment of the lease if either of two events occur: (i) the franchisee’s lease is terminated by the landlord; or (ii) the franchisee’s franchise agreement is terminated by the franchisor. Some landlords will consent to such a requested lease term by so providing in a three-party rider or addendum to the lease, which is executed by the franchisor, franchisee/tenant and the landlord. Landlords will usually require that the franchisor (or other assignee) must cure any defaults (including the payment of any outstanding rent/additional rent, etc.) before the franchisor or another franchisee can take over the lease. Savvy franchisors or franchisees may negotiate a lease term providing that, under such circumstances, the landlord’s consent will be “deemed” to have been given and that the only requirement is that proper notice and disclosure be provided to the landlord. Other landlords may resist agreeing to such a provision outright, while others may seek to obtain financial concessions from the franchisor in return for agreeing to

such a provision. For example, where landlords have required the franchisor or franchisee to provide either a full or partial guaranty of the lease (e.g., a “good guy” guaranty where the guarantor is responsible for the rent, or even for all of the obligations under the lease, for only so long as the tenant remains in possession of the premises), the landlord may require that a comparable guarantor be added (or substituted) as part of the transaction. Whether or not the franchisee/tenant, as well as any guarantor(s), will be released from liability under the lease upon such a sale is also a key issue to be negotiated.

7.3 Are there any restrictions on non-national entities holding any interest in real estate, or being able to sub-lease property?

Typically, not in the franchise context, in which franchisees and/or franchisors commonly hold leasehold interests in real property. While U.S. federal law restricts foreign ownership of certain federal oil, gas and mineral leases, and authorises the blocking of certain foreign acquisitions of U.S. companies with respect to particular industries which potentially impact on national security, energy resources and critical infrastructure, such restrictions are generally inapplicable to franchising opportunities in the U.S. Rather, federal laws generally impose reporting or disclosure requirements in which foreign investors report the real estate transaction to the appropriate federal agency. Under federal law, foreign owners or investors in U.S. real estate are subject to U.S. tax to the same extent as domestic owners are. In most instances, foreign investors would acquire U.S. real estate interests, including leases, by utilising single purpose U.S. entities which are created specifically in order to acquire or lease the real property.

7.4 Give a general overview of the commercial real estate market. To what extent has the real estate market been affected by the Coronavirus pandemic? Specifically, can a tenant expect to secure an initial rent free period when entering into a new lease (and if so, for how long, generally), or are landlords demanding “key money” (a premium for a lease in a flagship location)?

The U.S. commercial real estate market is large and varied. Prior to the emergence of the COVID-19 crisis (“COVID-19 Crisis”) the commercial real estate market was in the process of recovering from the “great recession” of 2008 through 2012. In certain metropolitan areas, the real estate market recovered fairly well and it was not uncommon for landlords to charge premium rents for “Class A” and other desirable retail locations. Prior to the COVID-19 Crisis, certain events had been negatively impacting the retail section of the U.S. commercial real estate market, including, in significant part, the impact that the purchase of products on the internet has had on retail sales generally, and inevitably, on the sale of products from franchised (or franchisor-owned) retail locations. According to an article published in *Forbes*, in 2022, digital commerce surpassed the \$1 trillion dollar threshold for the first time. Further, almost 80% of Americans make purchases via the internet. This trend will likely continue and is likely to have an increasingly negative impact on “brick and mortar” retail purchases generally, and on franchised retail outlets, specifically. Until the last recession (e.g., 2008–2012), malls and shopping centres in the U.S. had experienced explosive growth since the 1950s. However, based on the internet’s continuing negative impact on retail locations (including franchised outlets), malls and shopping centres may well become smaller and rents may have to be reduced in order to induce retailers to make long-term commitments that both

landlords and lenders desire or require. It is unlikely that we will see, in the foreseeable future, the kind of explosive growth that malls and shopping centres had previously experienced. We are starting to see retail space undergoing a major transformation, where the trend generally speaking, has been that “low-quality” retail premises have been struggling and “high-quality” retail premises are more likely to be successful (especially where consumers enjoy services and entertainment as opposed to buying durable goods which can easily be purchased “online”). This recent trend has helped to keep retail rents at more reasonable levels.

Partly as a result of these factors, reasonable construction periods (which vary depending on the location and type of work to be done), landlord contributions to tenant “work letters” and some “free rent” periods, continue to be frequently available in metropolitan areas. In other areas of the country, including more suburban and rural areas, where the real estate market (and the local economies generally) have been, perhaps, more “hard hit”, it is even more common for tenants to obtain a period of free rent and/or tenant improvement allowances.

The specific work that the landlord agrees to do in order to prepare the premises for the franchisee/tenant’s occupancy is memorialised in a “work letter” which is almost always subject to negotiation. It will be influenced by such factors as the length of the lease term, the tenant’s credit worthiness and overall “desirability” and, of course, the rent to be paid. The time needed to perform both landlord’s and tenant’s work will vary according to the nature of the work to be performed but will typically range from 60 days to six months and, sometimes, may be even longer where it is anticipated that particular zoning or “permitting” issues will apply. While no rent will be charged during the construction period, tenants frequently seek out an additional “free rent” period after the premises opens for business while still within the construction period and, in some cases, even after the construction period has ended. In certain areas, such as where a free-standing building is being constructed for the franchised unit, or for larger construction projects, such as hotels, even longer construction periods, and “free rent” periods, may come into play.

In certain metropolitan areas where the real estate market had recovered well, landlords would sometimes charge commercial tenants so-called “key money” as a premium for the tenant’s right to secure the lease. The pressure from internet sales has had a negative impact on this practice. In most cases, where key money is a factor, the deals usually involve transactions where an existing lease and infrastructure (e.g., built-in furniture, specialty plumbing or electrical work) are transferred to a new tenant and the landlord requests a one-time payment in recognition of the extra facilities and the convenience that the tenant is inheriting. Examples of this situation may include a restaurant having a recently upgraded infrastructure in place, or where a petrol station having substantial equipment improvements is being transferred to a new tenant (petrol distributor). Unlike the residential context where tenants are sometimes asked to pay “key money” to superintendents or building managers in order to secure a flat (such “off the books” practices are illegal), in the commercial real estate market context, requests may be presented so long as the money is requested by the landlord and is paid by the tenant and set forth in the lease.

Impact of the COVID-19 Crisis

Beginning in the spring of 2020, millions of American employees were unable to travel to their workplaces because state and local government authorities issued “stay at home” orders and ordered all “non-essential businesses” to “shut down”. As a result of the COVID-19 Crisis, many retail locations and other businesses

(including franchises) defaulted on their leases in 2020 and 2021 and attempted to negotiate with their landlords as to the waiving or deferring of rent and additional rent, and to avoid being evicted from their premises (when existing eviction moratoriums were eventually lifted). Further, as many larger businesses have been reluctant to require their employees to return to their offices, especially in urban areas, the commercial office market in metropolitan areas has continued to struggle, and this has caused some “brick and mortar” franchises to suffer, which rely on foot traffic by customers. Even though the COVID-19 Crisis is under control, the commercial real estate market in the U.S., especially with respect to “Class A” retail and office space, both in urban and suburban areas, is still struggling to fill vacant retail and office space. There is generally less demand for office space as many employers continue to offer remote work policies and also seek to save money to help offset increased costs due to inflation.

8 Online Trading

8.1 If an online order for products or request for services is received from a potential customer located outside the franchisee’s exclusive territory, can the franchise agreement impose a binding requirement for the request to be re-directed to the franchisee for the territory from which the sales request originated?

Yes. The franchise agreement can, and should, where applicable, regulate how online orders are allocated. Online commerce has exploded in the past few years, and even service-based franchisors and brick and mortar dependent franchise systems have had to incorporate increased online orders and services. Franchisors should take great care to adequately define in the franchise agreement, and similarly, to disclose in the FDD (along with required state disclosure documents), how such online orders will be handled. Franchisors should take advantage of the protective nature of a well-crafted FA and FDD, so they can put a prospective franchisee on notice of what is, and what is not, part of the market or territory they are purchasing the rights to, including digital commerce rights. Unless a territory is truly “exclusive”, franchisors should avoid words like “exclusive” territory in order to avoid confusion, and make sure that prospective franchisees are put on notice as to the manner in which online orders are handled within a franchisee’s territory. Item 12 of the FTC Rule requires that if a franchisor does not grant “exclusive” territories to its franchisees, the franchisor’s FDD must include a disclaimer underscoring that fact. The FTC Rule also requires that the FDD include separate detailed disclosures regarding whether a franchisor reserves the right to sell its products through “alternative channels of distribution” in the franchisee’s territory, including e-commerce. That means that franchisees must be made aware of whether or not a franchisor is granting them rights to engage in online commerce, and what limitations are placed upon those rights. Notice is key, and making sure a franchisee’s rights are well-defined will do much to prevent costly litigation in the long run. A franchisor’s failure to clearly define a franchisee’s rights with respect to online sales, especially in its required disclosure documents and franchise agreements, may result in litigation, including claims by aggrieved franchisees that a franchisor has committed “disclosure” violations (including violations of both federal and applicable state law), and common law claims for fraudulent or negligent omission, breach of contract, and/or breach of the implied covenant of good faith and fair dealing.

As e-commerce continues to mature, prospective franchisees who are purchasing a franchise should carefully review the territorial protections and online market provisions described in the

FDD and provided for in the franchise agreement with great care. Access to the online market can significantly impact the profitability of a franchise, and both franchisor and franchisee should be clear about their respective rights.

Given the speed at which the economy in the United States has embraced remote services, online commerce, and digital orders, many franchised systems, particularly those with “evergreen” franchise agreements that may span decades, could find that their standard franchise agreements do not specifically address online commerce. Indeed, entire franchise system models have had to adapt within the past several years to incorporate and adjust to these disruptive changes in how people shop and expect services to be provided. Franchisors who find that their agreements no longer reflect the new economic reality, need to take steps with knowledgeable counsel to update their agreements and disclosure documents.

Further, franchisors should be cautious about employing new methods of online purchasing, or implementing requirements that online business be conducted through a national website, where existing franchise agreements may not have fully contemplated or delineated the rights of the parties with respect to online sales. Where online sales divert enough business away from a franchisee’s exclusive territory, or the franchisor has not specifically reserved its rights to compete with franchisees online, such changes could violate implied covenants of good faith and fair dealing, or potentially even state-specific franchise laws (see, e.g., Wis. Stat. §1365.03 (franchisor may not substantially change the competitive circumstances of a dealership without good cause); IN Code §23-2-2.7-1(2) (prohibitions against franchisor competing unfairly with franchisee, or within franchisee’s designated protected territory); NJ Stat. §56:10-7I (franchisor may not impose unreasonable standards of performance)).

Franchise systems must continue to be flexible, and franchisors and franchisees should work together in this new increasingly digital landscape. In this regard, individual franchisees and franchisee associations can provide valuable input and innovation for a franchisor, as system-wide adjustments may be necessary, which will likely include significant re-working of online sales platforms and associated arrangements between franchisors and franchisees concerning online rights and restrictions affecting online sales. Systems that do not adapt and work together may suffer the loss of many of their franchised units. Customers now expect online services and sales, and franchisees need to be part of a system’s online business in order to survive. It is often no longer realistic or prudent for a franchisor to reserve digital commerce entirely to itself. Further, the failure of a franchisor to fairly and adequately address their franchisees’ needs in this new marketplace, may subject themselves to claims by franchisees for refusing to reasonably accommodate them in these new circumstances, including for breach of the implied covenant, impossibility, and frustration of purpose, despite what the FDD or franchise agreement may say.

8.2 Are there any limitations on a franchisor being able to require a former franchisee to assign local domain names to the franchisor on the termination or expiry of the franchise agreement?

No. A franchisor may require (in its franchise agreement) that a franchisee utilise a specific domain name, and return usage of that domain to the franchisor after expiration of the franchise. It is advisable that a franchisor disclose domain name requirements within the FDD, and that the franchise agreement clearly set forth any post-termination requirements with respect to domain names. The ICANN regulates the usage of

domain names, and franchisors may seek transfer of a domain name under ICANN’s UDRP proceedings to effectuate the transfer of a domain name. Where a franchisee’s domain utilises a franchisor’s protected trademark within the domain name, the UDRP is far more likely to require transfer back to the franchisor, even if a dispute arises (and the usage of a protected trademark in the domain name may give a franchisor additional Lanham Act claims). If the infringement involves a generic top-level domain (“gTLD”) and in clear-cut trademark infringement matters, ICANN’s newly adopted URS domain name suspension procedure can be used to suspend infringing domain usage (but suspension of the infringing domain is the only remedy in a URS matter).

Franchisors should incorporate domain-specific provisions in their FDDs and franchise agreements with care and take steps to ensure they maintain control over their domain names. Franchisors may consider having franchisees agree in writing to transfer their domain rights to a specific domain at the time of termination of the franchise, or alternatively, control the rights to a specific domain themselves, and grant the franchisee a licence to utilise the sub-domain during the franchise relationship. Notably, if a franchisor does not take steps to timely effectuate the transfer of a domain name, or object to a former franchisee’s continued use of a domain in violation of an agreement, it opens itself up to laches, acquiescence and waiver arguments (see, e.g., *American Express Marketing and Development Corp v. Planet Amex et al.*, NAF UDRP Proceeding, Claim No. FA1106001395159 (January 6, 2012) (the domain would properly stay with the franchisee, as the franchisor “acquiesced to the use of its mark in the Respondent’s domain name for at least a period of several years”)).

Franchisees should be aware that if a domain name is the property of a franchisor, any systems reliant upon that domain name, including any e-mail accounts, internal data and communications, associated online media content and contacts, and any other identifiers tied to that domain name may be abruptly discontinued at the end of a franchise agreement’s term. Indeed, intellectual property rights may also attach to such communications and content, and as owner of the domain, the franchisor may retain such rights in the content. A termination could therefore result in significant business disruption, including the loss of client contacts, and potentially years of e-mails and other domain-dependent communications and information. Where content matters, such content may also be retained by the franchisor (particularly where the franchisor has made clear in its franchise agreements and disclosures that any IP is theirs). However, in other instances, content rights may be retained by the franchisee or its agents or employees, while the domain remains the property of the franchisor, creating complications and potential litigation. One example where such issues arise is in the realm of real estate franchises, where property listings, properly pictures, and individual agent’s online portfolios and prior deals might be on a franchisor’s domain or “portal”, but the content may be subject to differing rights, and even local laws regarding who controls the rights to property listings.

Also of importance is the longevity of a domain, and its value as a highly-listed domain in major search engines. In the realm of digital commerce, it is crucial where a search engine (such as Google) lists a particular domain. The value of a long-standing and high-listed domain, with carefully cultivated links and online presence, can be substantial. Counsel should examine relevant provisions in an FDD or franchise agreement carefully, so clients are fully aware of the implications of termination of the franchise upon domain-name usage, and potentially the ability of a business to continue functioning after de-identification. Indeed, large portions of a customer base may be easily transferred to a

new owner of a franchised territory if the domain remains with the franchisor, despite a former franchisee's efforts in fostering that customer good-will and usage, and boosting the "listing" of a domain. All these issues need to be examined at the outset of a franchise relationship, so that the parties understand the implications of domain names on their business.

Domain name ownership also has significant consequences in the event of litigation, as the abrupt cessation of communications may lead to additional claims. Transfer of a domain without consideration for the preservation of data (or electronically stored information that may be relevant evidence in a litigation), particularly with cloud-based storage and services, and the consequences of who has (or takes) possession of that data, or who even has access to that data, can be significant if litigation ensues. As a cautionary note, franchisors who terminate a franchisee, and take possession of a domain used by the terminated franchisee (along with any "Electronically Stored Information" ("ESI") attendant thereto), but that do not take steps to preserve electronic evidence (such as ESI, including e-mails, that may reside on a domain that they control), may find themselves the target of motions for discovery preservation sanctions. Franchisors should be careful to preserve evidence if litigation is reasonably anticipated. Franchisees should be aware that if they are terminated, they may not have access to ESI that is critical to day-to-day functionality, which now may be in the exclusive possession custody or control of a franchisor. Therefore, given the ever-increasing importance of this issue with the expansion of e-commerce, it is imperative that at the outset of a franchise relationship, both franchisee and franchisor should be aware of what the relevant FA states with regard to ESI and domain names, and be guided accordingly.

9 Termination

9.1 Are there any mandatory local laws that might override the termination rights one might typically expect to see in a franchise agreement?

Yes. While federal law in the United States, e.g., the Amended Federal Trade Commission Franchise Rule, governs the requirements with respect to how franchisors must provide proper disclosure to prospective franchisees in the U.S., federal law does not govern any aspect of the franchisor-franchisee relationship after the parties enter into a franchise agreement. However, almost half of all states in the United States (and U.S. territories of Puerto Rico and the U.S. Virgin Islands) have so-called "relationship laws" which govern one or more substantive aspects of the franchisor-franchisee relationship. Common examples include: restrictions on termination (which is discussed further in the next paragraph), non-renewal and/or transfer; limitations on the franchisor's ability to open a new company owned or franchised unit in the vicinity of the franchisee's location (encroachment); limits on post-term restrictive covenants including non-competition and non-solicitation agreements; permitting "free association" among franchisees; requiring that a franchisor act in good faith or with reasonableness when dealing with its franchisees; and the inclusion of "non-waiver" provisions with respect to the state statute's protections. Beginning in the 1970s, these relationship statutes were enacted by state legislatures in an attempt to correct some of the significant perceived abuses that franchisors were committing against prospective and current franchisees. State relationship laws vary considerably, both in terms of the breadth of the issues that are addressed, and with respect to the specific provisions and restrictions which are contained within them.

Some relationship laws are made part of the state's franchise registration or disclosure statute, while others are set forth in a statute which is separate from the state's disclosure/registration laws. Some states, however, have relationship laws but have enacted no franchise disclosure/registration law.

State relationship laws typically address (e.g., restrict) the franchisor's ability to terminate or fail to renew the franchise. Most of them require a franchisor to have "good cause" (or "reasonable cause") before it is permitted to either terminate or not renew a franchisee's franchise. (Where applicable, such laws will override and make unenforceable, inconsistent provisions contained in the franchise agreement. For example, a provision stating that the agreement will expire at the end of a particular term if the franchisee has no right to renew, may be unenforceable, and the franchisor may be required to renew the franchise agreement.) While some relationship laws define "good cause" (or "reasonable cause"), others do not, leaving this determination to the courts. However, good cause generally exists if the franchisee has breached a material obligation of the franchise agreement. Typically, under relationship laws, which vary significantly, the franchisor is required to provide the franchisee with written notice of termination or cancellation (with such notice often being 60 days, which is often significantly longer in duration than what is typically provided for in the franchise agreement), within which the franchisee may cure the alleged default and avoid termination. However, in instances where the default involves the franchisee's failure to pay monies owed to the franchisor, the permitted notice/cure period under relationship laws is often considerably shorter. Additionally, for certain defaults which are perceived to be egregious and/or which pose a threat to the well-being of the public or which are damaging to the franchisor's brand, including, for example, posing a threat to the public's health and safety (often, for example, in a food-related franchise), and/or are otherwise "uncurable" (for example, unauthorised use of the franchisor's registered trademarks, or voluntary abandonment of the franchise), or where certain exigent circumstances are present (for example, the franchisee's insolvency or bankruptcy or the franchisee's loss of its right to occupy its premises), the franchisor is usually statutorily permitted to terminate the franchisee's franchise agreement, either immediately, or with a much shorter notice/cure period than what might otherwise be required. As applicable relationship laws supersede whatever inconsistent provisions are contained in the franchise agreement, franchisors, and their counsel, need to be aware of any applicable relationship law when evaluating how to handle a franchisee's default and/or potential termination. Of course, as relationship laws are meant to provide franchisees with additional protections which may not be included in their franchise agreement, such relationship law provisions may increase, but may not decrease or "take away" any of franchisee's rights that are contained in the franchise agreement.

Almost all franchise agreements provide that the franchisor may terminate the franchise if the franchisee becomes insolvent or files for bankruptcy. However, under the U.S. Bankruptcy Code, a contractual provision permitting the franchisor to terminate the franchise agreement in the event of the franchisee's bankruptcy may not be enforceable (see 11 U.S.C. §365(e)(1)(A)). If a franchisee files for bankruptcy before its franchise agreement and/or its lease has expired or has been properly terminated, such agreement(s) become(s) part of the debtor-franchisee's ("debtor") "bankruptcy estate". However, the franchise agreement and/or lease may be terminated relatively quickly if the debtor (franchisee) files either a Chapter 7 "liquidation" or a Chapter 11 "reorganisation" but "rejects" the agreement(s) (e.g., consents to their cancellation). In the event that a debtor in a Chapter 11 reorganisation wishes to "assume" its franchise agreement or lease (i.e., keep it/them "in place"), it is unlikely that the franchisor will

be able to quickly terminate these agreements provided that the debtor/franchisee was not in default of these agreements at the time the bankruptcy petition was filed. It is likely that the Bankruptcy court will approve the assumption of these agreements if the debtor/franchisee is able to otherwise perform their respective terms, the agreement(s) appear(s) to be in the best interests of the debtor's bankruptcy estate and the assumption of the agreement(s) is supported by reasonable business judgment. However, if the debtor/franchisee was in default of its agreement(s) at the time that the bankruptcy petition was filed, it is more difficult for it to assume them. In this situation, the debtor will likely have to: (i) cure, or provide adequate assurance that the trustee will promptly cure such defaults; (ii) compensate, or provide adequate assurance that it will promptly compensate another party for any actual pecuniary loss that the party may suffer as a result of such default; and (iii) provide adequate assurance with respect to the future performance of such agreement(s).

9.2 Are there local rules that impose a minimum notice period that must be given to bring a business relationship that has existed for a number of years to an end, which will apply irrespective of the length of the notice period set out in the franchise agreement?

Yes. As was discussed above in question 9.1, almost half of all states in the United States (and U.S. territories of Puerto Rico and the U.S. Virgin Islands) have so-called “relationship laws” which govern one or more substantive aspects of the franchisor-franchisee relationship, such as the franchisor's ability to terminate or fail to renew the franchise. In addition to typically requiring the franchisor to have “good cause” (or “reasonable cause”) before it is permitted to either terminate or not renew a franchisee's franchise, most relationship laws require the franchisor to provide the franchisee with written notice (with such notice often being 60 days, which is often significantly longer in duration than what is typically provided for in the franchise agreement), within which the franchisee may cure the alleged default and avoid termination. The reason for such provisions is to protect franchisees from having their livelihood (and often a large financial investment) taken away from them on short notice. Where applicable, such relationship laws will apply irrespective of the express notice provisions (and/or governing law and jurisdiction provisions) contained in the franchise agreement, and any such inconsistent provisions will be deemed unenforceable. While U.S. courts generally cannot “revive” or reinstate a franchise after the franchisor has terminated the franchise agreement, a franchisee who successfully asserts a claim that the franchisor violated an applicable relationship law and improperly terminated the franchisee's franchise agreement, will be awarded appropriate damages, prejudgment and post-judgment interest as well as court (or arbitration) costs, including reasonable attorneys' fees which were incurred by the franchisee in connection with the litigation or arbitration. Franchisors, and their counsel, need to be aware of any applicable relationship law when evaluating how to handle a franchisee's default and/or potential termination.

10 Joint Employer Risk and Vicarious Liability

10.1 Is there a risk that a franchisor may be regarded as a joint employer with the franchisee in respect of the franchisee's employees? If so, can anything be done to mitigate this risk?

The “joint employer” doctrine is a concept in employment law. It expands the definition of “employer” to include additional

persons or entities that exert sufficient influence or control over the “terms and conditions” of employment (directly, or sometimes, even indirectly) in such a way that they will be considered a “joint” employer, and therefore jointly liable for a statutory violation. Notably, the joint employer doctrine only applies in connection with, and is therefore limited to, violations of employment law (like the Fair Labor Standards Act, 29 U.S.C. 201 *et seq.*, or National Labor Relations Act, 29 U.S.C. §151 *et seq.*).

Applying the “joint-employer” standard in the franchise context is troublesome because the franchisor-franchisee relationship, by its very nature, requires a franchisee (and its employees) to follow certain designated procedures. The hallmark of liability under the “joint-employer” standard is the exercise of sufficient control over employees to be considered an employer. A franchisor in trying to keep the franchise system uniform, may discover that by regulating what the franchisee's employees do too closely, it will be considered liable for employment law violations.

Recently, in *Browning-Ferris Industries*, the NLRB utilised the joint employer doctrine and concluded that a franchisor could be considered a joint employer – even if only exercised “indirect” control over a franchisee's employees, or even if it sufficiently reserved the “ability to exercise such control”. Subsequently, the U.S. Dept. of Labor (“DOL”), and the “EEOC” among others adopted similar rules. However, during the Trump Administration, on February 20, 2020, the NLRB issued a new joint employer rule under the National Labor Relations Act (“NLRA”), which removed the prior “indirect” control language, and in relevant part states “the entity must possess and exercise such substantial direct and immediate control over one or more essential terms or conditions of their employment...”. More recently, the Biden administration rescinded the 2020 rule, reverting to the *Browning-Ferris* “joint-employer” standard. See DOL Notice for 29 CFR Part 791, RIN 1235-AA37 (July 29, 2021). (“This action finalises the Department's proposal to rescind the final rule titled “Joint Employer Status Under the Fair Labor Standards Act”, which was published on January 16, 2020 and took effect on March 16, 2020.) This rescission removes the regulations established by that rule. With the Biden Administration adopting the *Browning-Ferris* “joint-employer” standard, and the recent passage of the Protecting the Right to Organize (“PRO”) Act (S. 567) passed in the Senate Health, Education, Labor and Pensions Committee that proposes to codify that standard, franchisors should assume “indirect” control over a franchisee's terms and conditions of employment will subject it to liability in the employment context. Therefore, franchisors must be aware of the extent of the control they exert over their franchisee's employees, as even “indirect” control may result in liability.

In addition, at the state level, many laws maintained the *Browning-Ferris* “joint-employer” standard throughout or had distinct state statutes with broader interpretations of “joint-employer”, and the cases brought by multiple Attorneys General's offices challenging the Trump Administration standard have been working their way through the courts. Each state may have its own laws and standards, some of which may be more permissive with respect to claims against the franchisor. Outcomes will largely depend on the franchise system and the jurisdiction involved, and Franchisors should consult with knowledgeable franchise counsel, and exercise caution where some control over a franchisee's employees may occur, particularly within the realms of wage and hour, labour relations, or other terms and conditions of their employment.

However, this is a problem with a solution, and franchisors should remember that the application of a “joint-employer” standard is limited to issues within the employment context and only has the potential to impact franchisors who directly – or

indirectly (depending on the standard) – exert control over the terms and conditions of their franchisees’ employment relationships, or specifically became involved in opposition to unionisation or collective bargaining with respect to their franchisees’ employees. Franchisors that do not seek to impose any significant control over the employees of their franchisees, especially in the labour relations arena, or wage and hour concerns, and who distance themselves from controlling the details and methods of franchisees’ operations, involvement in working conditions, setting “required” work hours, mandating and controlling employee time-tracking software, becoming involved in employees’ wage and salary levels, training “line” employees, becoming involved in hiring or firing, setting employment practices and policies, and management or even the training of a franchisee’s managers with respect to employment issues, will significantly reduce their risk of being considered joint employers, or subject to NLRB scrutiny or NLRA liability.

Nonetheless, concerns about “joint-employer” liability has led industry groups to lobby for “carve-outs” that would exempt franchise systems from the new regulations, for example, the IFA is advocating for legislative action to avoid subjecting franchised systems to increased liability (and costs associated with it). *See, e.g.,* <https://www.franchise.org/advocacy/brand-standards/joint-employer>. Another front in the franchise employer liability battle is in California, which has enacted legislation (Assembly Bill 5, Labor Law) that utilises a more permissive “ABC test”, which makes it easier for a court to consider someone an employer than more traditional “independent contractor” tests. Lobbyists are also actively working to get legislatures to recognise the unique ramifications of enacting legislation designed to protect employees that may have an unintended impact upon the franchising industry and exposing franchisors to significant liability and court costs in defending “joint-employer” allegations.

While the dire predictions of an avalanche of litigation ensuing from “joint-employer” rules have yet to materialise, this may be because the issue is confined to employment law or it may be because of the continually fluctuating legal standards on the topic. And it is exceedingly difficult to assemble a class that should afforded class-wide certification across multiple locations that unless a franchisor has flagrantly engaged in system-wide malfeasance directly impacting the terms and conditions of its franchisee’s employees, it is often difficult for plaintiffs to connect the alleged misconduct to system-wide malfeasance committed (or even known to) a franchisor. It is also likely that the utilisation of the “joint-employer” doctrine in litigation has been blunted by prudent steps that franchisors have proactively taken the steps advised above to properly distance themselves from active involvement in their franchisees’ employment issues, and providing franchise agreements, operations manuals and other franchise guidance that would have the effect of avoiding joint employer liability.

Nonetheless, to reiterate, franchisors should wisely balance the need to avoid exerting excessive control over the terms and conditions of employment of their franchisees’ employees, as the need to maintain system standards. As a rule, franchisors should not only continue to maintain system standards and employee practices that have to do with the end product or service (sometimes called “control of outcomes”), while distancing themselves from directly engaging in setting policies or procedures regarding how a franchisee’s employees are managed in order to produce the end product or service (sometimes called “control of means”). For example, a franchisor of a sandwich shop can dictate in its operations manual precisely how a franchisee’s employees must assemble and produce its sandwiches, but should not dictate training, hiring, firing, or setting hours and pay rates for the low-level employees producing those sandwiches and,

this limitation must also include point of sale (“POS”) systems, and mandated electronic software by a franchisor. As Franchisors are increasingly utilising such system-wide POS systems, accounting software, and centralised franchise intranet portals for franchisees, they should carefully consider whether such systems can exert too much control over franchisees, or even violate state and local law, and it is often prudent to not only allow franchisees access, but also to provide the option to utilise their own employee management, time tracking, payroll, and employment-related software systems. *See, e.g., People v. Domino’s Pizza, Inc.*, Index No. 450627/2016; 2020 N.Y. Misc. LEXIS 2349 (Sup. Ct. May 27, 2020) (Dominos avoided regulatory action for, *inter alia*, wage violations, by showing that franchisee usage of its PULSE software system, which if used for time tracking and payroll miscalculated wages due under NY law, was not mandated, other franchisees often used their own software, and it was ultimately a franchisee’s burden to ensure compliance with all wage and hour laws). To conclude, reflecting such delineations in writing, in franchise agreements and operations manuals, and keeping away from direct involvement in a franchisee’s affairs with its employees, will significantly assist franchisors in avoiding “joint-employer” pitfalls.

10.2 Is there a risk that a franchisor may be held to be vicariously liable for the acts or omissions of a franchisee’s employees in the performance of the franchisee’s franchised business? If so, can anything be done to mitigate this risk?

Franchisors have been found to be vicariously liable for the acts or omissions of their franchisees and their franchisees’ employees. However, vicarious liability, generally, will only attach where a franchisor exerts so much control over the franchisee’s performance of the process or activity that is being complained of, that courts will find that the franchisor should be held responsible. For example, if a franchisor specifically mandates that coffee be served at a scalding hot temperature, it may be vicariously liable if a franchisee’s customer burns themselves. Where a franchisor has mandated a particular practice or policy that is directly responsible for the harm, there is a significant risk that vicarious liability will attach. However, almost every jurisdiction has found that general operations manuals or enforcement of a franchisor’s general franchise system will not, by themselves, create vicarious liability. Where detailed specific controls over the day-to-day operations of franchisees are not necessary to maintain quality control of the franchised system, they should be avoided.

Traditional agency liability remains a basis for vicarious liability. The problem is that it is often used to justify negligence liability where agency liability is premised upon controls that are largely unavoidable in a franchise business context. *See, e.g., Domino’s Pizza, LLC v. Wiederhold*, No. 5D19-2343 (Fla Dis. Ct. App. October 23 2020) (9 million jury verdict affirmed against franchisor based upon agency factors inherent in most franchise relationships); *but see* Dissent (noting issues in franchising and “day-to-day” operations not provided in jury instruction). There is no absolute shield, and a lawsuit can always be filed, however, the degree of control exerted over franchisees is within a franchisor’s decision-making power.

Franchisors can also minimise potential damages, even where vicarious liability is found, by including an appropriate indemnity provision in their franchise agreement, and by requiring that franchisees maintain adequate insurance coverage, and naming the franchisor as an insured party, especially where necessary to protect against known liability concerns. Furthermore, franchisors should take care that their system standards and operations

manuals do not conflict with any federal and local laws, and make clear that the burden of assessing, and complying, with all local laws, rests upon the franchisee, since if the two conflict, then the law will override any system standards or requirements.

One problematic area where a franchisor is often named in lawsuits (or class actions) alongside a local franchisee, is for joint violations of the Americans with Disabilities Act (“ADA”). Specific to this area (in addition to the precautions discussed above), franchisors should avoid such over-involvement in the construction or “build-out” of a location, particularly where it concerns compliance with ADA access. Similarly, franchisors should avoid the training of managers or employees with respect to how accommodations are to be given to disabled persons. Operations Manuals and FAs should state that compliance with all disability laws is the franchisee’s burden. Guidance can be given in Operations Manuals, but it should always be tempered with language that makes it clear that ultimately it is the franchisee’s responsibility to ensure its own compliance with federal and local disability laws. It should be noted that where the guidance in a manual is in conflict with a law or rule, the law or rule should control.

Another area of concern for franchisors, is in the franchised Hotel Industry under the Trafficking Victims Protection Reauthorization Act (“TVPRA”). In recent litigation, victims of sex trafficking have tried to hold franchisors of hotel chains responsible for their purported indirect participation in, or benefit from, sex trafficking and related illegal conduct. Here, the risk can be mitigated by showing that the franchisor was unaware of the issue, or otherwise made clear that it would not tolerate such conduct within their franchises. A hotel franchisor will often defeat such claims at the summary disposition stage of litigation if the franchisor can demonstrate that it did not directly “participate” in such an illegal venture, was not directly involved in such conduct, and had no reasonable awareness of the illegal acts. *See, e.g. A.B. v. Hilton Worldwide Holdings, Inc.*, 484 F.Supp.3d 921 (D.Or.Mar.31 2021); *H.G. v. Inter-Continental Hotels Corp.*, 484 F.Supp.3d (ED Mi. 2020).

Franchisors can greatly reduce their risk of vicarious liability, regardless of legal theory, by taking care to only become involved in operational issues critical to the day-to-day management of the system and maintaining its standards, avoid employment issues, and, with the aid of knowledgeable counsel, properly memorialise the responsibilities of franchisees.

11 Currency Controls and Taxation

11.1 Are there any restrictions (for example exchange control restrictions) on the payment of royalties to an overseas franchisor?

Foreign franchisors that expand their reach into the United States usually set up a U.S.-based subsidiary or Master Franchisee, which is granted a licence to the trademark and the right to sell franchises in the U.S. So, most often, U.S. franchisees pay their royalties to the U.S.-based subsidiary or Master Franchisee.

While U.S. law does not impose any restrictions on a U.S. franchisee’s ability to pay royalties to an overseas franchisor, it is far more typical for foreign franchisors to set up a U.S.-based subsidiary or Master Franchisee within the U.S. As such, any franchisees (or sub-franchisees) would most often pay their royalties to the subsidiary or Master Franchisee. However, absent a U.S.-based subsidiary or Master Franchisee, the only restriction based on U.S. law would be if the franchisor’s home country is subject to economic sanctions.

Notably, while there are no specific franchise exchange control restrictions, a foreign based franchisor must still comply with all other laws. This includes standing U.S. foreign embargos and

sanctions. In such circumstances, knowledgeable counsel should be sought, as the potential consequences for violating such embargos and sanctions can be significant.

11.2 Are there any mandatory withholding tax requirements applicable to the payment of royalties under a trade mark licence or in respect of the transfer of technology? Can any withholding tax be avoided by structuring payments due from the franchisee to the franchisor as a management services fee rather than a royalty for the use of a trade mark or technology?

The royalties paid by a U.S. franchisee to a foreign franchisor are considered U.S. sourced income. Therefore, a 30% tax is typically withheld from the royalty payments made to the franchisor (and paid directly to the IRS). If the U.S. has an income tax treaty with the franchisor’s home country, the royalties may be taxed at a reduced rate. There is no advantage to structuring the royalties as management service fees since such fees are also subject to the 30% withholding tax. However, the franchisor may try to negotiate a “gross-up” provision in the franchise agreement that requires a U.S. franchisee to make up the difference and pay at, or close to, the full royalty rate.

11.3 Are there any requirements for financial transactions, including the payment of franchise fees or royalties, to be conducted in local currency?

No, it is standard for a U.S. franchisee to operate its business using the local currency. Major banks can wire franchise fees or royalties on behalf of a U.S. franchisee to the foreign franchisor using the franchisor’s foreign currency. However, this is not usually necessary since a foreign franchisor typically conducts its franchise business in the U.S. through a U.S. subsidiary or a master franchisee.

12 Commercial Agency

12.1 Is there a risk that a franchisee might be treated as the franchisor’s commercial agent? If so, is there anything that can be done to help mitigate this risk?

Yes, a theory of agency can be used to hold a franchisor responsible for the acts of its franchisees. If a franchisee is found to be an actual or apparent agent of the franchisor, the franchisor may be held vicariously liable for certain harm caused by the franchisee’s actions (or failures to act).

Unfortunately, contractual language alone is not likely to be dispositive on the issue of agency. A franchisor therefore cannot summarily eliminate agency risk by inserting a clause in the franchise agreement providing that the franchisee is an “independent contractor” (and not an agent), although such language in a franchise agreement can be helpful factual evidence.

If a franchisor retains the right to exercise control over the day-to-day business operations of its franchisee, or in a particular area that becomes the subject of liability or dispute, then it may inadvertently create an “actual” agency relationship, regardless of what disclaimers within the franchise agreement may call for. In addition, courts may also find that a franchisor is liable for the acts or omissions of a franchisee who has “apparent authority” to act on behalf of the franchisor. Generally, this theory of liability will only apply if an innocent third party: (a) reasonably believes, based on the franchisor’s representation, that the subject franchisee is an agent of the franchisor; and (b) reasonably relies upon that belief to its detriment. Other theories of

agency and vicarious liability, some statutory in nature, also may apply, depending upon the situation and jurisdiction. *See also* Section 10, Joint Employer Risk and Vicarious Liability, *supra*.

To minimise risk, the franchisor should only do what is necessary to maintain brand integrity and ensure uniformity and consistency throughout the franchised system. The more areas in which a franchisor exerts control, particularly where such control is outside of what is required to ensure system standards, the more likely it is that agency liability may arise. The franchisor should include in its franchise agreement: (a) a clause making it clear that the franchise relationship is one of an independent contractor, not an agent; (b) an indemnification provision, obliging the franchisee to indemnify the franchisor; and (c) a provision requiring that the franchisee list the franchisor as an additional named insured under the franchisee's insurance policy. Where training of a franchisee's managers or employees by a franchisor is involved, the training should be specific and cover only franchised system standards (what is necessary to ensure brand and system integrity and uniformity). The Operations Manual or Franchise Agreement should be clear that the franchisee is ultimately responsible for all other general training and employee supervision. The franchisor should also require franchisees to hold themselves out to the public as independent owners in their marketing and advertising materials. While such steps are not foolproof, they will do a great deal to minimise the risk and impact of the franchisor incurring agency liability for the acts or omissions of its franchisees.

13 Good Faith and Fair Dealings

13.1 Is there any overriding requirement for a franchisor to deal with a franchisee in good faith and to act fairly in its dealings with franchisees according to some objective test of fairness and reasonableness?

The answer to this question is dependent upon the jurisdiction. Most (but not all) states, through common law, enforce an implied covenant of good faith and fair dealing into every contract within their jurisdictions, including franchise agreements. In other words, in states that enforce the implied covenant, a party may be free to exercise its discretion, but it should not do so unfairly, or in bad faith, to deny the other party the benefit of the contract. This covenant does not act as an objective test of fairness or reasonableness, but rather one that prevents one party from acting in a way that deprives the other of the benefit of the bargain. A few states do not enforce this implied covenant, and a few only do so in limited non-franchise contexts. As such, it is important to know which state's law applies given the situation.

The implied covenant of good faith and fair dealing, generally, cannot conflict with an express term of a contract. As such, well-drafted franchise agreements address most issues with sufficient particularity to minimise the application of the implied covenant. However, when a party exercises discretion and a franchise agreement is silent on the point in questions, issues can arise. When they do, courts employ a fact-driven analysis, and even well-drawn contracts may not anticipate every contingency. Therefore, if a franchisor wants to retain absolute discretion with respect to important decisions that may be to a franchisee's detriment, it is important to address that specific circumstance as an express term in the franchise agreement in order to avoid the inadvertent application of the implied covenant of good faith and fair dealing.

When exercising discretion under a particular term of a contract, a franchisor must also ensure that the term itself is enforceable. Even if an express contractual term grants a franchisor absolute discretion, a franchisee may still argue a breach of the implied covenant of good faith and fair dealing, particularly

if the term is so one-sided that it would be prohibited by statute, deemed unconscionable, or otherwise void. For example, a franchisor may retain the right to open new franchise locations but, in exercising that discretion, if existing franchisees are negatively impacted, it could constitute a breach of the implied covenant. *See, e.g., Michael D. Bryman, et al. v. El Pollo Coco, Inc.*, MC026045 (Cal. Super. Ct., L.A. Cty., August 1, 2018) (jury verdict of 8.8 million against franchisor for violating implied covenant of good faith and fair dealing when franchisor placed competing units near franchisee, despite terms in franchise agreement that gave the franchisor that right) (settled on appeal); *Kazi v. KFC US LLC*, 19-cv-3300-RBJ (D. Colo., May 17, 2021) (jury awarded damages of \$792,239 for breach of implied covenant of good faith and fair dealing due to bad faith exercise of discretion in locating new outlet too close to existing franchise, and failing to perform legitimate impact study in good faith). As such, franchisors must remember that contract law and well drafted franchise agreements are not an absolute defence, and many jurisdictions will prevent the abuse of a party's discretion by applying the implied covenant of good faith and fair dealing.

However, while a franchisor is required to act in "good faith" and "deal fairly", that does not mean that they have to sacrifice their own economic interests in favour of the franchisee. Generally, parties are free to include provisions in their contracts as they wish, especially if the parties are sophisticated and represented by counsel. As such, a franchisor or franchisee may knowingly enter into an unfavourable economic agreement and, if the contract is clear, the implied covenant of good faith and fair dealing typically cannot be used to contradict the express terms of the contract. *See, e.g., ReBath LLC v. Foothills Service Solutions Company*, No. 21-cv-00870-PHX-DWL, 2021 WL 2352426 (D. Ariz. June 9, 2021) (the court acknowledged the "harsh" result, but refused to apply the implied covenant of good faith and fair dealing over the express terms of the FA and allowed termination after three defaults in a year, even if the defaults were cured); *SAT Aginara, LLC v. 7-Eleven, Inc.*, No. 19-19994 (MAS) (ZNQ), 2021 US Dist. LEXIS 8617 (DNJ January 15, 2021) (the franchisee's implied covenant argument rejected where parties had specifically amended FA to address change in ordinance prohibiting certain hours of operation).

In the context of franchises specifically, some states go beyond the common law good faith requirement. Those states have franchise "relationship" statutes, as discussed in question 9.1, *supra*, and question 14.1 below. These statutes are powerful tools for franchisees that have the ability to override or void provisions, or even the entirety of, a contract. These relationship statutes prohibit, *inter alia*, unfair or inequitable conduct of a franchisor. Some even require "good" reasons for terminating a franchise agreement regardless of the express terms of the contract. *See, e.g., NJ Stat. §56:10-5* (making it a violation to "terminate, cancel, or fail to renew a franchise without good cause"), §56:10-7 (e) (prohibiting the imposition of "unreasonable" standards of performance on franchisees); MN Stat. §80C.14 (prohibiting unfair or inequitable conduct); CA Stat. BPC §20020 (requiring a "good faith" reason for termination). Many of these "relationship" statutes also contain "anti-waiver" provisions, which prohibit any attempt to waive or nullify their statutory protections through contractual language. *See NJ Stat. §56:10-7(a)* (anti-waiver provision). Conduct by a franchisor in violation of a state's "relationship" statutes may rise to the level of an "unfair and deceptive" act under other statutes such as the FTC Franchise Rule or a state's "Little FTC Acts".

Separate and apart from the legal consequences of acting in bad faith or dealing unfairly, franchisors also face serious economic consequences of taking advantage of their franchisees. The U.S. franchise marketplace is highly competitive.

As such, negative reviews of a franchise system by its franchisees can dissuade potential franchisees from buying into the system – especially because a franchisor must disclose (in the FDD) when their units close or fail. Franchisors must also disclose litigations against franchisees. As such, franchisors should tread carefully before placing their immediate economic interests ahead of those of franchised units.

Franchisors should be especially cautious in the current climate. Normally, requiring a franchisee to comply with certain provisions, or to strictly maintain system standards, would be well within the orbit of a franchisor's rights. However, many franchisees in the past few years may have been required to conduct business in accordance with emergency rules and regulations (e.g., governmental action regarding COVID-19 requiring deviation from system standards, hours of operation, staffing requirements, etc.), or to navigate unprecedented economic pressure and supply chain issues (making it impossible to timely pay fees, utilise only approved products or suppliers, or strictly comply with contractual obligations). Therefore, the blind use of a discretionary right by a franchisor to default or terminate a non-compliant franchisee, may give rise to potent claims under the implied covenant of good faith and fair dealing, particularly where a jury or finder of fact may feel especially sympathetic towards an aggrieved franchisee. Franchisees facing COVID-19 and supply chain disruption-related issues may have much better arguments excusing non-compliance, and will likely appear very sympathetic to a finder of fact if they were treated unfairly during these disruptive times. Franchisors may find the best course of action is to try and work with a franchisee, rather than default or terminate a franchisee, and risk a claim of breach of the implied covenant of good faith and fair dealing. Indeed, in states such as New Jersey (with the New Jersey Franchise Practices Act mandating "good cause" for termination, and prohibiting holding franchisees to an "unreasonable standard of performance") the franchisees are regardless of the express terms of the franchise agreement and should consider the potential legal and economic consequences.

13.2 Is there any limitation on a good faith obligation being unenforceable if it only applies from franchisee to franchisor, rather than being mutual?

In jurisdictions where the implied covenant of good faith and fair dealing exists, the obligation is mutual, automatically incorporated by law, and generally cannot overcome an express contractual term that establishes the parties' respective rights and obligations on a particular issue. However, there is no rule that overrides an express term of a contract that instils a good faith obligation by only one party. Therefore, the implied covenant acts more as a "gap filler" where a contract is silent to a particular issue, or when one party's exercise of discretion is questioned, and limits of that discretion are absent from the contract. The implied covenant will limit that discretion to be performed in good faith.

In jurisdictions that apply the implied covenant of good faith and fair dealing, express waivers of its application are prohibited. Additionally, the affirmative defence of "unclean hands" is often available in these jurisdictions. This means that a party that has acted in bad faith to the detriment of the other party will often be barred from arguing that the other party breached the obligation of good faith and fair dealing.

In jurisdictions where the implied covenant does not exist, it may be useful to require "good faith" with respect to a party's obligation, particularly where the specifics of the performance are not specified in, or anticipated by, the terms of the contract, or where discretion is reserved by the performing party. However,

this practice may not be beneficial to a franchisor that wishes to expand a uniformed franchise system across multiple jurisdictions. Instead, well-drafted franchise agreements should properly delineate a party's actual obligations, rather than leave them up to interpretation. If a franchisor wants to avoid a "good faith" obligation, or wants it to only work "one way" in a specific circumstance, it should expressly set forth the parties' rights and obligations in the contract.

14 Ongoing Relationship Issues

14.1 Are there any specific laws regulating the relationship between franchisor and franchisee once the franchise agreement has been entered into?

The FTC Franchise Rule's disclosure laws do not regulate the conduct of the franchisor after a franchise relationship has been established. However, 21 states, D.C., Puerto Rico and the U.S. Virgin Islands have enacted "relationship laws" that govern the substantive aspects of the franchise relationship after the offer and sale of the franchise is completed. Relationship laws generally address: (i) regulating the franchisors' ability to terminate or refuse renewal of the franchise agreement; (ii) the imposition of restrictions on transfer; (iii) granting franchisees the right to form an association with other system franchisees; (iv) prohibiting franchisors from discriminating against similarly situated franchisees without cause, including selective contract enforcement; (v) restrictions or prohibitions on the franchisor from directly or indirectly (for example, through another franchisee) encroaching upon a franchisee's territory; and (vi) obligations of the franchisor to repurchase inventory upon termination or non-renewal of the franchise. While the specifics of each states' franchise relationship laws vary, their common goal is to protect franchisees for the duration of the business relationship from the unequal bargaining power that typically favours franchisors. (Alaska, Arkansas, California, Connecticut, Delaware, Hawaii, Illinois, Indiana, Iowa, Maryland, Michigan, Minnesota, Mississippi, Missouri, Nebraska, New Jersey, North Dakota, Rhode Island, Virginia, Washington and Wisconsin currently have Relationship Laws.)

While there is no generally applicable federal franchise relationship law, there are both federal and state laws that govern franchise business relationships in specific industries, including: gas station operations; automobile dealerships; hardware distributors; real estate brokerage firms; farm equipment machinery dealerships; recreational vehicle dealerships; and liquor, beer and/or wine distributorship. For example, under the Federal Petroleum Marketing Practices Act, gas station franchisors or refiners cannot terminate the relationship with franchisees without first having "good cause". Good cause in relationship laws generally means that the franchisee has not "substantially complied" with the material terms of the agreement or has engaged in acts that have damaged the franchisor. Such acts, include, but are not limited to the franchisee: (i) voluntarily abandoning the franchised business; (ii) becoming insolvent; or (iii) selling competing goods. If sufficient grounds for termination exist, some states may additionally require the franchisor to provide the franchisee with notice of termination (60 days advance notice is a common requirement) and give the franchisee an opportunity to cure such violations (cure periods typically range from 30 to 90 days). If a franchisor elects not to renew a franchise agreement, the franchisor (under certain circumstances) may be required to either: (i) offer to buy the franchise, if the franchisee owns the gas station; or (ii) give the franchisee the opportunity to purchase the premises from the franchisor, if the franchisor owns the gas station.

There are also 28 states that have enacted unfair trade practice acts (typically referred to as “Little FTC Acts”) that grant “consumers” a private right of action under state law if a franchisor engages in unfair trade practices in violation of corresponding federal law (for example, a little FTC act would provide a private right of action where there is a violation of the Federal FTC Act of FTC Franchise Rule). Alabama, Alaska, Arizona, Connecticut, Florida, Georgia, Hawaii, Illinois, Louisiana, Maine, Maryland, Massachusetts, Mississippi, Montana, New Hampshire, New Mexico, New York, North Carolina, Ohio, Pennsylvania, Rhode Island, South Carolina, Tennessee, Texas, Utah, Vermont, Washington and West Virginia each have Little FTC Acts.

Furthermore, U.S. courts have generally upheld applying the implied covenant of good faith and fair dealing (typically used to interpret commercial contracts) to franchise agreements. The Implied Covenant of Good Faith and Fair Dealing requires each of the contracting parties to perform their contractual obligations in a way that is not inconsistent with the other party’s reasonable business expectations or that would prevent the other party from enjoying the “benefit of the bargain”.

Since relationship laws vary, it is essential to determine which state’s relationship laws apply. Most states, though not all, address jurisdiction in their relationship laws. Among the states that address the jurisdictional application, some apply jurisdiction more broadly than others. Some states, such as New Jersey, require the franchised unit to be located in its state for its relationship laws to apply. Other states apply a broader scope, allowing its relationship laws to apply if the franchisee is a resident of or is domiciled in the state, while others apply an even broader scope.

15 Franchise Renewal

15.1 What disclosure obligations apply in relation to a renewal of an existing franchise at the end of the franchise agreement term?

The FTC Franchise Rule requires franchisors to furnish *all* prospective franchisees with an FDD prior to consummating the sale of a franchise (*see* question 1.2 regarding disclosure obligations). However, the franchisor is not required to provide disclosure to a franchisee who is either: (i) exercising its rights under the existing franchise relationship to establish new outlets; or (ii) renewing or extending its franchise relationship by extending the term of its present franchise agreement or entering into a new franchise agreement, unless the terms and conditions of the new (or extended) franchise agreement are materially different from those under the previous franchise agreement, or if the circumstances surrounding the franchisor and its business have materially changed (e.g., there are changes: in ownership, to financial disclosures, the number of outlets opened and closed, the royalty and marketing fund contribution rates, etc.), in which case disclosure of the FDD is required.

Franchisors must also pay close attention to state disclosure laws that contain provisions addressing disclosure requirements in connection with renewals (i.e., California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Rhode Island, and Virginia). For example, most state laws require re-disclosure where there is an interruption in the business by the franchisee, whereas others state laws require disclosure if the terms of the franchise relationship under the renewal agreement are materially different from those provided for in the previous agreement.

15.2 Is there any overriding right for a franchisee to be automatically entitled to a renewal or extension of the franchise agreement at the end of the initial term irrespective of the wishes of the franchisor not to renew or extend?

States generally acknowledge parties’ freedom to negotiate the terms for renewal or extension of the franchise agreement. However, some states have franchise “relationship laws” that restrict the franchisor’s right or ability to refuse to renew a franchise agreement. The restrictions imposed by these relationship laws vary from state to state. Several states require that the franchisor: (i) have “good cause” or “just cause” to refuse renewal of a franchise agreement (e.g., California, Connecticut, Hawaii, Illinois, Indiana, Michigan, Minnesota, Nebraska, New Jersey, Rhode Island and Washington); (ii) provide franchisees with at least 90 days’ (e.g., Delaware, Mississippi and Missouri), and in some cases, six months’ (e.g., in Connecticut where the non-renewal is based on a determination to not continue to lease property to the franchisee), prior notice of the franchisor’s intent to not renew the franchise agreement; (iii) repurchase the franchisee’s assets (e.g., Arkansas, California, Connecticut, Hawaii, Maryland, Rhode Island, Washington and Wisconsin); and/or (iv) waive any post-term non-competition restrictions (e.g., California). While the goal of these relationship laws is to protect franchisees from the arbitrary termination or non-renewal of the franchise relationship, such relationship laws often have the side effect of creating perpetual franchises. However, in each case, a franchisee may choose not to renew its franchise agreement. Savvy franchisors and franchisees may take the varying state laws and the protections afforded by them into account when deciding where they wish to sell and/or buy franchises.

15.3 Is a franchisee that is refused a renewal or extension of its franchise agreement entitled to any compensation or damages as a result of the non-renewal or refusal to extend?

Franchisors typically offer franchisees the right to renew their franchise agreements provided that any conditions for renewal have been satisfied. However, if: (i) a franchise agreement is for a defined term without any right of renewal and the franchisor is not in breach of the franchise agreement; and (ii) the franchisee and franchisor do not agree to renew the franchise agreement; then, typically, the franchisee will have no claim for damages relating to the non-renewal. However, there are circumstances under the law where a franchisee may seek damages if a franchisor fails or refuses to renew the franchise agreement, including, for example, where a franchisor: (i) breaches a contract provision pursuant to which the franchisee has a right to renew its agreement; or (ii) violates a state relationship law that restricts the franchisor’s right to fail or refuse to renew a franchise agreement.

Several state relationship laws provide for recovery of the fair market value of the business if the franchisor unlawfully fails or refuses to renew the franchise agreement. For example, in New Jersey, if a franchisor fails to renew or terminates a franchisee in violation of the New Jersey Franchise Practices Act, it must reimburse the franchisee for its loss and pay damages equal to “the actual or reasonable value of the franchisee’s business when the franchisor cuts off the franchise”. *Westfield Ctr. Serv. v. Cities Serv. Oil Co.*, 86 NJ 453, 465-466 (1981). In addition, some state relationship laws require franchisors to repurchase the franchisee’s

business assets (in whole or in part) when a franchise agreement is not renewed. For example, in Iowa, a franchisor must repurchase the franchisee's assets at fair market value as a going concern. In Washington, franchisors are required to compensate franchisees for goodwill, unless the franchisor agrees (in writing) that it will not enforce the non-competition provision in the franchise agreement. In Arkansas, Hawaii and Washington, the franchisor is obligated to repurchase the franchisee's inventory, supplies, equipment, and furnishings. In California, the franchisor is only required to repurchase the franchisor's inventory, whereas Hawaii requires that the franchisor repurchase inventory from the franchisee upon termination of the franchise agreement, whether or not termination was for good cause. It is important for franchisees to know what their renewal rights, if any, are, so that they can make prudent business decisions concerning when and how much to invest in their franchised businesses.

16 Franchise Migration

16.1 Is a franchisor entitled to impose restrictions on a franchisee's freedom to sell, transfer, assign or otherwise dispose of the franchised business?

Yes. Franchisors typically provide in their franchise agreement that franchisees are not permitted to transfer or assign any interest in the franchise agreement (or any interest in the ownership, direct or indirect, of the franchisee entity) without the prior written consent of the franchisor. Franchisors in the U.S. are permitted to impose reasonable restrictions or "conditions" in connection with a proposed transfer of the franchised business. Examples of such conditions typically include: (a) requirements imposed on the existing franchisee (e.g., being current on all of its financial obligations to the franchisor, not being in default of the franchise agreement, the payment of a transfer fee, and the delivery of a general release in favour of the franchisor); and (b) requirements imposed on the transferee franchisee (e.g., entering into the franchisor's "then current" franchise agreement, meeting certain financial criteria qualifying as a franchisee under the franchisor's normal standards, and completing the franchisor's required initial training programme).

Many franchisors also provide in their franchise agreement that they will have a "right of first refusal" with respect to proposed transfers of the franchised business to third parties. This right is frequently waived by franchisors as they are not usually interested in "taking over" additional locations which are in their system by purchasing them at fair market value. However, as many franchisors will not waive their right of first refusal "up front" (e.g., before a deal between the franchisee and prospective transferee is negotiated), the fact that the franchisor has the "right of first refusal", generally has a "chilling effect" on the franchisee's ability to sell, because the proposed purchaser must spend considerable time, effort and money negotiating the deal with the franchisee and entering into an agreement, only to find that "its" deal has been usurped by the franchisor. If prospective purchasers are represented by knowledgeable franchise counsel, counsel may inquire as to whether the franchisor is willing to waive its right of first refusal "up-front" and if it is not, counsel may advise his or her client to move on to another deal.

Several state relationship laws impact on a franchisor's ability to impose restrictions on the franchisee's ability to transfer its business. For example, some relationship laws provide that it is an unfair or deceptive act for a franchisor to refuse to permit a transfer without having "good cause". Others permit a franchisor

to reject a proposed transfer if the transferee fails to satisfy the franchisor's then-current requirements, as long as the franchisor's refusal is not arbitrary. Other relationship laws require the franchisor to provide a timely response to a franchisee's request to transfer, and if the franchisor denies the request, it must provide the franchisee with a "material" reason for the rejection, such as the proposed transferee's failure to meet the franchisor's "standard" requirements relating to financial ability, business experience or character. Some relationship laws provide that in the event of the death or disability of the franchisee (or franchisee's principal, if franchisee is an entity), the franchisee's spouse or heirs will have a reasonable amount of time and opportunity to elect to operate or own the franchised business, so long as the spouse or heir satisfies the franchisor's various then-current standards and requirements for operating the franchise.

16.2 If a franchisee is in breach and the franchise agreement is terminated by the franchisor, will a "step-in" right in the franchise agreement (whereby the franchisor may take over the ownership and management of the franchised business) be recognised by local law, and are there any registration requirements or other formalities that must be complied with to ensure that such a right will be enforceable?

Many franchise agreements in the U.S. contain provisions which provide that the franchisor, under certain circumstances, has a right to "step-in" and take over the operations and management of the franchised business. This may be for a limited period of time, for example, where a principal owner passes away and the franchised business has no manager in place to properly manage the business, or where the business has been experiencing operational difficulties. If this occurs, and where the franchise agreement provides that the franchisor may take over the operations of the franchised business (for the benefit of the franchisee), the franchisor may do so and will typically have the right to retain an agreed upon "management fee" for its services. The franchisor may also have the right to "step-in" and take over the franchised business following its termination of the franchise agreement. If this occurs, it is common for the franchise agreement to grant the franchisor an option, but not necessarily an obligation, to purchase the assets of the franchised business pursuant to a defined formula, which formula may often provide for the purchase of assets for less than market value as a "going concern". However, if a state relationship law is applicable, it may call for a more favourable result for the franchisee and would likely override any less favourable provision contained in the franchise agreement. Reasons for asserting such "step-in" rights, whether "short term" or as a result of termination, include where a franchisee is failing financially, has abandoned the franchised business, or where the franchisee (or its principal(s)) has engaged in egregious and/or criminal conduct which is likely to negatively affect the brand's reputation or good will. This may include the franchisee knowingly defrauding the franchisor, using the brand's trademarks for unauthorised purposes or being found guilty of a felony or crime of moral turpitude. Such "step-in" provisions, which must be disclosed in the franchisor's offering prospectus (FDD) given to prospective franchisees, are typically provided for in the franchise agreement and are generally enforceable. Where the franchisee is going to be leasing the franchised business premises (as is frequently the case), the franchisor should require that the franchisee enter into a "Collateral Assignment of Lease" agreement (typically, a three-party

agreement between franchisor, franchisee and the landlord) which will provide for the various circumstances in which the franchisor will be permitted to assert its “step-in” rights. If such an agreement is entered into (or the landlord otherwise consents in writing, such as in a lease rider or lease amendment), the franchisor will likely be able to enforce its “step-in” rights, including the right to take an assignment of the franchisee’s lease.

While there are no registration requirements or formalities that must be complied with in connection with a franchisor’s enforcing its “step-in” rights (other than complying with “notice” requirements contained in the franchise agreement), the franchisee and/or the landlord (if no “step-in” rights have been provided for in a lease rider or amendment) may object to or seek to frustrate the franchisor’s attempts to assert “step-in” rights. In such case, the franchisor would usually not be permitted to use any form of “self-help” (under governing state law) and it is likely that it would be forced to commence an action or proceeding in court to assert its rights. Where the franchisee files for federal bankruptcy protection before a franchisor tries to enforce its “step-in” rights, the bankruptcy filing typically results in the triggering of an “automatic stay” under bankruptcy law which will initially protect the debtor/franchisee. Under those circumstances, the franchisor would have to petition the bankruptcy court to seek to enforce its “step-in” rights. However, this process could take several weeks or even months.

16.3 If the franchise agreement contains a power of attorney in favour of the franchisor under which it may complete all necessary formalities required to complete a franchise migration under pre-emption or “step-in” rights, will such a power of attorney be recognised by the courts in the jurisdiction and be treated as valid? Are there any registration or other formalities that must be complied with to ensure that such a power of attorney will be valid and effective?

With some exceptions (see below), franchisors do not generally use basic powers of attorney in attempting to enforce “step-in” rights which are provided for in the franchise agreement. Rather, as explained above at question 16.2, franchisors often use a “collateral lease assignment” in order to protect and enforce their “step-in” rights. However, franchise agreements commonly include provisions which appoint the franchisor and perhaps “any officer or agent of franchisor” as attorney-in-fact (e.g., holder of a power of attorney), in connection with providing for the orderly (and peaceful) transfer of certain assets of the franchised business which franchisor believes that it has a right to retain after the franchisee no longer has the right to operate the franchised business. These include such assets as telephone numbers, fax numbers, and internet domain names, etc., used by the franchised business. These issues typically arise in the context of an involuntary transfer or termination of the franchised business (as opposed to an approved transfer of the franchised business, that is requested by the franchisee, where the approved transferee will continue operating the business). Such provisions authorising the franchisor to take such action as “attorney-in-fact” are generally enforced.

17 Electronic Signatures and Document Retention

17.1 Are there any specific requirements for applying an electronic signature to a franchise agreement (rather than physically signing a “wet ink” version of the agreement), and are electronic signatures recognised as a valid way of creating a binding and enforceable agreement?

In 2000, the United States Congress passed the Electronic Signatures in Global and National Commerce Act (“ESIGN”), confirming that electronic signatures have the same legal status as “wet ink” signatures. In order to be a valid electronic signature, it is essential that, among other things: (i) each party intends to sign the document; (ii) the signature must be associated with the applicable document; and (iii) in certain consumer situations, the contracting parties must consent to do business electronically. ESIGN pre-empts state laws regarding electronic signatures whenever inconsistent to do so. ESIGN does not mandate the use of electronic signatures, but it affords parties the option.

If the franchise agreement is a deed (not frequently the case), further formalities such as needing to be executed in front of a witness are required. The witness must be present to witness the signing of the document, and there is no current authority on whether the requirement that the witness be present to see the signing can be satisfied by virtual means under normal circumstances. During the COVID-19 era, 46 states have passed laws or (temporarily) rules that allow the remote witnessing of deeds and counterpart signatures. As COVID-19 measures have subsided or expired, 38 states have enacted some form of permanent remote online notarisation (“RON”) law. In May 2021, the “Securing and Enabling Commerce Using Remote and Electronic Notarization Act of 2021 (the “SECURE Notarization Act”) was re-introduced in the U.S. Senate, with the aim of establishing standards for electronic and remote notarisations that affect interstate commerce. In June 2021, the same bill was introduced in the U.S. House. The bipartisan RON bill, if passed, would authorise every notary in the country to perform remote online notarisations for interstate commerce purposes. The bill remains stalled in committee.

While best practices would usually still suggest that the franchise agreement be signed in “wet ink”, so that the witnessing of the signature is less able to be challenged, it is vital to research each state’s current laws, to explore what options are available.

17.2 If a signed/executed franchise agreement is stored electronically (either having been signed using e-signatures or a “wet ink” version having been scanned and saved as an electronic file), can the paper version of the agreement be destroyed?

A franchise agreement that is currently in effect must be retained in either electronic or hard copy for the duration of the contractual term. Once expired, best practices and Internal Revenue Service guidelines recommend a retention period of 10 years. Franchisors also must retain a copy of each materially different

version of their FDD and also a copy of the signed receipt, both for at least three years after the close of the fiscal year when the documents were last used. Many states impose similar, if not stricter, requirements.

Franchisors should also maintain e-signed or “wet ink” copies of executed franchise agreements even if they have been scanned and saved. While many states allow for such document retention to be digital rather than “wet ink”, and the FTC Franchise Rule does not specify a preference, it is prudent to keep “wet ink” versions of these important documents. From an evidentiary perspective, a “wet ink” version provides the best evidence in the event a dispute arises.

18 Current Developments

18.1 What is the biggest challenge franchising is facing in your jurisdiction and how are franchisors responding to that challenge?

Franchising continues to adapt to economic challenges caused, in part, by the COVID-19 pandemic and the fast and consequential shifts in consumer engagement patterns. In the U.S., over a short period of time, a significant portion of the workforce shifted to hybrid or completely remote work environments. As a result, many consumers have relocated, virtually eliminating their demand in some locations, or now seek to shop and access franchised business services where they reside, as opposed to where they once worked. Additionally, many former consumers embraced remote-access shopping and services once provided by local franchisees. Simultaneously, many other customers are yearning for more personal interaction, and have returned to in-person shopping and services, desiring interpersonal interactions with the sellers and service providers they know and trust. As a result of these shifts, both franchisees and franchisors must adapt and adopt creative, individualised approaches in response to how their customer base wishes to access franchised services and what impacts remain unaddressed within a system; particularly for commercial real-estate and brick-and-mortar-based franchises. Upheaval presents challenges and opportunities for franchises; many possibilities exist where markets are shifting or recovering. How franchise systems adapt to their customers is essential to success.

The regulation of restrictive covenants also represents a significant challenge. As discussed *supra* in question 3.6, in-term and post-term non-compete covenants “no-poach” agreements are the targets of increased legislation and regulation at both the federal and state levels, with legislators and regulators seeking to inhibit restraints upon employment and poaching. In addition, at the federal level, the Biden Administration issued an Executive Order “Promoting Competition in the American Economy”, which, *inter alia*, targeted employment restrictive

covenants, including anti-poaching clauses with the DOJ aggressively enforcing labour and employment-related rules. And recently, the Protecting the Right to Organize (PRO) Act (S. 567) passed in the Senate Health, Education, Labor and Pensions Committee that codifies the Browning-Ferris “joint-employer” standard, under which an employer can be required to negotiate with a union over the wages and working conditions of workers it does not directly control, a standard that has already disrupted franchisor-franchisee, contracting, and other business relationships. At the state level, state statutes and regulators vary in their approaches to this issue. More aggressive state regulators have been prosecuting cases under state law seeking to, effectively, judicially prohibit such clauses on their face and several states’ AG’s Offices have aggressively pursued state “no-poach” regulations under state anti-trust laws notably CA under its Cartwright Act, and WA under its Consumer Protection Act.

It also appears that more regulatory challenges remain on the horizon, as the FTC appears ready to proceed with further regulation of the franchisor-franchisee relationship. In June 2023, the FTC closed a comment period in which it requested that the public comment and provide information on franchise agreements and franchisor business processes, with an apparent focus on the balance of power between franchisors and franchisees. This request alarmed franchisor associations and individual franchisors (and some franchisees) because of the possibility that increased FTC regulation would alter the environment surrounding franchise agreements and a wide array of issues that affect franchises, their workers, and the franchise business model overall. Counsel should remain vigilant and keep abreast of these developments.

Finally, it is impossible to ignore the significant upheaval that artificial intelligence (“AI”) may present across all industries, including franchising. Considerable investment and development in AI has already resulted in possibly game-changing AI tools appearing in the U.S. market that are being utilised by more financially robust franchise systems. Both franchisors and franchisees must recognise that AI is neither an omnibus threat, nor an all-encompassing solution. AI is a tool like any other, and, if properly used, can present tangible opportunities to improve franchised systems, including streamlining customer services, identifying potential customers and their needs, improving advertising, and automating previously laborious tasks. We anticipate that franchisors and franchisees who creatively imagine how AI can help their specific system models, and collaboratively explore how AI may be used to help their systems, to become early adopters, obtaining a significant competitive advantage. However, early adopters must remain cognisant that AI is still in its infancy, is prone to potentially significant errors (including those that could cause public-relations issues), is only appropriate for certain tasks and requires human supervision, proper programming, and training. AI will be a game-changer if used appropriately.

Acknowledgments:

The authors would like to thank Jeffrey Mailman, Elizabeth Zakheim, Dennison Marzocco and Brian Looser for their invaluable contributions to the writing of this chapter.

Dennison Marzocco and Jeffrey Mailman are Transactional Associates at the Firm, engaged in a diverse range of business transactions and franchise matters (including the structuring of franchise programmes, the drafting and negotiation of contracts, intellectual property, business formation and commercial leasing transactions. Dennison and Jeffrey are engaged in the formation and guidance of franchisee associations as well as the drafting of franchise documents and the registration of franchisors in various states. Dennison's email address is dm@rosenlawpllc.com and Jeffrey's email address is jm@rosenlawpllc.com.

Elizabeth Zakheim and Brian Looser are Associates at the Firm and members of our litigation team. They are engaged in litigation, in both state and federal courts, as well as in alternate dispute resolution, including both mediations and arbitrations. While both Brian and Elizabeth are primarily engaged in our franchise practice, each of them is familiar with general commercial matters and their areas of practice with the Firm includes these matters, as well. Brian's email address is bl@rosenlawpllc.com and Elizabeth's email address is ez@rosenlawpllc.com.



Richard L. Rosen, the founding member of Rosen Karol Salis, PLLC, whose offices are located at 110 East 59th Street, New York, New York 10022, has been actively engaged in the practice of franchise law for over 40 years, during which time he has represented many franchisors and franchisees, both as an attorney and as a business adviser. Mr. Rosen has counselled and represented franchisors in the setting up of franchising systems and programmes, has formed franchising entities, drafted, and negotiated franchise agreements, registration statements, disclosure documents and other ancillary franchise documents. He has represented franchisees and franchisee associations, has litigated in both state and federal courts (and is admitted to practice in the State of New York, the Southern District of New York, the Eastern District of New York, the 2nd Circuit Court of Appeals and the 9th Circuit Court of Appeals) and has arbitrated and mediated matters on behalf of both franchisors and franchisees. He has represented franchisors and franchisees in essentially every field.

Mr. Rosen is the immediate past Chairman of the American Association of Franchisees and Dealer's Fair Franchising Standards Committee, having served in that position for more than 15 years, and is a member of the AAFD's Board of Directors. He is also a past Chairman of the Legal Steering Committee and the Chairman of the Alternative Dispute Resolution Committee of the AAFD. In 2008 he received the AAFD's Total Quality Franchising Lifetime Achievement Award for his contributions to the field of franchising. He has been a member of the American Bar Association's Forum Committee on Franchising and its Anti-Trust Section since 1968, a founding member and past Chairman of the Franchise, Distribution and Licensing Law Committee of the New York State Bar Association (and the Chairman of its Franchise Relations and Mission Statement Committees), is a Panel Member of the Committees on Franchising and Corporate Law sponsored by the Association of the Bar of the City of New York, a member of the Executive Committee of the Business Law Section of the New York State Bar Association and a member of the International Franchise Association ("IFA"). Mr. Rosen is a member of the Steering Committee of the National Franchise Mediation Program, a member of the CPR Institute for Dispute Resolution's Distinguished Panel of Neutrals in conjunction with the National Franchise Mediation Program and has served as an arbitrator and mediator of franchise cases. Richard Rosen and his firm have earned Martindale-Hubbell's highest rating for legal ability and integrity and Richard is rated amongst Martindale-Hubbell's List of Preeminent Attorneys. Richard is listed in *Who's Who Legal* in America, (and has recently been chosen to receive its Lifetime Achievement Award), *Who's Who Legal* in American Law, *Who's Who Legal* in the World, Best Lawyers in America, "101 Best Franchise Lawyers in America" (the *Franchise Times*), a charter member of the *Franchise Times* "Hall of Fame" of Franchise Attorneys, *Best Lawyers* in the U.S., *America's Super Lawyers*, *Chambers and Partners*, *Who's Who Legal: Franchise* and *The International Who's Who Legal* (Compendium Edition), the *International Who's Who of Business Lawyers* and a recipient of the Global Award for Franchise Law. In 2016, 2017, 2018, 2019, 2020, 2021, 2022 and 2023 Richard was chosen as Franchise Attorney of the Year for the U.S. by Lawyer Monthly and received the Global Award as Franchise Attorney of the Year for the U.S. from Finance Monthly in 2019. Richard was chosen as Franchise Attorney of the Year for the U.S. in 2017, 2018, 2019, 2020, 2021, and 2022 by Global 100. Richard Rosen was named Franchise Lawyer of the Year in the United States by Intercontinental Finance and Law in 2017, 2018 and 2019. Richard and his firm were recently honoured as International Franchise Law Firm of the Year by Global Franchise Organization. In 2018, 2019, 2020, 2021, 2022 and 2023, Richard was named one the 100 Best Attorneys in the World by *LegalComprehensive.com*.

Rosen Karol Salis, PLLC
110 East 59th Street, 23rd Floor
New York, NY 10022
USA

Tel: +1 212 644 6644
Email: rlr@rosenlawpllc.com
URL: www.richardrosenlaw.com



Leonard S. Salis is a Brooklyn Law School graduate with 27 years of legal experience. He has worked closely with Richard Rosen since August 2002, becoming a partner in the firm in 2010. Leonard has become an experienced business lawyer with an extensive knowledge of franchise law and franchise-related matters, as well as corporate law, real estate and dispute resolution. In 2022 and 2023, Leonard was recognised with the award for Franchise Lawyer of the Year in the U.S. by ACQ5 Gamechangers TM Global Awards. Also, in 2022, The Lawyer Network awarded Leonard with its Annual Awards Winner in three categories: Real Estate Lawyer of the Year – New York; Distribution Lawyer of the Year – New York; and Corporate Lawyer of the Year – New York. Leonard was featured in *Marquis Who's Who* Top Lawyers 2020–2021. In 2019, Leonard was awarded the Albert Nelson Lifetime Achievement Award from *Marquis Who's Who* and he has been listed in *Marquis Who's Who* since 2019. Leonard is the co-author of the chapter on Franchise Law in the U.S. which appears in the third, fourth and fifth editions (published 2016–2018) of the (International) Franchise Law Review, the review of Franchise Law in the U.S. which appears in the 2018, 2020, 2021, 2022 and 2023 editions of the International Comparative Legal Guide for Franchise Law, the 2021, 2022 and 2023 editions of the Lexology Guide to Franchising in the US (New York and New Jersey), and the 2023 edition of the International Comparative Legal Guide for Real Estate Law. Leonard is admitted to practice law before the courts of the State of New York, the Southern and Eastern Federal Districts of New York and the 2nd and 9th Circuit Courts of Appeals. He is a member of the American Bar Association's Forum on Franchising, as well as the New York State Bar Association (Business Law Section's Franchise Distribution and Licensing Committee), the Association of the Bar of the City of New York and New York County Lawyers' Association.

Rosen Karol Salis, PLLC
110 East 59th Street, 23rd Floor
New York, NY 10022
USA

Tel: +1 212 644 6644
Email: ls@rosenlawpllc.com
URL: www.richardrosenlaw.com



John A. Karol joined the firm in 2010 and has been a partner since 2014. Mr. Karol practises litigation, arbitration, mediation, franchise law, intellectual property law and employment law. Mr. Karol has successfully litigated and arbitrated many franchise-related disputes, for both franchisees and franchisors, litigating in federal and state courts, as well as arbitrating and mediating in a variety of forums. Mr. Karol has worked with Mr. Rosen on a wide variety of franchise-related, commercial, trademark and intellectual property matters, including representing franchisors and franchisees on statutory violation issues, wrongful termination matters, restrictive covenant issues, trademark, copyright, DTSA and IP disputes. Mr. Karol has also represented many employers and employees in various employment-related matters. Mr. Karol has several significant reported decisions, including decisions concerning state and federal franchise laws, the NYFSA and its potential application against individual officers and directors, enforcement of arbitration provisions, and spoliation of evidence ("ESI"), along with litigating to successful conclusion general commercial disputes and commercial real estate matters. Mr. Karol graduated from Fordham Univ. School of Law in 2002 and is admitted to practise in New York, New Jersey, the 9th Circuit, and the United States District Courts for the SDNY, EDNY, DNJ, DMI. He is a member of the NYSBA (Business Law Section's franchise committee), and the NYC Bar Association.

Rosen Karol Salis, PLLC
110 East 59th Street, 23rd Floor
New York, NY 10022
USA

Tel: +1 212 644 6644
Email: jak@rosenlawpllc.com
URL: www.richardrosenlaw.com

Rosen Karol Salis, PLLC (formerly known as The Richard Rosen Law Firm, PLLC) and its predecessors have been providing high-quality legal services in the franchise field for over 40 years from their offices located in New York City. Our firm has represented franchisors, franchisees and franchisee organisations in virtually all areas of franchise law, from setting up franchising systems and programmes, forming all entities, drafting and negotiating (on all sides) franchise and multi-unit development agreements, disclosure and other ancillary documents, to mediating, arbitrating and litigating in both state and federal courts. Our firm negotiates leases, agreements for the sale or acquisition of franchise-related real estate, financing documents and handles all matters applicable to franchise transactions. We have represented franchisors and franchisees in virtually all fields, including restaurants, real estate brokerage, healthcare, fast food, fitness, energy, hospitality, education, health and beauty, telecommunications, senior care, courier services, apparel and many more. Rosen

Karol Salis, PLLC is highest rated by Martindale Hubbell and amongst franchise law firms in the U.S. In 2018, 2019, 2020 and 2021 we were named Franchising Law Firm of the Year in the USA by *Lawyers Worldwide Awards Magazine* and in 2020 we were recognised as the Best Franchise Law Firm by *Global Magazine* and the *Global Organization*.

www.richardrosenlaw.com



International Comparative Legal Guides

The **International Comparative Legal Guide (ICLG)** series brings key cross-border insights to legal practitioners worldwide, covering 58 practice areas.

Franchise 2024 features two industry chapters and 20 Q&A jurisdiction chapters covering key issues, including:

- Relevant Legislation and Rules Governing Franchise Transactions
- Business Organisations Through Which a Franchised Business can be Carried On
- Competition Law
- Protecting the Brand and other Intellectual Property
- Liability
- Governing Law
- Real Estate
- Online Trading
- Termination
- Joint Employer Risk and Vicarious Liability
- Currency Controls and Taxation
- Commercial Agency
- Good Faith and Fair Dealings
- Ongoing Relationship Issues
- Franchise Renewal
- Franchise Migration
- Electronic Signatures and Document Retention
- Current Developments