ICLG

The International Comparative Legal Guide to:

Franchise 2018

4th Edition

A practical cross-border insight into franchise law

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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.

EDITORIAL

Welcome to the fourth edition of *The International Comparative Legal Guide to: Franchise*.

This guide provides corporate counsel and international practitioners with a comprehensive worldwide legal analysis of franchise laws and regulations.

It is divided into two main sections:

Three general chapters. These are designed to provide readers with an overview of key issues affecting franchising, particularly from the perspective of a multi-jurisdictional transaction.

Country question and answer chapters. These provide a broad overview of common issues in franchise laws and regulations in 21 jurisdictions.

All chapters are written by leading franchise lawyers and industry specialists, and we are extremely grateful for their excellent contributions.

Special thanks are reserved for the contributing editor Iain Bowler of DLA Piper for his invaluable assistance.

Global Legal Group hopes that you find this guide practical and interesting.

The *International Comparative Legal Guide* series is also available online at www.iclg.com.

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Franchising as a Means to Access New and More Lucrative Markets

DLA Piper

Iain Bowler

The high street in many of the world's traditional leading economies is becoming increasingly difficult and growth in those economies is frequently stagnant. These are difficult times for retailers who need to keep moving their share price forward in an environment of falling sales and diminishing margins. Inevitably overseas markets, particularly in countries where there is a burgeoning middle class hungry for established brands and with money to spend, are seen as a significant opportunity for new, more profitable growth. Yet at the same time, the costs involved in corporate expansion, and the risks associated with beginning new operations in a country that may be geographically remote from existing supply chains and support systems and linguistically and culturally different can be significant. Balancing the desire for growth with the need to mitigate some of these considerable risks often leads businesses that have not previously been franchised to consider whether franchising provides the opportunity they are looking for. The answer in many case is "*yes, it does*".

It is also an undisputable fact that global markets are continuing to integrate and the World Wide Web and social media platforms provide even more powerful tools for businesses large and small to reach new potential customers. As a result, new and relatively underdeveloped markets are being targeted by businesses that are finding their traditional markets saturated and increasingly stagnant in terms of growth.

International expansion is sometimes even seen as an end in itself (which is often a mistake in my opinion). But for many, expanding internationally is seen as an easy and – some believe – cheap way to grow their business, increase revenues and add critical mass.

There are numerous ways to introduce one's brand, products or services to overseas markets, and modern businesses that have international or global ambitions are becoming increasingly adept at finding ways of taking their brands, products or services into new and often culturally alien environments. For many, the expansion methodology of choice has been franchising.

One of the myths that fuels the belief that international expansion through a franchise structure should be easy is the statement that franchising uses other people's (the franchisees') capital. The truth of the matter is somewhat different, at least initially for any business that is considering franchising its brand for the first time. It is undoubtedly the case that once the franchise system has been set up and has become established, the magical leverage enables the franchisor to replicate successful franchise units time and time again at relatively little cost to the franchisor each time a new unit or store opens. However, the costs of setting up the franchise system in the first place, and then the additional costs of adapting your existing domestic franchise system so that it can be rolled out and successfully replicated in new geographic locations, should not be underestimated. Moreover, the importance of getting the system right from the outset cannot be overemphasised. The success of a franchise system depends on the franchisor providing franchisees with a proven and successful business model. Investing properly in developing the system and developing a workable and palatable (to a franchisee) set of franchise documents will repay you time and time and time again. Failure to do so can cause you a never-ending world of pain in the shape of dissatisfied franchisees, a militant franchisee association and a system that could become more trouble than it is worth and ultimately impact the reputation of the brand.

The first piece of advice I therefore give to a client considering geographic expansion by way of franchising, maybe for the first time, is: make sure your expectations are realistic.

Having established a realistic set of expectations, having then put those expectations into a deliverable programme (timetable) and having identified, as far as possible, the resources (human, capital, infrastructure and other) that will be needed successfully to deliver the international expansion plan, while at the same time not taking your eye off the core business at home, you can begin to think about executing your international expansion plan. Some refer to this stage as evaluation, some refer to it as due diligence; others call it planning. Whatever your situation and your preferred turn of phrase, the message is always the same, and can be succinctly abbreviated to the "*6 Ps*" – *Proper Planning and Preparation Prevents Poor Performance*.

Let us now imagine we are in your office: the office of the General Counsel of a well-known fashion retailer, "Pumpkin" which has 65 company-owned stores in the UK. Pumpkin also has three franchised stores operating at three UK airports. Four months ago, Pumpkin's owner Nicholas Black appointed a former New York investment banker as non-executive Chairman of Pumpkin to oversee the growth of Pumpkin with a view to creating a means by which Nicholas Black would be able to realise some of the equity in the Pumpkin brand in a few years' time. Nicholas Black is in his late 50s, and having spent the past 20 years building Pumpkin and the brand up from a market stall in the East End of London, his mind is turning towards retirement and the inevitable question of how he will capitalise on the years of development he has put into the business.

Earlier in the year, Nicholas attended a franchise conference presented jointly by a global law firm and private equity house active in the franchise sector, where he learned that the M&A market for successful and well-managed franchise systems is still very strong. The acquisition by private equity firm Apollo Global Management of CEC Enterprises (Chuck E. Cheese's restaurants) for $1.3 billion and other recent transactions where private equity houses had acquired or made significant investments into franchised businesses resonated with Nicholas.

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You are in your office. The phone rings and the Chairman asks if you have a few minutes. As you rise from your desk, a voice in the back of your mind whispers "*Here we go*!" The Chairman explains that he has had a discussion with Nicholas Black, and they have been thinking about the likely appetite for Pumpkin's range of fashion apparel in a number of different countries. He also explains that he has been researching countries where franchising is a recognised and mainstream method of business expansion. He talks about rapid growth rates amongst franchise systems over the last few years in Brazil, India, China, and South East Asia, where a lot of the Pumpkin products are sourced from. He talks about critical mass, about the importance of market penetration and about the need to build the business to one with earnings before interest, tax depreciation and amortisation (EBITDA) of at least £15 million over the next two to three years to ensure that the business will be attractive to a prospective purchaser. Then, just as you think your head is about to explode, the Chairman also mentions that he has a vision for introducing Pumpkin concessions into a number of leading department stores in the UK, France, Germany and the US and Canada under a series of brand licensing deals.

You return to your office. You are excited. You are impressed by the Chairman's vision for the growth of the business and you are curious about what the achievement of this growth might mean for you and the management team, but first and foremost you are asking yourself "*How am I going to find out what we need to do to establish a franchise system and concession arrangements in multiple countries in the next 24 hours*?".

Welcome to *The International Comparative Legal Guide to: Franchise 2018*. This publication has been compiled to give you the first-line response to the above question. The content has been provided by lawyers and industry specialists in each country who specialise in franchise law and brand licensing, and who are familiar with the needs of General Counsel such as yourself, and others, who need to develop an understanding of the key regulatory, legal and practical considerations that must be considered and addressed when contemplating business expansion through the medium of a franchise system.

But don't be lulled into a false sense of security. This publication will not make you an instant expert in the laws and practice of international franchising. Franchising, as a body of law itself, does not exist in many countries, including the UK. Even in those countries that do have specific franchise laws (like the US), a franchising code of practice (like Australia), or relationship laws that govern the rights and responsibilities that franchisors and franchisees have and owe to one another, franchising as a legal concept involves a number of other disciplines that have a material impact on the way you will structure your franchise system in any given country. Franchising is, in essence, a combination of regulatory compliance (sometimes), contract law, tax structuring, IP law (in the form of trade mark protection and brand licensing), real estate issues and competition law issues, with a bit of employment law (especially with the emergence of the principle of joint employer liability that seems to be spreading out from its origins in the USA), corporate law and data privacy compliance (and more) thrown in for good measure. On top of this, 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 General Counsel of Pumpkin Retail plc, you may already be familiar to some degree with a number of these aspects, but it is almost certainly the case that you will want to consult local legal counsel, or the relationship Partner at the international law firm you have consulted in the past, who in addition to advising on the structural issues relating to the set-up of the franchise system and the preparation of the legal documents, will also coordinate, on your behalf, local legal input from each of the countries into which you are going to take your system.

What this publication will do is enable you to see, at a glance, what you need to know about building a franchise system for the first time or taking your franchise system into other countries, and to identify the key interfaces between franchising and the other areas mentioned above. You can use this publication to get a well-informed insight into the questions you will undoubtedly have when you consider taking your brand abroad. The questions have been formulated based on actual experience of advising clients in relation to international expansion programmes, and have been sense-checked by asking a number of existing international franchisors about the issues they have faced and the specific questions to which they wanted answers when they were considering entering a new territory for the first time.

You can also read across the same question in relation to a number of different countries to produce your own specific *matrix of key issues, by country*, which can be used as a briefing tool and as a checklist for your discussions with your external legal, tax and accounting advisors.

This publication is an essential part of your "*6 Ps*" approach to successfully planning for and delivering your business's international or global expansion strategy. It will enable you to be better informed, to anticipate issues, scope your requirements and so be better prepared, and it will enable you to manage the external resources you will need to engage in an efficient and cost-effective way.

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Iain qualified as a solicitor in 1988 and specialised in corporate merger and acquisition, stock exchange and complex commercial and joint venture work. Between 1998 and 2002, Iain was Director of Corporate Finance at a corporate industrial developer, responsible for the commercial and financial evaluation of acquisition opportunities, transaction structuring and negotiation. He joined DLA Piper as a Partner in 2002 and is Global Co-Chair of the Commercial Contracts & Franchise & Distribution Group.

Iain's work includes commercial transactions of all descriptions, including supply chain management, procurement of goods and services, procurement and maintenance of capital assets, outsourcing, offshoring, manufacturing, logistics, consultancy and services agreements; as well as arrangements for getting goods and services to market, including direct sale, agency, franchise, distribution, brand licensing, e-commerce and international trade, and includes advising on appropriate deal structures and delivery mechanisms relating to national and multi-jurisdictional transactions.

DLA Piper has more than 4,200 lawyers and provides a range of legal services around the world. Lawyers operating from offices in Asia, Australia, Europe, the Middle East and the Americas (including Canada) provide high-quality legal advice to clients in their local market and internationally.

Our vision is to be the leading global business law firm. We draw on the knowledge of our locally- and internationally-trained lawyers advising on a broad range of matters including commercial, corporate, bankruptcy and restructuring, tax, finance, human resources, litigation, real estate, regulatory and legislative, technology, and media and communications in every major market around the world.

Our global services are grounded by the strength of our domestic offices, our sector knowledge and our commitment to client-driven services. We support the strategic and operational needs of our clients, wherever they do business.

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Five Key Difference Makers: Best Practices in Enhancing the Likelihood of Your International Franchise Success

Brian Schnell

Lucie Guyot

Faegre Baker Daniels

The international franchise journey can take longer than expected and often is filled with frustrations and failed expectations. The roadside for that journey can look like an empty highway in a war zone with stalled developments and crash and burn ventures littered along the way. Why?

Our objective with this article is to share our insights on the best practices that will make a difference for every franchisor regardless of whether you are a mature franchisor with an established international presence or a franchisor just preparing to launch its international expansion. Each franchisor who moves the needle in a positive direction with each of these five difference makers will see noticeable, positive and sustainable changes in its international franchise performance.

1. Develop a Proactive Strategy for International Growth

Adopt a Winning Strategy. Before making the commitment to expand internationally, a franchisor should critically evaluate whether its brand is ready for expansion. Has the brand been successfully and sufficiently tested and proven in your home country? Are the brand and franchise system mature enough domestically? In other words, has the franchisor developed a well-functioning support system for its franchisees, including providing operations manuals, offering a proven training curriculum administered by experienced trainers, as well as providing first class marketing resources and any applicable integrated technology solutions? A ready franchisor will have invested in developing quality web-based educational, marketing and other resources as well as an intranet for its franchisees, all of which it will be able to roll out internationally. In addition, a franchisor must know the details of its system's unit level economics, as any sophisticated prospective foreign franchisee will demand this data. Ask yourself: Can our franchise system produce an acceptable return on investment for a foreign franchisee?

An essential step in committing your franchise system to international growth is a critical self-evaluation of the brand and operating system. Your leadership team must identify the core values of your brand and system:

- What aspects of the system are key elements of the brand?
- What aspects of the brand are critical to its success?
- How is the brand perceived by consumers?
- What aspects of the system can be modified to accommodate foreign cultures?

Don't guess or assume the answers to these questions. Commit the strategic plan to writing. Then commit to working that plan proactively rather than reacting to outside forces.

Protect Your Trademarks. A global trademark protection strategy needs to align with your international expansion plans. To protect trademark ownership rights, you should register your trademarks in a country (or in certain countries at least have an application for trademark registration filed) before you market your franchise in the country. Otherwise, you risk that someone else will register your marks first, and in "first to file" countries that may effectively foreclose you from entering the country, or at least potentially significantly increase your cost of entry, as you will have to buy back your trademark rights from the third party. Also, timing in obtaining registrations in different countries is important – in some countries a registered mark may be subject to cancellation unless the mark is used in the country within a certain period of time. You need to plan accordingly and avoid premature registrations of your marks.

Before registering your trademarks in a foreign country, understand what (if anything) a translation or transliteration of your mark means in local language. You may have to adjust your marks to avoid an embarrassing situation where your trademark's local language translation or transliteration is offensive or otherwise inappropriate in the context of the foreign culture. Also, in some countries, obtaining registration can take years. For example, a trademark registration in Brazil can take up to five years.

Understanding these considerations, the associated costs and the timeline for obtaining foreign trademark registrations will help guide your international expansion strategy.

2. Commit to Supporting International Operations and Adapt Your Concept to International Markets

Be Nimble but Stay True to Your Brand's Core Values. It is tempting to chase the one-off internet lead from a distant foreign country. However, that approach to international expansion fails too often. To succeed at international franchising, your leadership team must commit to growing the brand globally. True commitment requires education, preparation and resources.

International expansion will test your team's understanding of the core principles of your franchise system because any successful global expansion will require adaptations to make the system fit within the foreign market and its custom and culture. A clear understanding of these core values will facilitate your team's collaboration with international franchisees in adapting the system successfully to the unique aspects of each country.

Know the Local Market. Developing a successful expansion strategy takes time and resources. You will need to research foreign

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markets to determine which countries/markets are most suitable for your brand. Ask yourself:

- Does the country have a track record of franchising success?
- Is the country friendly to new concepts?
- What does the competitive landscape look like?
- Does the country have a sufficiently large potential market for the franchisor's products or services (i.e., does the country have an established middle and upper class with discretionary income available to spend on the franchisor's products or services)?
- What do consumers in the foreign country value in new brands?
- What adaptations will local culture and traditions demand of the franchised business?
- Does the country have a stable political and economic environment?
- Does it have a pro-business regulatory environment and investment climate?
- Does the country have an established legal system that will allow the franchisor to protect its brand and enforce its rights against a foreign franchisee?
- Are there geographic and/or language barriers or other increased costs of doing business that need to be considered?
- Are there franchise laws to address?

Your strategy should prioritise countries based on the aforementioned considerations.

Develop a Budget. With your international strategy and understanding the core aspects of your franchise system, next, you will need to educate yourself on what resources international expansion will require. For each country, no matter how big or small, certain investments will need to be made:

- translating your operations manuals, training, marketing and other brand materials (if English is not one of the official languages in the target country);
- adapting some of these materials to the peculiarities of the foreign market;
- building a competent team that will provide effective support to international franchisees;
- assessing the costs of in-country training and visits; and
- understanding the impact of foreign exchange controls and withholding taxes on the economics of each proposed transaction.

Building a budget for introducing your brand to a foreign market and supporting a foreign franchisee long-term in the market will be essential to your success and will guide your negotiations of the fees to be paid by the franchisee. In addition to the new market's initial investment, you will need to educate yourself about the ongoing costs involved in the long term relationship. The fees you will require the international franchisee to pay should be calculated based on the budget you build for the foreign market.

Although some costs will apply no matter what country and what the business arrangement between the parties will be, certain costs will vary depending on the structure of the relationship. For example, a master franchise arrangement will require a lesser investment on the franchisor's part because the master franchisee will carry the burden of marketing the brand in the country, training the unit operators and sometimes the translation and other similar costs. On the other hand, direct unit franchising or joint venture arrangements will require a larger investment on your part; however, these latter arrangements will allow you to retain more control over your brand in the foreign country. Assessing which model is appropriate for your brand is critical. And sometimes, you will decide to adopt a different model in different countries, depending on your familiarity with the foreign market, the similarity of cultures, geographic distance, the size of the territory, language barrier, and other considerations.

As part of your global expansion, your team may need to educate itself on supply chain considerations. The foreign franchisee may be able to assist in such efforts and may already have established relationships with suitable suppliers. Understanding supply chain challenges early on, as well as costs involved in overcoming any challenges, will allow you to better assess your investment in entering the foreign market. If a franchisor will supply any goods to the foreign franchisee directly, the franchisor will also need to educate itself on any import and export restrictions involved.

Be Prepared to Negotiate. Unlike domestic franchisees, you need to be prepared to negotiate heavily the terms of the international franchise agreement with the foreign franchisee who is often a significant player in the foreign market. You may need to be prepared to make certain concessions to get the deal done. Being flexible does not mean giving up control over your system and brand though. Again, understanding the core aspects of your brand and system will help you determine what areas you can negotiate. Also, you will need to be prepared that the process will take longer than domestically. You should educate yourself about the cultural nuances of the foreign country that influence the negotiation process. In many cultures outside the U.S., building a relationship first is essential to getting an agreement signed, and that takes time. A U.S. style of direct, aggressive negotiation will not work in many cultures.

Embrace a Spirit of Collaboration. A commitment to international franchising means embracing the spirit of collaboration with your international franchisees. Building a relationship with your foreign franchisee and communicating frequently and effectively will support long term success. This commitment to communication should not be underestimated. Most international franchise failures result from a breakdown in communication, so be sure authentic communication is a core component to the relationship. Do not assume it will simply happen.

Your international franchisee must understand the business and share your devotion to the brand. Educating the franchisee on the core values of the brand but at the same time seeking the foreign franchisee's input on how to best adapt the system to fit within the nuances of the foreign market are important aspects of the relationship with your foreign franchisee. Guidance provided to the franchisee should aim to maximise the franchisee's likelihood of success. For example, appropriate guidance to a foreign master franchisee means being intentional regarding when a master franchisee is allowed to subfranchise if at all. A common mistake is that a foreign master franchisee begins to subfranchise too early, typically before it truly understands the operational aspects of the business or before it knows what it takes to be a subfranchisor and support subfranchisees. Requiring a master franchisee to operate the franchised business for at least 12–18 months before being allowed to subfranchise is a franchisor control that focuses on maximising the master franchisee's likelihood of success.

Finally, a true commitment to global growth means adopting a pace of growth that is sustainable. A franchisor needs to assess what international growth rate its team can support successfully. Granting too many international franchises too quickly is a recipe for failure. A more cautious approach will allow you to learn from mistakes, apply the needed resources to each market and build the success for your brand, country by country. The damage caused by moving too quickly in international expansion can be substantial and foreclose you from entire countries for years.

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3. Avoid Poor Partnering Decisions

The Right People Matter. Sustainable international expansion means taking the time to learn what qualities a suitable international franchisee should possess. In your search for the right people, consider a candidate's:

- passion for your brand;
- understanding of your franchised business;
- alignment with your brand's core values;
- experience in your industry;
- business reputation in the foreign country;
- resources necessary to succeed (i.e., the capital to grow the brand in the foreign market as well as an experienced management team); and
- appropriate skill set for the role (i.e., area developer *vs.* master franchisee).

For example, different skills are required of a multi-unit operator versus a master franchisee. As noted earlier, don't assume that every international franchisee should have the right to subfranchise. A successful master franchisee (i.e., a subfranchisor) can effectively recruit and vet suitable candidates for unit operators, provide support and training to unit operators as well as enforce the unit operators' compliance with your system standards. On the other hand, a successful multi-unit area developer must have the ability to develop and operate a large number of units using the developers' own financial and human resources.

Verifying the candidate's financial resources (by requiring delivery of financial statements) should be an early due diligence step so that you are not pursuing an under-capitalised candidate. Also, understanding the candidate's ownership structure is important in verifying compliance with anti-corruption and anti-terrorism laws. Requiring the prospect to present a proposed business plan for the launch and growth of your brand in the foreign country will help align the parties' expectations as to the pace of the growth, as well as the financial and other resources needed to support such growth, and it will help guide negotiations regarding the development schedule as well as fees paid by the franchisee.

It is essential that you develop an effective due diligence process for vetting candidates and apply it faithfully. Developing a checklist that identifies the various business and legal due diligence considerations is helpful. Even if the prospect presents its business plan, you should independently educate yourself on what investment, initial and ongoing, your foreign franchisee will be required to make in order to successfully launch and grow the brand in the foreign market.

Patience and thoroughness are critical in identifying and vetting the right foreign franchise candidates. The consequences of cutting corners in conducting due diligence on international franchisees can be severe and costly, including significant penalties for violations of the U.S. Foreign Corrupt Practices Act and similar anti-corruption and anti-terrorism legislation. Unwinding international relationships can also be costly and time consuming.

4. Implement an International Structure That Minimises Tax Risks

International franchising poses tax risks and uncertainties. In working on dozens of international franchise transactions in dozens of countries, our firm has developed an approach to initially assess the issues and risks, starting with Five "Prisms", to help franchisors navigate, plan and structure international expansion effectively. Specific areas of concern include: avoiding having an inadvertent "PE" (permanent establishment or business nexus abroad), having proper documentation substantiating transfer pricing decisions when dealing with related parties, being able to remit funds back home at the least tax cost – and at the shortest FX (foreign exchange) approval delays, and using foreign tax credit rules effectively.

Review the Five Prisms. We suggest that early in the planning process, franchisors assess their international expansion through five different tax "prisms":

1. the impact, when relevant, of the extra-territorial reach of U.S. tax law as contained in the Internal Revenue Code (e.g., including the rules regarding reporting of "controlled foreign corporations" and "passive foreign investment companies" and beneficial application of foreign tax credit rules);
2. the impact of local country tax laws where international expansion is to occur;
3. the tax consequences to the company (i.e., franchisor and local affiliates), which include the direct reporting and withholding of tax obligations, and the risk of unexpected tax nexus locally (e.g., triggering an inquiry regarding a PE) where none was intended;
4. the tax consequences to the individual employees, contractors or agents who will be located in or periodically visiting the foreign country (and the effect of the activities and authority of such persons on the tax situation of the franchisor); and
5. the presence and applicability of a tax treaty.

Evaluating international expansion through these "prisms" will help anticipate, and plan in advance for, structures, contract requirements, timely data collection, and cash flows, all with more accuracy and confidence.

Avoid an Inadvertent PE. This is a complex subject, one that should be discussed at length with your international tax advisors. Suffice it to say that no one wants to find out, after its international structure, contracts and payments are set, that it has unanticipated corporate income tax liabilities and reporting responsibilities in the new country. While certainly not an exhaustive list, here are a few of the "traps for the unwary" that could result in having an unanticipated PE:

1. Having an office or fixed place of business abroad that is regularly available to the franchisor (even if it is in an affiliate's or franchisee's facilities).
2. Installing abroad an owned server of the franchisor.
3. Having franchisor employees or officers "habitually" signing contracts in foreign countries that bind or commit the franchisor (these obligations clearly include signing new franchise agreements or amendments to existing agreements, but also include such contracts as sourcing raw materials or ingredients, corporate procurement or purchasing contracts, contract manufacturing and distribution agreements or supply contracts).
4. Performing "services" abroad for customers (e.g., franchisees or subfranchisees) for certain durations provided in various tax treaties (such as U.S. treaties with Canada, China, and India).

Be Prepared with Proper Transfer Pricing Documentation. The international standard for "related party" transactions and pricing generally is: "What would an unrelated party pay for the same product, service or licence under the same or substantially similar circumstances?" Many countries require "contemporaneous documentation" to be in the taxpayer's files at the time its local tax returns are filed, and many countries require specific disclosure on those returns about related party transactions. Having secured in advance a proper transfer pricing study to support the pricing utilised between the related parties is essential these days, but these studies to be effective must be updated periodically (such as every two to three years) and may need to be in the language of the foreign country.

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Get Your Money Out. Many countries require pre-filing with or preapproval by government regulators in order to remit funds abroad, especially if the remittance is to be in hard currency. China, in fact, requires both "SAFE" approval (for FX purposes) and tax clearance, two separate processes. Proactive filings of required tax forms to substantiate lower withholding tax than otherwise provided by local law (such as allowed by applicable tax treaty) is key to ensuring that the franchisor receives the most cash at the least tax cost. And, as a business matter, these approvals may take longer than the standard payment terms and due dates in your standard agreements, so allowances should be made in appropriate cases.

Use the Foreign Tax Credit Rules. Proper application of and planning for the effective use of applicable foreign tax credit rules can also help offset the "net" tax cost of operating abroad. Tax efficiency overall can be improved by knowing which of the two "buckets" of income categories under those rules that the franchisor's foreign source income will fall into, and then planning ahead for utilising foreign income that will be subject to higher rate foreign taxes to be offset by lower rate foreign income.

5. Understand the Legal Environment

Know The Legal Landscape. As discussed above, as an initial step, you need to secure registration for your trademarks. However, your understanding of the laws of the foreign country needs to go beyond intellectual property protection. You should become familiar with the laws (if any) that will govern your offer and sale of a franchise in the foreign country as well as the laws that will impact the day to day operations of the franchised business. In this respect, you must consider any:

(a) franchise, distribution and agency laws that may apply to your relationship with the foreign franchisee, and what obligations or restrictions they will impose on you. For example:
- Are you required to deliver a franchise disclosure document (FDD) to the franchisee? If so, when?
- Are you required to register as a franchisor, or register your FDD and/or franchise agreement with the country's government? What consequences will such registration have? E.g., certain agency laws apply to franchise agreements and they make it difficult and expensive for a franchisor to terminate the agreement;

(b) privacy and data security laws that will impact issues such as:
- what types of data you may require the franchisee to collect from its customers;
- what types of data the franchisee may transmit to you, and how;
- who owns the collected data;
- how you may use the collected data;
- what security measures you and your foreign franchisee should implement with respect to the collection, sharing and storing of data; and
- what protocols you should put in place with your foreign franchisee to address responsibilities and cooperation in the event of a data breach;

(c) antitrust and competition laws that may restrict your ability to enforce a post-termination noncompetition covenant;

(d) tax laws, as discussed above;

(e) local laws that may impose any limitations on your ability to enforce your rights under the franchise agreement, as well as to pursue legal remedies against an international franchisee and to subsequently enforce a judgment or an international arbitration award in the foreign country against the franchisee; and

(f) domestic laws that may apply (e.g., for U.S. franchisors, the U.S. Foreign Corrupt Practices Act, the USA PATRIOT Act as well as U.S. export controls if you will be supplying any goods or products to the foreign franchisee).

You should understand the impact of other influences on the legal system of the foreign country, such as culture, customs and religion. For example, in Saudi Arabia, the law is based on the application of Shari'ah law, which is a collection of principles derived principally from the Qur'an and the Sunnah (the witnessed sayings and actions of the Prophet Muhammad). Also in Saudi Arabia, agreements should be witnessed by two male Muslim witnesses.

One approach that we have used with clients is to prepare a detailed country specific checklist that outlines the various business and legal steps or actions that must be met or satisfied to effectively and efficiently do what is necessary to get an international franchisee launched in a new market. Try it. It will make a difference.

Engage Experienced Legal Advice. It is helpful to engage the services of an experienced international franchise lawyer early in the process of developing your international strategy. Experienced counsel will leverage relationships with reputable lawyers in the foreign countries in which you are interested in expanding and can provide helpful insights into the nuances of doing business in the country and assist you with interpreting and implementing local counsel's advice (particularly when your domestic jurisdiction is subject to common law and the target jurisdiction is subject to civil law, or *vice versa*).

Local counsel will review the franchise agreement and advise of any revisions required in order to make the franchise agreement valid and enforceable in the foreign country. Even if the franchise agreement can be governed by the laws of your domestic country, certain mandatory provisions of local laws (i.e., public policy matters) will apply and local counsel will advise on how to address any inconsistencies between the mandatory law and franchise agreement terms.

Local counsel will assist in preparing a franchise disclosure document if required. Local counsel will also provide guidance on what dispute resolution mechanism is most effective for enforcing your rights under the franchise agreement. Many countries are parties to the New York Convention on the Enforcement of International Arbitration Awards and so generally international arbitration is the preferred mechanism as local court judgments may not be enforceable in a foreign jurisdiction; however, in some countries, choosing local courts will yield most efficient dispute resolution. In countries where English is not one of the official languages, local counsel will also advise on whether the franchise agreement and/or the FDD must be translated into the foreign language to be enforceable (which will be the case in any countries that require franchise registration). Local counsel can arrange for such translation and review it for accuracy.

Experienced local counsel will also advise generally on how developed the foreign country's legal system is, how laws are enforced in the country against foreign parties, and whether the legal system can adequately protect your rights to your system and intellectual property, and such advice will influence your international expansion strategy.

Serious missteps with respect to the applicable legal framework of a foreign country could lead to the demise of the franchisor's system in that country and make it impossible for the franchisor or its franchisees to continue operations in the country. Worse yet, it could lead to fines, penalties or even criminal convictions.

Conclusion. Be thoughtful, deliberate and intentional regarding each of the five key difference makers with input from key stakeholders and advisors with international expertise. Doing so will enhance the likelihood of your international franchise success.

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Mergers & Acquisitions Involving Franchise Systems: Key Due Diligence Considerations

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The number of mergers and acquisitions involving franchise systems has steadily increased in recent decades, but there has been a surge in such M&A transactions in the past few years, largely due to the insatiable appetite of private equity and other investment groups for generally predictable cash flow of franchise systems (compared to company-owned business operations) and the limited capital and hard assets required to run the franchise system (*i.e.* the primary assets of the franchisor are its franchise agreements).[1] However, M&A transactions involving franchise systems present unique issues that must be carefully considered during the due diligence phase and demand a different approach to evaluating the business than the approach customarily taken in M&A transactions involving non-franchise companies. This chapter will discuss certain aspects of due diligence of franchise systems that require a deeper analysis.[2]

Unique Characteristics of the Private Equity Investor in Franchise Systems

Many private equity groups tend to distinguish themselves from other potential investors by having diverse portfolios housing more than one franchise system.[3] Franchisors that have an existing franchise system and seek to expand their portfolio are in the same position. In some cases, these franchise systems involve franchise businesses that compete in the same industry or market segment.[4] While most franchise agreements do not extend promises of market exclusivity by a franchisor to its franchisees beyond the franchisor that is a party to the franchise agreement, rarely are disputes over exclusivity so black and white so as to eliminate disputes about cannibalisation of markets by the affiliates of the contracting franchisor where those affiliates offer franchises for businesses selling similar products or serving similar customers. Other restrictions can pose similar issues where a franchisor requires its franchisees to adhere to product, sourcing or supplier exclusivity or limitations. Therefore, due diligence risk assessment should include the potential impact of acquiring the franchise system on the buyer's existing portfolio of franchise systems and the suppliers and providers that service those systems.

In addition to the challenges presented by acquiring competitive franchise systems, private equity groups may seek to advance objectives for the franchise system that are not aligned with the culture of the franchise system (*i.e.* the primary objective of private equity is to drive the franchise system's growth – for future sale or an IPO – which may include implementing system changes such as introducing new products or reimaging the brand that may be viewed by the franchisor's existing management and franchisees as inconsistent with established and successful operations).

Overview of the Role of Due Diligence in the Acquisition of a Franchise Company[5]

A private equity firm typically selects M&A counsel to represent it through the acquisition of a franchise company as it would a non-franchise company. Due diligence of franchise companies necessarily focuses on: the franchisor's financial health (*e.g.* royalty stream, advertising fund contributions, product sales, rebates and incentives); regulatory compliance under franchise disclosure, registration and relationship regulations and laws; terms of material agreements with suppliers and existence of purchasing cooperatives; the franchisor's allocation of advertising fund contributions; and the health of the franchisor's relationship with its franchisees including assessment of the risk of franchisee non-performance under the franchisor's contracts with its franchisees and role of franchisee associations and franchise advisory councils.

These franchise due diligence topics normally are not at the top of M&A counsel's due diligence list which typically addresses other more generic inquiries such as requests for information about pending claims and litigation, risks of industry non-compliance or exposure (*e.g.* environmental), restrictions on real estate held or leased by the franchisor (*e.g.* whether a franchisor's real estate or other third party contracts are assignable or terminable upon notice (such as in situations involving special venue/concessionaires)), employment benefit plans, intellectual property and corporate matters (*e.g.* organisation, formation documents and history).

This approach to due diligence is typical of a franchise system acquisition, but only scratches the surface of the information that should be obtained to meaningfully value a franchise system. The results of due diligence can be made significantly more beneficial to the buyer by deepening the "dive" into the issues, including an examination of the: (A) evolving landscape of franchising (*e.g.* changes in the economy and franchise-related regulations and the valuation of the franchise system in light of those changes); (B) purchasing arrangements (including credibility of rebates paid to the franchisor and margin of franchisor's revenue comprising such rebates); (C) compliance rate of franchisees generally with the franchise system standards; (D) facts underlying transfers (including multiple transfers of the same location, or "churning"), re-franchising, terminations, non-renewals and failure of multi-unit franchisees to meet development obligations; (E) degree to which franchisees are in agreement with the franchisor with respect to marketing and advertising programmes, purchasing arrangements and initiatives for investment in future development; (F) methods for communicating operational standards and enforcement of those operational standards and degree of control over franchisee operations; and (G) restrictions on the franchisor with respect

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acquiring additional franchise systems or operating with non-traditional venues or different channels of distribution. The information that results from this "deep dive" into the franchise system is necessary to accurately assess the current value of a franchise system and identify potential risks to such value that may arise in the future.

The following outlines documents to be reviewed and issues to be evaluated, with specific emphasis on categories in which buyers should consider making a "deeper dive" when conducting due diligence of franchise companies. The first section addresses the franchise-specific issues that franchise counsel typically handles in the due diligence process. The second section identifies categories of review that are often handled – at least initially – by other counsel but relate to franchise-specific issues or nuances.

Key Franchise Issues and Information for Private Equity Buyers

Franchise-Specific Due Diligence

The logical place to begin due diligence is the disclosure document, which provides insight into the franchise system and its financials. Due diligence will include a review of the disclosure documents issued during a specific review period for compliance with the FTC Franchise Rule disclosure requirements and state law requirements in the applicable registration states.[6] In addition, comparisons of the form of disclosure document issued in recent years will reveal the degree to which the franchisor has made changes to the franchise and area development agreements and to the franchise system, each of which might be material to the assessment of the franchisor, the status of the franchisees' compliance with the franchisor's most current standards and terms of the current franchise offering, and valuation of the franchise system. In this regard, review of the methodology used in preparing the information disclosed in Items 8, 11, 19 and 20 is important to obtaining an accurate assessment of the condition of a franchise system.

1) Purchasing Arrangements by the Franchisor

The buyer should request a list of all supplier contracts and conduct a review of: (A) the franchisor's renewal rights and conditions that must be met to exercise such rights under supply agreements with material suppliers and whether the terms of such agreements are subject to re-negotiation by the supplier upon renewal; (B) the minimum volume purchase commitments under the supply agreements and the franchisor's right to modify such commitments; and (C) the franchisor's right to terminate its agreements with suppliers, and, if it exercises such right to terminate, the obligations of the supplier to participate in an orderly transition to a new supplier.[7]

In addition to confirming that Item 8 complies with the disclosure requirements set forth in the FTC Franchise Rule,[8] the buyer's due diligence also should include a review of the franchisor's purchasing arrangements; this includes mandatory or required product purchases, use of approved and sole supplier arrangements, and adherence to product specifications and standards, as well as revenue the franchisor derives from product purchases. This revenue may be attributable to purchases by franchisees from the franchisor or its affiliates, a payment from a distributor or supplier to the franchisor or its affiliates and, in either case, may include an increase in the purchase price to franchisees, which increase may be paid or received by the franchisor or its affiliates.

With respect to analyses of data on rebates and other allowances the franchisor receives from vendors, the buyer's investigation should include how such rebates and allowances are used, the sustainability of such rebates or allowances, and whether the franchisees historically have supported or objected to these financial arrangements.

The buyer should also confirm whether the information regarding such purchasing arrangements raises red flags with respect to the franchisor's relationship with its franchises. If the franchisor is receiving significant revenue from products purchased directly from the franchisor or from fees added to the purchase price by the franchisor or a supplier who then passes on all or some part of the added fees to the franchisor (referred to as commissions, mark-ups or rebates), there may be reason to further evaluate the sustainability of the revenue stream and/or the franchisees' relationship with the franchisor.

In evaluating the credibility of purchasing arrangements, the buyer's review may include whether the product price paid by franchisees compares reasonably with pricing for similar products in the market, whether the price includes valuable services or other benefits, and whether franchisees could realistically purchase the products or obtain comparable pricing in the open market. Buyers should also consider the degree to which the products are proprietary to the franchisor or otherwise tied to the franchisor's trademarks and brand standards. When a significant percentage of a franchisor's revenue is derived from required franchisee purchases, franchisees often are more likely to question whether the purchase price of the products is fair or competitive. The frequency and volume of complaints by franchisees about purchasing requirements can signal a potential issue with a franchisor's purchasing arrangements. Ultimately, a lack of franchisee acceptance of purchasing programmes casts doubt on the buyer's reliance on the purchasing revenue continuing or at least continuing as forecasted in the future.

Further, the due diligence should include an examination of the franchisor's relationships with its suppliers. For example, what quality control obligations and key performance indicators must the supplier satisfy and what indemnity obligations does the supplier have to the franchisor and franchisees in the event it fails to satisfy such quality control obligations or key performance indicators? Has the supplier consistently met quality control obligations or satisfied key performance indicators?

Finally, the buyer may consider the limitations imposed on its ability to make changes to the supply chain by forming purchasing cooperatives or buying groups in which the franchisees take part in managing the supply chain, including supplier selection and application of incentives or rebates provided by suppliers. The motivations of the franchisees with respect to supply chain management (*e.g.* maximising quality while minimising cost and favorable credit terms) may differ from the motivations of the buyer to maximise profits of the franchise system through purchasing arrangements that increase the franchisor's revenue.

2) Marketing Arrangements, Advertising Fund Management, and Gift Cards and Loyalty Programmes

In addition to ensuring that the disclosure obligations with respect to advertising and technology set forth in the FTC Franchise Rule[9] have been satisfied, due diligence on behalf of a buyer should include evaluation of the marketing and advertising undertaken by the franchisor and any advertising fund administration – specifically, an evaluation of the rights and obligations of the franchisor in administering the advertising fund as set forth in the franchise agreement, as well as the actual treatment of the marketing or advertising contributions in the franchisor's financial statements and in practice.

The buyer should consider the requirements to hold contributions in a separate account or in a trust and the reporting obligations of

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the franchisor and auditing rights of the franchisees with respect to administration of the advertising fund. If the franchise agreement or any communications by the franchisor to the franchisees creates a fiduciary or special and confidential relationship with respect to the advertising contributions, the buyer should ensure the franchisor has segregated the advertising fund from other accounts and maintained appropriate records of the amount and type of expenditures made from the advertising fund. From those records, an analysis of the allocation of advertising contributions should be made to confirm whether the franchisor used contributions only for purposes that are permitted. As with the due diligence of purchasing arrangements, due diligence of marketing arrangements and administration of the advertising fund impacts the relationship with franchisees, as the franchisor's use of the advertising fund is a frequent source of complaints by franchisees. Finally, the buyer should review the performance of any national, regional and local marketing arrangements including P&L statements and reports reflecting contributions, expenditures and deliverables including creative, production and media related to the franchisor's advertising and marketing programmes.

In addition to the foregoing, the buyer should undertake a careful review of the terms of the franchise agreements concerning the franchisor's right to allocate and modify advertising fund contributions and any restrictions as to the franchisor's use of such contributions (*e.g.* restrictions against the use of the advertising fund for overhead or in-house expenses incurred in administering the marketing fund; older forms of franchise agreement may permit only traditional uses such as the purchase of print or television ads). Consideration of whether limitations on the franchisor's use of the advertising fund restrict any plans of the buyer with respect to brand re-image of the franchise system should be made. Further, the buyer should review the franchisor's existing policies with respect to social media and other digital media campaigns implemented by franchisees, including the franchisor's right to set guidelines with respect to such social media campaigns to increase their efficacy for and minimise risk to the brand and whether franchisor retains the right to administer such social media accounts following expiration or termination of the franchise agreement.

Finally, the buyer should examine the performance of any loyalty programmes and gift card programmes, including reimbursement commitments to franchisees, obligations to third party service providers that maintain such programmes and the programmes' compliance with applicable law. With respect to hardware and software utilised by franchisees (particularly the POS and any proprietary software), the buyer should investigate whether there is consistency in the POS system approved for use by the franchisor and actually in use by franchisees across the franchise system; whether the franchisor has access to data regarding the performance of franchised units and whether the franchisor may require the franchisees to upgrade or change any existing hardware or software making up the POS system.

3) FPRs, Unit Economics and Financial Statements

If the franchisor includes financial performance representations ("FPRs") in its Item 19, the unit-level financial performance information provides initial insight into the historical financial health of the franchisor and its franchised units. Given that FPRs often come under scrutiny in franchisor-franchisee disputes, the buyer should take special care to ensure the franchisor's FPRs comply with the requirements of the FTC Franchise Rule.[10] The buyer should request copies of the substantiating data that would be provided to prospective franchisees in support of the franchisor's FPRs and that data should be compared with financial information provided separately through due diligence such as unit sales reports, unit profit and loss statements and any supplemental FPRs prepared by the franchisor in connection with franchise sales. This comparison permits analysis of the "reasonable basis" of the FPRs, the key driver for evaluating any financial performance representation.[11] Omissions in information supporting the FPRs, as well as sampling issues and inaccurate bases or assumptions for representations made, signal potential issues of concern about a financial performance representation's "reasonable basis". In addition, the buyer should review any media claims with respect to franchise unit performance and supplemental financial performance claims, including those prepared by the franchisor to support a refranchising programme for company-owned units. Further, FPRs – or the absence of FPRs – may be material in evaluating future growth expectations, as it can be a powerful sales tool or it can be a litigation risk.

4) Terminations, Non-Renewals and Credibility of Development Commitments

In Item 20, the franchisor must disclose the current number of franchised units, by state, and the changes to those numbers through terminations and non-renewals, as well as information on transfers,[12] which is crucial for planning the due diligence scope.[13] It also provides trending information with respect to transfers and the number of franchisees entering or exiting the system. The buyer should pay special attention to the footnotes in Item 20 which may reveal units that have changed hands multiple times within the same fiscal year. Frequent occurrence of multiple transfers within the same fiscal year (or, "churning") may be indicative of potential problems within a specific market (*e.g.* seasonality and lack of suitable real estate) or indicative of a system-wide weakness. The number of franchisees that have left the system, including transfers, may show "red flags" in the system. A high percentage of transfers, relative to the total number of units, could be an indicator that existing franchisees have lost faith in the brand or other relationship issues.[14] In a similar vein, a large number of unopened units (also disclosed in Item 20) could be an indicator that the system has grown too quickly and there is a shortage of sites or the franchisor is decreasing the number of units it opens.

The buyer should analyse the franchise companies' terminations and non-renewals, including review the correspondence between the franchisor and troubled franchisees that may reflect a problem with the franchise system or the relationship between the franchisor and franchisees. In addition, the franchisor's records with respect to defaults, terminations and non-renewals will confirm whether the franchisor has complied with the franchise agreement and applicable state relationship laws and, importantly, highlight whether any franchise litigation is of material concern to the deal. The buyer should also confirm that the information and documentation regarding such franchisee claims is consistent with the disclosures made by the franchisor in Item 3 of its disclosure document. If serious allegations or common complaints against the franchisor are prevalent, they should be thoroughly investigated as they may reflect a litigation risk or large-scale defections from the system. Both the recent history of franchise renewals (or elections not to renew) and the number of upcoming renewals will shed light on the ongoing value of the franchise system. The buyer should examine: (A) the renewal dates of all of the franchisees in the system; (B) the number of franchise agreements eligible for renewal in the three years post-closing; (C) the number of franchise agreements that were eligible for renewal during the buyer's look-back period that were not renewed by the franchisee (including any demographic and related market trends of such non-renewals); (D) the number of franchisees that were eligible for renewal and failed to renew yet continue to operate their franchise units; and (E) the management team's strategy for motivating franchisees to exercise their renewal rights.

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5) Franchise Agreements

Reviewing each franchise agreement typically is unnecessary and impossible within the budget and time parameters for the due diligence, so the franchise agreement review often focuses on the form of franchise agreements attached to the disclosure document as well as the frequency with which the form of franchise agreement is negotiated and the method of memorialising modifications to the form. Although the key provisions of the franchise agreement that should be considered will vary depending upon the franchise concept, the following list summarises key provisions that typically are material to the franchise relationship.

a) Territorial Protection; Reservation of Rights

The buyer should evaluate whether the franchisor has granted territorial exclusivity to franchisees, and if so, determine whether the scope of such exclusivity restricts any plans of the buyer with respect to anticipated growth of units or development of other distribution channels. For example, whether the franchisor has reserved the right to sell to customers in any protected territory and with respect to potential future markets and alternative channels of distribution, such as online sales, captive markets, other retailers, and national accounts (if applicable) may be important to the valuation of the company.

b) Special Deals or Addenda to Franchise Agreements

The buyer also must evaluate the degree to which the franchisor has negotiated to amendments of the franchise agreement. The less uniform the executed franchise agreements, the more review will be necessary to ensure that standard rights and obligations of the franchisor are consistent and may be relied upon in valuing the system. Administration costs associated with different franchise agreements alone could impact the valuation; but, more importantly, negotiated addenda could materially impact the franchisor's right to receive revenue or impose obligations on the franchisor that a buyer would view as material to any valuation assessment. The buyer also should consider whether the negotiated terms may be eliminated at renewal because the franchisee is required to sign the franchisor's then-current form of franchise agreement as a condition of renewal. In connection with reviewing negotiated terms of the franchise agreements, the buyer also should confirm that the franchisor complied with franchise sales laws in negotiating changes to the standard form franchise agreement.[15]

In addition, the buyer should interview the franchisor to identify whether informal amendments of the terms and conditions of the franchise agreement have been made (*e.g.* communications to the franchise system – either to an individual franchisee, select group of franchisees, the franchise advisory council or association or system-wide – in which the franchisor promised to provide certain benefits to the franchisees or modified the system standards can create an obligation or waiver of rights).[16] Further, the buyer should review the franchisor's franchise sales practices to identify the existence and frequency of pre-signing representations creating a similar risk of the buyer bearing different rights and obligations that those set forth in the form of franchise agreement.

c) Franchisor's Ability to Modify the Franchise System

The degree to which the franchise agreements allow the franchisor to implement necessary changes as the franchise system evolves is critical. Typically, the franchise agreement provides that certain terms and conditions contained in the agreement may be modified by the franchisor and further that such terms and conditions are supplemented by the franchisor's standards set forth in the manuals, which may be updated by the franchisor from time to time.[17] Additionally, the buyer should consider whether the franchise agreement provides the franchisor the right to modify the system trademarks or substitute new trademarks. Finally, the buyer should investigate the method by which the franchisor has historically implemented requirements that franchisees update their units (*e.g.* Are technology updates subsidised by the franchisor? What is the time period within which franchisees are required to complete upgrades to the units?).

d) Non-Traditional Venue Franchise Agreements

Many franchisors grant franchisees the right to operate in non-traditional venues, such as stadiums, airports, hotels and shopping centers. These non-traditional franchise units typically involve contractual relationships between the franchisor and franchisee and between the franchisee and facility owner. The franchisee's rights are commonly limited by the terms of its contract with the facility owner (*e.g.* restrictions with respect to pricing and product offering, operating hours, term of agreement, marketing and technology). The number of non-traditional franchise units and limitations set forth in the agreements with the facility owners should be considered by the buyer in evaluating the sustainability of the revenue stream from such units.

6) Franchisee Associations and Franchise Advisory Councils

A buyer should request information regarding any franchisee advisory council or independent franchisee association, including whether the council or association advises the franchisor regarding specific matters related to the operation of the franchise system and whether the council or association has any consent privileges. The buyer should review the by-laws to determine how the franchisee representation is determined, the types of issues typically considered by the council or association, the percentage of the franchisees that are members and the frequency with which the members meet. The minutes of meetings and communications to and from the council or association also may be useful in determining the extent the council or association has a substantive role in making decisions that impact the administration of the franchise system.

7) Joint Employment Issues

While the issue of joint employer liability of franchisors has been somewhat attenuated by the current political environment, it continues to be a key consideration in evaluating the degree to which the franchisor directly or indirectly exercises control in managing the franchise system in light of the unpredictability regarding how joint employer liability will be handled by federal and state agencies as well as the developing body of common law emanating from the courts.[18] Although there is ongoing disagreement about the degree of control exercised by a franchisor over its franchisees' business to warrant a finding of joint employer liability, it is worthwhile for the buyer to evaluate the franchisor's right to exercise control (or reservation of rights to exercise control) the essential terms and conditions of the franchisees' day-to-day operations (including any rights with respect to the franchisees' personnel). This assessment should include review of the franchise agreement terms, training programmes, operations manual, POS software, and any requirements related to the franchisees' employee hiring, discipline, supervision, scheduling, and direction.

Related Franchise Issues

1) Intellectual property

The service marks and trademarks (including logos) identify a franchise system. The due diligence must include review of the primary marks and registrations to assess their distinctiveness and overall strength. In addition, checking that the franchisor has protected and policed its trademarks (both within the franchise system and from potential infringing use by third parties) is germane to this analysis.

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The buyer should ask whether the seller has registered all key domain names relating to the marks and the targeted franchise system. The buyer should determine whether the seller has maintained control over key domain names respecting the franchise system domestically and in foreign markets where the seller currently conducts activity or may plan to do so in the future. The buyer should confirm: (A) whether the franchisor own the marks or are they licensed from another entity; (B) whether there are intercompany licences reflecting any licence arrangements; (C) the status of all marks (*i.e.* registered or pending, domestically or internationally); (D) whether any marks have been abandoned; and (E) whether there are any outstanding third party claims affecting the marks.

2) International Operations

It is not uncommon for a franchise system to structure its domestic and international programmes differently to facilitate management of franchisees abroad. US franchisors often expand internationally through master franchise arrangements that obligate the master franchisee to provide copies of disclosure documents used in connection with the offer and sale of franchises in its territory and confirmation of any filings required to comply with laws in the applicable jurisdictions as well as communicate regularly with the franchisor regarding compliance of the sub-franchisees with the franchise agreements and franchise system standards. Unfortunately, the franchisor oftentimes has little insight into the operations of its brand abroad. Accordingly, the buyer should investigate the franchisor's relationships with its master franchisees, including: (A) the form of disclosure document used and whether such disclosure document complies with franchise law, if applicable; (B) whether the terms of the franchise agreements executed by the master franchisee and its sub-franchisees are inconsistent with the franchisor's form of franchise agreement, and further, whether any sub-franchisees are in breach of their respective franchise agreements or otherwise operating outside of an executed franchise agreement; (C) whether master franchisee is in compliance with its obligations under the master franchise agreement (including payment obligations and obligation to maintain a letter of credit); (D) any pending litigation involving the master franchisee and/or any sub-franchisees with respect to the franchised units; and (E) whether there is privity of contract between the franchisor and the sub-franchisees and to what extent the franchisor must rely on the master franchisee to enforce the terms of the franchise agreements with sub-franchisees.

In conclusion, as franchise systems increasingly are the target of private equity and other investment groups, it is critical that due diligence include a deeper analysis of the key franchise issues described in this chapter to adequately assess risk and measure value of the franchise system, and it is incumbent upon franchise counsel to educate the buyer and M&A counsel as to the integral role these key franchise.

Endnotes

1. In July 2017 alone, Roark Capital acquired Jim 'N Nick's Bar-B-Q (J. Maze, "Roark Capital Group acquires Jim 'N Nick's Bar-B-Q", Nation's Restaurant News (Jul. 10, 2017) (http://www.nrn.com/mergers-acquisitions/roark-capital-group-acquires-jim-n-nick-s-bar-b-q?NL=NRN-01a&Issue=NRN-01a_20170630_NRN-01a_505&sfvc4enews=42&cl=article_1_b&utm_rid=CPG06000001679561&utm_campaign=17186&utm_medium=email&elq2=081867bb6a814223ad7cc2685acdee90)); JAB Consumer Fund and JAB Holding Co. acquired through an investment fund Panera Bread (R. Ruggless, "Panera shareholders approve sale to JAB Holdings" Nation's Restaurant News (Jul. 11, 2017) (http://www.nrn.com/mergers-acquisitions/panera-shareholders-approve-sale-jab-holding)); Bain Capital (through its investment vehicle Bain Capital Double Impact) acquired an interest in a large multi-unit operator of Planet Fitness franchised fitness clubs (K. Leach, "Bain Capital Double Impact makes debut investments in Planet Fitness franchisee and Living Earth Waste Manager", The Middle Market (July 19, 2017) (https://www.themiddlemarket.com/news/bain-capital-backs-planet-fitness-franchise-operator)); Axum Capital Partners buys Back Yard Burgers (J. Maze, "Axum Partners buys Back Yard Burgers", Nation's Restaurant News (July 10, 2017) (http://www.nrn.com/mergers-acquisitions/axum-capital-partners-buys-back-yard-burgers)); "Advent International announces majority investment in daytime café operator First Watch Restaurants", PR NewsWire (July 27, 2017) (http://www.prnewswire.com/news-releases/english-releases/advent-international-announces-majority-investment-in-daytime-cafe-operator-first-watch-restaurants-300495749.html); and Brentwood Associates invested in Blaze Pizza ("Brentwood Associates invests in Blaze Pizza," Nasdaq (July 13, 2017) (http://www.nasdaq.com/press-release/brentwood-associates-invests-in-blaze-fastfired-pizza-20170713-01302).
2. All issues that should be considered when conducting due diligence of a franchise company are too voluminous to address adequately in this Chapter; however, the authors recommend reviewing the relevant chapters of L. Vines & C. Noyes, Mergers and Acquisitions of Franchise Companies, (2d. Ed. 2014) for general guidelines regarding due diligence in M&A transactions involving franchise companies.
3. Roark Capital often is the first private equity firm to come to mind in discussions of private equity ownership in franchise systems, with ownership in franchise systems in the restaurant industry (*e.g.* Focus Brands, CKE Restaurants, Corner Bakery Cafe), automotive industry (*e.g.* Driven Brands), fitness industry (*e.g.* Anytime Fitness) and healthcare (*e.g.* Great Expressions Dental Centers), among others. But, increasingly, private equity firms are acquiring franchise systems–NRD Capital acquired Frisch's Big Boy restaurants in 2015 and Fuzzy's Taco Shop in 2016. *See* J. Maze, *Frisch's acquired by NRD Partners in $175M deal*, Nation's Restaurant News (May 22, 2015), http://www.nrn.com/mergers-acquisitions/frisch-s-acquired-nrd-partners-175m-deal; R. Ruggless, *NRD Capital buys 70% stake in Fuzzy's Taco Shop*, Nation's Restaurant News (Feb. 26, 2016), http://www.nrn.com/finance/nrd-capital-buys-70-stake-fuzzy-s-taco-shop. L Catterton private equity firm expanded its portfolio to include franchise systems Noodles & Company and Pure Barre. *See* J. Maze, *Noodles & Co. sells $31.5M in shares to investment firm*, Nation's Restaurant News (Mar. 14, 2017), http://www.nrn.com/fast-casual/noodles-co-sells-315m-shares-investment-firm; G. Tan, *Catterton Buys Majority Stake in Pure Barre*, Wall Street Journal (May 1, 2015), https://www.wsj.com/articles/DJFLBO0120150501eb51k379a.
4. In addition to the numerous examples of different restaurants operated within the same franchise system (*e.g.* Hardee's and Carl's Jr.), other industries and taking advantage of efficiencies in operating different concepts with the same franchise system, such as Grease Monkey International, which earlier this year acquired SpeeDee. *See* B. Davis, *Grease Monkey buying SpeeDee business from TBC*, Tire Business (Feb. 3, 2017), http://www.tirebusiness.com/article/20170203/NEWS/170209972/grease-monkey-buying-speedee-business-from-tbc.
5. The authors provide a high-level overview of the due diligence process in the sale of a franchise company to provide context. For an in-depth discussion of due diligence in the acquisition of a franchise company, see the relevant chapters in L. Vines & C. Noyes, Mergers and Acquisitions of Franchise Companies, (2d. Ed. 2014).

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6. Part of franchise state law compliance is registration of the FDD with certain states' franchise examiners. To determine compliance with the registration requirements, franchise due diligence counsel should review registration orders for a time period representing the longest applicable statute of limitations. We typically use a five-year time period. In addition to the registration orders themselves, a review of correspondence between the franchisor and the state franchise examiners should be undertaken, as the comments may be indicative of the completeness of the FDD. Additional information that franchise due diligence counsel must review includes: (1) list of states that the FDD is registered; (2) registration files for each registration state during the appropriate "look back" period; (3) notes used in the preparation of the FDD, often interviewing the counsel assisting with FDD registration is helpful to address questions and concerns; (4) all communications with state examiners regarding the registration of FDD; (5) any stop order or other orders of discontinuance; and (6) receipts showing the dates of disclosure to the franchisee (and compare to the dates the franchise agreements were signed).
7. Private equity groups that maintain a portfolio of franchise systems within the same or similar industry may seek to leverage efficiencies in their supply chains by consolidated purchasing of certain products or services with a single supplier, so flexibility in exiting existing purchasing arrangements between the franchisor and its suppliers may be important to a prospective buyer.
8. 16 C.F.R. §436.5(h) (2008).
9. 16 C.F.R. §436.5(k) (2008).
10. 16 C.F.R. §§436.5(s) (2008).
11. 16 C.F.R. §§436.5(s)(3), 436.9(c) (2008).
12. 16 C.F.R. §436.5(t) (2008).
13. For example, for evaluation of compliance with state sales laws, Item 20 provides information about the number of franchisees in each registration state.
14. The buyer should consider contacting former franchisees identified in the disclosure document to determine why the former franchisees left the system.
15. *See* Ca. Corp. Code §31109.1 (requiring a franchisor to register material changes of negotiated franchise sales). Other than in California, franchisors and franchisees have the right to negotiate changes to the franchise agreement prior to sale without the need to register the amendment with state regulatory agencies unless the changes are repeated in multiple franchise sales such that the changes constitute an amendment to the franchise offering.
16. For example, in rolling out a new POS system or upgrade, did the franchisor promise economic assistance, or did the franchisor indicate it would forgive prior defaults in a "new day" communication regarding system or even monetary requirements?
17. This is not to say that the franchisor has free reign to completely change the franchise system at its whim; courts have many times considered the breadth of the franchisor's right to unilaterally make system changes that apply to existing franchisees. *See e.g. Carlock v. Pillsbury Co.*, 719 F. Supp. 791 (D.Minn. 1989) (upholding the franchisor's right to modify product distribution set forth in the franchise agreement to allow the franchisor to sell products to convenience stores and super markets instead of only through Haagen-Dazs franchised and company-owned shops); *Economou v. Physicians Weight Loss Centers of America*, 756 F. Supp. 1024 (N.D. Ohio 1991) (upholding the franchisor's right to modify the system, including the products offered by franchisees, based on the express language of the franchise agreement reserving to franchisor the "right to modify or change the System."); *cf Bird Hotel Corp. v. Super 8 Motels, Inc.*, 246 FRD 603 (D. S.D. 2007) (rejecting the franchisor's interpretation of the language in the franchise agreement that the franchisor "may, from time to time, make revisions in or amendments to such rules of operation" to mean that the franchisor could impose additional fees on its franchisees in connection with implementing a customer loyalty programme).
18. *See Browning-Ferris Indust.*, 362 NLRB No. 186 (2015); *Casey v. Dept. of Health and Human Servs.*, 807 F.3d 395 (1st Cir. 2015); *Donahue v. Asia TV USA Ltd.*, 2016 WL 5173381 (S.D.N.Y. Sept. 21, 2016) (citing *Clinton's Ditch Co-Op Co. v. NLRB*, 778 F.2d 132, 137 (2d. Cir. 1985); *Arculeo v. On-Site Sales & Mktg., LLC*, 425 F.3d 193, 198 (2d. Cir. 2005) and *NLRB v. Solid Waste Servs., Inc.*, 38 F.3d 93 (2d Cir. 1994); *Thompson v. Real Estate Mortg. Network*, 748 F.3d 142 (3d Cir. 2014) (citing *In re Enterprise Rent-A-Car Wage & Hour Employment Practices Litigation*, 683 F.3d 462 (3d Cir. 2012); *Butler v. Drive Automotive Indus. Of American, Inc.* 793 F.3d 404 (4th Cir. 2015); *Salinas v. Commercial Interiors, Inc.*, No. 15-1915, 2017 WL 360542 (4th Cir. Jan. 25, 2017); *Gray v. Powers*, 673 F.3d 352 (5th Cir. 2012); *Grace v. USCAR*, 521 F.3d 655 (6th Cir. 2008); *Ash v. Anderson Merchandisers, LLC*, 799 F.3d 957 (8th Cir. 2015) (citing *Baker v. Stuart Broadcasting Co.*, 560 F.2d 389 (8th Cir. 1977)).

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Australia

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1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

To best understand the meaning of a franchise, reference should be made to the definition of Franchise Agreement outlined in Clause 5 of the Franchise Code of Conduct ("the Code").

Clause 5: A Franchise Agreement is an agreement (either written or implied) that meets the following conditions:

1) the franchisor has granted the franchisee the right to carry on the 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);
2) the operation of the business is substantially or materially associated with a trade mark, advertising or commercial symbol that is owned, used, licensed or specified by the franchisor (or the associate); and
3) the franchisee is required to pay, or has agreed to pay a fee to the franchisor (or its associate) before starting or continuing the business, which may be:
   i) an initial capital investment fee;
   ii) a payment for goods or services;
   iii) a fee based on a percentage of gross or net income; or
   iv) a training fee or training school fee.

A motor vehicle dealership agreement will automatically be covered by the Code even if the above conditions have not been met. However, the Code will not apply where the agreement was entered into before 1 October 1998 (unless the agreement has been transferred, renewed or extended on or after that date).

1.2 What laws regulate the offer and sale of franchises?

The sale and offer of a franchise in Australia is regulated by the mandatory Code under the Competition and Consumer (Industry Codes – Franchising) Regulation 2014, implemented under the Competition and Consumer Act 2010. It is a Federal Act that covers all States and Territories in Australia.

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 the purposes of any franchise disclosure or registration laws?

The obligations to provide disclosure exist between a franchisor and its prospective or existing franchisee (including a Master Franchisor in its dealings with Sub-Franchisors). A Master Franchisor is not required to comply with these obligations in relation to a sub-franchisee unless the Master Franchisor is a party to the Sub-Franchise Agreement.

The terms and definitions have changed under the new Franchise Code in Australia:

- An overseas or Head Franchisor is now referred to as a *Master Franchisor*.
- An Australian Master Franchisor is now referred to as a *Sub-Franchisor.*
- The Sub-Franchisor then appoints sub-franchisees (Unit Franchisee).

The terms Master Franchise and Sub-Franchisor have been defined under the Code.

The Master Franchisor, sub-franchisee and Sub-Franchise Agreement are not defined.

There is no longer a need for joint disclosure or a separate disclosure document to be provided by the Master Franchisor (foreign or overseas franchisor) to a sub-franchisee.

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

There are no registration requirements for Franchise Agreements in Australia; however, Agreements can be inspected by the Regulator, the Australian Competition and Consumer Commission ("ACCC").

Record-keeping is necessary for compliance with the Code. Franchisors are required to retain anything provided to them in writing by franchisees or prospective franchisees, including documents provided electronically.

1.5 Are there mandatory pre-sale disclosure obligations?

Yes, the franchisor is required to provide a prospective first-time franchisee with an "Information Statement" on enquiry, or as soon

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as practicable after an enquiry on interest in acquiring a franchise. In addition, a Disclosure Document (in the form set out under the Code) with a copy of the proposed Franchise Agreement, a copy of the Code, and any other ancillary agreements such as a licence to occupy or other agreements relevant to the franchise, must be provided. The Code requires the franchisor to give the franchisee the above documents at least 14 days before they:

1. enter into a Franchise Agreement (or an agreement to enter into a Franchise Agreement);
2. pay any non-refundable money or other valuable consideration to the franchisor or associate in connection with the Franchise Agreement; and
3. renew or extend 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, an Australian Master Franchisor, now called a Sub-Franchisor, must provide disclosure to sub-franchisees (unit franchisees). However, foreign or overseas franchisors are no longer required to provide disclosure to sub-franchisees. Master or overseas franchisors must still provide Code-compliant disclosure to their Sub-Franchisor.

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; as the disclosure must be in the form set out in the Code and updated within four months after the end of each financial year, a failure to do so may leave the franchisor liable to a civil penalty.

There is no requirement to update each year where:

(a) the franchisor did not enter into a Franchise Agreement, or only entered into one Franchise Agreement during the year; and

(b) the franchisor does not intend, or its directors do not intend, to enter into another Franchise Agreement in the following financial year.

The franchisor must update the disclosure document to reflect the position of the franchise as at the end of the financial year before the financial year in which a request for disclosure is made.

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

Yes, as stated above in questions 1.3 to 1.7 inclusive.

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

No; however, membership with the Franchise Council of Australia ("FCA") is highly recommended, as it provides credibility and access to education and resources.

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

Franchisors who become members of the FCA are required to comply with the ethical standards and codes of conduct set out in the Association's Memorandum and Constitution.

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

Yes, foreign franchisors entering into Australia must provide disclosure and franchise documentation in the English language to comply with the requirements that the franchisee must have read and obtained legal and accounting advice in respect to the documents.

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; however, these are unlikely to impact on a franchisor as the thresholds for foreign investment are very high.

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

Generally, the establishment of an incorporated proprietary limited company under the Corporation's Act 2010 is used. Ownership of the Australian company may be held by the foreign parent company as a wholly owned subsidiary.

Generally, foreign franchisors appoint a Master Franchisor subject to certain performance criteria being met. The Master Franchisor will generally establish a stand-alone company which would then offer franchises to unit franchisees.

Other rights and structures include the grant of area developer rights, joint venture arrangements, and limited partnership arrangements.

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?

Under the Australian Corporations Law, an incorporated legal entity must have at least one resident director, and this can often create an issue where a foreign company does not have any resident able to take up that role.

There are professionals in Australia that will take on the role of a resident director to assist a foreign company.

3 Competition Law

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

Franchising as stated is governed Australia-wide by the mandatory Franchise Code under the Franchise Regulations; however, franchisors must also comply with the Australian consumer laws under the Australian Competition and Consumer Act 2010, which govern issues such as not engaging in misleading and deceptive conduct, not engaging in unconscionable conduct and not engaging in third-line forcing and often anti-competitive conduct.

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3.2 Is there a maximum permitted term for a Franchise Agreement?

No, there are no restrictions as to a minimum or maximum term in a Franchise Agreement.

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

No, there is no minimum or maximum term for any related product or supply agreement.

Franchisors, however, should ensure that they are able to supply product necessary for the franchisee to maintain and operate the franchise business over the franchise term.

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

Yes, under the Australian Consumer Laws, there are resale price maintenance provisions which prevent franchisors and businesses imposing minimum resale prices.

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

There are no legislative restrictions. It is a contractual matter. The franchisor must provide clear disclosure on whether it will offer similar services or product itself in the territory granted to the franchisee and or online. Most Franchise Agreements now provide no territory and an exclusive right to operate only from a site and provide a marketing area or territory. This will depend on the nature of the franchise and the products and services being offered.

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

Restraints, non-compete and non-solicitation of customer covenants are contractually enforceable during the term of the Franchise Agreement. In respect to post-term non-compete and non-solicitation covenants, non-compete provisions depend on the individual circumstances and whether the restraint is considered to be reasonable.

In Australia, non-compete provisions are considered to be anti-competitive and against public policy.

Any post-term non-compete provision must be clear, and usually provides for cascading provisions, both as to time and area, which enable a court to read down the non-compete term.

Generally, non-solicitation of customers and employees and protection of a franchisor's confidential information and know-how are enforceable post-franchise term.

4 Protecting the Brand and other Intellectual Property

4.1 How are trade marks protected?

It is vital, before entering into the Australian market, that franchisors conduct necessary searches with IPO Australia and register their brand and relevant trade marks in the correct classes. In some cases, overseas companies have found that they are unable to register their brand in Australia.

The registration of a trade mark gives a registered trade mark owner exclusive right to use the mark for a term of 10 years.

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

No. Franchisors need to protect their confidential information and trade secrets contractually under the terms of their 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?

No, copyright is inherent under common law and under the *Copyright Act 1968*.

5 Liability

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

A failure to comply with the mandatory disclosure obligations under the Franchise Code of Australia is a fundamental breach which may allow a franchisee to terminate the Franchise Agreement, recover its loss, cost and expenses. The breach may also be referred to the Australian Competition and Consumer Commission ("ACCC") for investigation for imposition of fines and penalties against the franchisor for the breach.

5.2 In the case of sub-franchising, how is liability for disclosure non-compliance or for misrepresentation in terms of data disclosed being incomplete, inaccurate or misleading 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?

Ultimately, a claim by a unit franchisee for inadequate disclosure or misrepresentation will be brought against a Master Franchisor. If the Master Franchisor relied on information supplied to it by the Head/foreign Franchisor, it is likely that the Master Franchisor could join the Head/foreign Franchisor to the cause of action and seek an apportionment of any liability as between it and the franchisor.

Where a Head/foreign Franchisor has an indemnity from liability from the Master Franchisee, there are no legislative restrictions on their relying on the indemnity, as it would be a contractual term between the parties. However, this does not necessarily give the Head/foreign Franchisor complete protection if it failed to disclose material information or provided misleading information to the Master Franchisor which was then supplied on to the sub-franchisee.

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

No. However, it is a good idea for franchisors to have franchisees sign a Representation Statement setting out any representations made prior to signing the Franchise Agreement. If any representation has been detailed, the franchisor should clarify this with the franchisee. The Franchise Agreement should also contain an "entire agreement" provision which states that the Franchise Agreement comprises the "entire agreement" between the parties. However, these "entire agreement" clauses offer limited protection.

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

The requirements for bringing a class action in Australia vary between the States. Class action waiver clauses are likely to be unenforceable in Australia under the Franchise Code and recent implementation of the Unfair Contracts provisions was effected on 12 November 2016.

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.

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 rogue franchisee to prevent damage to the brand or misuse of business-critical confidential information?

Yes, under the Cross Vesting legislation, the *Foreign Judgments Act 1991* and the *Foreign Judgments Regulations 1992*, the local courts provide for the procedure and scope of the judgments that can be enforceable under the statutory regime. Additionally, Australia is party to the bilateral treaty for the *Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Matters 1994* with the United Kingdom. However, Australia is not party to the Hague Convention on *Recognition and Enforcement of Foreign Judgments in Civil and Commercial Matters 1971*.

7 Real Estate

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

Lease terms vary, but are generally 3–5 years long.

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?

Generally, Franchise Agreements provide franchisors with power of attorney provisions that will enable a franchisor, in the event of a franchise's default under the lease, to enter into the premises and sign documents on behalf of the franchisee.

It is often recommended that the franchisor hold the head lease and provide a licence to occupy to the franchisee to return control of the site or head tenant in the event of the franchisee abandoning the premises or being terminated.

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

Yes, under the Financial Investment Review Board ("FIRB") Federal government policies.

Foreign persons need to notify the FIRB before acquiring an interest in developed commercial land only if the value of the interest is more than the relevant notification threshold. The general notification threshold for developed commercial land is $252 million, unless the proposed acquisition is considered to be sensitive, in which case the threshold is $55 million.

If the foreign person is from an agreement investor country, the threshold is $1,094 million regardless of whether the land is considered sensitive.

Corporations and trustees of trusts that meet the definition of a foreign person under the *Foreign Acquisitions and Takeovers Act 1975* ("Act") are required to seek foreign investment approval to acquire interests in residential real estate and these applications will be assessed according to the normal rules. Foreign persons can apply to purchase new dwellings, vacant land for residential development, or established dwellings for redevelopment into multiple dwellings. Foreign persons are generally ineligible to purchase established dwellings as homes, for use as a holiday home or to rent out.

7.4 Give a general overview of the commercial real estate market. Specifically, can a tenant reasonably 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 of a particular location)?

Generally, landlords and Shopping Centre Operators provide an initial rent-free period (of 1–3 months), or a landlord fit-out contribution. This varies between shopping centres, and it also varies greatly between the States and Territories.

The demand for key money is illegal in most States under the State-specific Retail Leasing Legislation.

For landlord investors, the general returns have decreased substantially and are usually around 3–5% returns.

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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 Code now imposes further obligations of disclosure on franchisors as follows:

- Item 12 sets out the information the franchisor must disclose to a prospect franchisee or franchisee if the franchisee may make goods or services available online, if the franchisor or an associate of the franchisor may do so, and if the franchisor may or is expected to make goods or services available online in the future.
- Item 12.5 requires a franchisor to provide details of arrangements that would affect the franchisee, directly or indirectly, including agreements with third parties and other franchisees.

The items seek to promote transparency. Parties should approach the disclosure mindful of good faith.

The Franchise Agreement may require that a lease on a request from a customer outside a franchisee's territory be directed to the franchisee's territory, although this is not common.

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 end-of-term arrangements on termination or expiry of a Franchise Agreement generally impose obligations on franchisees to deliver up phone numbers, customer lists, domain names and cease use of the franchisor's confidential information.

9 Termination

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

Under Division 5, Clauses 26 to 29 of the Franchise Code, there are various events upon which the Franchise Agreement may be terminated with or without notice. The franchisor must comply with the Code provisions. Additionally, the Unfair Contracts provisions under the Australian Consumer Law, which came into effect on 12 November 2016, are applicable to standard form contracts and will affect clauses that give franchisors the unilateral right to vary terms 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?

This issue has recently arisen in Australia where franchisees in a prominent franchise system were underpaying their staff. Although there is no legislative obligation imposed on franchisors, there is proposed legislation through the Fair Work Act and by the Fair Work Ombudsman that will impose liability on franchisors to ensure that their franchisees meet their statutory obligations to employees. This will apply where the franchisor knew or ought to have known that the franchisee was underpaying its staff.

Franchisors therefore need to ensure that they have policies, practices and training to ensure their franchisees meet their workplace obligations.

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 less likely that a franchisor can be held vicariously liable for the acts or omissions of their franchisee's employee; however, there are occupational health and safety requirements that apply to the franchisee. Where a franchisor has failed to provide necessary training and support or is aware there are breaches by the franchisee, the franchisor and its directors may be found to be vicariously liable.

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 restrictions on royalties being paid directly to an overseas franchisor. There are tax treaties between countries that apply and an overseas franchisor looking to establish a franchise system in Australia would need to obtain taxation advice both in Australia and in its own jurisdiction.

Australian laws control and regulate or permit the control and regulation of a broad range of payments and transactions involving non-residents of Australia. Pursuant to a number of exemptions, authorities and approvals, there are no general restrictions on transferring funds from Australia or placing funds to the credit of non-residents of Australia. However, Australian foreign exchange controls are implemented from time to time against proscribed countries, entities and persons. At the present time, these are:

a. Withholding taxes in relation to remittances or dividends (to the extent they are unfranked) and interest payments.

b. The sanctions administered by the RBA in accordance with the Banking (Foreign Exchange) Regulations 1959:
   - transactions involving the transfer of funds or payments to, by the order of, or on behalf of:
     - specified supporters of the former government of the Federal Republic of Yugoslavia (the Milosevic regime);
     - ministers and senior officials of the Government of Zimbabwe;
     - certain entities and an individual associated with the Democratic People's Republic of Korea; and
     - individuals associated with the Burmese regime,

   are prohibited without the specific approval of the RBA.

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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?

Where royalties are paid to a foreign resident, the amount paid is subject to a final withholding tax.

A foreign resident can be an individual, company, partnership, trust or super fund.

Royalties are generally payments made by one person for the use of rights owned by another person. They may be periodic, irregular or one-off payments.

Australian payers must withhold amounts from the payments they make. An Australian payer can be either an Australian resident or foreign resident with a permanent establishment in Australia.

Franchisors should always seek accounting advice on their financial model.

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 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?

This is unlikely as the Franchise Agreement would clearly state the relationship is that of a franchisor and a franchisee, and that the franchisee conducts its own independent business using the brand systems and training supplied by the franchisor and is not an agent of 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?

The Franchise Code, which was amended effective from 1 January 2015. It imposes an obligation on each of the parties to act in good faith, at the entry, during the course of the relationship and at termination. The test of good faith remains set by common law.

Under common law, the duty of good faith requires a party to act reasonably and not exercise their powers arbitrarily or for irrelevant purpose. While good faith requires a party to have regards to the rights and interest of the other party, it does not require a party to act in the interest of the other 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?

The standard laws as governed by the Franchise Code, the Australian consumer laws and unfair contract provisions are the specific laws regulating the relationship between the franchisor and the 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?

The Franchise Code, as from 1 January 2015, imposes end-of-term arrangements and obligations on franchisors. The Code requires franchisors to update their disclosure document within four months after the end of their financial year. The Code requires a franchisor to notify a franchisee in writing at least six months before the end of the term whether the franchisor intends to extend the Franchise Agreement or enter into a new Franchise Agreement when the term expires.

In that event, a franchisor must include a statement in the notice to the effect that the franchisee may request a copy of the Disclosure Document.

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 Franchise Agreement provides the franchisee a further term or option, or option to enter into a new agreement once the term ends. However, the franchisor must give notice in writing to the franchisee as stated in question 15.1. If the franchisee seeks to extend the Agreement and the franchisor does not grant the extension, the Code now provides protection to a franchisee if the franchisor then wishes to enforce a restraint of trade or non-compete provision.

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; however, under the Franchise Code the franchisee has certain protections. The protections only apply if:

1. The franchisee has indicated in writing that it wanted to extend the Agreement on substantially the same terms as those contained in its current Franchise Agreement.
2. The franchisee was not in breach of the Agreement at the time it expired.
3. The franchisee had not infringed the franchisor's intellectual property or breached its confidentiality obligations during the term of the Agreement, and either:
   a. the franchisee claimed compensation for good will because the Agreement was not extended and the compensation given was merely nominal and not genuine compensation for good will; or

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b. the Agreement did not allow the franchisee to claim compensation for good will in the event that it was not extended.

Whether the compensation offered is genuine will depend on the circumstances. There is no definition or criteria for "genuine" compensation set out in the Code.

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 Franchise Code, Division 4 provides that a franchisee may request the franchisor's consent to the transfer of a Franchise Agreement accompanied by all information that the franchisor would reasonably require and expect to be given to make an informed decision.

The franchisor must then advise in writing whether it consents (subject to any conditions) and if not, provide reasons why not.

The franchisor may withhold consent in certain circumstances which are set out under Clause 25 (3) of the Code.

If consent is not given within 42 days of the date on which the request is made by the franchisee, and the date on which the last of the information requested by the franchisor is provided by the franchisee, the franchisor is then taken to have given consent and that consent cannot be revoked.

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, these are enforceable contractual rights if they are contained in the Franchise Agreement.

There are no registration requirements or other formalities; however, it is likely that the franchisor will need to obtain the consent of a landlord to exercise its step-in rights. It is for this reason that many franchisors will hold the head lease and grant a licence to occupy or sublease to the franchisee, in order that the franchisor can control the site and its brand in the event of a breach or termination by the franchisee.

16.3 If the franchise agreement contains a power of attorney in favour of the franchisor under which it may complete all the 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 country 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, most Franchise Agreements provide power of attorney provisions in favour of the franchisor; these are contractual rights and may be relied upon subject to the good faith provisions.

Please note that there are no registration requirements or other formalities that must be complied with.

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Austria

Rechtsanwaltskanzlei Dr. Amelie Pohl

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1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

There is no legal definition of a franchise in Austria. The Austrian Franchise Association uses a definition that refers to the European Franchise Federation. According to Para. 1 of the Code of Ethics of the European Franchise Federation, the definition of franchising is as follows:

"Franchising is a system of marketing goods and/or services and/or technology, which is based upon a close and ongoing collaboration between legally and financially separate and independent undertakings, the Franchisor and its individual Franchisees, whereby the Franchisor grants its individual Franchisee 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, supported by 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.

'Know-how' means a body of non-patented practical information, resulting from experience and testing by the Franchisor, which is secret, substantial and identified:

- 'secret' means that the know-how, as a body or in the precise configuration and assembly of its components, is not generally known or easily accessible; it is not limited in the narrow sense that each individual component of the know-how should be totally unknown or unobtainable outside the Franchisor's business;
- 'substantial' means that the know-how includes information which is indispensable to the franchisee for the use, sale or resale of the contract goods or services, in particular for the presentation of goods for sale, the processing of goods in connection with the provision of services, methods of dealing with customers, and administration and financial management; the know-how must be useful for the Franchisee by being capable, at the date of conclusion of the agreement, of improving the competitive position of the Franchisee, in particular by improving the Franchisee's performance or helping it to enter a new market; and
- 'identified' means that the know-how must be described in a sufficiently comprehensive manner so as to make it possible to verify that it fulfils the criteria of secrecy and substantiality; the description of the know-how can either be set out in the franchise agreement or in a separate document or recorded in any other appropriate form."

1.2 What laws regulate the offer and sale of franchises?

There is no special law that regulates the offer and sale of franchises. Franchising is covered by the general principles relating to commercial law, civil law, antitrust law, etc.

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 the purposes of any franchise disclosure or registration laws?

Yes, this person will be treated as a franchisee.

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

There is no registration required relating to a franchise system, except that the trade mark should be registered for the target market.

1.5 Are there mandatory pre-sale disclosure obligations?

There are no mandatory pre-sale disclosure obligations, but the franchisor must present correct figures and data to the potential franchisee and can be held liable for false sales figure forecasts or other necessary information for the franchisee that is wrong.

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

There is no specific mandatory disclosure law that applies to sales to sub-franchisees. Also, the master franchisee must present the correct figures and data to the sub-franchisee, and can be held liable for any incorrect information.

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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 format of disclosure is not prescribed by law. There is no obligation to provide continuing disclosure to existing franchisees.

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

The franchisor should have a franchise contract, a manual and a pilot shop. The brand should also be protected by registration.

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

Membership of the Austrian Franchise Association is not mandatory but is advisable, as it is a sign of quality.

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

Members of the Austrian Franchise Association must comply with its code of ethics.

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

There is no official requirement for translation but the franchisee should be able to understand the documents; therefore, there might be the need for a translation if the franchisee does not speak the 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, but in general, a seller of goods must have an Austrian trading licence or, depending on the services being delivered, other trading licences may be required.

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

Franchisors tend to use private limited 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?

No. See also question 2.1.

3 Competition Law

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

The following laws apply:

- Commission Regulation (EU) No. 330/2010 of 20 April 2010 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.
- The Austrian Antitrust Law 2005.
- The Austrian Unfair Competition Act.

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

According to Commission Regulation (EU) No. 330/2010 (see question 3.1), a fixed period with a duration of five years can be agreed. There are some exceptions where the duration can be longer (for example, when the franchisor is the owner or tenant of the store of the franchise outlet of the franchisee and sublets it to the franchisee).

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

Depending on the circumstances, there is a maximum term of five years, 10 years or even 20 years, if a fixed duration is agreed.

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

Due to Austrian and European antitrust law, minimum resale prices are forbidden.

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

In general, the franchisee should conduct market research for its new franchise outlet. The franchisor should give to the new franchisee all information pertinent to the market research including the factors which are essential to take into account in order to be successful in the relevant area (population, consumer-flow, parking possibilities, competition, etc.). Also, it depends upon whether the franchisor grants territorial protection to the franchisee or not. If an already existing franchisee has territorial protection, it is not prohibited for a new franchisee to open an outlet in an adjoining territory.

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

In-term and post-term non-compete clauses are enforceable. The maximum duration of the term depends on antitrust law.

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4 Protecting the Brand and other Intellectual Property

4.1 How are trade marks protected?

At national level, a trade mark can be registered at the Austrian Patent Office.

At EU/International level, there are institutions such as the Office for Harmonization in the Internal Market for the EU.

There is also a trade mark right under trade mark law. Copyright law and competition law protects intellectual property.

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

The following protections are in place:

- In franchise contracts, there should be a confidentiality clause.
- The Unfair Competition Act protects business secrets from employees.
- Business and industrial secrets are protected under criminal law.

Business secrets are sometimes protected under the Data Protection Act.

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?

Manuals and software are protected by copyright law.

5 Liability

5.1 What are the remedies that can be enforced against a franchisor for failure 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 in Austria, but the franchisor must present correct figures and data to the potential franchisee and can be held liable for false sales figure forecasts or other wrong information that is necessary for the franchisee.

5.2 In the case of sub-franchising, how is liability for disclosure non-compliance or for misrepresentation in terms of data disclosed being incomplete, inaccurate or misleading 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 is liable for the information he gives to the master franchisee. The sub-franchisee can recover his loss against the master franchisee if the master franchisee has given wrong information. If the master franchisee has received incorrect information from his master franchisor, he can recover against the master franchisor.

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

No. If the franchisor provides incorrect information, he is liable.

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

Class actions are not regulated under Austrian law in general. Only consumers can bring 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?

No, any law is accepted; however, there is national mandatory law that can influence the contract. Every contract should be checked with respect to Austrian mandatory 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 rogue franchisee to prevent damage to the brand or misuse of business-critical confidential information?

Injunctions of a Member State of the EU are recognised due to European law (European Convention on Jurisdiction and the Enforcement of Judgments).

Injunctions of non-EU Member State countries referring to damage to a brand or misuse of business-critical confidential information are not recognised.

7 Real Estate

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

There is no typical length of term for a commercial property. The length of a commercial property lease will depend on the particular circumstances.

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, but it has to be regulated 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?

No, there are no such restrictions.

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7.4 Give a general overview of the commercial real estate market. Specifically, can a tenant reasonably 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 of a particular location)?

Key money as a premium for a lease is not permitted in Austria. A rent-free period cannot be expected but rather it needs to be agreed by, and depends on, the landlord.

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, this is not allowed according to European antitrust law (Commission Regulation (EU) No. 330/2010).

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?

If the domain name includes a trade mark of the franchisor, the franchisee has to either delete the domain name or assign the domain name to the franchisor (against payment). In general, this should be arranged within the franchise contract.

9 Termination

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

With regard to a typical Austrian franchise contract, the answer is no. Agreements of other countries have to be checked, and it depends upon which type of law will apply to the contract. There can be civil law provisions or civil law principles that might override termination rights.

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, there is no risk because the employee of the franchisee will, in general, have a contract with the franchisee and not 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?

No, but the franchisor can be held liable due to the Austrian Unfair Competition Act if the franchisee or his employees infringe the law of unfair competition.

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?

Licence fees (for trade marks or know-how) and services are liable to withholding tax in Austria. If a trade mark is licensed within a franchise system, this situation cannot be avoided.

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 special requirements for financial transactions.

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?

As the franchisee does not sell the goods on behalf of the franchisor, he will not be treated as the franchisor's commercial agent. However, due to rulings of the highest court, some provisions of the Law on Commercial Agents (HVertrG 1993) apply to the franchisee (for example, the compensation for customers at the end of the franchise contract analogous to § 24 HVertrG). One cannot mitigate this risk that some rules will apply to the franchisee; however, the franchisor should check, for example, the possibility and risk of the aforementioned compensation.

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?

Fair dealing is a general principle in Austria according to Austrian general civil law. There is no objective test for that as it is only a principle.

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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 are no specific franchise laws, but there is Austrian general civil law, commercial law and some provisions of the Law on Commercial Agents. Depending on the circumstances, other laws are applicable, for example the Unfair Competition Act.

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 special disclosure law in Austria. If there are circumstances that influence the decision as to the renewal of the franchise contract for the franchisee, the franchisor has to inform the franchisee.

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 overriding 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. Depending on further circumstances, there may be compensation for customers which might apply in a way which is analogous to § 24 HVertrG.

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, as contracts are most often signed by the franchisee in person and not by a company. If the contract is concluded with the company of the franchisee, there should be specific regulations within the franchise contract 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?

There is no law as to whether the franchisor is allowed to "step into" the franchise agreement. We assume that a contractual clause regulating a step-in right by means of taking over the ownership of the company of the franchisee in the above-mentioned case will not be recognised by court. It is different with the rental agreement. If the franchisor wants to "step into" the rental agreement, there can be relevant regulations within the franchise contract, as well as the rental agreement.

16.3 If the franchise agreement contains a power of attorney in favour of the franchisor under which it may complete all the 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 country 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 common practice in Austria.

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Belgium

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1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

There is no legal definition of a franchise as such in Belgian law. However, Book X, Title 2 of the Code on Economic Law concerns pre-contractual information in the framework of commercial co-operation agreements as defined. A commercial co-operation agreement is defined as an agreement between 'several' (i.e. two or more) persons, in which one of those persons grants to the other(s) the right to use certain commercial formula, when selling products or providing services, in one or more of the following forms:

- a common sign;
- a common trade name;
- transfer of know-how; and/or
- commercial or technical assistance.

See Belgian Code on Economic Law (*Code de droit économique / Wetboek van economisch recht*) Book I, Title 2, Article I.11 (definitions applicable to Book X) and Book X, Title 2, Article 26. In many cases, the commercial formula will include more than one of these elements. However, when one of the above elements is present in the commercial formula, mandatory legal requirements concerning the provision of pre-contractual information must be complied with.

1.2 What laws regulate the offer and sale of franchises?

Apart from BCEL Book X, Title 2, the most important statutes were the Law of 6 April 2010 relating to Market Practices and Consumer Protection (*Loi relative aux pratiques du marché et à la protection du consommateur / Wet betreffende marktpraktijken en consumentenbescherming*) and the law on the Protection of Economic Competition consolidated on 15 September 2006 and modified by the provisions of the Law of 6 May 2009 making general amendments (*Loi sur la protection de la concurrence économique, coordonnée le 15 Septembre 2006 / Wet van 15 September 2006 tot bescherming van de economische mededinging, gecoördineerd op 15 September 2006*). These have also now been replaced by equivalent provisions of the Code on Economic 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 the purposes of any franchise disclosure or registration laws?

Yes, the person/entity will be treated as subject to the mandatory rules on pre-contractual information in the framework of commercial co-operation agreements as they are defined. See question 1.1 above.

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

There are no formal registration requirements as regards the franchise system itself.

1.5 Are there mandatory pre-sale disclosure obligations?

Yes, there are mandatory pre-sale disclosure requirements. Although the scope of Title 2 of Book X of the Belgian Code on Economic Law (Articles 26 through 34 inclusive) (inserted by the Law of 2 April 2014) (hereafter "BCEL-X Title 2") is wider than franchise contracts alone (see question 1.1 above), its application means that every franchisor in Belgium is required to communicate a document setting out certain pre-contractual information at least one month before the conclusion of a franchise agreement.

The law specifically aims to ensure that the candidate franchisee is fully aware of the obligations he or she will be taking upon themselves. The mandatory pre-contractual information requirement and 'cooling-off' period give candidate franchisees an opportunity to reflect before embarking on important contractual and commercial commitments. (Other jurisdictions have similar requirements.) The obligations of BCEL-X Title 2 have applied since 31 May 2014. Before that date, a similar (but not identical) Law of 19 December 2005 was applicable.

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

Yes, the mandatory pre-sale disclosure requirements apply to sub-franchisees. The (head or master) franchisee would be required to fulfil these obligations in respect of its sub-franchisee.

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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, the content of the disclosure is prescribed by law.

As well as the draft franchise contract itself, a separate document has to be provided in writing or in another durable format at least one month before any contract is signed or any payment, guarantee or other sum is paid. (An information document in a simplified form can be used for the renewal of existing franchises.)

The information document is divided into two sections.

(i) The important contractual provisions, insofar as they are to be included in the commercial relationship, namely:

- whether or not the franchise agreement is concluded *intuitu personae* (i.e., in consideration of the active participation of particular natural person(s));
- the obligations (i.e., the significant contractual terms);
- the consequences of a breach of the contractual terms (e.g., failure to achieve a contractual commercial target);
- what direct compensation is to be paid by the person who receives the [commercial] rights (franchisee) to the person granting those rights (franchisor) and how the indirect remuneration of the person granting the [commercial] rights will be calculated and, where applicable, how such remuneration may be revised during the contract and upon renewal;
- any non-compete clauses, their duration and conditions;
- the length of the franchise agreement and the conditions for its renewal;
- the conditions of notice and of termination of the franchise agreement, notably in relation to expenses incurred and investments made;
- the right of pre-emption or the purchase option of the party granting the franchise, and the rules for determining the value of the business at the time that this right or option is exercised; and
- the exclusive rights reserved by the franchisor.

(ii) Facts contributing to the correct understanding of the franchise agreement:

- the name or correct designation of the party conceding the franchise as well as its contact references;
- if the contract rights are being granted by a corporate person, the identity and the status of the physical person(s) acting on its behalf;
- the nature of the activities of the party conceding the franchise;
- the intellectual property rights whose use is being granted;
- where available, the annual accounts of the last three accounting years of the party granting the franchise;
- the franchisor's experience of operating the franchise, and its experience of operating the commercial formula independently of any franchise agreement;
- the history, current status and future prospects of the relevant commercial market on which the activities are exercised, both from a general and local point of view;
- the history, current status and future prospects of the franchise network's market share, both from a general and local point of view;
- for each of the last three years, as the case may be, the number of franchises belonging to the Belgian and international network, as well as the expansion prospects for the network;
- for each of the last three years, as the case may be, the number of franchise agreements signed, the number of agreements terminated at the initiative of the franchisor, the number of agreements ended by franchisees, as well as the number of agreements that were not renewed at the end of their term; and
- the expenses that the franchisee agrees to incur and investments it agrees to make at the beginning and during the course of the agreement, detailing their amount, purpose and their depreciation term, the investment timetable and how these amounts will be treated at the end of the contract.

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

No, there are no other formal legal requirements. Commercial leases and business premises are subject to specific rules. However, the laws in question apply to all business enterprises, irrespective of their form, and independently of whether or not they have adopted a franchise format. Particular dietary or religious laws restricting food service or service of alcohol do not apply in Belgium – other than the normal licensing laws.

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

Although membership of the Belgian Franchise Federation ("**BFF**") (which is itself a member of the European Franchise Federation) is not a mandatory requirement, it does give access to a wide range of useful contacts, publications and seminars.

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

Membership of the BFF does not impose any additional legal obligations. Note also that a prospective franchisor is not automatically granted access to the various categories of membership. Membership does imply acceptance of the European Franchise Code.

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

There are three Belgian language communities: French, Dutch and German. There is no requirement for franchise documents to be translated into one of the official languages of Belgium. However, making such a translation may be advisable. Doing so will prevent a franchisee from arguing, in a potential future dispute, that it did not fully understand the documentation provided thus seeking to have unclear or disputed clauses interpreted in its favour. In any event, model agreements prepared in another language, for another jurisdiction, will need to be 'localised' to take account of the requirements of Belgian law.

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. Such laws did exist at one time – but they have been abolished.

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

The form of business entity typically used by a franchisor is the *Société Anonyme / Naamloze vennootschap* ("SA"/"NV"). The SA/NV has a minimum of two shareholders and a minimum capital of €61,500. It is established by notarial deed. A franchisor might also consider incorporating a private limited liability company SPRL/BVBA with a capital of €18,500. Franchises will be subject to the ordinary corporation tax on commercial companies. The Belgian Federal Government announced its intention to reform the Belgian corporate tax system in April 2016. On 27 July 2017, it announced that nominal corporate tax rate, currently 33.99%, will be reduced to 29% in 2018 and in 2019, and will further decrease to 25% in 2020. For small and medium-sized enterprises (SMEs) a reduced tax rate of 20% will apply as of 2018 on that part of the taxable profit not exceeding €100,000.

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?

Yes. They are the following:

A. Official publication of the incorporation in the Belgian State Gazette (*Moniteur Belge / Belgische Staatsblad*).

B. Registration of the operating company with the Commercial Register (*Banque-Carrefour des Entreprises* ("BCE") / *De Kruispuntbank van Ondernemingen* ("KBO"). The BCE/KBO is maintained by the Federal Ministry for the Public Service Economy. It acts as an identifying register for all businesses active in Belgium.

C. Registration for VAT purposes. In general, goods and services provided by a business for commercial gain on an independent and regular basis (as specified under the Belgian VAT Code) are liable to Value Added Tax ("VAT"). VAT is a consumption tax that is borne by the end consumer and is paid at successive stages of the value chain (i.e. for each transaction in the manufacturing and distribution process). The standard VAT rate in Belgium is 21%. Lower rates of 6% and 12% may apply to certain categories of goods and service.

D. Where a retail business has a sales area greater than 400 sq./m. an administrative authorisation must be obtained from the appropriate regional authority (in Wallonia, Flanders or Brussels).

3 Competition Law

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

Franchisors will have to respect applicable national and EU anti-trust rules prohibiting agreements that are in restraint of trade or any abuse of a dominant position on a particular product or service market.

Belgian competition law will apply to agreements the geographic scope of which is limited to Belgium. Legislation of 3 April 2013, amending Belgian competition law, entered into force on 6 September 2013. This Law has been incorporated in the BCEL Book IV (*Protection de la concurrence* / *Bescherming van de mededinging*). It replaces the former Competition Council and Directorate General for Competition by a single body called the Belgian Competition Authority. It should be noted that Belgian competition rules may be of stricter application than the EU rules (see question 3.6 below).

Articles 101 and 102 of the Treaty on the Functioning of the European Union ("TFEU") only apply to the extent that an agreement is capable of having an effect on trade between EU Member States; but in practice the courts have found that this threshold requirement is relatively easily met. Commission Regulation 330/2010 of 20 April 2010 (OJ L 102, 23.04.2010, p. 1) (Block Exemption Regulation on Vertical Agreements) (hereafter "VBER") sets out the principal EU rules in this area. Together with the explanatory Guidelines on Vertical Restraints (OJ C 130, 19.05.2010, p. 1), it identifies restrictive contract terms that are generally considered anti-competitive between companies who act at different levels of the distribution or supply chain, as well as those that will not generally be considered to be so.

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

There is no maximum permitted term for a franchise agreement. Given the investments that the franchisee may be required to make, terms of between 3 to 15 years would not be unusual. A term of nine years will be chosen where it is useful to align the duration of a franchise agreement with a commercial lease agreement.

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

No, but supply agreements should be the subject of self-assessment under the relevant competition laws to ensure that a term longer than five years is either not restrictive of competition or, if it is, that the benefits of the longer term outweigh the possible competitive detriments.

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

Yes. Re-sale price maintenance is prohibited by both EU and Belgian national competition law. This is without prejudice to the franchisor's ability to recommend retail prices.

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

Belgian law does not impose minimum obligations. The history, current status and future prospects of the franchise network's share of the market, both from a general and local point of view, is one of the pieces of information that is to be provided in the mandatory pre-contract disclosure – see question 1.6 above. Any such obligations must be foreseen in the contractual arrangements made between the parties, taking into account the feasibility of the individual business plans of existing neighbouring franchisees.

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

Yes. The transfer of substantial know-how usually justifies an in-term non-compete obligation for the whole duration of the supply agreement in the context of franchising. (EU Commission Guidelines on Vertical Restraints para. 148.) A post-term non-

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compete clause of up to one year's duration may fall within the express permitted exceptions for terms that restrict competition under Article 5(3) of the VBER (*op. cit.* question 3.1 above). This is without prejudice to the possibility of imposing a restriction which is unlimited in time on the use and disclosure of know-how which has not entered the public domain.

Should a particular agreement contain non-compete clauses that are more extensive than permitted by the VBER, they would need to be carefully assessed for compliance with the efficiency criteria of Article 101(3). Note that Belgian competition rules may be of stricter application than the EU rules. In practice in Belgium, a non-compete clause applying for more than one year outside the geographic area initially licensed to the franchisee will generally be considered to be invalid.

4 Protecting the Brand and other Intellectual Property

4.1 How are trade marks protected?

Trade marks must be registered in order to be protected. Separate registration procedures are available for national, Benelux (Belgium, Netherlands, Luxembourg) and EU trade mark registrations. The franchisor's needs have to be reviewed to decide which level of protection is most appropriate to their particular case. The competent authorities are BOIP at the Benelux level and OHIM at the European level. International trade marks that extend to cover Belgium are protected through WIPO.

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

There is no statutory definition or protection for know-how in Belgian law. Generally speaking, the franchise know-how (including computer software, manuals, etc.) is only protectable as such through the franchise contract itself. However, there are a number of provisions that provide protection for particular types of know-how. See, for example, question 4.3 below as regards databases.

N.B. The European Commission Directive on the protection of undisclosed know-how and business information (trade secrets) against their unlawful acquisition, use and disclosure (Official Journal L157 of 15 June 2016) introduces a common definition of trade secrets, as well as means through which victims of trade secret misappropriation can obtain redress. EU Member States are required to bring compliant laws into force by 9 June 2018.

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, provided the work in question is an original work and is expressed in a concrete form. Copyright protection arises automatically from the creation of an original work, including for example books and software. It is not necessary to mark your work with a copyright symbol in order to enjoy copyright protection in Belgium – although it may be advisable to do so.

Note that databases may enjoy particular protection under the rules implementing the EU Database Directive in Belgian law. The law transposing the Database Directive was published in November 1998 (Moniteur Belge 14.11.1998, p. 36914). It amended the existing Belgian Copyright Act. (Law of 31 August 1998, transposing the European Directive of 11 March, 1996, on the legal protection of databases, into Belgian law.)

The Belgian law on copyright was replaced as from 1 January 2015 when the provisions of the Belgian Code of Economic Law concerning intellectual property, now found in BCEL Title XI (*Propriété intellectuelle / Intellectuele eigendom*), came into effect.

5 Liability

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

The principal remedy provided for is that the franchisee may invoke the nullity of the agreement during the first two years after signature of the contract if the mandatory disclosure obligations or the one-month cooling-off period are not respected. (Similarly, if a draft agreement and a simplified document are not provided at least one month before a proposed renewal or modification of an existing agreement.) The nullity of individual 'essential' clauses omitted from the disclosure document may be invoked after the two-year period has expired.

A judgment of the Belgian Supreme Court (Cass., 12 May 2016, n° C.15.0218.N available at www.juridat.be) confirms that the disclosure document must be provided at least "one month" before the conclusion of the franchise agreement (article X.27. first indent of BCEL-X Title 2). The one-month period referred to above should be understood to have its ordinary everyday meaning. It begins to run from the day following the date of the provision of the pre-contractual information document, and ends one month later.

Further, the franchisee may invoke the judge-made (i.e. 'common') law on lack of consent or restitution (quasi-delict) when: data for proper assessment of the commercial partnership agreement is missing, incomplete or inaccurate; significant contractual arrangements are incomplete or incorrect; or significant (proposed) changes to contractual arrangements are incomplete or inaccurate.

Provision has been made to allow the franchisee to waive its legal protection after the expiry of the period of one month following the conclusion of the contract, provided the causes of nullity for which it is providing a waiver are specified (BCEL-X Title 2 Article X.30 last paragraph).

5.2 In the case of sub-franchising, how is liability for disclosure non-compliance or for misrepresentation in terms of data disclosed being incomplete, inaccurate or misleading 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 (head or master) franchisee would be required to fulfil such obligations in respect of its sub-franchisee. (See question 1.6 above.) In view of the provisions of the law, we would not advise the franchisor to give such a contractual indemnity, as any type of exoneration regarding the disclosure regulation would be unlawful.

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

No. However, some clauses might help to reduce the franchisor's liability for the content of a provisional business plan which falls out of the scope of BCEL-X, Title 2.

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

The Belgian Class Action Law (*loi sur l'action en reparation collective / wet over rechtsvordering tot collectief herstel*, as inserted in Book XVII of the BCEL) is currently restricted to violations of specific legislative acts. Violations of a limited list of Belgian and European legislative acts (including, for example, competition law) whose common ground for damages arose after 1 September 2014, can give rise to a cause of collective action on the part of consumers. Book X of the BCEL, which concerns B2B relationships, is not enumerated as giving rise to any such cause of action in BCEL XVII.37.

Only consumer protection organisations can act as class representatives in Belgium BCEL XVII.39. The law grants exclusive competence to the Brussels courts. On the other hand by an Act of 6 June 2017 (*Loi portant insertion d'un Titre 3 "L'action en dommages et intérêts pour les infractions au droit de la concurrence dans le Livre XVII du Code de droit économique / Wet houdende invoeging van een Titel" "De rechtsvordering tot schadevergoeding wegens inbreuken op het mededingingsrecht" in Boek XVII van het Wetboek van economisch recht*) most of the substantive provisions of the EU Directive 2014/104/EU on private damages actions for breaches of competition have been made available in the Belgian class action regime. This means that a group of consumers who have been harmed because of restrictive practices will be able to make use of such provisions, including for discovery of documents.

See further as regards the scope of the 2014 Law: Judgment 41/2016 of 17 March 2016, of the Belgian Supreme Court (Cour de cassation). Given the legislative scope and intent (as to which see Judgment 41/2016, *op cit,* at p. 28, paragraph B.16.3.) to assist consumer claims: one may doubt that a class action waiver clause would be enforceable, but the question has not yet been considered judicially.

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 provisions of Belgian law concerning the pre-contractual phase of the franchise agreement are mandatory and cannot be circumvented by using a "choice of law" clause. Provided the franchisee performs the activities arising from the commercial agreement predominantly on Belgian territory, Belgian law applies and the Belgian courts will have jurisdiction. BCEL-X, Title 2, Article X.33. (An equivalent provision existed in the Law of 2005.)

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 rogue franchisee to prevent damage to the brand or misuse of business-critical confidential information?

Yes. Franchisors can obtain relief before local courts either through summary injunction proceedings, cessation proceedings if third parties are involved, or proceedings on the merits of the case. Foreign awards will be enforced in Belgium based on a set of international treaties.

7 Real Estate

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

The provisions of the Law of 30 April 1951 on commercial leases are of mandatory application to such rentals. The lease duration is a minimum of nine years and is renewable three times. It is common for there to be break or review clauses at three and six years. Where the lessee has made substantial investments in the premises, the lessor may not break the contract and may only refuse a nine-year renewal under specific circumstances. However, it is not uncommon for the lessee to negotiate a one-way break clause at three years – so that the lessee can step out of the contract but the lessor cannot.

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 substitution should expressly be stipulated in the franchise and lease agreement. Even if it is not so agreed, the lessor could not prevent the simultaneous assignment of the lease and the franchise to a third party under Article 10 of the Law of 30 April 1951.

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 no such restrictions.

7.4 Give a general overview of the commercial real estate market. Specifically, can a tenant reasonably 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 of a particular location)?

Depending on the specific location, either situation may exist. Franchisors seeking an "A" location in large commercial malls or in certain reputed high streets where they face waiting lists may need to pay key money. In a depreciated real estate market (such as for certain office locations), initial rent-free periods can be negotiated.

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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, it may not. The EU Competition guidelines on vertical agreements are clear that such an automatic re-direction will be treated as being anti-competitive.

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, provided that such re-assignment is foreseen in the franchise agreement. However, experience shows that such a re-assignment may not be easy to obtain in practice and summary injunction proceedings may be needed to assign or protect the IP rights of the franchisor. However, online dispute resolution regarding domain names, based on trade mark ownership, has become more common and results in quick assignment of domain names.

9 Termination

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

No, termination rights that are contractually provided for will, in principle, be enforceable. At the same time, the Belgian courts retain a measure of discretion to review contract terms that could be considered unfair, abusive, or contrary to fundamental principles of good faith.

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 is possible that the courts could re-qualify a franchise agreement as a contract of employment. For this reason, it is important to seek professional advice on writing the agreement and avoid all wording which could put the franchisee or franchisee's employee(s) in a subordinated position *vis-à-vis* the franchisor. On the other hand, it is commonly accepted that a franchisor is entitled to give economic directives to its franchisees which may be considered as exerting a legal authority. However, it would not be advisable for the franchisor to give other directives or instructions to the franchisee or to the franchisee's employee(s).

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?

Belgian contract law recognises a general principle similar to that which is referred to as "privity of contract" in common law systems. Article 1165 of the Civil Code provides that (in general) contracts only produce effects between the contracting parties. Accordingly, provided that the independent nature of the relationship between franchisor and franchisee is properly established, this question should not arise. As stated above (question 10.1), for this reason it is important to seek professional advice when writing the franchise agreement so as to avoid all wording which could be interpreted as putting the franchisee in a subordinated position *vis-à-vis* the franchisor and/or any behaviour on the part of the franchisor that could be interpreted as that of an employer.

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?

The withholding tax on the gross amount of royalties, after a standard expense deduction of 15%, was increased to 30% (from 27%) as from 1 January 2017. It was 15% for income from authors' and neighbouring rights and for income from legal and compulsory licences not exceeding EUR 57,590 (for tax year 2017). The rate may be reduced or eliminated under an applicable tax treaty. No withholding tax is levied on royalty payments made to qualifying associated EU companies under the EU Interest and Royalties Directive.

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, but in practice we find all transactions are conducted in euros. The payment of franchise fees in a currency other than euros will require thought to be given to contractual provisions governing the exchange rates used for conversion to/from another currency.

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. It is possible that the courts could re-qualify a franchise

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agreement as an agency contract. For this reason it is important to seek professional advice on writing the agreement. It is important to understand the business format and, assuming it falls outside the scope of the imperative law on commercial agents (now incorporated as BCEL Book X, Title 1, Articles X.1 through X.25 inclusive), this should be stated in the franchise 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?

Yes, the basis for BCEL-X Title 2 is that the negotiation for the franchise agreement should be conducted in accordance with the fundamental principles of good faith and fair dealing. (Belgian Civil Code, Article 1134.) Breaking the good faith rule could result in liability to pay the franchisee for any prejudice that it suffers. (Principles of loyalty and good faith govern the formation of contracts under Articles 1109, 1116, 1134, 1213 and 1382 of the Belgian Civil Code.)

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 are no specific franchise laws regulating such relationship. The most important statutes are the Civil Code, the law on contracts and the law relating to Market Practices and Consumer Protection and the law on the Protection of Economic Competition as now implemented in the Code on Economic law. (See question 1.2 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?

BCEL-X Title 2 will apply. However, pre-contractual information may be provided in a simplified form where there is a 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 such overriding right is provided by statute, but a renewal right will normally be provided for contractually.

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, provided that the refused renewal or extension is not abusive, and is in accordance with the contract terms and fundamental requirements as to good faith.

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. Any contractual provisions for the franchisee to assign the franchise, or to introduce a purchaser if it does not wish to continue the franchise, tend to be the subject of pre-emption rights and strict contractual limitation due to the *intuitu personae* character of a 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, such a "step-in" right will be recognised, provided that it has been provided for in the franchise contract and was properly notified under BCEL-X Title 2. It is not subject to registration or other formalities in order to be enforceable.

16.3 If the franchise agreement contains a power of attorney in favour of the franchisor under which it may complete all the 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 country 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?

Provided that the requirement for the power of attorney was properly notified under BCEL-X Title 2 and is in due form and executed by the relevant part(y)(ies), it will be enforceable.

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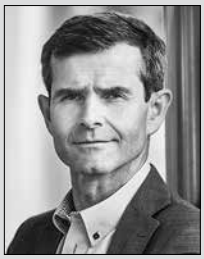

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FLINN

FLINN helps to implement and develop franchise networks and offers a complete range of legal services in the field of franchising. The existence of a franchise network strives to multiply success – so that an individual franchisee's success reflects positively on the other members of the network. However, even if the franchise agreement states that the franchisee is an independent contractor; given the franchisor's obligation to assist the franchisee, there can be a fine line between contractual obligations and potential interference with the franchisee's business.

As well as accompanying you through the negotiations and contractual arrangements – whether they are for the establishment of your master franchise or for the purchase of your first franchise outlet – FLINN lawyers are also aware of the tensions that can arise in franchise networks. We are there to help you solve any such problems in a commercial and cost-effective manner.

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1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

Franchise is defined as the system by which a franchisor grants to a franchisee the right of trademark or patent use, associated with the right to exclusive or semi-exclusive distribution of products or services and, optionally, also the right of use of technology of implantation and administration of a business or operational system developed or owned by a franchisor against direct or indirect remuneration, however without being characterised as an employment relationship.

1.2 What laws regulate the offer and sale of franchises?

The main Brazilian regulation applicable to the offer and sale of franchises is Law n. 8,955 of December 15, 1994 ("Brazilian Franchise Law"). The Brazilian Franchise Law governs all franchise chains established and operated in the Brazilian territory. Additionally, Normative Act 70/2017 along with Resolution 199/2017, both issued by the Brazilian Patent and Trademark Office ("BPTO"), demand the recordation of international franchise agreements for the effectiveness of specific 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 the purposes of any franchise disclosure or registration laws?

The Brazilian Franchise Law is not a relationship law and, consequently, the legal environment for franchise is quite liberal. The parties may freely stipulate in the franchise agreement all terms and conditions of the franchise relationship, including territory exclusiveness. Therefore, although the concept of "business format franchising" usually involves the establishment of multiple units operated by multiple franchisees, if a brand owner decides to appoint only one franchisee in Brazil, said relationship should follow all applicable rules that normally apply to a franchise relationship, irrespective of the number of franchise units initially envisaged by the brand owner.

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

The local disclosure document does not require registration with any regulator. The franchise agreement, however, must be recorded at the BPTO. The record is indispensable for the following purposes: (i) to make the agreement effective against third parties; (ii) to permit the remittance of payments to the foreign party; and (iii) to qualify the licensee for tax deductions. In addition to the recordation of the franchise agreement at the BPTO, for the purposes of remuneration remittances, the registration of the agreement at the Brazilian Central Bank ("BACEN") is also required.

1.5 Are there mandatory pre-sale disclosure obligations?

Yes. The main purpose of the Brazilian Franchise Law is to introduce transparency to franchise relationships, introducing an obligation to the franchisor to provide a franchise disclosure document ("FDD") to prospective franchisees 10 days before the execution of any agreement or payment of any amount to the franchisor or other designated recipients.

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

Yes. Sub-franchisees must also be provided with an FDD 10 days before the execution of any agreement or the payment of any amount to the franchisor, master franchisee or other designated recipients. Although the Brazilian Franchise Law does not specify who is required to make the necessary disclosures to a sub-franchisee, it is common practice that the party that directly relates to the sub-franchisee (normally a master franchisee) performs such obligation.

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 FDD must be provided to the prospective franchisee in written form, drafted in clear and accessible terms. Although not mandatory, we recommend that the FDD be updated annually. There are no legal statutes requiring continuing disclosure to existing franchisees.

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

It is important to highlight that the franchised trademarks must be, at least, filed at the BPTO before a franchise may be offered and/or sold in Brazil. Therefore, in addition to the filing of the franchised trademarks at the BPTO, the disclosure of a written FDD 10 days

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before the execution of any agreement or payment of any amount by the prospective franchisee is the exclusive requirement determined by law.

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

Although not mandatory, franchisors and franchisees may join the Brazilian Franchise Association ("ABF"). The ABF is a non-profit entity which has been establishing itself as the most representative entity for the franchising sector at the Federal Government, other administrative spheres, and official national and international entities.

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

The payment of a membership fee is the most relevant obligation imposed on franchisors. For more information, please go to www.portaldofranchising.com.br.

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

The Brazilian Franchise Law sets forth that the disclosure document should be in a language which is precise and clear to the prospective franchisee. Since Portuguese is the official language in Brazil, it is possible to assume that it should be in Portuguese. However, we believe that the parties in international franchising may decide to adopt the English language for the disclosure document as long as, in order to avoid translation of such document, the Brazilian party knows English fluently and expressly acknowledges that fact.

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?

Although Brazilian law does not properly impose restrictions, we confirm that there are some legal requirements to be observed by any legal entity (or individuals) domiciled abroad that holds equity interests in a Brazilian company.

Foreign entities, for example, must be enrolled with the Federal Taxpayer Registry for Corporate Entities ("CNPJ") and with BACEN. For that purpose, as well as for receiving summonses on its behalf, such foreign legal entity has to appoint a Brazilian-resident individual to act as its attorney-in-fact.

There are specific restrictions on the participation of foreign investors in certain sectors and types of company, such as the aerospace industry and cable TV.

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

Along with corporations ("S/A"), limited liability companies ("LLC") are the most common corporate entities in Brazil, although with distinct tax and corporate features, under Brazilian law, though the costs of setting up an LLC are less significant, as they are not subject to the considerable expenses of publishing certain relevant corporate acts that an S/A incurs.

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?

Yes. Registration, licences and formalities normally vary depending on (i) the type of entity to be incorporated, and (ii) its field of activity. In order to set up an LLC, i.e., there are some basic licences and authorisations that all companies are required to obtain, regardless of the field of activity in which they operate, as detailed below:

1. Federal Taxpayer Registry for Corporate Entities – "CNPJ" of the Foreign Investor (for the foreign partners of the Brazilian company);
2. registration of the articles of association with the Trade Board ("*Junta Comercial*") that will generate the "NIRE", an identification number of the Registry of Companies;
3. CNPJ of the Brazilian Company;
4. State Taxpayer Registry for Corporate Entities ("*Inscrição Estadual*" – "IE");
5. Municipal Registry and Operating Permit ("*Inscrição Municipal*" – "IM" and "*Alvará*"); and
6. Social Security Registration ("*Instituto Nacional de Seguro Social*" – "INSS" and "*Fundo de Garantia do Tempo de Serviço*" – "FGTS").

3 Competition Law

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

Law n. 12,529/2012 (the "Competition Law"), effective as of May 29, 2012, regulates competition in Brazil and establishes rules concerning the abuse of a dominant position. The Competition Law lists those anticompetitive practices that may constitute a breach of the economic order and, therefore, may have an impact on franchise agreements.

The following provisions may have relevance in a franchise agreement:

1. limiting or restraining market access by new companies;
2. creating obstacles for the establishment, operation or development of a competitor company or supplier, purchaser, or financier of a specified product or service;
3. imposing on distributors, retailers or representatives of a specified product or service retail prices, discounts, payment conditions, minimum or maximum volumes, profit margins or any other marketing conditions;
4. refusal to sell products or services normally available for sale; and
5. tying the sale of one product to the acquisition of another or to the use of an additional service.

The Administrative Economic Protection Counsel ("CADE") is the administrative government body competent for examining and assessing the occurrence of actions that may impair or limit free competition or result in the control of significant market shares.

Anticompetitive practices, especially the provisions listed above, are only characterised as such in the event that they are likely to unjustifiably limit competition, concentrate economic power, dominate markets, arbitrarily increase profits or impose abusive

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practices. In light of the above, CADE considers specific aspects such as the peculiarities of the business, the product or service involved, the size of the market, the commercial sector and the nature of the transaction. Franchise agreements have been considered pro-competitive and the restrictions usually imposed are intended to protect the network.

Since international franchise agreements must be submitted for recordation with the BPTO, the governmental agency's approval can be considered a *prima facie* confirmation that the franchise agreement complies with the antitrust regulations because if this were not the case, the BPTO should have forwarded the agreement to CADE for analysis prior to its regulation.

As mentioned above, the Competition Law lists the anticompetitive practices that may constitute a violation of the economic order and therefore should be considered by the franchisor when enforcing the agreement. As a result, tying provisions (those that fix the price of products commercialised by franchisees, establish supply arrangements, or make compulsory the acquisition of certain products due to specific standards of quality) may be considered admissible in the context of rule of reason. They may be abusive and their validity may be questioned if such restrictions are unduly enforced by the franchisor without reasonableness. For instance, extending the franchisee non-competition obligation to non-competing goods could be construed as anticompetitive practice, depending on the circumstances.

CADE may authorise certain contractual restraints provided that: (i) they are intended to increase productivity, quality of goods/services and/or generate technological or economic efficiency and development; (ii) the resulting economic benefits are equitably distributed among the participants in the contract on one side, and the consumers on the other; (iii) they do not cause the elimination of a substantial number of competitors from the relevant market of goods/services; and (iv) they are limited to the extent necessary to the fulfilment of their goals.

Further, Law n. 9279/96 (the "Brazilian Industrial Property Law"), which regulates rights and obligations relating to industrial property, sets forth that the party who discloses, exploits or uses, without authorisation, confidential knowledge, information or data usable in industry, commerce or the providing of services, except that which is of public knowledge or which is obvious to a person skilled in the art, to which he has had access by means of a contractual or employment relationship, even after the termination of the contract, shall be deemed to have committed a crime of unfair competition practice.

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

No. There is no legal limitation related to the validity of franchise agreements.

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

No. There is no legal limitation related to the agreements executed between franchisors and the suppliers of the franchise network.

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

As a general rule, tied restrictions imposed by the franchisor in the franchise agreement must be carefully analysed, so that it can be confirmed if such restrictions can be considered abusive under Brazilian law.

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

Considering that there are no legal restrictions related to the offering of franchises in adjoining areas or streets, the Brazilian Franchise Law determines that the franchisor discloses to prospective franchisees whether the franchisee is guaranteed exclusivity or a right of first refusal in any particular territory or activity and, if so, under what conditions.

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

Non-compete covenants (which also include non-solicitation of customers) are very common in franchise agreements in Brazil. Although the Competition Law establishes that any act that obstructs the establishment and operation of businesses in the local market is an infringement of the economic order, covenants that prohibit franchisees from competing directly or indirectly with the franchisor during or after the term of the franchise agreement should be legally valid and enforceable due to the special features of a franchised business.

4 Protecting the Brand and other Intellectual Property

4.1 How are trade marks protected?

Any trademark whose right of use is granted by the franchise agreement must be registered or at least be subject to a pending application with BPTO. The franchisee will only have rights to use the franchised trademarks as long as the franchise agreement is in force. Once the agreement is terminated or has expired, the franchisee does not hold any rights over the trademark.

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

Yes. Know-how, trade secrets and confidential information are entitled to intellectual property protection in Brazil under the laws addressing unfair competition. Such protection is specified in article 195 of the Brazilian Industrial Property 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?

Yes. Copyright is protected by Law n. 9,610/1998. Computer programs fall under the concept of creative effort, and are therefore subject to protection by copyright, under Law n. 9,609, dated February 19, 1998 (the "Software Law").

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5 Liability

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

Failure to deliver the FDD within the term established by the Brazilian Franchise Law entitles the franchisee to seek the cancellation of the Franchise Agreement and the refund of any and all monies paid by franchisee to franchisor, or to any third party indicated by franchisor, as franchise fees and royalties (duly updated) plus damages.

5.2 In the case of sub-franchising, how is liability for disclosure non-compliance or for misrepresentation in terms of data disclosed being incomplete, inaccurate or misleading 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?

Our comments to question 5.1 above also apply to sub-franchising. Therefore, the franchisor is fully responsible for the compliance of the disclosure obligations in connection with its master franchisee and, similarly, the master franchisee will be responsible for the compliance of the disclosure obligations in connection with its sub-franchisees in Brazil.

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

As a general rule, disclaimer clauses cannot avoid liability under Brazilian law. The existence of liability caused by pre-contractual misrepresentation would be analysed by the local Courts, on a case-by-case basis.

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

Although class actions are available in Brazil, their scope is limited to situations in which damages are caused to the general public with respect to issues such as consumers' rights, the environment and public order. Furthermore, only a few entities can act as plaintiff in such Court actions – mainly Public Prosecutors, the State, the Brazilian Bar Association and Class Associations.

Therefore, class actions are not an option to discuss strictly private rights, so their applicability in a franchise agreement is highly unlikely.

In any event, considering that common and collective rights can be asserted regardless of any contractual provisions, a class action waiver clause would not be enforceable in Brazil.

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?

Brazilian law provides that international franchise agreements may be governed by foreign law and jurisdiction. However, Brazilian law prevents the application of foreign law whenever said application results in a violation of national sovereignty, public order, local practices or any mandatory Brazilian 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 rogue franchisee to prevent damage to the brand or misuse of business-critical confidential information?

Our local Courts do provide a remedy for interlocutory relief in case of urgent matters related to franchise, especially involving the use of trademarks after termination, intellectual property, unfair competition practices, repossession of inventory and equipment (if relevant) and non-compete covenants.

The number of available tools has been increased as of March 2016, when Brazil enacted a new Civil Procedural Code. One of the new and most efficient options is to file an autonomous and *ex parte* request for a preliminary injunction that, if granted, may lead to the immediate closure of the case if the defendant fails to appeal in time. In the case that the defendant appeals, the plaintiff has a 15-day term to file a full claim.

However, in order to obtain a fast response from the Courts, it is necessary for the parties to choose Brazilian law and jurisdiction to govern the agreement. Although foreign decisions can be enforced in Brazil, they need to go through confirmation proceedings in Brazil, which are rather complex and time-consuming, by means of analysis and approval at the Superior Court of Justice, in order to be locally enforceable.

Among the main requirements to be complied with are: (a) the parties must prove that the decision attends to all legal formalities; (b) the decision must be final, with no possibility of further revision; (c) it needs to be notarised by a Brazilian Consul in the country where it was delivered and translated into Portuguese; and (d) in addition, in order to receive the *exequatur* from the Superior Court of Justice, the foreign decision cannot be contrary to Brazilian public order and local practices. Although the case should not be retried, the approval of the decision may take some time locally.

Such homologation procedure currently takes from two to 24 months, if the decision complies with all procedural requirements of the rendering country. Once homologated, such decision is then forwarded to the Federal Court in the State where the defendant has its headquarters, to begin its enforcement procedure, which usually takes from four months to two years, varying according to the complexity of the case.

7 Real Estate

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

Based on article 51, II of Law n. 8,245/1991, commercial property is normally leased for a period of five years.

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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 conditional lease assignment over the lease might be difficult to negotiate with landlords (especially in the case of shopping malls), if the parties were able to negotiate such condition in the lease agreement, it will be duly valid and enforceable under Brazilian law.

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

Although there are no legally established restrictions to properties located in urban areas, some restrictions apply to non-national entities holding an interest in rural areas. In this regard, Law n. 5.709/71, Decree 74.965/74 and Normative Act 76/2013 from the National Institute of Land Reform ("INCRA") must be noted.

7.4 Give a general overview of the commercial real estate market. Specifically, can a tenant reasonably 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 of a particular location)?

After the real estate market boom in Brazil, the prices seen in common practice have significantly increased over the past three years but are now starting to decline. Based on this commercial scenario, landlords do not usually accept the negotiation of an initial rent free period, even when entering into a new lease agreement.

Although not expressly authorised by Law n. 8,245/1991 (which is the law that regulates lease agreements in Brazil), our local Courts have the understanding that shopping malls, acting as landlords, are authorised to demand payment for *res sperata*, which may be understood as "key money", as a precedent condition for the execution of the lease agreement for the mall.

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?

Considering that the Brazilian Franchise Law is not intended to govern the private franchisor-franchisee relationship, we confirm that the franchise agreement can impose such binding re-direction 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?

Provided that the domain names registered by the franchisee are directly related to the franchise business and/or franchisor's IP rights, there will be no limitations on the requirement of said assignment.

9 Termination

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

There are no mandatory local laws that might override the termination rights typically detailed in franchise 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?

It is relatively common for plaintiffs to insert the franchisor as a co-defendant in a Labour Court action. However, Labour Courts have established that franchisors are neither jointly nor secondarily liable, provided that they refrain from directly intervening in the business administration of the franchisee. In a typical franchise agreement, there is no hierarchical subordination of the franchisee's employees in relation to the franchisor.

Notwithstanding, to minimise risks it is recommended that the franchise agreement expressly contains a clause of non-responsibility of the franchisor with respect to the labour and tax activities of the franchisee.

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 directly responsible for its employee's acts or omissions, as defined in article 932, III of the Brazilian Civil Code.

Nevertheless, with regard to consumer protection, it is worth mentioning that the Brazilian Consumer Code ("CDC") sets forth joint and strict liability of all the parties involved directly or indirectly in the supply chain of products and services to consumers. Considering that said liability arises irrespective of fault, the end consumer can file a claim against any of the economic agents that have participated in the circulation of a product or service that has caused harm or has a defect.

Therefore, the franchisor could be deemed liable towards end consumers for acts of the franchisee's employees.

To minimise such risk, it is recommended that the franchise agreement expressly foresees that the franchisor will not be responsible for any act or omissions by the franchisee or its employees.

In any event, article 88 of the CDC grants to the franchisor the right to recover from the franchisee the amount of damages paid to consumers, as long as the franchisee was the party directly responsible for the infringement.

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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?

International franchise agreements must be recorded with the BPTO and BACEN to allow payment of franchise fees and royalties to parties outside Brazil.

As a general rule, the parties may freely set out the percentage of remuneration insofar as it stays within the price commonly practised in the respective field and in the national and international market. The remuneration may be established as a percentage of the net sales or by means of a fixed amount based on each unit produced.

Nevertheless, royalties involving subsidiary and parent companies are limited by the corresponding ceiling of fiscal deductibility specified by Ministerial Ordinance n. 436/58, which varies between 1% and 5% of the net sales of contractual products, depending on the field of activity involved.

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 Withholding Income Tax ("IRRF") will always apply on royalties paid under franchise agreements. Therefore, once the parties execute a franchise agreement the royalties will be paid in consideration of the use of the whole system. The IRRF is legally due from the foreign franchisor: the franchisee shall collect IRRF on behalf of the franchisor (taxpayer), although the financial burden for such tax may be contractually shifted. The tax is levied at a general tax rate of 15% of net revenues, which may be higher or lower depending on where the franchisor is resident or domiciled (e.g. in a tax haven or jurisdiction with which Brazil has executed a double taxation convention).

The abovementioned rule for IRRF over royalty payments also applies to the payment of a services fee, whatever its nature.

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

Brazilian law authorises that the franchise agreement determines royalties in foreign currency.

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 agreements are strictly regulated by Law n. 4.886/65 (with amendments introduced by Law n. 8.420/92) and by the Brazilian Civil Code. The main characteristic of agency agreements is that the property of the products is not transferred to the party that will receive them for sale, marketing or distribution. Generally, the products are deposited or delivered on consignment to the distributor, which shall receive a commission or another agreed fee for the sale of such products.

Conversely, franchise relationships are much more complex than agency relationships, since franchising normally involves the granting of several rights to the franchisee, as well as the transferring of know-how.

Therefore, a real franchise operation would hardly be considered an agency in Brazil, since both commercial structures are ruled by specific laws and are distinctly separate from each other.

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 general rules and principles of the Brazilian Civil Code also apply to franchise agreements. According to articles 113 and 422 of the Brazilian Civil Code, all contracts are subject to the principles of good faith, which means that the parties must proceed with fairness and mutual trust when establishing and executing contractual provisions.

Thus, beyond the obligation not to harm, the principle of good faith establishes the party's obligation to cooperate with fairness and honesty during all phases of the transaction in order to ensure that the other party obtains the expected results.

The observance of good faith clearly drives the offering stage of franchise transactions, where the franchisor is obliged to provide prospective franchises with an FDD, describing in detail the main information on the franchised business.

The standards of the principle of good faith shall subsist through all phases of the transaction and even survive termination, which means that the contracting parties must observe and act in accordance with such standards during negotiations, before and during the term of the agreement, as well as after its termination.

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 mentioned above, the Brazilian Franchise Law is not intended to govern the relationship between franchisor and franchisee. Thus, after the franchise agreement is executed, the franchisor-franchisee relationship will mostly be regulated by the franchise agreement itself, according to the general rules and principles of the Brazilian Civil Code.

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 mandatory renewal in franchise agreements. The parties are free to include renewal conditions in the franchise business, if any. However, once such conditions apply, they must be disclosed in the FDD, which must also contain a draft of the Franchise Agreement and of any preliminary agreement.

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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. Considering that there is no mandatory renewal in franchise agreements, there is no overriding right for a franchisee to be automatically entitled to a 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 Brazilian Franchise Law does not regulate the relationship and, therefore, it does not deal with breach, non-renewal or other reasons for termination. Considering that the law does not require mandatory renewal, if the franchise agreement does not provide for automatic renewal, it will end upon expiration of the term set by the parties. If the agreement provides for automatic or conditional renewal, those provisions will prevail.

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. As franchises are deemed *intuitu personae* agreements, the franchisor may impose restrictions on a franchisee's freedom to sell, transfer, assign or otherwise dispose of the franchised business. In this sense, the franchisor is also able to include restricting clauses on the agreement, requiring its approval for the transfer of assets, equity or even preventing it from happening at all. The main purpose is to maintain the administration and guidance of the franchisee business as initially agreed with 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?

As long as said "step-in" right is detailed in the franchise agreement, it will be recognised by Brazilian law and, consequently, it will be enforceable in Court. In practical terms, if the franchisee business is based on a lease agreement, said "step-in" rights must be detailed both in the franchise and lease agreements, to guarantee that the landlord agrees to the assignment of the lease to the franchisor. There are no registration requirements or other formalities that must be complied with for enforceability purposes.

16.3 If the franchise agreement contains a power of attorney in favour of the franchisor under which it may complete all the 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 country 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 there are no registration requirements or other formalities that must be complied with for the enforceability of "step-in" rights duly detailed in the franchise agreement, a power of attorney ("PoA") in favour of the franchisor could be granted by the franchisee through the franchise agreement, as long as said PoA is granted for specific and determined rights. There is no additional registration or formalities to be observed to ensure the validity of said PoA.

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Canada

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1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

In Canada, six of the 13 provinces and territories have adopted franchise specific legislation: Alberta; British Columbia; Manitoba; New Brunswick; Ontario; and Prince Edward Island. Each provincial franchise statute defines a 'franchise' in a similar manner to include the following key elements: the grant of a right to sell or distribute the goods and services of the franchisor in return for (indirect or direct) payment or ongoing payments where: (i) the franchisee is also granted the right to use the trademark (or other intellectual property) of the franchisor and the franchisor exercises significant control or offers significant assistance; or (ii) representational or distribution rights are granted together with location assistance (e.g. securing retail outlets). The definition is broad and can in some circumstances bring within its ambit business arrangements that would not typically qualify as "franchise" arrangements.

1.2 What laws regulate the offer and sale of franchises?

In Canada, the offer and sale of franchises is regulated provincially and not at the federal level. As stated above, six provinces have enacted franchise specific legislation which sets out the legal requirements with respect to offering and selling franchises. Provincial franchise statutes are remedial and are intended to level the perceived imbalance of power in a franchisor-franchisee relationship. Each of the six provincial franchise statutes, among other things:

- requires a franchisor to provide a prospective franchisee with a disclosure document before the prospective franchisee signs the franchise agreement or makes any payment to the franchisor. Canadian franchise legislation specifies the content required in such disclosure document;
- imposes upon each party a duty of fair dealing in the performance and enforcement of the franchise agreement and, with the exception of Alberta, a duty to act in good faith and in accordance with reasonable commercial standards. A breach of such duty provides the innocent party with a right of action for damages;
- entitles a franchisee to associate with other franchisees and to form or join an organisation of franchisees. A franchisee has a right of action for damages against a franchisor that tries to penalise its franchisees from associating/organising;
- allows a franchisee to rescind the franchise agreement if the franchisor failed to provide a disclosure document (or statement of material change) within the time required, or if the contents did not meet the requirements, or if the franchisor never provided the disclosure document;
- entitles a franchisee to a right of action for damages if a franchisee suffers a loss because of a misrepresentation contained in the disclosure document (or statement of material change); and
- includes an anti-waiver provision which deems any purported waiver or release by a franchisee of a right given under the applicable statute to be void.

The offer and sale of franchises is also subject to laws applicable to all contracts generally.

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 the purposes of any franchise disclosure or registration laws?

Generally speaking, the answer is "yes". Having said that, there is an exception in each provincial statue (other than Alberta) for the granting of a single licence with respect to a specific trademark (or other specific intellectual property) where no other licences of that general nature and type have been granted.

Where the single grant is to a prospective master franchisee, the question arises as to whether the provincial franchise statutes operate to deem such arrangement a "franchise" for the purposes of disclosure requirements. While this issue has not been formally addressed by the courts, the practice in Canada is to provide disclosure as though it is required. The rationale for this approach stems from language found in several provincial statutes that are stated to apply if the franchise is to be operated "partly or wholly" in the province.

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

There are no franchise specific registration requirements in Canada. More particularly, there is no requirement for registration before a franchisor can offer franchises for sale, and there is no requirement that disclosure documents or marketing materials be registered.

Having said that, there are non-franchise specific registration requirements that apply to franchisors and to franchisees pursuant to, for example, intellectual property laws, corporate laws, employment laws, and potentially other specific laws that may apply, such as environmental laws and laws of regulated industries.

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1.5 Are there mandatory pre-sale disclosure obligations?

Disclosure obligations form the backbone of franchise legislation in the regulated Canadian provinces.

A franchisor must provide a prospective franchisee with a disclosure document containing all required information contained in one document and delivered at one time at least 14 days before the earlier of either (i) the franchisee signing a franchise agreement or any other agreement forming part of the franchise, and (ii) the franchisee paying any fee or consideration to the franchisor. The disclosure document must include all "material facts". In addition to defining the term "material fact", each of the provincial statutes prescribes specific information (some of which is contained in regulations) that must be disclosed. The prescribed information includes: financial statements; copies of all proposed franchise agreements and other agreements; the business background of the franchisor and the directors and officers; certain legal proceedings and insolvency history of the franchisor and its directors and officers; full financial disclosure including costs necessary to establish the franchise; and ongoing costs payable by the franchisee. The franchisor has a continuing obligation to update the franchisee with any material changes to the disclosure up until the franchisee signs a franchise agreement or pays fees/consideration to the franchisor.

Each provincial statue contains a number of limited exemptions that may apply to specific cases to absolve franchisors from disclosure requirements. Such exemptions are very similar from one provincial statute to the other.

If a franchisee suffers a loss because of a misrepresentation contained in the disclosure document or the statement of material change, a franchisee has a right of action for damages. Additionally, a franchisee can rescind the franchise agreement (i) within 60 days of receiving the disclosure document if the contents of the disclosure document do not meet the disclosure requirements, or (ii) within two years after entering into the agreement if the franchisor never provided a disclosure document, or if there are deficiencies so material that the disclosure document is considered not to be a disclosure document at all.

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

The definition of "franchisor" in each of the provincial statutes includes a "sub-franchisor". As a result, the obligation to provide pre-sale disclosure applies to sub-franchisors. The entity granting the franchise has the obligation to provide the pre-sale disclosure. The pre-sale disclosure may be more extensive for sub-franchisors, as it would have to include a reasonable amount of information regarding the arrangements between the sub-franchisor and the franchisor, in order to make full and complete disclosure.

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 precise format and content of franchise disclosure document varies slightly from province to province. While there is no exact form prescribed by the provincial statutes, some franchisors have adopted the practice of creating a disclosure document that satisfies the requirements set out in each of the six provincial statutes (which is then used across all of Canada).

The franchise disclosure document must be current and up to date each time it is provided to a prospective franchisee (there are no annual updating requirements as in registration jurisdictions). However, information pertaining to the advertising fund, closures in the last fiscal year and last three fiscal years, as well as the financial statements of the franchisor, must be updated on an annual basis.

There is no obligation to make continuing disclosure to existing franchisees under any of the current provincial franchise statues.

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

Apart from compliance with general principles of law, and the franchise specific provincial statutes and regulations, there are no other legal requirements that must be satisfied before a franchise may be offered or sold in Canada.

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

While not mandatory, there are commercial benefits to being a member of the Canadian Franchise Association ("CFA"), the only national trade association serving the franchise industry in Canada, including heightened credibility (in part arising from the requirement to comply with the CFA's Code of Conduct), educational sessions, as well as networking opportunities.

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

The CFA has a Code of Conduct that its members are required to abide by. Some of the requirements include: (i) compliance with franchise legislation, including disclosure requirements; (ii) providing guidance and support to franchisees to help them in their business; (iii) encouraging franchisees to obtain independent legal advice with regards to the franchise agreement or any disputes that arise; and (iv) to resolve disputes amicably and in good faith, among other obligations that promote the continued success of franchisees.

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

The predominant language in Canada is English, and franchise documents are generally prepared in English. Having said that, in Quebec, the Charter of the French Language requires that franchise documents be prepared in French where they are to be used in Quebec unless the parties expressly agree that another language be used (which is not uncommon) which is effected by adding the following language to the document: "*The parties to this agreement acknowledge having required that this agreement as well as all notices, documents or agreements related to this agreement be drafted in English. Les parties aux présentes reconnaissent avoir exigé que la présente convention ainsi que tous avis, documents ou ententes s'y rapportant soient rédigésen Anglais*."

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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?

International franchisors must be aware of the *Investment Canada Act*, which states as its purpose: "to provide for the review of significant investments in Canada by non-Canadians in a manner that encourages investment, economic growth and employment opportunities in Canada and to provide for the review of investments…that could be injurious to national security". The *Investment Canada Act* opens up any cross-border franchising to potential review. However, the minimum threshold of investment for the operation of the statute is $5,000,000.

There are also corporate and tax law implications that must be considered that may mandate that a certain amount of directors or shareholders be Canadian residents.

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

Franchisors typically use one or more corporations to conduct their franchise operations, although the use of limited partnerships and unlimited liability corporations is not uncommon. International franchisors typically enter the Canadian market in one of three ways: (i) by incorporating a subsidiary in Canada, which is owned by the foreign parent; (ii) by using a Canadian branch or division; or (iii) granting franchises directly from their foreign entity, without incorporating in Canada. Each approach has significantly different tax consequences and the best structure for one franchisor may not be ideal for another.

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?

Principally, the requirements involve properly incorporating and organising a corporation (or establishing a limited partnership), obtaining appropriate extra-provincial and business name registrations, if applicable, and registering certain tax programme accounts (i.e. GST/HST and payroll accounts), if applicable. However, depending on the type of business to be operated, there may be additional licences and permits that need to be obtained.

3 Competition Law

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

While the sale of franchises is generally not affected by Canadian competition law, the Canadian *Competition Act* sets out certain practices that are reviewable by the Competition Tribunal, upon application by the Commissioner. Matters reviewable include: abuse of a dominant position; mergers; price maintenance; delivered pricing; refusal to deal; refusal to supply by foreign parties; consignment selling; exclusive dealing; tied selling; market restriction; and misleading advertising and trade practice matters.

The *Competition Act* also sets out certain criminal offences and allows for the recovery of damages for persons injured by the criminal anti-competitive activities of others. Criminal matters include: conspiracy bid rigging; pyramid and referral selling; telemarketing; and certain misleading advertising and trade practice matters.

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

There are no restrictions on the maximum term permitted for franchise agreements. The typical term for franchise agreements in Canada ranges between five and 15 years.

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

There are no restrictions on the maximum term permitted for product supply agreements.

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

A franchisor must always be cognisant of the price maintenance provisions in the Competition Act. Imposing a minimum resale price may become a reviewable event under the *Competition Act* if it results in an adverse effect on competition. It is not always clear what might constitute an adverse effect, but the Competition Bureau defined it in 2014 as an effect that is likely to "create, preserve or enhance the market power" of a supplier of goods and services.

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

There are no specific statute-based obligations that a franchisor must observe in such circumstances. However, franchisors are required to disclose their policies regarding the proximity of new franchises to existing franchises.

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

Non-compete and non-solicit clauses are enforceable to the extent they do not create an unreasonable restraint on trade, especially relating to the geographical extent and duration of the restriction. A Canadian court will not re-write, write down or otherwise modify a restrictive covenant in order to make it reasonable and enforceable, but rather will either uphold or strike down the covenant in its entirety. As a result, these clauses should be written no more broadly than necessary in order to protect the franchisor's interests.

4 Protecting the Brand and other Intellectual Property

4.1 How are trade marks protected?

Trademarks in Canada are protected by common law and federal legislation, the *Trademark Act*. The *Trademark Act* defines a trademark as a "mark that is used by a person for the purpose of distinguishing or so as to distinguish wares or services manufactured,

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sold, leased, hired or performed by him from those manufactured, sold, leased, hired or performed by others, a certification mark, a distinguishing guise or a proposed trademark". While trademarks do not have to be registered to be afforded protection, registration strengthens the protection across Canada, and in the province of Quebec enables the use of any English only terminology that is a registered trade mark (provided that no French version of the trade mark has been registered and that a generic description of the goods and services is included in French).

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

Canadian law provides protection for all forms of intellectual property. Having said that, not all 'know-how' falls within a category of intellectual property in Canada. Franchisors can protect their trade secrets and other business-critical confidential information through contractual provisions and consistent confidential treatment, practices and the enforcement of such 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?

Original works are granted copyright protection automatically by law, without a need to register the work. Registration is helpful in establishing what work is protected and who owns that work. Such protection would potentially apply to the contents of operations manuals and any proprietary software (provided it meets the copyright criteria). The presumption in Canada is that the owner of the copyright is the individual who created the work. A franchisor can maintain ownership of the copyright work, and such ownership is not disturbed by licensing it to franchisees. Franchisors are also permitted to restrict the use of the work to certain activities.

5 Liability

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

A franchisee can bring an action for damages or rescission for non-compliance with mandatory disclosure obligations. New Brunswick's *Franchises Act* provides that a party to a franchise agreement may, in the event of a dispute with another party to such agreement, trigger a mandatory alternative dispute resolution mechanism (mediation). Instituting one of these actions does not, however, preclude any party to such franchise agreement from pursuing other recourses available under contract or common law.

Rescission

Each of the six provincial franchise statutes (other than *Alberta's Franchises Act*) provides the franchisee with a right to rescind the franchise agreement without penalty or obligation: (a) if the franchisor failed to provide disclosure document or a statement of material change within the prescribed time, or if the contents of the disclosure document do not satisfy statutory requirements, and the franchisee rescinds within 60 days of the late or deficient disclosure; and (b) for 'absence of disclosure' no later than two years after entering into the franchise agreement.

In either case, within 60 days of the effective date of rescission the franchisor must:

- purchase from the franchisee any remaining inventory, supplies and equipment purchased pursuant to the franchise agreement, at a price equal to the purchase price paid by the franchisee, and refund any other money paid by the franchisee to the franchisor; and
- compensate the franchisee for the difference between any losses incurred in acquiring, setting up and operating the franchise, and any amounts paid or refunded pursuant to the preceding paragraph.

In Alberta, if a franchisor fails to provide the disclosure document as required under the *Alberta Franchises Act*, the franchisee is entitled to rescind the franchise agreement by giving a cancellation notice to the franchisor by the earlier of 60 days after receiving the disclosure document or two years after the grant of the franchise. The franchisor does not have an obligation to purchase any of the franchisee's assets under the *Alberta Franchises Act* but must instead, within 30 days after receiving a cancellation notice, compensate the franchisee for any net losses incurred by the latter in acquiring, setting up and operating the franchised business.

Damages

Each of the six provincial franchise statutes (other than the *Alberta Franchises Act*) provide that if a franchisee suffers loss because of a misrepresentation contained in the disclosure document or in a statement of a material change or as a result of the franchisor's failure to comply with any disclosure requirements, the franchisee has a right of action for damages against the franchisor, the franchisor's broker (if any), the franchisor's associates, every person who signed the disclosure document or statement of material change (and, under the Ontario *Arthur Wishart Act (Franchise Disclosure), 2000*, the franchisor's agent), all of whom are jointly and severally liable. Under the *Alberta Franchises Act*, a franchisee who suffers a loss resulting from a misrepresentation contained in a disclosure document has a right of action for damages against the franchisor and every person who signed the disclosure document, on a joint and several basis.

5.2 In the case of sub-franchising, how is liability for disclosure non-compliance or for misrepresentation in terms of data disclosed being incomplete, inaccurate or misleading 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 sub-franchisor is responsible for its own misrepresentations in disclosure documents and compliance with the relevant franchise legislation. An indemnity will be invalid to the extent that it provides for the release or waiver of obligations owed by the franchisor to its master franchisee under the Canadian franchise legislations, but is otherwise enforceable.

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

Any covenants which have the effect of waiving one or more rights of franchisees, or releasing a franchisor of its obligations to franchisees, under the various provincial franchise statutes are void. As such, a franchisor cannot avoid liability for pre-contractual misrepresentation as this is a protection afforded to franchisees under

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the various provincial franchise statutes. In Quebec, a contractual disclaimer will generally be enforceable except in cases of fraud or intentional or gross fault but, in the context of a franchise agreement that is characterised as a contract of adhesion, it is possible that such clauses may be considered abusive and unenforceable in certain circumstances.

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

Each of the six provincial franchise statutes specifically provide for franchisees' rights to associate. However, a contract may contain provisions which can curtail the right of franchisees to pursue class actions. In addition, in the presence of a mandatory arbitration clause, class action waivers have been given effect by Canadian courts.

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?

Any provision of a franchise agreement that attempts to restrict the application of the relevant franchise statute is void. In provinces and territories that do not have franchise legislation, Canadian courts will generally recognise and uphold the parties' choice of foreign governing law, provided that there is a sufficient nexus to the parties' relationship. However, a choice of foreign governing law made with a view to avoiding the consequences of the applicable provincial laws of any Canadian jurisdiction will generally be considered invalid. Furthermore, where the applicable law is that of any province in Canada, the Vienna Convention on the International Sale of Goods will automatically apply in respect of sales of goods by foreign franchisors who are nationals of any other signatory nation, unless expressly set aside by the parties in the contract.

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 rogue franchisee to prevent damage to the brand or misuse of business-critical confidential information?

Canadian courts have well developed remedies for interlocutory relief. Foreign judgments are typically recognised in Canada if they are rendered in a court with proper jurisdiction and provide for monetary awards. Conversely, non-monetary foreign orders, such as an injunction, are unlikely to be recognised and enforced in Canada. Canada is a signatory party of the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards. As a result, there are fewer defences to enforcement of a foreign arbitral award than to that of a foreign judgment. Canada is also a signatory to the UNCITRAL Arbitration Rules and both the federal and provincial governments have adopted substantially similar legislation.

7 Real Estate

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

Terms of a commercial property lease typically range between five and 15 years, with terms of at least 10 years being typical for established brands. Renewal rights for additional periods of between five and 10 years are not uncommon. Among other things, factors such as the strength of the franchise brand, the location and the type of shopping centre influence lengths of 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?

These concepts are understood, typical and enforceable in Canada. In addition, it is not uncommon for franchisors to be the head tenant (under a head lease) with broad rights to sublet the premises to a 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 few restrictions imposed on non-national entities with respect to holding interest in real estate or sub-leasing property in Canada. These restrictions, however, are mostly related to agricultural or cultural land.

7.4 Give a general overview of the commercial real estate market. Specifically, can a tenant reasonably 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 of a particular location)?

Landlords may actively favour tenants with an international reputation or top-tier Canadian brands in highly populated urban shopping centres given the lower vacancy rates in those areas. That market is typically measured by discrete urban centres, given the concentration of the Canadian population in major cities, with lower vacancy rates in high-end shopping centres and other desirable locations.

Although always subject to the law of supply and demand, we have not observed tenants of such calibre being asked for key money or given initial rent-free periods covering actual retail operations, though rent-free fixturing periods of between one and six months, advances by landlords for tenant improvements and, at times, additional scope for a landlord's work have been observed. One must assume, however, that each of the latter are factored into the rental rates being charged.

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?

Franchisors may grant exclusive territorial rights to franchisees, including with respect to online channels. Accordingly, a franchisee with exclusivity for the province of Ontario may be contractually

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required to redirect an online order received from a customer residing in Quebec to the franchisee with exclusivity over the province of Quebec. The franchisor can include particular terms and conditions around how such transfers take place and may have a role in the enforcement of these 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?

There are no limitations imposed on franchisors from requiring franchisees to assign local domain names upon termination or expiry of the franchise agreement. However, any assignment obligation should be expressly included in the franchise agreement. Best practice involves having franchisees sign an assignment in advance (at the time that the franchise agreement is signed) which takes effect upon termination or expiry.

9 Termination

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

There are no statutory restrictions on the parties' rights to contractually set out their agreed termination rights. However, a franchisor, when enforcing a right of termination of a franchise agreement, must abide by the implied covenant of fair dealing under the provincial franchise statutes and at common law. A franchisor does not have a right to unilaterally terminate a franchise agreement without cause and, if a franchisor does so, it can be liable for damages to the franchisee. Typically in Canada, the franchise agreement does not contain provisions allowing a franchisee to terminate a franchise agreement before its expiry date. As a result, any right to early termination by a franchisee will only arise where the franchisor significantly breaches the franchise 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?

The concept of 'common employer' has been recognised in Canada. This concept considers whether two companies really function as a single integrated unit in order to attribute liability. The concept is most often cited in wrongful dismissal cases by employees who allege to being employed by a group of entities. Whether a common employment relationship exists depends upon whether there is a sufficient degree of relationship between the different legal entities for the purpose of determining liability for obligations owed to employees. The joint employer status is distinct from common employer with the former being much broader; most franchise relationships fall under the joint employer principle.

The common employer principle may extend to franchisor liability in connection with human rights and discrimination issues. To mitigate the risk of this occurring, each franchisee must operate as a truly independent and distinct entity from its franchisor (and such arrangement should be clearly reflected in the franchise agreement and related documents). Additionally, it is also crucial to ensure that there exists no common control or direction emanating from the franchisor greater than that which is necessary to maintain the integrity of the brand.

Moreover, an effective way to limit the chances of being a common employer is by setting best practice standards and avoiding exercising direct authority over franchisees' 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?

In addition to the common employer principle, a franchisor may be held vicariously liable for various claims and damages associated with the franchised business, including for personal injury, data security and privacy breaches, human rights violations and other matters arising as a result of the use of the franchisor's brand and marks in the operation of the franchised business in a manner likely to mislead third parties into believing that they are interacting with the actual franchisor. To mitigate the risk of vicarious liability, franchisors must ensure that they are not exercising direction or control over their franchisees on a day-to-day basis. Franchisors must also ensure that any third parties, including the franchisee's employees, suppliers and customers, are clearly advised that the franchisee is an independent entity from 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?

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?

Fees and royalties paid to a franchisor that is not a resident of Canada are generally subject to a withholding tax of 25% (tax treaties may have the effect of reducing the rate to 10%). The characterisation of a payment as a service fee would not necessarily be sufficient to escape the application of withholding requirements altogether, particularly if the payment is made in consideration of the use of the trademark or technology (and could otherwise be characterised as a royalty). If a fee qualifies as a 'service fee' taxes may be avoided. However, it is crucial that such payment be related to a legitimate third-party service for an 'arm's length' fee which the franchisor provides to its franchisees (and not otherwise constitute a disguised royalty).

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

Nothing prevents foreign franchisors from requiring franchisees to make payments in a foreign franchisor's domestic currency. It should be noted that the Canadian *Currency Act* prevents a Canadian court from giving judgment in any currency other than Canadian currency.

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?

Canada does not have commercial agency laws as that term is understood in other jurisdictions. However, a franchisee may be treated as the franchisor's agent if, on an objective assessment, the franchisee is acting on behalf of the franchisor and the franchisor held out that the franchisee was authorised to do so. A franchise agreement which expressly provides that the franchisee is not the agent of the franchisor can mitigate this risk. Furthermore, franchisors should ensure that the franchisee conducts itself in a manner that reflects that it is an independent entity from 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?

Each of the six provincial franchise statutes imposes upon each party a duty of fair dealing in the performance and enforcement of the franchise agreement and, with the exception of Alberta, a duty to act in good faith and in accordance with reasonable commercial standards. There is also an inherent duty that the Supreme Court of Canada has determined applies to every contract: to act in an honest fashion and perform the duties as agreed upon in the agreement. The obligation includes payment of amounts owed in a timely manner, communicating promptly and responsibly with the other parties, and exercising any discretion granted to one party over the other in a reasonable fashion. This area of law continues to evolve in Canada and the courts have still not established a consistent legal test that can be applied to all contracts.

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?

Once disclosure has been made and the franchise agreement has been signed, the relationship between franchisors and franchisees is governed by general principles of contract law.

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?

Where a franchise agreement is being renewed on the same terms (and no material changes have occurred), there are no additional disclosure requirements. However, if a material change in circumstances has occurred, or if the terms of the contract have changed materially, the disclosure obligations referred to above for an initial grant of a franchise apply. Best practice in Canada is to re-disclose on a renewal of 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?

There are no laws in Canada that provide franchisees an automatic right to renew or extend their franchise agreement. Renewal and extension rights must be set out in the franchise agreement (or otherwise agreed between the parties). In the event a renewal or extension right has been granted in a franchise agreement, the franchisor must be cautious not to deny such renewal or extension without justification.

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?

Absent a contractual right, there is no legal obligation for a franchisor to renew or extend a franchise agreement. If such a contractual right exists, and a franchisee complies with all of the conditions of renewal or extension set out in the franchise agreement, the franchisor is not at liberty to refuse the renewal or extension. If the franchisor does so anyway, the franchisee can have the right to damages for breach of contract and/or an injunction to force the franchisor to co-operate with the 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?

In Canada, a franchisor may restrict the franchisee from assigning the franchised business under the terms of the franchise agreement with its franchisees. The typical conditions that franchisors impose on a franchisee's right to sell, transfer or assign the franchise business include obtaining the express consent of the franchisor, payment of a transfer fee, payment of all trade creditors, finalising arrangements under any lease for premises, qualifying the prospective franchisee, and providing a release to the franchisor.

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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 in a franchise agreement will generally be recognised by Canadian law, subject to other competing interests under contractual arrangements or common law. There are no registration requirements, but appropriate notices under the franchise agreement and legislation may need to be provided as part of the step-in process. It is more advisable for franchisors to take security over the franchised business and enforce such security, or that seek a court order for such step-in rights. It should be noted that if the franchised business is insolvent, Canadian law requires that only an insolvency practitioner can be given the mandate to manage the affairs of the business.

16.3 If the franchise agreement contains a power of attorney in favour of the franchisor under which it may complete all the 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 country 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 properly drafted power of attorney clause in the franchise agreement given by a franchisee in favour of the franchisor will be recognised under Canadian law. The power of attorney need not be registered but local counsel in each province should be retained to ensure the power of attorney is in compliance with any specific provincial or territorial requirements.

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Ned is one of Canada's leading authorities in franchising and distribution law. He has represented some of the world's foremost franchises, and provides legal services to Canadian and International clients on all aspects of Canadian franchise law. Additionally, from 2000 to 2007, he was General Counsel to the Canadian Franchise Association and is currently a member of the International Committee of the International Franchise Association.

Ned is often called upon to lecture on the topic of franchise law and shared his knowledge and experience at law schools, franchise associations and at Canadian and US BAR associations. He is a distinguished academic author, having written numerous books and articles, as well as a frequent commenter on franchise law in the media. As a member of the Ontario Franchise Sector Working Team, Ned was instrumental in the creation of Ontario's franchise legislation and has had significant input in the franchise legislative process throughout Canada.

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Andrae frequently presents at Canadian and international franchise conferences and events, and writes for national and international journals and publications. He is an active member of various North American franchise organisations, and serves on several of their steering committees.

Andrae has been awarded the Certified Franchise Executive designation by the Institute of Certified Franchise Executives and is repeatedly named on the prestigious list of "Legal Eagles" by Franchise Times. He is also recognised in *Who's Who Legal: Franchise, The Canadian Legal Lexpert Directory* and the *Lexpert Guide to the Leading US/Canada Cross-Border Corporate Lawyers in Canada*. Andrae's literary contributions on the subject of franchise-related mergers and acquisitions have earned him the title of "Expert" by *Getting the Deal Through*.

DICKINSON WRIGHT

Dickinson Wright is one of only a few law firms with franchise lawyers in both the United States and Canada. As a law firm with more than 450 lawyers with 18 offices, we have the expertise to assist you in all matters pertaining to franchise law. Dickinson Wright also has the ability to assist franchise clients who require advice in other areas of law, such as corporate structuring, tax, employment, real estate, and intellectual property.

Dickinson Wright has extensive experience acting on behalf of franchisors, franchisees and distributors operating in North America and beyond in a wide range of industries. Our clients range from start-up systems, to regional/master franchisees, to vast franchise and distribution systems operating internationally.

We draft and review all types of legal documents specific to franchising, product and service distribution, manufacturing agreements, product licensing, and intellectual property, including trademarks and copyrights. Because of our experience acting on behalf of franchisors and franchisees, we understand the nuances of each perspective, especially when handling franchisee default and termination situations, including lease terminations, realisation on assets and security, receiverships, bankruptcy and injunctions to enforce non-competition provisions of franchise licence agreements.

We are dedicated to obtaining positive results for our clients in a way that is cost-effective and tailored to meet the particular needs and budgeting of our clients. Our team would be pleased to meet with you for a free consultation to discuss any franchise matter requiring legal assistance.

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China

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1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

"Franchise" is defined 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**) as an arrangement whereby an enterprise (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; whereby the franchisee conducts business under a uniform mode of operation; and whereby the franchisee pays franchise fees according to the agreement.

In summary, there must be a grant of rights, the payment of fees, and a uniform mode of operation for there to be a franchise.

The Chinese term for franchising, 特许经营 (*texujingying*), is also used in broader contexts. The courts of the People's Republic of China (**PRC**) tend to interpret 特许经营 (*texujingying*) very broadly, including what many would regard as distribution systems within the scope of a "franchise".

1.2 What laws regulate the offer and sale of franchises?

All franchise agreements must conform to the general contractual principles, found in Articles 1 to 129 of the PRC Contract Law (合同法, *Hetong Fa*).

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*), 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 Xinxi Pilu Guanli Banfa*), Decree No. 2 of 2012 (**Information Disclosure Measures**); and
- the Administrative Measures for Foreign Investment in Commercial Fields (2004) (外商投资商业领域管理办法, *Waishang Touzi Shangye Lingyu Guanli Banfa*) MOFCOM Decree No. 8 of 2004 (**Foreign Investment Measures**).

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 the purposes of any franchise disclosure or registration laws?

Yes. PRC franchise laws and regulations (see question 1.2) apply regardless of the number of franchisees.

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

The Registration Measures require a franchisor to register with the Ministry of Commerce (**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 compliance with the 2+1 Rule (see question 1.8).

Trademark licences are required to be submitted to the China Trademark Office for registration, consequently, some franchisors put the trademark licence in a separate agreement.

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 22 of the Franchise Regulation and Article 5 of the Information Disclosure Measures. This list can be supplemented by MOFCOM. Article 23 of the Franchise Regulation provides that a franchisor shall not conceal any relevant information, even if not specifically listed, which can be interpreted as a requirement to disclose all material facts.

General contract law provisions also apply to disclosure. Article 42 of the Contract Law 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.

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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 when there is a significant change in the information provided by the franchisor.

1.8 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 (directly or through its parent or subsidiary) and operated at least two outlets for at least one year (the "2+1 Rule"). According to the practice developed by MOFCOM officials, the outlets may be owned and/or operated by the franchisor's affiliates; the outlets may also be located outside of China as long as they are operated under the same franchise brand. If the outlets are located outside of China, statements issued by trade organisations (such as the International Franchise Association) may be used to establish the compliance of the franchisor 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 lack of qualifications has been disclosed to the franchisee.

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

No, membership of any franchise association in China is not mandatory.

1.10 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, requires its members to abide by its Code of Ethics.

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

There is no requirement to provide disclosure to a prospect 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. Translation will also be required for courts if there is a dispute, or by the authorities.

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. Generally, the types of activities found in franchising are not restricted.

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

Most international franchisors prefer to enter China directly, without establishing a local entity. Franchisors who decide to incorporate in China usually establish a wholly foreign-owned enterprise (WFOE).

Chinese partners often suggest to form a joint venture company with the franchisor, either a Sino-foreign equity joint venture or Sino-foreign cooperative joint venture. Joint venture structures generally should be avoided unless there is no other way to establish a franchise in China.

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?

Since the Chinese government abolished a requirement to obtain MOFCOM approval for foreign investment enterprises, a simple registration with MOFCOM is now sufficient for WFOEs not operating within restricted industry sectors.

When establishing a business entity in China, it is important to ensure that the scope of the business licence of the new entity includes offering franchises, and the activities covered by the franchise model.

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.

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

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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 fraudulent or misleading use of trademarks or fraudulent advertisement. This statute is currently being revised by the State Council.

Anti-Monopoly Law prohibits monopoly agreements in vertical relationships which: (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.

Resale price maintenance is treated by the enforcement authorities as a *per se* offence, meaning that the authorities do not need to prove intent or a negative effect on competition to secure a conviction.

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

Article 11(2) of the Franchise Regulation requires that a franchise agreement must have a "期限" (*qixian*) which is best translated as an allotted time period or time limit; but there is no statutory maximum term.

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

No, there is no mandatory maximum permitted term for product supply agreements. 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?

China'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 such sectors as pharmaceuticals and auto dealers). Franchise agreements which set "recommended prices" will likely attract scrutiny if there is evidence that the franchisor enforces the recommendation.

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?

PRC laws do not restrict the parties from entering into a restrictive covenant (except with respect to employees). 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 fairness set out in the Contract Law and the General Principles of the Civil Law.

Under the Labour Contract Law (劳动合同法, *Lao Dong He Tong Fa*), a post-term non-compete covenant is 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?

PRC is a party to all major international conventions related to trademark protection. PRC's Trademark Law (商标法, *Shangbiao Fa*) uses a "first to file" approach to trademark registration. Trademarks registered outside of PRC are generally not protected in China without a local registration.

Registration of a trademark with the China Trademark Office takes between one and two years, if there are no oppositions or complications. The registration is valid for 10 years, with an option to renew.

It is recommended to apply for the registration of trademarks in PRC as early as possible, as Chinese squatters are aware of foreign trademarks and are 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 courts under Article 15 of the Trademark Law.

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 and can also be protected by a contract between the parties.

Trade secrets protection has been poorly enforced in the PRC because parties often fail to collect evidence properly. 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. In these circumstances, narrower Non-Disclosure Agreements, with clear scope of information covered, have some merit.

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. PRC is a party to all major copyright treaties. PRC Copyright Law (著作权法, *Zhuzuoquan 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 enforcement against online parties 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 are the remedies that can be enforced against a franchisor for failure 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 a franchisor

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conceals relevant information or provides false information. The most common type of franchise case in the PRC courts is a franchisee suing the franchisor for non-disclosure, and the franchisor claiming that the agreement is not a franchise arrangement. In these cases, the franchisor usually loses and rescission is ordered.

The Franchise Regulation also provides for an administrative penalty for breach of the disclosure obligation, but MOFCOM rarely acts on it.

5.2 In the case of sub-franchising, how is liability for disclosure non-compliance or for misrepresentation in terms of data disclosed being incomplete, inaccurate or misleading 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 franchisor 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.

With respect to contractual indemnity between the franchisor and the master franchisee, general principles set out in the Contract Law will apply, including "good faith" requirements (see questions 1.5 and 13.1). Under PRC laws, limitation of liability for bodily injuries or death, or exclusion of liability on the grounds of gross negligence or negligence, are unenforceable.

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

No, the franchisor cannot contract out of liability for misrepresentation.

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

PRC Civil Procedure Law (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) a claim by a party or against a party which consists of two or more persons (Article 52 of the Civil Procedure Law);

b) a claim by numerous plaintiffs, whose number and identity is known when the action is initiated (Article 53 of the Civil Procedure Law); and

c) a claim on behalf of an undetermined number of unidentified plaintiffs at the point at which the case is filed (Article 54 of the Civil Procedure Law).

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

Collective actions are not common in China. We are not aware of any such proceedings being brought in a franchising context.

Waivers of collective actions 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 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 5th in The World Bank Group's Enforcing Contracts ranking, while Hong Kong, a popular jurisdiction of choice in international transactions related to China, is ranked 21st.

A choice of foreign law by the parties may be trumped by public policy interests. In 2010, the Law on the Application of Laws to Foreign-related Civil Relationships (中华人民共和国涉外民事关系法律适用法) clarified that if 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 intentional violation of the disclosure requirement to be a fraud.

Enforcement of foreign judgments and orders is difficult in China. Many western countries are not prepared to enforce the judgments of Chinese courts, and accordingly judgment 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.

China is a party to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958). However, 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.

International franchisors should strongly consider choosing PRC laws and Chinese courts when 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 rogue franchisee to prevent damage to the brand or misuse of business-critical confidential information?

PRC courts are unlikely to enforce the orders of foreign courts.

As of January 1, 2013, the amended Civil Procedure Law extended the scope of preservation measures (Chinese equivalent of injunctions) beyond IP-related disputes. However, successful preservation measures requests are still rare in the PRC.

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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. Foreign franchisors not having a Chinese legal entity are prohibited from owning or leasing real estate.

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, so a foreign franchisor will need to incorporate a Chinese entity with a business licence of appropriate scope to be able to enforce these types of provisions.

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.

7.4 Give a general overview of the commercial real estate market. Specifically, can a tenant reasonably 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 of a particular location)?

The commercial real estate market in major cities, for example Beijing and Shanghai, is very competitive. Rental rates in those locations are on a par with other regional commercial hubs such as Toronto, although other costs of doing business are lower. It is quite difficult to find a good location for a franchise store in a major city in China. Franchisors should engage their local real estate agent for an assessment of locations and costs. The terms of the lease agreement, including rent-free periods or key money, will depend on the location of the property and negotiations with the landlord.

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 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 a '.cn' domain name.

9 Termination

9.1 Are there any mandatory local laws that might override the termination rights that 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 detailed termination stipulations in the agreement. Otherwise, the provisions of the Contract Law will apply.

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 is difficult to imagine a situation under PRC law where the franchisor could be considered a joint employer of the franchisee's employees. PRC law does not recognise a relationship between a franchisor and 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?

Like many emerging economies, China has a significant problem with consumer fraud. Franchisors should be aware of consumer fraud and 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 contain 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.

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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, known as the "renminbi" or "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 $50,000 per resident in 2017), 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 China Trademark Office, otherwise a bank will not be allowed to make a 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 the 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 subject to withholding tax, in an effort to prevent withholding tax avoidance.

Some franchisors have incorporated in Hong Kong to take advantage of 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.

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 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?

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 Contracts Law 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 the legislation in the PRC. Article 4 of the General Principles of the Civil Law, Article 6 of the Contract Law, and Article 4 of the Franchise Regulation require the parties to act fairly, honestly and in good faith.

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 in the Contract Law (Article 60) 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 of the franchise agreement.

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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, 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, subject to the good faith requirements (see question 13.1), a franchisor can restrict the franchisee's freedom to dispose of the franchised business. Article 18 of the Franchise Regulation prohibits the franchisee from assigning the business to a third party without the franchisor's consent.

Franchisees are prohibited from disclosing a franchisor's trade secrets to third parties without the franchisor's authorisation (see question 3.1), which makes unauthorised transfer of the franchised business a violation of the law.

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 the proper scope of a business licence. The business licence of such entity would need to include every activity required for running a franchise business, such as leasing commercial premises, food handling, distribution of franchised products, etc. For a foreign franchisor without presence in China, it is more efficient to use other remedies, such as termination of the franchisee.

16.3 If the franchise agreement contains a power of attorney in favour of the franchisor under which it may complete all the 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 country 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.

Acknowledgment

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Jones & Co. is a multi-lingual 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.

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Denmark

Horten Advokatpartnerselskab

Peter E. P. Gregersen

1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

There is no legal definition of a franchise in Denmark. As there is currently no Danish Franchise Association, the definition used by the European Franchise Association can be used as guidance.

1.2 What laws regulate the offer and sale of franchises?

Offer and sale of franchises are not governed by specific legislation and such offer and sale is thus governed by the principle of freedom of contract under the general rules of Danish 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 the purposes of any franchise disclosure or registration laws?

Please see the answer to question 1.5 below.

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

It is not required to register a franchise system under Danish law.

1.5 Are there mandatory pre-sale disclosure obligations?

There are no mandatory pre-sale disclosure obligations under Danish law. However, franchisors will frequently disclose relevant information to franchisees in order to reduce the risk of subsequent disputes and claims.

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

Please see the 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 see the answer to question 1.5 above.

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

There are no requirements under Danish law that must be met before a franchise may be offered or sold.

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

Currently, there is no national franchise association.

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

Please see the answer to question 1.9 above.

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

No, there is no requirement for the translation of any franchise documents, but to ensure that the franchisee fully understands the franchise documents, it may be advisable to have the franchise documents translated. Generally, however, Danes have a very good understanding of 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?

No, there are no such laws.

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

Franchisees are typically public or private limited liability 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?

Companies must be registered with the Danish Business Authority and comply with certain requirements in this respect. Registration for VAT is also required.

3 Competition Law

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

As Denmark is a Member State of the EU, Articles 101 and 102 of the Treaty of the Functioning of the European Union ("TFEU"), as well as the Block Exemption for Vertical Agreements, apply for the offer and sale of franchises. Also, there are similar provisions in the Danish Competition Act (Sections 6 and 10).

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

No, but there may be a maximum permitted term for anti-competitive restrictions in the franchise agreement.

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

No, but there may be a maximum permitted term for anti-competitive restrictions in the franchise agreement.

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

Yes, imposing minimum resale prices is a violation of both Article 101 of the TFEU and Section 6 of the Danish Competition Act.

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

No; such matter is governed by the principle of freedom of contract. However, if a court finds that the franchisor acts grossly unfairly, the franchisor may be found to have breached the franchise agreement or the franchisee may have a right to rescind the franchise agreement. It is therefore advisable to clearly state in the franchise agreement under which terms adjoining territories will be offered to the franchisee or third parties.

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

Yes, if not grossly unfair and only to the extent permitted under applicable competition law – see the answer to question 3.1 above.

4 Protecting the Brand and other Intellectual Property

4.1 How are trade marks protected?

Trade marks are protected through national, EU or relevant international registration or use in Denmark.

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

Yes, all such information is protected under Danish 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?

Yes, if manuals or software constitute original works of authorship, such are copyright protected under Danish law. Copyright protection does not require registration of copyrights or licences thereto.

5 Liability

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

There are no disclosure obligations under Danish law. However, if a franchisor has withheld material information from the franchisee or if the franchisor has disclosed misleading or (materially) incorrect/inaccurate information to the franchisee, the franchisee may rescind the franchise agreement and claim damages from the franchisor.

5.2 In the case of sub-franchising, how is liability for disclosure non-compliance or for misrepresentation in terms of data disclosed being incomplete, inaccurate or misleading 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?

Again, there are no disclosure obligations under Danish law. However, generally speaking, a franchisee can only claim (contractual) damages from the other party to the franchise agreement.

As regards indemnity obligations, such are generally accepted by the courts (unless considered grossly unfair).

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

Disclaimer clauses are generally accepted by the courts (unless considered grossly unfair). Disclaimers resulting from franchisors' wilful acts or gross negligence will, however, not be valid.

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

Yes, under certain conditions, Danish law permits class actions.

As class action waiver clauses are not governed by specific legislation, such clauses are governed by the principle of freedom of contract under the general rules of Danish law. However, there is some risk that a class action waiver clause would be deemed void by the courts as it may be considered grossly unfair.

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. According to Danish international private law, parties to commercial contracts such as franchise documents can agree on which law shall apply to their 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 rogue franchisee to prevent damage to the brand or misuse of business-critical confidential information?

Local courts can be used against a rogue franchisee to prevent damage to the brand or misuse of business-critical confidential information. Thus, local courts can be used for interim collection of evidence or to issue an interim injunction.

Danish courts do generally not enforce orders granted by other countries' courts unless such enforcement is based on treaties/conventions/international agreements with such other countries. As for orders made by other EU Member States, such will be enforced (or not) in accordance with the provisions of the so-called Brussels-I Regulation.

7 Real Estate

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

The commercial lease of a property is governed by the Danish Business Lease Act. This Act contains mandatory provisions to protect the interests of the lessee. This means that commercial property leases cannot generally be entered into only for a fixed term, and that the lessor only has the right to terminate the lease agreement under certain, limited circumstances, whereas the lessee can terminate the lease agreement with the notice agreed in the lease agreement.

It is noted that it is assumed that the Danish Business Lease Act does not apply to (the lease under) a franchise agreement if the lease of the property is an inferior, integral part of the franchise. Therefore, great care should be taken when drafting franchise agreements which also cover the franchisee's use of 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?

Yes, this concept is common in lease agreements relating to franchise systems and is understood and enforceable.

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

If the non-national company does not have a registered address in Denmark, such company must obtain permission from the Danish authorities to acquire real estate in Denmark.

7.4 Give a general overview of the commercial real estate market. Specifically, can a tenant reasonably 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 of a particular location)?

The real estate market in Denmark's major cities is doing reasonably well and a tenant should not expect an initial free period when entering into a new lease; however, reduced payment in an initial period is not uncommon.

Landlords do not demand "key money", but if a lease is taken over from another lessee, such lessee may demand key money.

Quite often, a landlord will require a deposit or bank guarantee from a Danish bank as security for the tenant's payment and fulfilment of other obligations under the lease agreement.

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?

As the TFEU and the Danish Competition Act do not allow a prohibition against the franchisee's passive (on-line) sales, such re-direction would not be permissible.

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, provisions in a franchise agreement to this effect would be valid and enforceable.

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9 Termination

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

No, typical termination rights are not overridden by mandatory local laws, except, however, that automatic/immediate termination as a result of the bankruptcy of a Danish entity may not be fully enforceable as, under certain circumstances and conditions, the administrator of the bankrupt Danish entity may have the right to continue the franchise 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?

Normally, the franchise agreement will specify that the franchisor and franchisee are separate and independent businesses and that the franchisee is responsible for "hiring and firing" its employees. Further, the employees' (mandatory) employment contracts will be between the franchisee and the individual employees. Under such circumstances, it is very unlikely that a franchisor may be regarded as a joint employer with the franchisee in respect of the franchisee's employees.

To mitigate any risk, the above should be specified in the franchise agreement and it should be reflected in the franchisor's and the franchisee's day-to-day 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?

Please see the answer to 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 restrictions on the payment of royalties to an overseas franchisor. However, anti-money laundering and anti-terrorist rules and regulations must be followed and banks are obliged to report suspicion of violations thereof to the relevant authorities.

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 a point of departure, royalties paid by a Danish resident franchisee to a foreign franchisor under a trade mark licence, or in respect of the transfer of technology, are subject to Danish withholding tax at a rate of 22%. However, Danish withholding tax on royalties is – subject to certain requirements being met – waived under most tax treaties concluded by Denmark. Further, Danish withholding tax on royalties is waived if the foreign franchisor is a corporation, which is eligible for the benefits of the EU Interest-Royalty Directive.

The Danish withholding tax position is determined on the basis of the reality and substance of the transaction. Thus, withholding tax cannot 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.

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 requirements for financial transactions, including the payment of franchise fees or royalties, to be conducted in local currency (DKK, not EUR).

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 Danish Commercial Agents Act defines a 'commercial agent' as a self-employed intermediary who has continuing authority to negotiate the sale or the purchase of goods on behalf of another person, hereinafter called the 'principal', or to negotiate and conclude such transactions on behalf of and in the name of that principal. Thus, if a franchisee meets this definition, there is a risk that a franchisee may be treated as the franchisor's commercial agent. However, it does not seem that this would be the case for the vast majority of currently known franchise concepts.

To mitigate any risk, it should be made clear in the franchise agreement, and in fact, that the franchisee is an independent business acting in this capacity and for its own account.

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 objective test of fairness or reasonableness under Danish law, but contractual parties have duty of loyalty towards each other. However, the concept of this duty of loyalty is vague and a party is always allowed to put its own interests first (unless its conflicts with its explicit contractual obligations, of course).

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; once the franchise agreement has been entered into, it is regulated by the general rules and acts of Danish law.

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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 the answer to 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, there is no overriding right to a renewal or extension. However, the franchisor should be careful not to (tacitly) renew or extend a franchise agreement through its communication or actions.

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, if no renewal or extension has been agreed, tacitly or otherwise, the franchisee does not have a right to compensation or damages as a result of the non-renewal or refusal to extend. However, if the franchisor has required the franchisee to make significant investments shortly before the expiry of the franchise agreement, the franchisee may be able to claim 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. However, if a court would find that the franchise agreement is grossly unfair in this respect (which is very, very unlikely), the relevant parts of the franchise agreement may be set aside by the courts.

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, this will be recognised by Danish law as such matter is governed by the principle of freedom of contract. However, if a court would find that the franchise agreement is grossly unfair in this respect, the step-in right may be set aside by the courts.

"Step-in" rights are always difficult to enforce if the franchisee does not cooperate, but there are no registration requirements or other formalities that must be complied with to make a step-in right enforceable. However, the franchisor should ensure, through terms in the franchise agreement, that the franchisee does not enter into agreements with third parties which prevent the step-in.

16.3 If the franchise agreement contains a power of attorney in favour of the franchisor under which it may complete all the 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 country 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?

Please see the answer to question 16.2 above.

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England & Wales

DLA Piper

Iain Bowler

Note

Please note, the information set out in this chapter is given from the perspective of the laws of England and Wales, and not from a Scots law perspective.

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 1.4 below) adopts the following definition of "franchising", taken from the European Code of Ethics for Franchising:

"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 1.3 below.)

Pyramid selling legislation has specific application to franchising. The key legislation is the Fair Trading Act 1973, the Trading Schemes Act 1996 and a series of secondary legislation made pursuant to it ("**Pyramid Selling Legislation**"). The Pyramid Selling 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.

Accordingly, it is essential to ensure that any multi-layer franchise falls outside the Pyramid Selling Legislation. Regulation 3(b) of the Trading Schemes (Exclusion) Regulations 1997 (SI 1997/31) provides an exclusion where all UK franchisees in the network are registered for VAT at all times.

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 the purposes of any franchise disclosure or registration laws?

English law contains no franchise-specific legislation and there is no formal 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 point of view. However, the absence of any franchise-specific disclosure and registration laws in the UK makes this point rather theoretical, as the classification of the licensee as a "franchisee" has no direct 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 "full and accurate written disclosure of all information material to the franchise relationship within a reasonable time prior to the execution of these binding documents". The Guide to the Code contains further guidance on the extent of "full and accurate written disclosure".

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Voluntary disclosure along the lines specified by the BFA Code is, however, one of the most effective ways of managing the risk associated with potential 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-franchises.

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 potential 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?

No, it is not prescribed by law and there are no obligations.

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

There are no specific laws governing the 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.

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

Membership of the BFA is not mandatory.

However, some franchisors become members of the BFA as it operates as an accreditor of franchising companies as well as a Trade Association. However, membership carries certain obligations – see question 1.10 below.

1.10 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:

- its disciplinary procedure;
- its complaints procedure;
- its appeals procedure;
- the Advertising Standards Agency's Code of Advertising Practice (https://www.cap.org.uk/Advertising-Codes/Non-broadcast-HTML.aspx);
- the Code (http://www.thebfa.org/about-bfa/code-of-ethics); and
- certain reporting requirements.

The Code incorporates the European Code of Ethics for Franchising ("**European Code**"), along with certain UK-specific provisions which clarify the European Code positions.

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 the above, some franchisors are reluctant to become members of the BFA, notwithstanding that they may be highly reputable and ethical franchisors.

1.11 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 interest in relation to the franchise system.

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, there are no laws that impose any such restrictions.

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 limited companies whose shares are listed on a recognised stock exchange.

When expanding into foreign markets, franchisors may establish a presence in that country 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, certain IP rights might be held in a specific IP holding company resident in a certain jurisdiction (e.g. Ireland or Luxemburg), to take advantage of beneficial tax rates.

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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 can be located at http://www.companieshouse.gov.uk/about/gbhtml/gp1.shtml. There are no additional registration requirements relating to the commencement of business, although the company will have to register for corporation tax, VAT and employment withholding taxes with Her 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.

The offer and sale of a franchise is subject to both European and UK competition law provisions relating to agreements between undertakings and the abuse of a dominant market position, namely Articles 101(1) and 102 Treaty on the Functioning of the European Union ("**TFEU**"), the Vertical Agreements Block Exemption and the Technology Transfer Block Exemption and, in the UK, the Competition Act 1998 and the Enterprise Act 2002.

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 then 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 at least 80% of the products to be sold through the franchised unit from the franchisor or its nominated suppliers, the supply agreement will not qualify for the automatic "safe harbour" treatment under the Vertical Agreements Block Exemption if it is for a term of more than five years, or if 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, 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 may be deemed a "hard-core restriction" under European competition law. The imposition of minimum resale prices would be considered a "hard-core restriction". The inclusion of a "hard-core restriction" will 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. The Vertical Agreement Block Exemption Guidelines 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 2–6 weeks) which will benefit consumers.

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 his or her ability to optimise the income, for his or her franchise, is being impaired due to the proximity of the neighbouring franchise. However, the general English law 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 which substantially deprives B of the enjoyment of that benefit. The obligation not to derogate from grant is implied by English law into the franchise agreement.

Under English law there is, at least as yet, no overriding duty of good faith and fair dealing which 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 need to 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.

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 require 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.

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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 non-compete clause does not contain any hard-core 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 EU competition law 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 will be invalid, but without invalidating the entire franchise agreement.

Post-term non-compete obligations are not normally covered by the Vertical Agreement Block Exemption, except where the obligation is deemed indispensable to protect know-how transferred by the franchisor. In that case, 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 is required to be classed as "secret", which it might be hard for a franchisor to prove.

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**") 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 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 European locations other than the UK, it may be preferable to obtain a Community Trade Mark which applies across all European Union Member States. This can be achieved by making an application to the Office for Harmonization in the Internal Market.

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 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) 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 are the remedies that can be enforced against a franchisor for failure 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

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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 could bring a claim for misrepresentation against a franchisor that made untrue statements of fact which led the franchisee to enter into the franchise agreement and suffer loss (see question 5.3). 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 misrepresentation in terms of data disclosed being incomplete, inaccurate or misleading 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 need to 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 could establish that the franchisor owed the 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 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 disclaimer clauses 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 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 the law permit class actions to be brought by a number of allegedly aggrieved claimants 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 rogue 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.

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.

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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 tenancy, and appropriate wording to cover this issue can be included in the original lease. It would require the assignment of the lease to the franchisor (and that would generally require the franchisor to assume 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 of law preventing non-national entities 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 the non-national entity.

7.4 Give a general overview of the commercial real estate market. Specifically, can a tenant reasonably 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 of a particular location)?

The market is currently mixed. It is normal to negotiate a rent free allowance 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 balance of supply and demand. This is especially relevant in the retail sector. However, in London and the South East, and other prime locations such as the major out-of-town retail parks, this is becoming more difficult as the local economy improves. For substantial assets in growth 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 customer in an attempt to secure a sale.

A ban on passive sales is a "hard-core restriction" under European competition law, which provides that every franchisee must be allowed to use the Internet to sell its products or offer its services. Selling via the Internet is deemed by the European Commission to be a form of passive selling.

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.

9 Termination

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

No. However, see the comments on TUPE in section 14 below.

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.

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

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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 to be insufficient to create a franchisor duty under which it may be vicariously liable.

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.

Franchise fees often comprise 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 to be a "Commercial Agent" for the purposes of the Commercial Agents (Council Directive) Regulations 1993 ("**Regulations**"). The Regulations include (amongst other non-excludable obligations) implied duties between the parties (including good faith), implied terms as to the length of termination notice, and an obligation for the principal to pay severance payments to its agent following either termination or expiry of the agency agreement.

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 over the last 24 to 36 months, 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, such as 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".

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 laws regulating the on-going 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 is facing huge changes which will come into effect on 25 May 2018, when the EU General Data Protection Regulation ("GDPR") comes into force. As this will be before "Brexit", GDPR will have direct effect on businesses with operations in the UK.

Additionally the UK Government has recently introduced an intention paper for a new Data Protection Bill (the "Bill"), which will be introduced to Parliament after the summer recess 2017. The Bill is designed to (i) exercise certain derogations under GDPR that the UK Government negotiated, (ii) apply the new data protection standards to all areas, not just areas of EU competence, and (iii) repeal the Data Protection Act 1998 ("DPA") to avoid inconsistencies with GDPR. Although not explicitly stated, given these aims it is likely that the Bill will come into force concurrently with GDPR on 25 May 2018. Businesses with operations in the UK should therefore be taking urgent steps to ensure compliance

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with GDPR from May 2018, and keeping a watch on the progress of the Bill for any further requirements, bearing in mind that unlike the current DPA which regulates only "data controllers", the GDPR directly regulates "data processors" for the first time.

Failure to comply with GDPR (and the Bill, once it passes into English law) 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 in this column. During this transitional period in particular, it is therefore essential that detailed advice is sought from appropriate experts in the data privacy field.

Bribery: the Bribery Act 2010 created various new 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 of 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 will have to 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 cover advertising to consumers) and the Business Protection from Misleading Marketing Regulations (which cover advertising to traders and comparative advertising). Significant consumer protection reforms are currently proposed to give consumers a direct right of redress.

UCTA: The Unfair Contract Terms Act 1977 ("**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. 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 Unfair Contract Terms Act 1977, 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 its franchisees who trade under its 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.

Transfer of Undertaking Regulations (2006) ("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 would be payable unless the contract provided for an extension right which the franchisor refused to honour (in which case contractual damages for breach could apply).

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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 on 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 the 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 country 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 ("**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.

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Iain qualified as a solicitor in 1988 and specialised in corporate merger and acquisition, stock exchange and complex commercial and joint venture work. Between 1998 and 2002, Iain was Director of Corporate Finance at a corporate industrial developer, responsible for the commercial and financial evaluation of acquisition opportunities, transaction structuring and negotiation. He joined DLA Piper as a Partner in 2002 and is global Co-Chair of the Commercial Contracts and Franchise & Distribution Group.

Iain's work includes commercial transactions of all descriptions, including supply chain management, procurement of goods and services, procurement and maintenance of capital assets, outsourcing, offshoring, manufacturing, logistics, consultancy and services agreements, as well as arrangements for getting goods and services to market, including direct sale, agency, franchise, distribution, brand licensing, e-commerce and international trade, and includes advising on appropriate deal structures and delivery mechanisms relating to national and multi-jurisdictional transactions.

DLA Piper's Franchise & Distribution Group is a global leader in franchise and distribution law – in 2014, 2015, 2016 and 2017 the firm was ranked Band 1 by Chambers Global Directory, and it has been recognised as the International Franchise Law Firm of the Year by Who's Who Legal for the 13th consecutive year. Our unique combination of geographic reach and experience enables us to provide a comprehensive, seamless service on all franchise and distribution transactions. We have extensive experience in structuring, negotiating and documenting multi-national master franchise, area and regional representative and development arrangements, joint ventures and other distribution relationships in the Americas (including Canada), Europe, the Middle East, Africa, China and Asia Pacific. We have handled transactions in every major country in the world and have represented some of the best-known franchisors, manufacturers and distributors in relation to their domestic and international operations. Our clients come from all sectors and cover a broad spectrum of size and experience, from entrepreneurs and companies that are establishing new programmes, to the largest franchisors, manufacturers and distributors.

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Germany

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1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

There is no statutory legal definition of a franchise.

In practice, the most common franchise system is the so-called subordination franchising. The following definition of franchise is recognised in literature and legislation: a continuing obligation based on which the franchisor grants the franchisee against a fee (franchise fee) the right to distribute certain goods and/or services using the name, brand, equipment, etc., as well as the commercial and technical experience of the franchisor with due regard to the organisation and advertising concept developed by the franchisor, whereby the franchisor gives the franchisee assistance, advice and training in technical and sales terms and exercises control over the business activities of the franchisee.

1.2 What laws regulate the offer and sale of franchises?

There is no franchise-specific legislation in Germany. Therefore, the jurisdiction of the courts has to be considered, as well as the general provisions for contractual relationships. As franchise agreements are often standardised contracts, the law of General Terms and Conditions (§§ 305–310 of the German Civil Code) with its strict regulation applies.

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 the purposes of any franchise disclosure or registration laws?

Yes, in case the criteria of the above-mentioned definition are met. As there are no franchise-specific laws with regard to, e.g., disclosure or registration, it does not matter how many franchisees/licensees the franchisor proposes to appoint.

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

No, there are not any registration requirements relating to the franchise system as such. Nevertheless, there exist registration requirements relating to specific sectors (e.g. distribution of medical products) in Germany. Furthermore, the franchisee must usually submit an application for his business registration.

1.5 Are there mandatory pre-sale disclosure obligations?

Although there is no legislation or clear definition with regard to mandatory pre-sale disclosure obligations, the franchisor must reveal performance, mode of operation and prospect of success to the franchisee.

The franchisor – like any other economically independent entrepreneur – will carry the financial risks which come along with the conclusion of the franchise agreement. In order to assess its risks, the potential franchisee must be made aware of any conditions which are known by the franchisor and which might influence the decision of the franchisee with regard to the conclusion of the franchise agreement. In the German jurisdiction, the pre-sale disclosure obligation has been anchored due to the pre-contractual relationship of trust in §§ 311 Abs. 2, 241 Abs. 2 BGB (German Civil Code).

Lately, the courts have become stricter regarding pre-sale disclosure obligations. For example, the franchisor has to provide numerical data and give information about the profitability of the franchise system and the achievable turnover; if the franchisor only gives an estimation, he has to reveal this to the franchisor. Incorrect statements of the franchisor might lead to its liability.

Besides, the extent of pre-sale disclosure obligations depends on each individual case, especially with regard to the (economical) experience of the franchisee.

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

First of all, a sub-franchise is not usual in Germany. But in the case of a sub-franchise, the same pre-sale disclosure obligations (as mentioned in question 1.5) prevail in the relationship between the master-franchisee and the sub-franchisee. The master-franchisee will be obliged to reveal the relevant information to the sub-franchisee. Therefore, it is recommended to have the contractual relationships between the franchisor and the franchisee, as well as between the master-franchisee and the sub-franchisee, "synchronised"; in this context it is also important to note that the master-franchisee must be given the right by the franchisor to reveal the relevant information to a sub-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 format of disclosures is not described by law or other regulation,

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but by case law and varies from case to case. Nevertheless, it is recommended to have a document regarding the pre-sale disclosure signed by the franchisor and the franchisee.

There is an obligation to make continuing disclosure insofar as facts, essential to the franchise change, or new circumstances occur (e.g. discontinuation of a trade mark).

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

No; there are no other franchise-specific requirements to be met before a franchise may be offered or sold. However – according to jurisdiction – the franchisor usually has to have a tried-and-tested system in the sense that he has two businesses (franchise shops) which are ran successfully.

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

No, membership of a national franchise association is not mandatory, but commercially advisable. In Germany, the Deutsche Franchiseverband (German franchise association) represents franchisors as well as franchisees and is an institution which supports and promotes franchise systems and their images and quality in Germany, e.g. through getting in touch with members of parliament, federal ministries, etc. The Deutsche Franchiseverband also holds cooperation with various business partners.

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

As the members of the Deutsche Franchiseverband belong to a so-called community of quality, they are obliged to comply with a code of ethics, which is part of the constitution of the Deutsche Franchiseverband.

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

No, there is no legal requirement for documents to be translated into German language. Nevertheless, with regard to the requirement of transparency of standardised formulations (§ 307 section 1 sentence 2 of the German Civil Code), it is necessary that both parties understand the content of any documents. Therefore, an informative German translation of documents is recommended.

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, unless the business operates in specific sectors (e.g. electricity, nuclear energy and armament).

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

There is a variety of business forms available to franchisors depending on initial capital, founding members, accountancy, tax, liability, obligation to publicly disclose, etc. Typically, an incorporated company such as a GmbH (limited liability company) or a GmbH & Co. KG (a limited commercial partnership where the general and individually liable partner is a limited liability company) is used by franchisors. For a large business entity, a stock company can also be used by the franchisor.

Regarding the type of business entities through which a franchisor might establish its franchise network, this is mostly subsidiary. Partnership franchises have become more common, however such franchises may cause trouble with regards to the anti-trust law.

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?

Depending on the form of the business entity, an incorporated company must be registered in the commercial register as part of founding. Furthermore, each business entity has to have a valid VAT number and must register its business at the trade office, and depending on the type of business, a business licence will be required (e.g. restaurants, bars and hotels).

3 Competition Law

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

Since franchise agreements also regularly include a combination of different vertical regulations with regard to the products that are distributed (e.g. selective distribution, non-competition, exclusive distribution), as well as licence and know-how contractual use, Art. 101 of the Treaty on the Functioning of the European Union (TFEU) applies in principle, if this involves a perceptible restriction on trade. Regardless of the perceptible threshold, a prohibition of competition in respect of the goods or services acquired by the franchisee, for example, is not subject to the ban of cartels of Art. 101 TFEU if that obligation is necessary in order to preserve the uniformity and reputation of the franchise system (the criterion of indispensability). According to the Vertical Block Exemption Regulation (Vertical BER), based on Art. 101 TFEU, there is perhaps also an exemption from the ban on cartels if the market share of both parties does not amount to more than 30 per cent. If there is no cross-border external impact, the German Act against Restraints on Competition (ARC), which is substantially identical to Art. 101 TFEU in sections 1, 2, applies; the Vertical BER is also applicable. Furthermore, businesses in Germany must comply with the Act Against Unfair Competition, which serves the purpose of protecting competitors, consumers and other market participants against unfair commercial practice.

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

No, but usually the term of a franchise agreement is five years. This is due to the regulation that a franchisee can only be prevented from selling competing products or providing competing services for five years.

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

No, because the franchisee is obliged to promote the products and/or services of the franchisor during the term of the franchise agreement. However, since product supply agreements are part of today's standard franchise systems in the sense that the franchisee is obliged to accept contract goods and services from the franchisor, a particular provider or supplier, only a maximum contract term of five years is permissible in the case of an exclusive purchase obligation. If, however, the product supply agreement contains no exclusive purchase obligation or other restriction of competition, a contract term of more than five years is possible.

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

Yes. The franchisor must not restrict the franchisee's ability as a buyer to determine its (re)sale price. Nevertheless, the franchisor as a supplier may impose a maximum sale price or recommend a sale price, provided that it does not amount to a fixed minimum sale price as a result of pressure from or incentives offered by the franchisor.

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

In most sectors, territorial protection is one of the functional conditions of a franchise. Therefore, franchise agreements contain so-called territorial protection clauses which are intended to protect the franchisee from the fact that another franchisee is taking advantage of other's acquisition efforts and is competing in the same territory. However, an absolute protection of the territory cannot be agreed, as franchisees are always entitled to carry out so-called passive sales at the request of a customer.

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

Yes. Whereas the in-term restraint on competition is inherent to the franchise system and does not need to be expressly stated in an agreement, the post-term restraint on competition has to be subject to an agreement of the franchisor and franchisee. Usually, the franchise agreement contains an in-term and a post-term restraint on competition, whereas the post-term restraint on competition must only last for one year. However, the requirements to be granted injunctions by court are high.

4 Protecting the Brand and other Intellectual Property

4.1 How are trade marks protected?

Trade marks can be registered at the Deutsche Patent- und Markenamt and, therefore, are protected by registration. The proprietor of the trade mark is entitled to injunction relief and claim damages in the case of infringement of the trade mark (§§ 14, 15 of the Act on the Protection of Trade Marks and other Symbols). Unregistered trade marks are only protected by the Act Against Unfair Competition or through contractual regulation.

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

In general, no; unless it is a trade or industrial secret which has been entrusted to an employee who communicates it for the purpose of competition (criminal offence according to § 17 of the Act Against Unfair Competition). However, know-how, trade secrets and other business-critical confidential information can be protected by a non-disclosure agreement. Plagiarism by competitors is prevented by § 4 of the Act Against Unfair Competition. The proprietor of know-how, etc. is entitled to claim damages and injunction relief.

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 is granted by the Act on Copyright and Related Rights to any intellectual creations of the franchisor within the meaning of this Act.

5 Liability

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

In any case of a (culpable) breach of contractual duty by the franchisor, the franchisee will be entitled to claim damages (§ 280 of the German Civil Code) and – usually after expiration of an appropriate deadline – rescind from the contract.

5.2 In the case of sub-franchising, how is liability for disclosure non-compliance or for misrepresentation in terms of data disclosed being incomplete, inaccurate or misleading 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?

Liability is defined by and on the basis of each contractual relationship. Therefore, the master franchisee is responsible for complying with disclosure obligations in a sublicensing context. As the relevant raw data has to be provided by the franchisor, it is recommended that the master franchise agreement contains a release from liability.

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

No, because such a disclaimer clause will be invalid as it leads to an unreasonable disadvantage for the franchisee.

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

No, class actions are not permitted in the context of a franchise. Nevertheless, franchisees can claim against a franchisor as joint parties. A waiver clause will not be enforceable in the case of compulsory joinder.

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 neither such requirement nor a generally accepted norm. Moreover, the parties are free to choose the applicable law. However, with regard to standardised franchise documents, the choice of law must not be surprising to the other party (franchisee); therefore, the chosen law has to have a connection to the parties or the place of performance of the contract.

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 rogue franchisee to prevent damage to the brand or misuse of business-critical confidential information?

Yes, interlocutory relief can be granted by local courts; foreign court rulings are also enforceable in Germany under certain requirements (e.g. under a Regulation of the European Union, court rulings are usually enforceable in all Member States). However, before interlocutory relief is granted, a warning letter requiring the franchisee to cease and desist is usually necessary.

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 two to five years, although longer terms of 10 years or more are possible. The parties usually agree on one or two prolongation options.

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 an assignment is understood and will be enforceable if certain requirements with regard to the contractual regulations are met. Therefore, the franchisor's right has to be clearly stated not only in the franchise agreement but also 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?

No, there are not.

7.4 Give a general overview of the commercial real estate market. Specifically, can a tenant reasonably 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 of a particular location)?

The location is one of the essential criteria for the success of a franchise business. The real estate market depends on demand and need in a specific area. An initial rent free period can be expected up to six months. "Key money" is not usually demanded by landlords, but the cost of a lease can be a lot higher for particular favoured locations.

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. With reference to Art. 101 of the Treaty on the Functioning of the European Union (AEUV) and the Vertical Agreement Block Exemption (GVO), absolute territorial protection cannot be granted. Any franchisor or franchisee may advertise its products and/or services in the media and via the internet, as long as distribution is not specifically addressed to customers in the area of another franchisee. The franchisor may only impose general binding requirements on the quality and design of advertisements.

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?

The domain name is transferable under German law without limitations. However, as the franchisee and the franchisor have to expressly agree on the transfer, it must be clearly stated in the franchise agreement or any other document.

9 Termination

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

There are quite a few mandatory German regulations with regard to the termination of a franchise agreement. For example, termination with immediate effect is only effective if there is a good reason for it and usually only if the other party has previously been warned (§ 134 of the German Civil Code).

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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, there is no such risk as long as the franchisee is not integrated into the operations of the franchisor, but autonomous to the greatest possible extent within the franchise system. It depends on the degree of control of the franchisor exercises over the franchisee's business. The franchisee will be treated as autonomous if he controls the organisation, personnel and pricing within its territory; this means that the franchisee has to act in accordance with the Operations Manual, but he is not bound by the instructions of the franchisor. The distinction between franchisor and franchisee as regards the employment of the franchisee's employees may start to become blurred, e.g., when the franchisor determines the time and place of work.

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, there is no such risk as long as the franchisor does not act as *de facto* manager of the franchisee's business. This again depends on the degree of control the franchisor exercises over the franchisee's day-to-day operations or, more specifically, where the franchisor exercises a considerable degree of control over the "instrumentality" at issue (i.e. the act causing the damage). In order to mitigate a risk, neither the franchisee nor its employees must personally depend on 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?

In Germany, there are no exchange control restrictions on the payment of royalties 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?

For non-resident business entities or entrepreneurs, which do not have a permanent establishment in Germany, the income tax on domestic income from the assignment of rights or know how is levied at source in the absence of deviating rulings in double tax treaties. The tax rate is 15 per cent plus a solidarity surcharge of 5.5 per cent on the corporate income tax.

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 not.

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, if the franchisor does not act independently but on behalf of the franchisor. Nonetheless, the legal prescriptions on commercial agents also prevail in the case of a franchise. In particular, the role of subordinate franchises has been a development in the law on commercial agents. Only those regulations which explicitly apply to the commercial agent acting on behalf of an entrepreneur do not apply to franchises. For example, unless the franchisee is obliged to transfer its customer base to the franchisor, the franchisor may have to pay compensation according to the law on commercial agents.

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, as the franchisor and the franchisee are contractual parties, each is obliged to act in accordance with the general principle of good faith and take customary practice into consideration (§ 242 of the German Civil Code). Furthermore, as regulated by statute, the parties are obliged to take account of the rights, legal interests and other interests of each other (§ 241 section 2 of the German Civil Code; e.g. provide information, duty of care). As franchise agreements are usually standardised contracts, the strict regulations of the Law on General Terms and Conditions (§§ 305 *ff.* of the German Civil Code) applies, which enjoins the franchisor from any unreasonable disadvantage to the franchisee by contractual regulation.

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 not.

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 specific disclosure obligations with regard to a renewal of an existing franchise agreement.

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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?

In general no, unless such right for the franchisee is provided for in the franchise agreement. Based on contractual duty of care and loyalty, the franchisee may exceptionally and on a case-by-case basis be entitled to a renewal or extension of the franchise agreement if – due to an order from the franchisor – it has recently made substantial investments (e.g. redesign or expansion of location).

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?

In general, no.

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, because with the transfer of the franchise agreement comes all its rights and duties. Moreover, and as already stated in general contract law, the approval of the other party (franchisor) is required in order sell, transfer, etc. the franchised business.

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 can take over the franchisee's business. Such a provision with regard to a "step-in" right will be enforceable if the reason, premises and circumstances are explicitly and transparently stated in the franchise agreement and the compensation is serious.

16.3 If the franchise agreement contains a power of attorney in favour of the franchisor under which it may complete all the 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 country 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 in favour of the franchisor can only be validly agreed on in the franchise agreement if the franchisor is explicitly exempt from the prohibition of contracting with oneself (§ 181 of the German Civil Code). Usually, there are no formalities such as a written or notarised form of the power of the attorney, but this will depend on the specific type of franchised business. By all means, the premises and circumstances of the utilisation of the power of attorney must be explicitly and transparently stated in the franchise agreement in order to avoid misuse.

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India

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1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

The term "franchise" is not defined under any law in India. However, the term was defined for the purposes of services tax law (which has now been repealed in view of the consolidated indirect tax legislation of 'Goods and Services Tax') as "an agreement under which the franchisee has a representational right to sell or manufacture goods or to provide services or undertake any process identified by the franchisor, regardless of whether the agreement involves the use of a trade mark, service mark, trade name, logo or any such symbol".

1.2 What laws regulate the offer and sale of franchises?

There are no franchise-specific laws in India. The franchise arrangement is therefore governed by various statutes, rules and regulations, including:

- The Indian Contract Act, 1872, which governs the rights, duties and liabilities of the parties.
- Legislations relating to Intellectual Property *viz*. The Trade Marks Act, 1999, Copyright Act, 1957, Patents Act, 1970, Design Act, 2000.
- The Competition Act, 2002, with reference to anti-competitive agreements and abuse of a dominant position.
- The Foreign Exchange Management Act, 1999 and the rules and regulations framed thereunder with reference to cross-border franchises.
- The Foreign Direct Investment Policy, which regulates any investment in India and lists the sectors in which foreign investment is permitted both under the automatic route and the approval route.
- The Income-Tax Act, 1961 and Double Taxation Avoidance Agreements.
- Labour legislations.
- Real estate laws, major ones being: the Transfer of Property Act, 1882, governing the acquisition of immovable property (under both sale and lease agreements); Indian Stamp Act, 1899 and state stamp duty legislations; Registration Act, 1908, which contains rules on the registration of agreements; rent control legislation, which applies to tenancies and lettings of immovable property; and Development Control Rules.
- The Arbitration and Conciliation Act, 1996, which governs arbitration proceedings and the enforcement of foreign awards.
- The Consumer Protection Act, 1986, which provides remedies to consumers for defective products and deficiency in services.
- The Information Technology Act, 2000, with reference to data protection.

Furthermore, specific state legislations may apply depending on the industry/sector of the franchise business, as per which certain licences, permits and compliances under the relevant state laws would be 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 the purposes of any franchise disclosure or registration laws?

There are no disclosure requirements mandated under Indian law and the relationship is purely governed by the contract executed between the franchisor and the franchisee.

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

There are no registration requirements for a franchise system.

1.5 Are there mandatory pre-sale disclosure obligations?

There are no mandatory pre-sale disclosure requirements under Indian law. However, in accordance with the common law principles, parties are expected to deal with each other in good faith and reasonably. The parties are also required to be *ad idem* as per the provisions of the Indian Contract Act, 1872. Further, any misrepresentation or breaches of any warranties on the part of the franchisor would expose him to a claim for damages and action under criminal law for misrepresentation and criminal breach of trust.

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

As mentioned above, there are no disclosure requirements. However, the common law principles will also apply to every person making any representation for the purpose of the proposed contractual relationship.

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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 mentioned above, there are no disclosure requirements prescribed under any Indian law.

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

There are no mandatory requirements to be complied with before the franchisor can begin to market the franchise system to prospective franchisees. However, though not mandatory, the franchisor should consider registering its trade and service marks. Further, if the franchisor is proposing to advertise, they must ensure that all marketing and advertising literature complies with local advertising laws and standards, as prescribed by the Advertising Standards Council of India and various local laws (e.g. the Consumer Protection Act, 1986, Cable Television Networks (Regulation) Act, 1995, etc.).

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

No. However, though it is not mandatory, it may be commercially advisable to be part of an association, such as the Franchise Association of India, in order to garner the benefits of being in touch with peers, existing and prospective franchises and have a collective voice of the industry with regard to matters affecting franchises.

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

Associations normally prescribe a code of ethics. However, these are recommendatory in nature.

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

As mentioned above, there are no disclosure requirements.

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 Direct Investment Policy, the Foreign Exchange Management Act, 1999 and the rules and regulations framed thereunder prescribe the thresholds and conditions for foreign investment in India and compliances for outward flow of foreign exchange, *inter alia,* towards royalty, franchise fees, etc.

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

Local franchisors normally use direct franchising, in as much as they are familiar with local conditions, market and laws. On the other hand, international franchisors normally appoint a master franchisee, and develop a franchise network through such master franchisee. There are a few examples of international franchisors who have formed local subsidiaries to grant direct franchises. Franchise joint ventures are not common and these would be used where the foreign franchisor sees greater value in having a local partner for direct franchises.

Considering the large geography of the country, in India the franchisors follow a master franchise model for one or more of the East, West, South and North regions of the country, and have a target for opening a specific number of unit franchises in each region. It could also appear to be advantageous to the franchisor to have different arm's length entities operating in different parts of the country, thereby minimising dependence on a single master franchisee.

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?

A new business entity, particularly which has or proposes to have foreign investment, would usually be a company incorporated and registered under the Companies Act, 2013. The Company would have to be registered under the said Act.

3 Competition Law

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

Section 3 of the Competition Act, 2002 prohibits agreements that are likely to cause an appreciable adverse effect on competition within India. Further, the Indian Contract Act, 1872 makes agreements which are in restraint of trade void. This includes vertical agreements amongst enterprises or persons at different stages or levels of the production chain in different markets resulting in a tie-in arrangement, exclusive supply arrangement, exclusive distribution arrangement, refusal to deal or resale price maintenance, having such an appreciable adverse effect on competition within India. However, certain reasonable restrictions are permitted, e.g. reasonable restrictive conditions may be imposed by the franchisor on the franchisee for the purpose of protecting any of its intellectual property rights. Likewise, provisions restraining the franchisee from carrying out a competing business during the term of the agreement would be considered reasonable.

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

Indian laws do not mandate any minimum or maximum term for a franchise agreement.

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

There is no maximum limit of the duration of a related product supply agreement.

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

Under the Competition Act, 2002, agreements that directly or indirectly determine the purchase or sale price are considered to be

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likely to cause an appreciable adverse effect on competition within India and are therefore prohibited. However, Indian courts have upheld that reasonable restrictions to protect franchisors' brands or intellectual property rights are not considered as anti-competitive. Hence, the franchisee can be mandated by the franchisor to buy products and services including those for resale only from the franchisor or its nominated suppliers.

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

There is no requirement under any law that obligates a franchisor in any manner to observe any obligations when offering franchises in adjoining territories. These issues would have to be dealt with contractually.

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

Generally non-compete, non-solicitation agreements are considered to be a restraint of trade. However, Indian courts have held reasonable restrictions, such as restraining a party from not competing and/or non-soliciting the customers during the term of the agreement would not be considered as being in restraint of trade and such restrictions would be enforceable. However, post-term non-compete and non-solicitation restrictions are normally not considered reasonable, particularly where the post-term period is long and, if challenged, the decision in this regard is subject to the court's discretion. It is normal practice for franchisors to build in suitable clauses to maximise the non-compete and non-solicitation term subject to law.

4 Protecting the Brand and other Intellectual Property

4.1 How are trade marks protected?

The Trade Marks Act, 1999 ("**Trade Marks Act**") provides for registration and protection of trade marks. The Trade Mark Registry presently administers the Trade Marks Act and the rules made thereunder. It also acts as a resource and information centre and its main function is to maintain the register of trade marks.

Trade mark registration is valid for a period of 10 years from the date of registration. The trade mark may be renewed from time to time in accordance with the provisions of Trade Marks Act & Rules formed thereunder. Application for renewal of a trade mark must be made not more than six months before the expiration of last registration of the trade mark.

According to the Trade Marks Act, the registered proprietor of the trade mark has the exclusive right to use the mark in relation to the goods and services in respect of which the mark is registered and to obtain reliefs for protection of the trade mark. The Trade Marks Act provides that the original registration of the trade mark, along with all subsequent assignments and transmissions of the trade mark, shall be *prima facie* evidence of the validity of the same. The owner of an unregistered trade mark will not be able to sue for "infringement" under the Trade Marks Act. However, the remedy of passing off, as prescribed and defined by common law and various court rulings, will be available in such a case. Indian courts also recognise trans-border marks.

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

There is no specific law in India for the protection of know-how, trade secrets and confidential information. However, various statutes, rules and regulations may be applied for enforcement of rights for such protection such as:

- the Indian Contract Act, 1872 if there is a contractual obligation to protect know-how, trade secrets and confidential information;
- Indian Penal Code, 1860, which governs provisions related to theft, cheating, criminal breach of trust, etc.;
- Indian Copyright Act, 1957 which will apply to the protection of copyrighted material; and
- the Information Technology Act, 2000 ("**IT Act**"), which contains provisions for the protection of information technology.

India follows common law and, therefore, as a general culture, plagiarism with regard to know-how, trade secrets and confidential information will be decided according to the terms of the agreement and aforesaid statutes.

Conditions and limitations can be imposed under the franchise agreement on the use of know-how, trade secrets and confidential information (including, for example, restrictions on the territory in which the know-how, trade secrets and confidential information can be used, the duration of use and so on) and a breach in respect therefore would entitle the franchisor to relief including damages and injunction.

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, 1957 (**"Copyright Act"**) protects original literary, dramatic, musical and artistic works and cinematograph films and sound recordings from unauthorised uses with respect to copyrighted work. Though registration of a copyright is not compulsory in India, the certificate of registration of copyright and the entries made therein serve as *prima facie* evidence in a court of law with reference to a dispute relating to ownership of copyright. India follows common law and, therefore, as a general culture, plagiarism with regard to software will be decided according to the terms of the agreement. Under the Copyright Act, the definition of "literary work" includes computer programs, tables and compilations, including computer literary data bases. Hence, such a protection will extend to the Operations Manual or the proprietary software developed by the franchisor.

Franchisors would be entitled to seek remedy to prevent unauthorised use of the copyrighted material based on the terms and conditions in the agreement and the rights available under the Copyright Act.

5 Liability

5.1 What are the remedies that can be enforced against a franchisor for failure 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 on the franchisor under Indian law.

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However, parties are expected to deal with each other in good faith and reasonably in accordance with the common law principles. Any misrepresentation or breaches of any warranties on the part of the franchisor would entitle the franchisee to rescind the agreement and expose the franchisor to a civil claim for damages and/or action under criminal law for misrepresentation and/or criminal breach of trust.

5.2 In the case of sub-franchising, how is liability for disclosure non-compliance or for misrepresentation in terms of data disclosed being incomplete, inaccurate or misleading 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 above, under Indian laws, there are no mandatory requirements for disclosure by the franchisor. Generally speaking, in sub-franchising, the primary liability for misrepresentation or inaccurate and/or misleading statements will be determined by the terms of the sub-franchise agreement. However, if the inaccuracy is as a result of misrepresentation by the franchisor to the master franchisee then the master franchisee may, in turn, seek relief against the franchisor.

The franchisor can enforce the indemnity provisions as per the master franchise agreement. However, courts in India would normally allow direct reasonable damages and not grant a claim for indirect or consequential losses.

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

While disclaimers for limitation of liability are common and valid in India, the same are subject to certain conditions. In India, fraudulent misrepresentation to induce a party to consent to the contract is illegal and will make the contract voidable at the request of the misrepresented party. Further under Indian law, illegality and the application of the provisions of a statute cannot be contracted out of. Therefore, if there is an agreement entered into in fraudulent circumstances, the same and any clause waiving the right to seek damages in such a case will also generally be held to be illegal. The viability of a clause to limit liability in other instances will depend upon the nature of the disclaimer (including its proportionality/reasonability) and the discretion of Indian courts, if such a clause is challenged. Further, as mentioned earlier in the chapter, since parties in India are required to be *ad idem*, it is advisable for the franchisor to disclose clearly the limitations of liability to the franchisee.

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

Suits can be filed on behalf of or by a large group of individuals for a common interest in India. While class action suits are not barred by Indian law, the same are not common in India.

As mentioned in question 5.3 above, a waiver of illegality or the provisions of a statute is not allowed under Indian law. A complete waiver of the right to file class action suits will therefore not be recognised generally. However, the enforceability of such a waiver will also more particularly depend on its nature and the discretion of the courts.

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 agreements to be governed by local law. Courts in India generally recognise a choice of foreign law. However, such a choice of foreign law can be overridden if the concerned foreign law is contrary to the established principles of the Indian legal system (for example, laws contrary to the public policy of India). It is common to have cross-border agreements (including franchise agreements) governed by a foreign law. However, in such case, the dispute resolution forum (court or arbitration) is also foreign.

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 rogue franchisee to prevent damage to the brand or misuse of business-critical confidential information?

Foreign judgments can be enforced in India (subject to certain conditions), if the foreign court is located in a reciprocating territory as prescribed under the Civil Procedure Code 1908 ("**CPC**").

If the foreign court is not based in a reciprocating territory, the Code of Civil Procedure requires a fresh suit to be filed in India.

Further, an application for an interlocutory relief of injunction can be also filed in Indian courts in accordance with the procedures laid down under the CPC. In the context, it may be noted that India is also a party to the UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 1958 (New York Convention) along with Geneva Protocol on Arbitration Clauses, 1923 and Geneva Convention on the Execution of Foreign Arbitral Awards, 1927 (Geneva Convention), and therefore recognises and enforces international arbitration awards as well. Such an enforcement will depend on whether (a) the relevant foreign jurisdiction is a party to the Geneva Convention or the New York Convention, and (b) whether it otherwise has reciprocal provisions recognising foreign awards as enforceable under the above two conventions and, being such a country, is notified by the Central Government of India.

7 Real Estate

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

There is no statutory requirement regarding the length of the lease and the same is governed by the contractual understanding. In case of commercial premises, the term may normally vary from three to ten years with further extensions based on mutual understanding. The treatment of the property at the end of the lease will depend on the lease deed. There is no statutory right available to a lessee to hold over after the expiry/termination of the lease. However, if the lessee does hold over and the lessor continues to accept rent or otherwise assents to the continuing possession of the lessee, the lease is considered to be renewed from month to month or year to year depending on the purpose for which the property is leased.

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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 franchise agreement, can contain provisions for termination along with a condition for vacation and assignment of lease on such termination.

Such a transfer of leasehold rights from the franchisee to the franchisor or a new franchisee can be done by way of assignment, provided that the lease deed with the landlord/lessor permits the same or, in absence of such a provision, if the prior consent of the landlord/lessor is obtained for the same.

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 Exchange Management Act, 1999 and rules formed thereunder, if the franchisor is a person resident outside India, it will require the prior approval of the Reserve Bank of India in order to acquire immovable property in India, except for a lease not exceeding five years. However, such restrictions would not apply to an Indian entity owned/controlled by a foreign franchisor as the same would be, for such purpose, considered an Indian company.

7.4 Give a general overview of the commercial real estate market. Specifically, can a tenant reasonably 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 of a particular location)?

The commercial and real estate market is driven by demand and supply. Currently, demand for premium locations and in malls is high, and landlords demand a high lease rent for these premises. Landlords normally agree for an initial rent free period usually for fit-outs.

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 is no restriction under Indian law preventing the franchise agreement to impose a binding requirement for re-directing an online order for products or request for services arising outside the territory of the franchisee to the territory from which the sales request originated. Such a requirement may be enforced, if provided for 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 the rights of the franchisor to require a (former) franchisee to assign local domain names on the termination or expiry of the franchise agreement if so provided in the franchise agreement. Domain names are transferable in India.

9 Termination

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

There are no local laws overriding the right of the franchisor to terminate the agreement. The franchisor and the franchisee can freely agree on the grounds of termination and subject to the terms of the agreement, the franchisor will not be prevented from exercising his rights to terminate 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?

The relationship between the franchisor and the franchisee is on a principal-to-principal basis. Further the franchisee is an independent entity and its employees cannot be regarded as employees of the franchisor. However, the risk may be mitigated by the franchise agreement including suitable provisions, in order to avoid an interpretation that the franchisor is the employer or deemed employer of the 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?

As mentioned above, the relationship between the franchisor and the franchisee, in India, is considered to be on a principal-to-principal basis. This is normally clarified in the franchise agreement. However, to further mitigate the risk of vicarious liability on the franchisor, it is advisable to include a clear provision in the franchise agreement for protecting the franchisor against any interpretation of implied agency, employment, or other such relationship inducing vicarious liability. So long as the agreement is unambiguous it would not matter if, from an operational perspective, the franchisor is exercising some amount of control on the franchisee's business to maintain certain quality standards.

It is further advised to clearly indicate the franchisee's status as a franchisee of the franchisor in all published materials (for example, all letterheads, bills, invoices, e-mails, and websites) and any other documents or literature in paper or electronic form used in the franchisee's business.

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, including those for management services fees, royalties, advertising levy and payments for the supply of products, made

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by an Indian resident to a non-resident as a part of an international franchise arrangement, are subject to the provisions of the Foreign Exchange Management Act, 1999 and to the rules issued thereunder.

Currently, the above-mentioned franchise payments made by an Indian resident to a non-resident are allowed under the automatic route and there are no approvals required or ceilings prescribed.

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 payments made by an Indian franchisee to an overseas franchisor will be subject to withholding obligations as applicable. Currently, income tax at the rate of 10% must be deducted by the franchisee at the time of the payment of royalties and/or technical fees to the overseas franchisor.

However, the applicable double taxation avoidance agreement (if any) between India and the country of the franchisor's domicile would also apply. The provisions of the Income Tax Act, 1961 (of India) will, however, continue to apply even in such a scenario if they are more beneficial to the franchisor.

The nature of the payment, i.e. whether it needs to be considered to be a royalty/fee for technical services or management fee services, will be determined by the relevant tax authorities and it would be difficult to structure a royalty as a management services fee unless it can be established that there are such services actually being provided.

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

Currently, there are no requirements for financial transactions to be made in Indian currency, including the payment of 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?

As stated above, the relationship between a franchisor and franchisee is generally considered to be on a principal-to-principal basis. Further, as explained in question 10.2 above, a specific provision to this effect in the franchise agreement will further mitigate the risk.

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 obligation on the parties to deal with each other in good faith and act reasonably during the term of the franchise agreement can be derived from the common law in India. The General Clauses Act, 1897 states that *a thing shall be deemed to be done in "good faith" where it is in fact done honestly, whether it is done negligently or not.* However, if a criminal action is taken for criminal breach of trust then the provisions of Indian Penal Code, 1860 ("**IPC**") would be followed unless the accused party has committed such an act in good faith believing himself to be bound or justified by law to commit the act. In such a case, the definition as prescribed in the IPC will have to be applied which states that nothing done or believed without due care and attention will be said to be done or believed in good faith. Besides the above, "fair dealings and good faith" is an evolving concept under Indian common law and whether an act would or would not constitute the same is decided subject to the relevant facts of the case.

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 is mentioned in question 1.2 above, there are no specific laws governing franchises in India. The various laws, *inter alia,* enumerated earlier in the chapter, will be applicable to the relationship 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?

As mentioned earlier, there are no laws mandating disclosure by the franchisor. The same is the case with regard to disclosure for renewal of an existing franchise.

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 right available to the franchisee to an automatic renewal or extension of the franchise agreement if the franchise agreement does not provide for the same. The parties are free to agree on the terms of renewal in 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?

Unless the franchise agreement provides for the renewal of a franchise, a franchisee would not be entitled to claim compensation if the agreement is not continued by the franchisor.

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 parties can agree on restrictions on a franchisee's freedom to sell, transfer, assign or otherwise dispose of the franchised business

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in the franchise agreement. Restrictions in restraint of trade are void in India. However, reasonable restrictions are not regarded as being in restraint of trade by Indian courts. The franchisor can, for example, obligate the franchisee to require its prior consent in order to sell, transfer, assign or otherwise dispose of the franchised business or provide an option to the franchisor to purchase the franchised business by itself or through a nominee.

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?

If a franchisee is in breach and the franchise agreement and the same is terminated by the franchisor, a "step-in" right in the franchise agreement (whereby the franchisor may take over the ownership and management of the franchised business) will be recognised by local law. There are no registration requirements or other formalities that must be complied with to ensure that such a right will be enforceable.

However, if the foreign franchisor has taken over the business by way of acquisition of the franchisee entity's shares then (a) necessary filings with the Reserve Bank of India ("**RBI**") would have to be made if the acquisition meets the conditions of automatic route, or (b) approval of the government or RBI would be required if the acquisition or industry is covered by the approval route.

Under Indian law, parties are free to provide for step-in rights in the franchise agreement and the Indian courts would normally uphold such provision. It would be prudent to provide, in the franchise agreement, the commercial terms/aspects such as the valuation of the business assets and the consideration (if any) to be paid in order to avoid or reduce the risk of challenge.

16.3 If the franchise agreement contains a power of attorney in favour of the franchisor under which it may complete all the 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 country 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 for representing the franchisee when completing the formalities of the transfer, etc. on enforcement of step-in rights would be enforceable provided the same is appropriately drafted in the franchise agreement and the agreement is duly stamped. However, it would be advisable for the irrevocable power of attorney to be executed separately, duly stamped as per the relevant State Stamp Act and notarised. Execution formalities would vary depending on whether the power of attorney is executed in India or overseas.

There are no limitations on the ability of the franchisor to include a valid power of attorney in a commercial contract, where the specific identity of the attorney cannot be known at the outset, but the attorney is described by reference to a position.

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Iran

Persia Associates

Dr. Alireza Azimzadeh

1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

International approach: Franchise is a formal system for joint enterprise between two independent entrepreneurs during which one party (the franchiser) receives a payment and under certain conditions grants the right to manufacture and sell his products, as well as the right to use the trademark or brand to the other party (franchisee). Furthermore, the franchisor gives the technical services, technical assistance and knowledge to the other party and teaches the business practice to him. Franchise contracts are concluded primarily with marketing objectives. According to the United Nations Industrial Development Organization, franchising is a way of distributing goods and services through licences and trademarks. It combines the licensing of technical knowledge, trade secrets, copyright and distribution agreements. The elements of franchise agreements can be summarised as follows: permission to use a name or a registered trademark; transfer of technical knowledge on the part of the franchisor to the franchisee; and the distribution of finished goods. In Iran, franchises are mainly applicable to the consumer goods and catering industry.

Franchise contracts require the licensing of trademarks and in that regard are very similar to licensing agreements. The main difference is the scope of the franchisor's monitoring activities and technical services as he is far more involved. Because of this, in some cases the franchisor may even be sued by a third party, namely if said party was hurt. Although franchise agreements are not yet defined by Iranian law, licensing agreements are (but they are mainly for industrial purposes).

When it comes to intellectual property, the improvement in the production of a product is usually the subject of a separate agreement. Contrary to that, in a franchising environment, the franchisor will update the franchisee on his progress as an integral part of their agreement and without the need for negotiation. The Iranian franchise is based on that approach.

As mentioned earlier, the contract type would either be a licensing agreement or a distribution agreement which includes clauses on the most important aspects of a franchise contract. This is predominantly based on the ICC Model of International Franchise Contracts or UNIDROIT.

1.2 What laws regulate the offer and sale of franchises?

There are no Iranian laws specifically related to franchise. Hence, the ordinary civil law has to be applied. Most prominent is Article 10 of the Civil Law, which deals with the general principle of freedom in contracts and the freedom of the parties to conclude them within the framework of the law and *Sharia* law. The bulk of franchising agreements are based on general contract regulations, commercial and corporate law as well as intellectual 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 the purposes of any franchise disclosure or registration laws?

The nature of the franchise contract does not change. Hence, it would just be a limitation or an additional clause in the franchise contract which the franchisor can freely accept or decline and the general legal provisions would apply.

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

Iran has acceded the Paris Convention, hence although a trade mark or the like may not be registered in Iran yet, the registration or the continuous usage pertaining to the foreign company outside Iran will apply. The rules and regulations set out in the convention are therefore accepted in Iran. Article 47 of the Trademark Registration Law of Iran also applies in the same sense.

All of the rights referred to in the franchise contract need to be registered, *inter alia*, patents, trade marks and so on. Besides that, registration with certain authorities is mandatory, namely the Ministry of Mines and Trade (MIMT) and the Ministry of Health (MOH) for import and distribution of foreign products as the case may be. Such registration is the responsibility of the franchisee and not the franchisor. In particular, in line with the provisions of the Consumer Protection Law 2009 (CPL), all providers of capital and durable goods must register themselves with the MIMT, as without this registration the import of products into Iran is not possible. To implement the CPL requirements, the MIMT has issued instructions relating to the registration of distributors and agents, namely the 2016 Instructions, which are currently in force.

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From a legal perspective, registration with MIMT is not for the purpose of granting or triggering commercial agency protection of registered franchisees in Iran, as there are no such legal provisions under Iranian law. Rather, the registration is intended to ensure continuity of supply, aftersales and similar requirements.

The same applies to the import and distribution of health-related products, where approval must be obtained from the MOH pursuant to Article 16 of the Law on Foodstuffs, Beverages, Cosmetics and Hygiene 1967. Numerous implementing regulations have been issued to implement the above in a number of different areas including pharmaceutical drugs, medical devices, foodstuffs, beverages, cosmetics, etc. by the Iranian Food and Drug Administration.

Having the above in mind, the correct registration requirements as per the specific agreement may be carried out with the relevant Ministry and bodies, such as registration with the Ministry of Commerce (Centre for Guilds and Traders). If the intended product is one that needs services (including aftersales) i.e., any machinery, the brand owner has to send a letter to the ministry committing to providing such services.

For some products (e.g. cosmetics, foodstuffs, drugs), registration with the Ministry of Health is required.

Such registration is the responsibility of the franchisee and not the franchisor.

1.5 Are there mandatory pre-sale disclosure obligations?

There is no explicit Iranian franchise disclosure law. Therefore, the general provisions apply.

According to Article 190 of the Iranian Civil Law, the consent of all parties involved is paramount in order for the contract to be regarded as concluded.

In view of this, if pre-sale disclosure would have been essential in order for the potential franchisee to accept the offer in the first place, any non-pre-sale disclosure would be regarded as in contradiction to Article 190.

In addition, Articles 199 and 200 of the Civil Law declare that if parties are misled in the subject matter of the contract then such contract is revocable.

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

Please see the answer to question 1.5.

If the franchisee is aware of the necessary pre-sale information he should inform the sub-franchisee.

Otherwise he is responsible for all losses of the sub-franchisee resulting from the lack of information.

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?

According to Article 190 of the Civil Law, pre-sale disclosures should be stated before the parties reach an agreement, otherwise the consent might not be valid. Continuous disclosure is not required by Iranian law but all parties must be informed of any substantial changes in the contract, as per mentioned above, as it is possible such changes would have a profound impact on the profitability of the operations of the other party.

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

There are no other requirements, but the subject of the agreement should not be illegal.

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

A national franchise association or similar does not exist in Iran.

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

This is not applicable in Iran.

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

There is no legal requirement to translate contracts although, depending on the Iranian partner, a bi-lingual contract may be asked for. In principle, once a dispute has arisen before local courts, the courts ask for an official translation of the contract.

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?

Restrictions in Iran are not known but there is protection for non-nationals in the form of law; for example the Foreign Investment Promotion and Protection Act (FIPPA). The numerous bilateral Investment Protection Treaties (with many Western countries already in place) can be facilitators as well. Of course foreign investors also have to respect several special rules which cover the initial set up of businesses in Iran – please see the following questions.

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

International companies tend to enter the Iranian market in two main forms: 1) establishing a branch office; and 2) establishing an Iranian legal entity. In the first case the entity is principally exempt from tax if it is compliant with all necessary regulations. This kind of entity usually has a small number of persons directly appointed from the company headquarters to oversee local operations, be it that of the distributor or franchise partner or the Iranian local entity established with a focus on "Marketing" and/or "Customer Relations, After Sales Services" or "Coordination".

If a direct sales approach or a Joint Venture with another partner in Iran is sought, the type of company under section 2) above is recommended. There are two types of Iranian local entities: a) Private Joint Stock Companies (PJSC); or b) Limited Liability Companies (LLC or Ltd.). PJSCs are usually recommendable as they are significantly more regulated and mature as per the Commercial Law of Iran and its standing.

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Franchise agreements are getting more and more common in the Iranian market. There are already franchising contracts in place, including one master franchise contract. These are mainly in the fashion industry. Local franchise contracts in their simplest form we see mainly for restaurant and fast food chains.

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?

Please see the answer to question 1.4.

3 Competition Law

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

Established competition law does not exist in Iran, but diverse regulations and circulars are used to handle any cases which arise.

There is, however, a Competition Council arm to the Presidency and this body has started to regulate competition matters in Iran – not yet for contracts, but for example for the automotive industry.

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

There are no Iranian regulations concerning the maximum term for a franchise agreement. It is, however, advisable to follow the UNIDROIT and ICC regulations. According to such regulations, a term of five to 20 years is possible.

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

No. Any terms in supply and distribution contracts would be specified by agreement between the parties.

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

The margins of importers, wholesalers and retailers are governed by the "Consumer Protection Law" of Iran and hence import prices and price structures are based on that. Inspectors would regularly check the market and compare the prices with competitors and international prices they have access to. On the other hand, Iranian Customs do have special regulations as per pricing and there is a specialised body to enforce such regulations.

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

It is customary that a franchise contract contains a clause pertaining to the situation where a product is offered for sale in an adjoining territory, especially if the price varies. In this way any negative competition would be regulated.

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

We refer to the Article 1 of the Civil Responsibility Law, which covers such covenants.

4 Protecting the Brand and other Intellectual Property

4.1 How are trade marks protected?

Iran is a member of the WIPO and protects brands, industrial design and inventions in line with the Madrid Protocol and Paris Convention. The Iranian Law for the "Registration and Protection of Trademarks, Industrial Designs and Inventions" is also relevant.

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

Such information is protected according to Article 1 of the Civil Responsibility Law and Article 648 of the Iranian Criminal Code.

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 not enforceable in Iran but there is a software law which can be relevant.

5 Liability

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

If the disclosure concerns essential terms of the contract, the franchise agreement is void because it hasn't been concluded.

If the matter is not serious enough to render the contract void in its entirety but the information missing would mislead the franchisee and subsequently cause losses, financial remedies can be claimed.

5.2 In the case of sub-franchising, how is liability for disclosure non-compliance or for misrepresentation in terms of data disclosed being incomplete, inaccurate or misleading 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 the indemnity is regarded by the courts as an "unfair clause" – based on the available information and its own discretion – the contract will be void. Generally speaking, agreement of the parties would be of immense importance to the judge after the obligatory provisions and regulations of the law maker.

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

According to Article 448 of the Iranian Civil Law, it is possible.

The burden of proof lies with the franchisee, but the misrepresentation must not be associated with any "criminal elements of misrepresentation".

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

This is not applicable in Iran.

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?

Contracts between an Iranian entity and a foreign entity are subject to the law of the place the contract is signed ("*locis regit actum*"), Article 968 of the Civil Code.

With reference to Articles 968 and 969 of the Civil Law, it has not been clarified in Iranian law if the relevant provision of the Code is mandatory or if the parties to a contract can voluntarily agree to choose the governing law of another country. In view of this, foreign nationals who agree with their Iranian partners to select the laws of a country other than Iran should sign the relevant contracts outside of Iran and, for verification purposes, have the contracts certified by a notary public. Although it is possible under Iranian law to provide for jurisdiction of foreign, non-Iranian courts, enforcement of judgments of foreign courts would usually fail due to a lack of reciprocal recognition and enforcement of judgments between Iran and the respective country where the judgment was obtained. However, Iran has been a member of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards requiring contracting states to recognise and enforce arbitral awards issued in other member states.

Parties can opt to subject the contract to international provisions, e.g. the UNIDROIT and ICC, in order to have a better structure.

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 rogue franchisee to prevent damage to the brand or misuse of business-critical confidential information?

In certain cases the enforcement law of Iran has provided such remedy.

7 Real Estate

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

Generally, the maximum term of a lease is 99 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?

It is not possible to substitute a franchisee with a franchisor as this would be regarded as a separate contract with another party.

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

The lease agreement can be transferred to the sub-leaser if the owner specified this right for the tenant. Principally, foreign nationals cannot own immovable property in Iran; however, through an Iranian company, they will be able to own immovable property.

7.4 Give a general overview of the commercial real estate market. Specifically, can a tenant reasonably 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 of a particular location)?

There is no rent free period given. Landlords can demand "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?

The same clause discussed under question 3.5 would apply. It is possible to insert a clause for non-competition clauses as per the general contractual principles.

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?

If such limitations are included in the agreement, no. It would be preferable if the foreign company registers the domain in Iran itself in the first place; this is possible from inside and outside of Iran.

9 Termination

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

Termination rights are usually determined by the parties or by trade procedure. They are changeable and part of complementary laws. Under Article 10 of Civil Law, the "Free Intent Principle" applies. The intent of the parties is given preference over complimentary

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laws. The intent of the parties and complimentary laws are valid so long as they do not breach obligatory laws.

Nevertheless, termination rights are usually decided according to the wish of the parties and set out in the agreement. Agreements may also come to an end due to circumstances other than those set out in 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?

Iranian law does not regard the parties to a franchise agreement as entering into a co-employer agreement. Hence the employees of the franchisee cannot file a lawsuit against the franchisor based on a presumed employer-employee relationship and therefore franchise agreements are excluded from employment law provisions.

It is, however, recommended to include a clause for that purpose in a franchise 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?

The franchisee's employees are not considered employees of the franchisor, and because of this illegal acts or omissions of such employees have nothing to do with 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?

Legally speaking, any payments to countries outside of Iran shall be carried out via the official banking system in order to ensure they are accepted by the relevant authorities. Hence transfers via exchange offices are not acceptable means. Although on paper the financial embargo on Iran no longer exists, in practice it remains to a greater extent. Because of this, the route via banks is costly and time-intensive.

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?

There is no longer any withholding tax in Iran, only income tax.

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 not.

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, there is not.

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?

Iranian law and Iranian jurisprudence take a fairly formalistic approach towards contract interpretation and performance of contracts. Therefore, there are no statutory provisions under Iranian contract law pertaining to the principle of good faith in performing contractual obligations. Good faith can nevertheless be voluntarily incorporated as a contractual clause if the parties agree to this and, if it is incorporated, this obligation must be complied with. There exist other contractual principles, including, by way of example, the *La Zarar* principle, which is similar to the doctrine of "abuse of right" under the UNIDROIT principle of International Commercial Law.

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?

We refer to Articles 184–230 of the Civil Code of Iran on the relationship of the parties in contracts.

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?

Based on general principles of contracts, if the agreement is only going to be renewed in its term and there is no new information to be shared, the answer is no. But disclosure might be necessary if there are new points that could affect the decision of the franchisee.

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 not. But it is possible that some rights outside the scope of the subject matter, including good will money or key money for the franchisee, shall be negotiated when the agreement is created.

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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 the non-renewal or refusal is in line with the contractual obligations, the franchisee is not entitled to any compensation or 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?

The subject of a franchise contract is often the subject of a trade mark and so the default rule is the prohibition of the franchisee to sell, transfer or assign a franchise business unless the franchisor specifies this right in the franchisee's contract.

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?

If the contract is terminated in the correct manner, the franchisor has to find a new franchisee. There is no step-in right available.

16.3 If the franchise agreement contains a power of attorney in favour of the franchisor under which it may complete all the 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 country 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?

We may answer this question by looking at the remedies available to a franchisee in Iran. On one hand we have a contractual freedom and any contract that has been concluded within the context of law and *sharia* law is assumed to be right. On the other hand we have the fact that two situations can be assumed by the franchisee:

1) Unfairness.
2) Emergency.

In this sense it may be argued that a power of attorney creates an "unfair" situation or the contract has been concluded as a result of an "emergency".

But the answer would be that an "emergency" situation will not make a contract void in Iran (Article 183 of the Civil Code) and it cannot be an argument before the court, as the contract has been rightfully concluded.

Beside that and once arguing an "unfair" situation, it would also be dismissed by the courts as this also is not yet established in the Iranian legal system The definition of an "unfair situation" is only slowly evolving as to be custom. Although we do see a growing trend of including specific "unfair clauses" in contracts in Iran, it is an expression of free will rather than any concept defined by law. And so far "unfair clauses" are only being included in the E-Commerce Law of Iran, under Article 48.

It is therefore important to conclude that contractual freedom would make it possible to add a power of attorney in favour of the franchisor. And the franchisee may not get legal remedy in arguing with clauses like "emergency" or "unfairness", once the contract has been concluded rightfully between the parties. Nevertheless, the franchisee may refuse to sign the contract in the first place.

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The team is being headed by Dr. Alireza Azimzadeh, who has got his doctorate degree from the School of Law of Vienna University. His main specialisation is in International Commercial Law, with a focus on Contract Law.

Persia Associates also has close ties with the German Embassy in Iran for corporate and commercial law and is listed with the Embassies of Switzerland, Austria, Spain and Denmark.

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Japan

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1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

There is no statutory definition of the term "franchise" in Japan. Nevertheless, there are relevant definitions with regard to franchise businesses.

For instance, the Guidelines Concerning the Franchise System (Franchise Guidelines) under the Act on Prohibition of Private Monopolisation and Maintenance of Fair Trade (Act No. 54 of 1947 – Antimonopoly Act) provide as follows:

"*The franchise system is defined in many ways. However, the franchise system is generally considered to be a form of business in which the head office provides the member with the right to use a specific trademark and trade name, and provides coordinated control, guidance, and support for the member's business and its management. The head office may provide support in relation to selling commodities and providing services. In return, the member pays the head office.*"

1.2 What laws regulate the offer and sale of franchises?

The Medium and Small Retail Commerce Promotion Act (Act No. 101 of 1973 – MSRCPA) is the main piece of legislation. It primarily targets medium and small retailers and defines a "chain business" as a business that, pursuant to an agreement with uniform terms and conditions, continuously sells or acts as an agent to sell products and provide guidance regarding management. In addition, a "specified chain business" is defined as a chain business where the agreement includes clauses permitting its members to use certain trade marks, trade names or other signs, and collects joining fees, deposits or other money from the members when they become a member. If a certain franchise business falls under this definition, the MSRCPA applies. Since to be a "specified chain business" requires continuously selling or acting as an agent to sell products, the MSRCPA does not apply to a chain business unrelated to the sale of products. With respect to subsequent references to the MSRCPA, the relevant franchise business (including the relevant sub-franchise business) is assumed to fall within the scope of a "specified chain business", unless otherwise stated.

Additionally, from the perspective of competition law, the Franchise Guidelines regulate the offer and sale of franchises in connection with the Antimonopoly Act. The Fair Trade Commission (FTC) has overall responsibility in this regard.

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 the purposes of any franchise disclosure or registration laws?

As stated in the response to question 1.2, the MSRCPA defines a "chain business" as a business that, pursuant to an agreement with uniform terms and conditions, continuously sells or acts as an agent to sell products and provide guidance regarding management. Where a franchisor is planning to appoint only one franchisee in Japan, under current practice, such business is not regarded as a "chain business" and is not subject to disclosure obligations. This is because the relationship is not based on an agreement "with uniform terms and conditions".

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

No, there are no such requirements.

1.5 Are there mandatory pre-sale disclosure obligations?

Yes. When a franchisor intends to negotiate a franchise agreement with a prospective franchisee, the MSRCPA obliges the franchisor to provide written documentation to the prospective franchisee describing the prescribed items and explaining the contents of the written documents.

Specifically, the franchisor must disclose information concerning the following points to the franchisee:

1. the initial fee, security deposit or any other fee to be paid when the prospective franchisee becomes a franchisee;
2. the conditions of selling goods to a franchisee;
3. the assistance over operation of the franchisee;
4. the trade mark, trade name or any other signs to be licensed;
5. the term of the contract as well as its renewal and termination; and
6. other information, which is more specific, required by an Ordinance of the Ministry of Economy, Trade and Industry (METI), including the one stated in question 3.5 below.

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

Whether pre-sale disclosure obligations apply to sales to sub-franchisees depends on the specific case. The relationship between

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the sub-franchisor and the sub-franchisee needs to be analysed; if it is considered to be a "specified chain business" under the MSRCPA, the sub-franchisor owes an obligation to disclose information relating to itself. The relationship between the franchisor and the sub-franchisor must also be analysed; if it too falls within the definition of a "specified chain business", the franchisor is also under a disclosure obligation.

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 MSRCPA imposes an initial disclosure requirement. Prior to executing the franchise agreement, the franchisor must provide written documentation to the prospective franchisee describing the prescribed items and explaining the contents of the written documents.

There are no laws or regulations regarding the frequency of updating disclosures or that impose an obligation to make continuing disclosure to existing franchisees.

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

There are no other requirements in general, except for those provided in the MSRCPA and the Franchise Guidelines. However, if the franchise operates in an industry that is regulated by industry-specific laws, it is necessary to check the relevant laws and regulations.

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

The Japanese Franchise Association (JFA) is the leading national franchise association in Japan. Membership of the JFA is not mandatory under Japanese law. Whether or not it is commercially advisable to become a member of the JFA depends on the specific case. Further information and guidance in English is available on the JFA website: http://www.jfa-fc.or.jp.e.ek.hp.transer.com/.

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

Yes. The JFA has implemented voluntary rules, such as the Japan Franchise Association Code of Ethics and the Voluntary Standard Regarding Disclosure and Explanation of Information to Prospective Franchisees. If a franchisor is a member of the JFA, these voluntary rules are an important consideration in the franchise relationship.

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

There is no clear requirement for disclosure documents to be in Japanese. However, since the disclosure obligation is designed so that prospective franchisees have sufficient information and a good understanding of the franchise, it is strongly advisable to prepare disclosure documents in Japanese.

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 Foreign Exchange and Foreign Trade Act (Act No. 228 of 1949 – FEFTA) is a key piece of Japanese legislation that provides general regulations for foreign transactions, including foreign direct investment in Japan. Under the FEFTA, certain foreign transactions involving "inward direct investment, etc." by a foreign investor require a notification to the Japanese government. There are also various specific restrictions contained in industry-specific legislation, such as the Broadcast Act (Act No. 132 of 1950) and the Banking Act (Act No. 59 of 1981).

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

A joint-stock company stipulated in the Companies Act (Act No. 86 of 2005) is the most typical form of business entity used by franchisors.

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 simplest means for a foreign company to establish a base for business operations in Japan is to set up a branch office. The branch office can begin business operations as soon as an office location is secured, the branch office representative is determined, and the necessary information is registered at a competent legal affairs bureau. Another way is to set up a foreign company's subsidiary in the form of a joint-stock company, in which case the articles of incorporation and other incorporation documents need to be prepared and registered at a competent legal affairs bureau. If the franchise operates in an industry that is regulated by industry-specific laws, it is necessary to check the relevant laws and regulations.

3 Competition Law

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

As stated in question 1.2, the Antimonopoly Act is relevant to the typical franchise agreement. The Franchise Guidelines and the Distribution Guidelines describe what kinds of activities or restrictions are problematic under the Antimonopoly Act.

The Franchise Guidelines require franchisors to disclose sufficient and accurate information in soliciting prospective franchisees, otherwise the franchisors' actions can be deemed to be deceptive customer inducement, which is illegal as it falls into the category of unfair trade practices.

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If the restrictions on unfair trade practices under the Antimonopoly Act are violated, the FTC can order the breaching party to cease and desist from the activity, to delete the relevant clauses from the agreement and to take any other measures necessary to eliminate problematic activities (Antimonopoly Act, Article 20). Some of the categories, such as abuse of a dominant bargaining position and resale price restrictions, could be subject to surcharges (Antimonopoly Act, Articles 20-5 and 20-6).

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

No. There is no specific regulation.

However, as mentioned in question 13.1 below, if the term unfairly disadvantages the franchisee then it may be deemed void for being against good public policy (Civil Code, Act No. 89, 1896, Article 90).

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

No. There is no specific regulation.

However, as mentioned in question 13.1 below, if the term unfairly disadvantages the franchisee then it may be deemed void for being against good public policy (Civil Code, Article 90).

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

The Franchise Guidelines regulate transactions between franchisors and franchisees. According to these guidelines, it is acceptable for the franchisor to propose selling prices if it is necessary to provide a clear market position for the company or to coordinate business operations. However, when the franchisor supplies products to the franchisee, constraints on the selling price that apply to the franchisee could be a resale price constraint under the Antimonopoly Act. In addition, when the franchisor does not directly supply products to the franchisee, but unduly constrains the price of products or services supplied by the franchisee, this could constitute dealing on restrictive terms under the Antimonopoly Act.

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

Yes. The MSRCPA and the ordinance of the METI require a franchisor to disclose information about the terms and conditions of the contract concerning whether a franchisor will engage in, or allow other franchisees to engage in, business operations conducting the same or similar retail business near the franchises of a franchisee. In addition, the Franchise Guidelines provide that it is desirable for the franchisor to properly disclose certain matters when inviting new franchisees to join the franchise. This avoids violating the Antimonopoly Act and enables prospective franchisees to make an informed decision. Specifically, the matters are those relating to restrictions that apply to the franchisor or other franchisees of the franchise in setting up a similar or identical business close to the proposed business of the party contemplating joining the franchise, including whether there are plans to set up additional businesses and the details of the plans.

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

Generally, yes. Franchisors usually include these sorts of covenants in their franchise agreements obliging the franchisee not to operate a business that is identical or similar to the franchisor's business, both during the term of the agreement and for a certain time after expiration of the term. However, these covenants may be deemed an excessive restraint of rights, including the franchisee's freedom to choose its occupation and operate its business. As a result, they are not always regarded as valid or enforceable. In determining the validity of the covenant, the court considers factors such as the geographical scope of the restrictions, the terms of the covenant and the nature of the restricted business activities.

4 Protecting the Brand and other Intellectual Property

4.1 How are trade marks protected?

Franchisors can register trade marks with the Patent Office of Japan to protect them from being infringed. Even without this registration, the franchisors may take legal action under the Unfair Competition Prevention Act (Act No. 47 of 1993) if the trade marks in question are well-known in Japan.

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

If the know-how, trade secrets and other business-critical information fall within the scope of a "trade secret" under the Unfair Competition Prevention Act, they will be protected against acts that constitute unfair competition. To be deemed a "trade secret", the information must fulfil three requirements: it must be useful; it must be unknown to the public; and it must have been controlled as a secret.

Confidentiality covenants between a franchisor and a franchisee are generally enforceable. If a franchisee breaches a confidentiality covenant, a franchisor may seek compensation for the damages caused by the violation or, in some cases, demand an injunction to prevent damages.

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?

If materials, including an Operations Manual or proprietary software developed by the franchisor and licensed to the franchisee under the franchise agreement, contain "creativity", these materials can be protected by the Copyright Act (Act No. 48 of 1970).

5 Liability

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

The METI and the relevant ministry which has authority to

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enforce the disclosure obligation under the MSRCPA may issue a recommendation to a franchisor who is not in compliance with the disclosure obligations (Paragraph 1, Article 12). If the recommendation is not followed, the minister may disclose this fact to the public (Paragraph 2, Article 12).

The MSRCPA does not provide a special remedy to franchisees when disclosure obligations are violated. Therefore, unless otherwise provided for in the franchise agreement, franchisees need to base any claims for damages on the general contract principles (Civil Code, Article 415) or general tort principles (Civil Code, Article 709). Franchisees can rescind the franchise agreement on the basis of fraudulent disclosure of information (Civil Code, Article 96). If there is a material misunderstanding about the franchise agreement, the franchisee can claim that the franchise agreement is void (Civil Code, Article 95). Please note that an amendment to the Japanese Civil Code, which substantively revises the provisions of the current Civil Code, was promulgated on 2 June 2017, and will take effect within three (3) years from the date of promulgation. The provisions cited in this Article are from the current version of the Civil Code (i.e., the provisions prior to such amendment).

5.2 In the case of sub-franchising, how is liability for disclosure non-compliance or for misrepresentation in terms of data disclosed being incomplete, inaccurate or misleading 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?

A franchisor or a sub-franchisor owes disclosure obligations and will be responsible for breaching them. In the case of sub-franchising, the sub-franchisor will usually be liable if there is a violation of a disclosure obligation because they are a party to the sub-franchise agreement and also the sub-franchisor directly provided the information to the sub-franchisee.

If a franchisor takes an indemnity from the master franchisee in the Master Franchise Agreement, the validity of the indemnification is assessed on a case-by-case basis. It may be deemed void if it is against good public policy (Civil Code, Article 90).

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

The validity of a disclaimer clause in the franchise agreement is assessed on a case-by-case basis. A disclaimer clause between business entities is usually deemed to be valid unless it is against good public policy (Civil Code, Article 90) or the good faith principle (Civil Code, Article 1); for example, where one party breached the agreement intentionally or due to gross negligence.

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

The Act on Special Provisions of Civil Court Procedures for Collective Recovery of Property Damage of Consumers (Act No. 96 of 2013), which introduced a new Japanese class action system, came into effect on 1 October 2016. However, franchisees will not fall within the scope of the new system because it is applicable only to disputes arising from a consumer contract (i.e. a contract between a consumer and business operator) and a franchise agreement is not deemed as such.

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. Under Japanese international private law, the parties can usually select the governing law (the Act on General Rules for Application of Laws (Act No. 78 of 2006, Article 7)) and, therefore, the franchise agreement is free to stipulate the law that the parties have chosen. However, in some cases, the choice of governing law can be invalidated or superseded; for example, if a public order becomes an issue.

There is no generally accepted norm relating to the choice of 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 rogue franchisee to prevent damage to the brand or misuse of business-critical confidential information?

Generally, if a rogue franchisee is located in Japan then the franchisor can obtain an injunctive relief order from a Japanese court under the Civil Provisional Remedies Act (Act No. 91 of 1989). However, injunctive relief orders issued by foreign courts, which are not final and binding foreign judgments, are unenforceable in Japan.

7 Real Estate

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

The length of term for commercial property leases (leases of buildings or houses) varies case-by-case, but they are usually two to five years. Moreover, under the Act on Land and Building Leases (Act No. 90 of 1991), the rights of lessees are highly protected and, in many cases, they have an option to renew the term.

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?

Generally, it is possible for a franchisor and a franchisee to stipulate a clause in the franchise agreement relating to an optional/conditional lease assignment in the lease agreement between the landlord and lessee (franchisee). Under Japanese law, however, transfer of the leasehold is subject to approval from the landlord. If approval is obtained in advance, the transfer can go ahead (although the franchisor may have to solve the issue of evicting the franchisee from the premises). If the landlord does not approve, the franchisor may not, in principle, validly implement the transfer of the leasehold.

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

Generally, non-national entities can hold an interest in real estate and are able to sub-lease property.

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Please note that the Act on Foreign Nationals' Rights in Relation to Land (Act No. 42 of 1925) provides that an ordinance can be enacted which restricts acquisition by foreign individuals or foreign companies due to considerations of reciprocity and national defence. However, no such ordinance is currently enacted.

7.4 Give a general overview of the commercial real estate market. Specifically, can a tenant reasonably 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 of a particular location)?

As of July 2017, demand for commercial offices has recovered in many cities and there is a solid forecast for the commercial real estate market.

Whether or not an initial rent free period is granted depends on the specific case. Usually, the lessee must pay a security deposit to the landlord and also pay some key money, which is non-refundable, to the landlord.

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?

Japanese law does not clearly prohibit the inclusion of this kind of requirement in the franchise agreement. However, passive restrictions on sales may be problematic depending on the situation.

The Franchise Guidelines provide that if the franchise agreement or action by the franchisor exceeds what is necessary to properly implement and operate the franchise business and causes some unfair disadvantage to the franchisee in the light of ordinary business activities, the franchise agreement and/or action by the franchisor may constitute an abuse of a dominant bargaining position.

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?

Generally, it is possible to require the former franchisee to transfer local domain names to the franchisor when the franchise agreement has expired or been terminated.

9 Termination

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

Usually, the franchise agreement lists the circumstances in which the franchisor may terminate a franchise relationship. In addition, the franchisor may terminate if the franchisee violates the franchise agreement (Civil Code, Articles 541 to 543).

Nevertheless, because franchise agreements are usually continuous long-term agreements, courts are likely to be more reluctant to terminate them compared to non-continuous agreements. The doctrine of the destruction of a mutual trust relationship, which was established in the area of real estate lease agreements that are generally considered to be continuous agreements, is relevant here. With regard to lease agreements, a lessor's ability to terminate a lease agreement is limited to circumstances where the mutual trust relationship is destroyed because of the lessee's violation of the agreement (Supreme Court, 28 July 1964 for the house lease, 21 April 1966 for the land lease). This means that a lessor may not terminate a lease agreement even if the lessee is violating it, provided that the violation is not sufficiently material to destroy the mutual trust relationship. In many cases, this doctrine is applied or considered by the court to restrict a franchisor's ability to terminate a franchise relationship.

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 a typical franchise arrangement, a franchisee's employees are not considered to be employees of the franchisor. To mitigate the risk that they might be regarded as such, a franchisor needs to structure the franchise relationship so that the franchisee is an independent entity, and needs to clearly explain the independent nature of the franchise relationship to the franchisee. In addition, if a franchisor is involved in hiring employees for the franchisee, it should explain its position and make it clear to the prospective employees that the employer will be the franchisee, not 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?

As for vicarious liability, the Civil Code of Japan stipulates that "a person who employs others for a certain business shall be liable for damages inflicted on a third party by his/her employees with respect to the execution of that business" (Paragraph 1 of Article 715). In order to be deemed "a person who employs others for a certain business", a substantive instruction and supervision relationship is sufficient and a direct contractual relationship such as an employment agreement is not always required. For instance, there was a case where a main contractor was held to be vicariously liable for the act of the subcontractor's employee in the light of the instruction and supervision relationship between the two (Supreme Court, 12 February 1970). Therefore, whether a franchisor may be held to be vicariously liable for the acts or omissions of a franchisee's employees depends on whether or not a substantive instruction and supervision relationship between the franchisor and the franchisee's employees exists in addition to (or *in lieu* of) an instruction and supervision relationship between the franchisee and the franchisee's employees. This is evaluated on a case-by-case basis. To mitigate this risk, a franchisor should avoid creating a situation where a *de facto* substantive instruction and supervision relationship exists, such as the cases where the franchisor directly gives instructions to the franchisee's employees regarding specific tasks, where the franchisor is involved in hiring the franchisee's employees, where the franchisor virtually decides the amount of the salary of the franchisee's employees and so on.

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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. The payment of royalties to an overseas entity was liberalised pursuant to the FEFTA. However, there are some reporting requirements which the franchisee must comply with, depending on the amount of remittance from Japan to the foreign state.

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?

Under the Income Tax Act (Act No. 33 of 1965), if royalties under a trade mark licence or consideration for the transfer of technology are paid to a non-resident individual or foreign entity which has no office in Japan, the payment will be deemed as fees; if these fees fall within the domestic withholding tax requirements then they will be subject to withholding tax at a rate of 20%. Whether a payment is subject to a withholding tax requirement does not depend on its name or nominal term, but instead depends on whether the substance of the payment has the nature of a fee under the Income Tax Act. Additionally, if the tax rate stipulated in a tax treaty which Japan has signed is lower than that stipulated by domestic Japanese law (i.e. 20%), the treaty will apply if certain procedures are complied with.

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?

Yes. For instance, if it is deemed that the franchisee does not buy products from the franchisor but instead the franchisor consigns the sale of the products to the franchisee, then the franchisee is not a party to the transaction with the customer (the parties will be the franchisor and the customer). Therefore, the franchisor will be directly liable as the seller against the purchaser of the product. In order to avoid this liability, the roles of the franchisor and franchisee should be clearly stipulated in the franchise agreement, and it should be made clear to the customer that the transaction with him/her is with the franchisee.

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 the Civil Code, there is a general duty to act in good faith (Article 1). In addition, if an agreement is unreasonably advantageous to one party, it may be deemed void for being against good public policy (Civil Code, Article 90). These clauses affect franchise relationships in various ways.

One area where the duty to act in good faith plays an important role is with regard to the franchisor's obligation to disclose information. Courts tend to construe this as an obligation to provide prospective franchisees with accurate and adequate information so that they can make decisions (Fukuoka High Court, 31 January 2006, *Shin Shin Do* case, Kyoto District Court, 1 October 1991).

Courts also tend to use Article 90 to limit or invalidate liquidated damages clauses. In the *Honke Kamadoya* case (Kobe District Court, 20 July 1992), the court stated that the clause providing for liquidated damages of an amount equal to 60 months' loyalty payment was significantly out of balance with the expected amount of damages. Consequently, the liquidated damages were declared void to the extent that they went beyond a reasonable amount of damages as such an amount was against good public policy.

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. The relationship should be regulated by ordinary contract law and the Antimonopoly Act, etc.

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?

Although the MSRCPA does not clearly specify, if the term of the existing franchise agreement is just extended, the franchisor's disclosure obligations under the MSRCPA do not apply at the end of the franchise agreement term. On the other hand, if the existing franchise agreement is terminated and a new agreement with new terms and conditions is executed, the franchisor's disclosure obligations under the MSRCPA will apply prior to executing the new 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?

The franchise agreement generally states that a franchisor may refuse to renew it, or states, with the same implication, that the agreement will not be renewed unless it is mutually agreed. In some cases, the franchise agreement states that it will be automatically

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renewed unless either party notifies otherwise. The effect of the franchisor's contractual right to refuse to renew can be denied or limited in cases where, for example, the franchisee has been heavily dependent on the franchise business and the franchisor has no or few reasonable grounds to refuse renewal. In the *Hokka Hokka Tei* case (Nagoya District Court, 31 August 1998), the court required compelling circumstances which make it difficult to continue the agreement for a franchisor to be able to refuse to renew a continuous 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 discussed in question 15.2, the franchisor's refusal to renew the franchise agreement is sometimes restricted. In these cases, if a franchisor unjustly refuses renewal they will usually be liable and must compensate for damage suffered by 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. If stipulated in the franchise agreement, a franchisor may effectively restrict a franchisee's ability to transfer its status or obligations under the franchise agreement. A franchise agreement usually requires the franchisor's consent for the franchisee to transfer its franchise under the agreement. Generally, however, the franchisor cannot unreasonably refuse to give 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?

Including a "step-in" right in the franchise agreement is not clearly prohibited and there is no registration system. However, if the provision unfairly disadvantages the franchisee then it may be deemed void for being against good public policy (Civil Code, Article 90). In addition, the contractual relationships which the franchisee has had with other parties may not be transferred to the franchisor without the consent of each of the parties. Further, the government licences, permissions and approvals which the franchisee has owned in relation to the franchise business do not automatically go to the franchisor.

16.3 If the franchise agreement contains a power of attorney in favour of the franchisor under which it may complete all the 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 country 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?

Including this sort of clause in a franchise agreement is not clearly prohibited and there is no registration system. However, from a theoretical viewpoint, there may be issues regarding the validity of this sort of clause. Further, from a practical viewpoint, we do not believe that this sort of clause will work effectively. If the franchisee delegates powers relating to completion of a franchise migration to the franchisor by including a power of attorney in the franchise agreement, Japanese law provides for a "delegation relationship" or "quasi-delegation relationship". This relationship is based on mutual trust between the parties and the franchisee can terminate the delegation at its own discretion and at any time. Even if the delegation of power involves a power of attorney in favour of the franchisor, it will be difficult for the franchisor to complete the necessary procedures if the franchisee objects.

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ANDERSON MŌRI & TOMOTSUNE

Anderson Mori & Tomotsune's franchise practice team has in-depth knowledge of the laws and regulations pertaining to franchising. Our firm provides comprehensive and tailored legal services to clients with respect to structuring and operating a franchise system, including the preparation of relevant documents such as franchise agreements and disclosure documents. AMT has considerable expertise in handling franchise litigation and alternative dispute resolution proceedings. Utilising our firm's expertise in resolving franchise disputes, we also provide strategic advice to clients in order for them to avoid future disputes in any aspect of their franchise business.

Leveraging AMT's many years of experience and expertise in international transactions, we act for overseas clients seeking to expand into Japan through international franchising. Our support includes structuring, negotiating and drafting relevant documents such as international direct franchise agreements, international master franchise agreements and joint venture agreements. In addition, we support clients by actively providing advice on legal issues and regulations relevant to franchising in Japan.

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Kazakhstan

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1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

The legislation of Kazakhstan uses the term 'franchising' (or 'complex business licence'), which has the following meaning: an entrepreneurial activity, where the franchisor provides a set of exclusive rights for use to another entity/person on a remuneration basis. In accordance with the Law of the Republic of Kazakhstan dated 24 June 2002, No. 330-II 'On complex business licences (Franchising)' (hereinafter – the 'Franchising Law'), under the complex business licence agreement, one party (the complex licensor) undertakes to provide the other party (the complex licensee), on a remuneration basis, with a set of exclusive rights (licence complex), including, in particular, the right to use the brand name of the licensor and protected commercial data, as well as other objects of exclusive rights (trademarks, service marks, patents, etc.) provided by the agreement for use in the licensee's business activities.

1.2 What laws regulate the offer and sale of franchises?

Franchises are guided by the Civil Code of the Republic of Kazakhstan (hereinafter – the 'Civil Code'), the Franchising Law, the Law of the Republic of Kazakhstan dated 26 July 1999, No. 456-I 'On Trademarks, Service Marks and Appellations of Origin' (hereinafter – the 'Trademarks Law'), the Patent Law of the Republic of Kazakhstan dated 16 July 1999 and other acts.

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 the purposes of any franchise disclosure or registration laws?

Yes, such a person will be treated as a "franchisee" for the purpose of any franchise disclosure or registration laws.

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

Yes, Kazakhstani legislation requires the obligatory registration of franchise agreements, which should include terms and conditions of the transfer of the exclusive rights for inventions, utility models, industrial designs, selection achievements, trademarks, service marks, and topographies of integrated circuits, registered under the laws of the Republic of Kazakhstan. Registration is carried out by the Ministry of Justice of the Republic of Kazakhstan (hereinafter – the 'competent authority'). Failure to comply with the registration requirement shall entail the invalidity of the agreement.

The franchise agreement for the IP objects not registered in Kazakhstan can be filed for registration with the competent authority at the discretion of the parties to the franchise agreement.

A franchise agreement shall be filed for registration not later than six months after the commencement date.

Note: the draft *Law on Amendments to Legal Acts Regulating Intellectual Property* is providing obligatory registration of franchise agreements regardless of local or international registration of trademarks, patents and other rights transferred under the franchise agreement. The changes in the registration procedure itself are expected to be introduced by the draft law.

1.5 Are there mandatory pre-sale disclosure obligations?

Yes, there are pre-sale franchise disclosures that may apply to franchise transactions before a franchise agreement is signed. The Franchising Law states that, prior to the execution of a franchise agreement, the franchisor shall provide a potential franchisee with information about the exclusive rights that are given to the franchise, when entering into the franchise agreement. In practice, as the case may be, this provision can be interpreted both as a franchisor's right and as a franchisor's obligation. However, the franchisor is obliged to warn a potential franchisee about the confidential commercial nature of such information.

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

The obligations set out under question 1.4 above apply to the master franchisee as soon as it begins to exercise its own rights under a master franchise agreement. Basically, in this case the master franchisee, as a contractual partner of the sub-franchisee, is obliged to fulfil these obligations. Therefore, we consider that pre-sale disclosure, in case of a sub-franchise agreement, falls within the responsibility of the (master) franchisee under the main franchise agreement rather than the franchisor.

In this respect, disclosure under the sub-franchise agreement is required from the (master) franchisee, unless otherwise provided by the franchise agreement.

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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 legislation of Kazakhstan does not provide for any specific format or scope for disclosure. Parties to the agreement are free to decide the extent to which confidential information will be transmitted in accordance with the disclosure agreement.

The relevant disclosures underlying the franchise relationship shall be sufficient for the other side to exercise its contractual rights and obligations. The issue of disclosure updates will normally be subject to agreement between the parties.

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

The laws and other regulations of Kazakhstan do not provide for specific requirements for the franchise before it is offered or sold.

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

Membership of the Franchise Association of Kazakhstan is not mandatory in Kazakhstan. Although the Franchise Association of Kazakhstan does not have any regulatory power, it may give certain useful practical recommendations and tips on doing franchising business in the Kazakhstani market.

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

One of the additional obligations may be a membership fee.

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

The Law of the Republic of Kazakhstan dated 11 July 1997, No. 151-I 'On Languages in Kazakhstan' (hereinafter – the 'Language Law'), requires that all agreements be made in the Kazakh language and in the Russian language with a translation into the language acceptable to the parties if necessary. In practice, some agreements are executed in three languages: Kazakh; Russian; and English. The parties may contractually agree on which version shall prevail, if there are inconsistencies between these texts.

This is a general requirement for all types of agreements, including franchise agreements and disclosure agreements.

There is no legislative requirement for other types of disclosure documents to be in a local language, but from a practical perspective it is advisable that the disclosure documents be in a language understandable to a Kazakhstani party.

The costs and timescale for translation depends on the volume of documents to be translated and translation experience and qualifications.

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?

For the most part, there are no legal restrictions on non-nationals in respect of the ownership or control of a business in Kazakhstan. Indeed, any business, including in the franchising area, shall comply with all relevant laws and regulations governing agreements, performance of obligations and the conducting of business operations in general.

At the same time, certain areas of investment are of strategic importance to the Kazakhstani government to protect state defence and national security.

Hence, a special licence or permission from the government has to be obtained before investing and/or transacting within certain industries (e.g. encryption, weaponry, space and aviation). The media and telecoms sectors have certain restrictions in terms of corporate ownership and control as well.

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

In Kazakhstan, there are two main and most widely used forms of legal entities: the limited liability partnership (hereinafter – 'LLP'); and the joint-stock company (hereinafter – 'JSC'). The main difference is that the charter capital in a JSC is divided into shares, while the charter capital in an LLP is divided into interests. Accordingly, interests in the charter capital of an LLP are property rights of the participants, while a share is a security. A foreign franchisor may also establish a wholly-owned subsidiary or a joint venture jointly with other companies or individuals, whether foreign or local.

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 foreign company to be registered in Kazakhstan. A foreign business entity is free to offer and sell a franchise directly or indirectly to a Kazakhstani business entity. Namely, the foreign business entity (franchisor) may conclude a franchise agreement with the Kazakhstani business entity (franchisee), or engage another foreign partner (franchisee) to sell a sub-franchise to the Kazakhstani company (sub-franchisee) under a sub-franchise agreement. There is no legal requirement or imperative to set up a new special Kazakhstani business entity as a pre-condition for performing franchising activities in Kazakhstan.

3 Competition Law

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

Competition protection issues are regulated by the Entrepreneurial Code of the Republic of Kazakhstan dated 29 October 2015, No. 375-V (hereinafter – the 'Entrepreneurial Code'). It prevents monopolistic (anti-competitive) activities, stops abuse of dominance and prohibits unfair competition. The requirements/restrictions of

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the Entrepreneurial Code to the anti-competitive agreements are not applicable to the agreements on performance of exclusive rights to the intellectual property, trade names, means of individualisation of production, works or services. However, where such agreements cause or may cause restriction or elimination of competition, the antimonopoly authority may apply to court to void such agreements. These provisions refer to the franchise agreements as well.

However, the Civil Code of Kazakhstan contains some restrictive conditions for franchises.

A complex business licence agreement may provide for restrictive (exclusive) conditions, in particular: (i) the obligation of the licensor not to grant other similar complex business licences for their use in the territory assigned to the licensee or to refrain from immediate self-employment in this area; (ii) the obligation of the licensee not to compete with the licensor in the territory of the complex business licence application in respect of a business performed by the licensee with exclusive rights belonging to the licensor; (iii) failure of the licensee to obtain other complex business licences from competitors (or potential competitors) of the licensor; and (iv) the obligation of the licensee to agree with the licensor upon the location, external and internal design of the premises used in exercising exclusive rights given by the agreement.

Some restrictive terms of the franchise agreements are void according to the Civil Code of Kazakhstan, namely: (i) the franchisor's right to determine the sale price or set an upper or lower limit of the price; and (ii) the terms defining the certain category of customers/buyers or the customers/buyers location/place of residence on the territory.

As mentioned above, the Entrepreneurial Code prohibits unfair competition. Accordingly, dissemination of false information that may damage the operating business entity is not allowed. The Code also bans the marketing of goods if intellectual property subject matters affixed to such goods are unlawfully or illegally used. It also prevents unfair competition in cases where other persons acquire and use intellectual property rights in bad faith.

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

Parties to a franchise agreement are free to enter into a franchise agreement for any term. The law does not set any maximum term requirements.

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

The law does not limit parties when they establish the term of a product supply agreement related to a franchise agreement.

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

The Civil Code forbids the franchisor from determining the price of goods for sale by the franchisee or the price of works (services) performed (provided) by the franchisee, or to establish an upper or lower limit of the said prices.

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

The laws of Kazakhstan do not provide for any obligations on the franchisor when offering a franchise in adjoining areas. Any such obligations might be foreseen in the contractual arrangements made between the parties, taking into account the feasibility of each individual business plan of neighbouring franchisees.

A franchisee may have claims against a franchisor for unfair competition in case of encroachment, mainly if that franchisee is expressly protected in the franchise contract for a certain area/territory. That means that if the franchisor had kept the right to act even in the franchisee's territory or area, or if the territory of the franchisee is not expressly protected in the contract, the latter will have to prove that he suffered damage and that this is due to the franchisor's acts and fault.

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

In-term and post-term non-compete and non-solicitation restrictive covenants may be enforceable under local law.

4 Protecting the Brand and other Intellectual Property

4.1 How are trade marks protected?

The legal protection of a trademark is ensured on the basis of its registration with the Ministry of Justice of Kazakhstan, or is otherwise based on the international treaties to which Kazakhstan is a party. When the trademark is registered it is entered into the Trademark Register and will be valid for 10 years. Trademark registration may be renewed for another 10 years for an unlimited number of times. The owner shall start using the trademark within three years after its registration. If the mark is not used during the three-year term upon the trademark's registration, any interested person may apply for cancellation of trademark protection on the grounds of its non-use.

An unregistered mark may be used by any third person or company and there are very limited possibilities to prohibit such use. Also an unregistered mark can be registered as a trademark by a third company and it is extremely difficult to prevent or appeal such a registration.

Infringement of trademark rights leads to liability and sanctions in accordance with Kazakhstani law. The trademark owner is entitled to commence administrative, civil or criminal proceedings against the infringer(s) depending on the circumstances surrounding the matter and remedies available.

Trademark registration will be the first key element in every franchise transaction.

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 confidential information are governed by the provisions of the Civil Code and the Entrepreneurial Code. In accordance with the Civil Code and the Entrepreneurial Code, the law protects information constituting an official or commercial secret, when the information has actual or potential commercial value by virtue of it being unknown to third parties, it not being freely accessible on a legal basis, and the owner of the information taking measures to protect its confidentiality. It is advisable to provide details of the type of confidential information and the obligation to keep it undisclosed also after the expiration of contractual relations.

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Persons illegally obtaining such information, as well as employees in violation of their employment agreement – or counterparties in violation of a civil contract – disclosing proprietary or trade secrets, shall be obliged to compensate for the damage caused.

Protection of a commercial secret shall include a prohibition on obtaining the illegal obtainment, as well as on distributing or using the information.

The state enforcement agencies have rights to obtain necessary information only on the grounds of sanction by the prosecutor, a decision of the investigating authority or a court decision.

A breach of the obligation to keep information secret may lead to administrative or criminal responsibility.

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 Kazakhstan by the Civil Code of Kazakhstan and the Law of the Republic of Kazakhstan 'On Copyright and Related Rights' dated 10 June 1996, as amended. Kazakhstan is a party to the Bern Convention for the Protection of Literary and Artistic Works.

Copyright of art works emerges by virtue of their creation; however, the registration of copyright is preferable for protection in cases of plagiarism and disputes, etc. The copyright does not apply to ideas, concepts, principles, methods, systems, processes, discoveries and facts.

In case of infringement of copyright (including software), the copyright owner may initiate civil or criminal proceedings before the court or enforcement agencies during the term of the franchise agreement or after the franchise agreement has expired or terminated.

5 Liability

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

The franchisee may file a lawsuit against the franchisor for breach of contract (i.e. for violation of contracted disclosure obligations). The franchisee is entitled to seek monetary relief if the court finds that some necessary information or assistance is withheld by the franchisor, or not provided in due course. Damages can be real and must be duly proved to be awarded. If the franchisee is able to show that failure of conveyance of the required information and/or assistance by franchisor is a material breach of the contract, the franchisee may have an option to rescind the contract. In any event, the enforcement of remedies shall depend on the circumstances surrounding the case and evidence of the breach in question.

5.2 In the case of sub-franchising, how is liability for disclosure non-compliance or for misrepresentation in terms of data disclosed being incomplete, inaccurate or misleading 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?

Under the laws of Kazakhstan, and unless otherwise provided by the Master Franchise Agreement or the relevant sub-franchise agreement, non-compliance related to disclosure or misrepresentation of data disclosed, whether it is incomplete, inaccurate or misleading, allocated between the franchisor and franchisee entails the franchisee's liability under the Master Franchise Agreement. To avoid liability, the franchisor should clearly express the disclosure obligations and liability in the Master Franchise Agreement.

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

There are no express rules governing these matters in Kazakhstani law. We consider that the franchisor may try to avoid liability for pre-contractual misrepresentation by including certain disclaimer clauses in the franchise agreement. However, in cases where the franchisor commits a material breach of the disclosure provisions, and in the event of losses suffered by the franchisee (due to disclosure non-compliance), the franchisee may bring an action for rescission of the agreement and reimbursement of damages.

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

The legislation of Kazakhstan permits class actions to be brought by a number of allegedly aggrieved claimants. The legal standing, requirements and causes for such actions, as well as proceedings related to the same, are specifically described in the Civil Procedural Code of Kazakhstan.

Class action waiver clauses will not be enforceable in Kazakhstan when such a waiver is in conflict with the law or infringes anyone's rights and legal interests. The Civil Procedural Code invalidates such a waiver of the right to apply for court protection.

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 agreement to be governed by Kazakhstani law. Under the basic principles of international private law, the contracting parties are free to choose the relevant governing law when entering into a deal (or afterwards). Hence, the franchise agreement may be governed by the applicable foreign law.

However, if the agreement includes provisions relating to the rights to real estate located in Kazakhstan or relations among shareholders or transfer of equity interest in a Kazakhstani legal entity, such provisions are required to be governed by Kazakhstani 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 rogue franchisee to prevent damage to the brand or misuse of business-critical confidential information?

The local courts will enforce orders granted by other countries' courts for injunction against rogue franchisees, to prevent damage to a brand and misuse of confidential information. In practice, a court judgment from another jurisdiction may be enforceable in

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Kazakhstan, provided that recognition and enforcement of the foreign court judgment is stipulated by the relevant international treaty to which Kazakhstan is a party.

Kazakhstan is a signatory to many multilateral and bilateral international treaties for recognition and enforcement of foreign judgments, including the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (hereinafter – the 'New York Convention'). Therefore, an arbitral award from another jurisdiction that is a signatory to the New York Convention may be enforceable as well.

7 Real Estate

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

There is no typical length of term for a commercial property lease in Kazakhstan. It is up to the parties to decide how long they want to lease the property for.

Under the Civil Code of Kazakhstan, a tenancy agreement is entered into for the period specified by the agreement. When a tenancy agreement is signed with no indication of its term, it is deemed concluded for an indefinite term. Each party may withdraw from such agreement at any time by giving notice to the other party at least three months prior in the case of a real estate lease, and one month prior in the case of a lease of other property, unless otherwise established by the legislative acts or the agreement.

Upon the expiry of the agreement, a tenant has a pre-emptive right to enter into a tenancy agreement for a new term, subject to the following conditions:

- the tenant properly performed its obligations under the initial tenancy agreement;
- the tenant gives notice to the landlord, in writing, of its willingness to enter into such an agreement within the term specified in the tenancy agreement; and when no such term is specified in the agreement, then within the reasonable term before the expiry of the agreement; and
- the tenancy agreement does not contain provisions that deny the tenant's pre-emptive right.

When entering into the tenancy agreement for a new term, terms and conditions thereof may be changed upon agreement between 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?

Under Kazakhstani law, tenants may assign their rights and obligations under the lease to a third party (franchisor or any other third party) upon the prior lessor's written consent. Such consent can be provided for by the lease agreement or otherwise obtained. Please note that including optional or conditional lease assignment provisions into the franchise agreement on its own would not be sufficient; the lease agreement must also contain such provision in order to allow the franchisor to use it when required.

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

With a few exceptions, foreign entities can hold proprietary rights over real estate in Kazakhstan. These exceptions are set by the Land Code of the Republic of Kazakhstan, dated 20 June 2003, as amended (hereinafter – the 'Land Code'). Namely, foreign entities cannot own:

- land plots intended for conduct of commercial agriculture and forest planting; or
- land plots located in the frontier zone and frontier belt of the Republic of Kazakhstan.

7.4 Give a general overview of the commercial real estate market. Specifically, can a tenant reasonably 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 of a particular location)?

Unfortunately, we are not able to give the overview requested, because commercial terms of lease agreements are not in the public domain. From a legal perspective, however, the parties to a lease agreement may agree upon both of the above-mentioned methods, depending on their commercial and negotiating positions.

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?

Kazakhstani legislation, including anti-trust law, does not prohibit the requirement of a franchisee to refer business leads that arise from outside his/her territory either to the franchisor (if the lead comes from a place that has not been allocated to anther franchisee) or to the franchisee for the territory from which the business lead arose.

According to the legislation of Kazakhstan, it is possible to create an obligation for the franchisee to sell goods or provide services (including online trading) exclusively within the contracted territory. Restrictive provisions of anti-trust legislation are not applicable to licence and franchise agreements. At the same time, the relevant clauses in the franchise agreement obliging the franchisee to sell goods or provide services solely to the customers located or residing in the contracted territory shall be void according to the Civil Code of Republic of Kazakhstan. In this regard, the franchise agreement should have accurate wording in order to avoid incorrect application of the 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 statutory limitations on the franchisor to require the former franchisee to assign local domain names to the franchisor on the termination or expiry of the franchise agreement. In this

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case, the procedure for transfer of domain names should be clearly described in the contract.

In order to be sure that the former franchisee does not keep using a local domain name, it is recommended that the franchisor protects its trademark (wordmark) in the local jurisdiction as well (through application to the World Intellectual Property Organization (hereinafter – 'WIPO') or local patent office). Further, any use by the franchisee of the trademark (or similar mark) on the Internet or under a similar domain name, upon termination or expiration of the franchise agreement, may lead to trademark infringement and other penalties established by the law and the contract. Unless assigned in an amicable (non-judicial) manner, domain names may be recaptured in the course of civil proceedings through the agency of the competent court.

9 Termination

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

According to the Civil Code of the Republic of Kazakhstan, a franchise agreement concluded within a specified term can be terminated in accordance with the regulations of the Civil Code (Chapter 24), i.e. by the parties' mutual agreement in case of material breach or in other cases provided by the agreement. The Civil Code provides an indemnity in case of material breach of agreement.

Please also note that according to the Civil Code a party to the agreement has the right to refuse an agreement for an indefinite term by giving six months' prior notice to terminate, unless the agreement stipulates a longer period of 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?

There is no such risk. There are two different types of relations based on two different types of contract: relations between the franchisee and its employees based on the employment agreement; and relations between the franchisor and the franchisee based on the franchise agreement, which is a civil contract.

The franchisor and the franchisee are separate legal entities; therefore, they have their own labour and employment obligations. The franchisor and the franchisee operate on the basis of a franchise agreement that is primarily governed by civil law (i.e. the Civil Code of the Republic of Kazakhstan), while the labour and employment relations of the entities operating in Kazakhstan are regulated by the Labour Code of the Republic of Kazakhstan.

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?

Pursuant to the Civil Code, the licensor shall be vicariously liable for the requirements imposed on the licensee with regard to the inadequate quality of goods (or works or services) sold (performed or rendered) by the licensee under the agreement of a complex business licence.

As mentioned above, vicarious liability only arises on the claims for non-conformity of quality of goods or services. The franchisor is not liable for any other claims against the franchisee or its employees. It is recommended that this provision be clearly set out in the agreement to avoid any vicarious liability of the franchisor on other claims against 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?

According to the Law of the Republic of Kazakhstan, dated 13 June 2005, No. 57-III 'On Currency Regulation and Control' and the Rules of Performing Currency Operations in the Republic of Kazakhstan dated 28 April 2012, No. 154, payments from residents to non-residents of Kazakhstan under export/import of goods/services agreements (i) for a period of less than 180 days, and (ii) for an amount exceeding USD 100,000 require notification to the National Bank of the Republic of Kazakhstan (the notification is to be made by the arranging bank), and (i) for a period of more than 180 days, and (ii) for an amount exceeding USD 100,000, require registration with the National Bank of the Republic of Kazakhstan (the registration is to be initiated by the Kazakhstani party to the agreement).

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 Kazakhstan are subject to withholding tax at a rate of 15% unless reduced by a relevant double-tax treaty. As for other categories of payments under a franchise agreement, they would likely be taxed at a rate of 20%, unless another rate is established by an applicable double tax treaty (for example, withholding tax on management fees may be reduced to zero if the franchisor provides to the franchisee a certificate of residence complying with legislative requirements). As regards the option of structuring payments as a management service fee, this is in principle possible, but in this case the franchisee should be able to demonstrate to the tax authorities that the services have actually been rendered (including the relevant physical products of the services). Otherwise, the tax authorities may treat the payments as 'other gains' under the franchise agreement and claim the difference between the tax due on royalty payments and the tax (if any) actually paid, with the applicable penalties. The tax authorities will treat this payment to a non-resident as income, which under the tax laws is subject to a high rate of tax under the current Kazakhstani budget.

Please also note that due to the changes in tax legislation effective from 1 January 2016, royalty payments made by a franchisee which is recognised as an autonomous educational organisation, are exempted from the withholding tax in Kazakhstan. Autonomous

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educational organisation refers to a non-commercial organisation established by the decision of the Parliament of Kazakhstan and involved in educational, healthcare or scientific activity.

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

Under Kazakhstani law, all payments between Kazakhstani residents shall be made in local currency only. Payments can only be made in a foreign currency when at least one of the parties is a non-resident.

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 Law on Franchise provides that the agent could be a third party to franchise agreement. The obligations and liabilities of the franchisor, franchisee and the agent should be agreed in the agreement. In practice, agents are not parties to the franchise agreement.

When an agreement is expressly meant to be a franchise agreement, we believe that there cannot be any risk of interpreting such an agreement as an agency agreement. However, it would be advisable to include in the agreement a provision expressly establishing that the agreement does not create agency relations between the franchisor and franchisee and the franchisee acts as an independent party.

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?

Pursuant to the Civil Code, citizens and legal entities must act in good faith, reasonably and fairly when exercising their rights, and comply with the requirements contained in legislation and the moral principles of the society. This obligation cannot be excluded or restricted by any agreement. The good faith, reasonableness and fairness of the acts of participants in civil rights relations shall be presumed. 'Good faith' and 'fairness' are understood as compliance with ethical principles in exercising rights. 'Bad faith' may be represented by a conscious disregard for the interests of other persons for one's own benefit, or by a negligent attitude to another's property, etc. For instance, a bad-faith owner is a person, who understands that he purchases property from a counterparty, which may not sell that property. As to fairness, it is stated that no one can exercise a right in breach of the principles of fairness. For instance, it is unfair to claim a share of costs and profits in a joint undertaking if such share does not correspond to the participants' input. 'Reasonableness' means the state of having sound judgment of circumstances related to the exercising of the right. A neglectful attitude to the appraisal of such circumstances is considered unreasonable. For instance, it is unreasonable to ask a person to do or provide something, when he (although acting in good faith) does not possess sufficient knowledge or experience in a particular area. However, there is no 'objective test' for these categories. Thus, the court decision will be based on the individual circumstances of a particular case.

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?

Once the franchise agreement is entered into, the relationship between franchisor and franchisee is governed and regulated by the local contract, corporate, anti-corruption, unfair competition, environmental, tax, advertising and promotion laws, as well as other Kazakhstani laws and 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?

Under Kazakhstani law, there are no special disclosure obligations in relation to the renewal of an existing franchise at the end of the franchise agreement. We believe that upon the renewal of a franchise agreement, the franchisor would be required to update the franchisee on any matters not covered by the continuing disclosures.

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 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.

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?

Pursuant to Kazakhstani law, liability of a franchisor for the refusal to renew or extend the franchise agreement may arise only if the relevant obligation of the franchisor is provided for by 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 as provided by the Franchise Law. If stipulated in a franchise agreement, a franchisor may effectively restrict a franchisee's ability to transfer its status or obligations under the franchise agreement. A franchise agreement usually requires the franchisor's consent for the franchisee to transfer its franchise under the agreement. The Franchise Law also provides a pre-emptive right of a franchisor in case of alienation by the franchisee, its business or part of it. And the violation of a franchisor's pre-emptive right leads to voidability of such transaction.

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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 'step-in' right is recognised under Kazakhstani law and is enforceable in practice in Kazakhstan. If the franchise agreement is terminated, the franchisor may 'step into the shoes' of the former franchisee and acquire its rights and obligations in due course, following necessary legal procedures. Such 'step-in' may be realised in various forms and must be registered with the competent authority in order to be enforceable.

16.3 If the franchise agreement contains a power of attorney in favour of the franchisor under which it may complete all the 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 country 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?

We believe that, depending on the particular case, such power of attorney is not always enough to enter into the ownership and management of a franchisee's franchised business. Therefore, in various cases additional formalities may be required; for instance, a decision of shareholders or participants of the franchisee, consent of the franchisee, any other agreements, approvals, etc. In any case, it is certain that the courts will examine very carefully the conditions under which the said power of attorney was concluded by the franchisee, and if they decide that it was a result of the pressure of the franchisor to the franchisee, they can render it invalid. However, there are no registration formalities required for the validity of the power of attorney in accordance with the legislation of Kazakhstan.

Note

The answers are given in accordance with the current laws; however, by the publication date some changes are possible.

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Portugal

Vasco Bivar de Azevedo

Cuatrecasas

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1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

There is no definition of franchising provided by law; however, a franchise is usually presented by most authors as the contract whereby the producer of goods and/or services grants to a third party, upon consideration, the marketing of its goods and/or services, through the use of its trademark and its distinctive signs of commerce in accordance with the business model, method and guidelines laid down by this, providing to the franchisee, in addition, knowledge and assistance for the marketing of the goods and/or services which are the subject of the franchising.

1.2 What laws regulate the offer and sale of franchises?

Besides general law there are no specific laws regulating 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 the purposes of any franchise disclosure or registration laws?

One of the characteristics of a franchise is the attribution of a territory for the franchisee to carry out the franchised activity. Nothing prevents the franchisor from appointing only one franchisee for the entire Portuguese territory and, therefore, this person shall be treated as a franchisee for all applicable purposes, including disclosure and registration laws.

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

There are no franchise registration requirements in Portugal. Nevertheless, attention should be paid to certain activities carried out by a franchisee that may require registration or the obtaining of authorisation to carry out such activity (for instance, in order to carry out the activity of postal or financial services, authorisation of the regulatory authority of the sector is required).

1.5 Are there mandatory pre-sale disclosure obligations?

There are no mandatory disclosure obligations in Portugal, besides the general obligation of the franchisor to provide the franchisee with all the elements and information necessary to carry out the franchised activity.

Nevertheless, the European Code of Ethics for Franchising ("European Code of Ethics"), which obliges members of the European Franchising Federation and has been applicable in Portugal since January 1991, establishes in articles 3.3 and 3.4 some disclosure obligations with which the franchisor must comply.

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 in Portugal which are applicable to the sale of a sub-franchise, besides the obligations mentioned in question 1.5 above. Thus, the disclosure of such information to sub-franchisees may always require the cooperation of the franchisor.

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?

No, the law does not prescribe any format for disclosures, besides the obligation for the information constituting the clauses of the franchise agreement to be provided by the franchisor in written form (see the European Code of Ethics, articles 3.3 and 3.4).

The only obligation, established in the law, which may imply continuing disclosure to the existing franchisee is the obligation of the franchisor to provide the franchisee with all the elements and information necessary to carry out the franchised activity.

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

There are no specific laws governing the sale and purchase of a franchise. Please note, however, article 2.2 of the European Code of Ethics.

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

The membership of a national franchise association is not mandatory but is commercially advisable because these types of collective entity generally promote and provide support to their members and they are usually very good networking channels.

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

The membership of a national franchise association will impose on the franchisors only the obligations deriving from the fact that the franchisor is a member of such association.

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

No, there is no such requirement.

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; however, in some sectors (e.g. aviation), European Union ("EU") law can impose restrictions.

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

If the franchisor is based abroad, it is not necessary to create a new business entity to carry on the franchise business in Portugal; however, if the franchisor decides to use a local business entity to manage the franchising activity in Portugal, the most common forms of entity are the limited responsibility company and the branch: the former is an autonomous corporate entity owned by the franchisor; the branch or permanent representation is an extension of the parent company without independent legal capacity, although, under the law, it is allowed to carry out some legal acts on behalf of the parent company.

If the franchisor is already locally based, the most common business entity used is the limited liability company – usually a company with shares (*sociedade anónima*) or a limited partnership company (*sociedade por quotas*).

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 incorporation of a limited liability company follows a legal procedure which includes the approval of the corporate name by the National Register of Legal Entities ("RNPC"), the conclusion of the document of incorporation of the company, the deposit of the share capital in a company's bank account previously created for that purpose, and the registration of incorporation of the company at the Company's Registry Office.

Although the company in formation may practise some legal acts before its incorporation and registration, it is only once it is listed on the Register that the company acquires legal personality.

The creation of a branch follows a simpler procedure, including the registration of the resolution of the parent company which decides upon the creation of the branch and the deposit of the capital funds allocated to the branch, if applicable.

Both the limited liability company and the branch must register the start of their business activities with the tax authorities, and are then subject to compliance with the tax obligations provided for in the law.

Moreover, the foreign legal representatives of the company or the branch will have to obtain a Portuguese tax number to be registered in such capacity at the Companies' Registry Office.

3 Competition Law

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

Portugal, as a Member State of the EU, fully complies with the EU legislation (notably articles 101 and 102 of the Treaty on the Functioning of the European Union) and the case law of the EU courts, including competition law.

Regarding national legislation, the Portuguese Competition Act – Law 11/2012 – does not contain specific references to franchising. However, the Competition Act shall be applicable if any questions are raised regarding the restrictive practices or other competitive concerns involving franchise agreements. It is worth noting that the Competition Act deems the European Block Exemption Regulations (notably Regulation 330/2010, "VBER") applicable to purely national situations.

Decree-Law 166/2013, which establishes the legal regime applicable to individual restrictive trade practices, may also apply to franchise situations.

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

There is no maximum permitted term. However, it should be mentioned that although a franchise agreement usually includes territorial exclusivity provisions, there may be some applicable restrictions – to be individually considered – regarding their potentially anti-competitive effect.

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

There is no maximum permitted term. Notwithstanding, if there is an exclusivity obligation or an obligation to purchase 80% of the products to be sold to the franchisor or its designated suppliers, the term should not be longer than five years in order to benefit from the VBER.

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

The franchisor's imposition of resale prices on the franchisee may be considered a hard-core restriction under European and Portuguese competition law. The imposition of minimum resale prices is prohibited, whether these are direct or indirect. It may lead

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to the invalidation of the agreement and to the imposition of a fine of up to 10% of the turnover and claims for damages.

There are a few exceptions to the prohibition on resale price maintenance. The VBER Guidelines give the example of fixed resale prices that are necessary for the launch of a new product or to implement a short-term low price campaign.

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

The Portuguese legal system is governed by the principle of good faith in contractual relationships. Therefore, there is an obligation for the parties to act and deal with each other in good faith, fairness and reasonableness. This applies to both the negotiation and execution of contracts. If the franchisor agrees to confer a benefit to the franchisee, then the former should not do anything that substantially deprives the latter of the satisfaction and fulfilling of such benefit.

In order to avoid or mitigate the risk of violation of the territory, it is advisable that the franchise agreement clearly specifies and defines the exclusive geographical territory that is granted to the franchisee.

If, in any event, this situation leads to an abrupt termination of the commercial relationship or refusal of supply, competition law and Decree-Law 166/2013 may apply, and the practice may be deemed forbidden considering previous contractual relationships, the contract itself and the general rules of commerce.

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

Non-compete obligations are those which preclude a franchisee from developing a competing business, and those which require the franchisee to purchase from the franchisor/franchisor's designated suppliers more than 80% of the franchisee's total purchases by the franchisee. The former category can be either in-term or post-term.

Regarding in-term, 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, whereas they are usually permitted for up to five years. Other conditions apply: any non-compete clause must be directly related to the franchise; transfer of know-how or intellectual property rights must not be the object of the agreement; and it should not include any hard-core restrictions.

As to post-term, if the obligation is deemed indispensable to the protection of know-how transferred by the franchisor, a one-year post-termination non-compete clause is permitted provided that it is limited to the products and services of the franchise and to a certain geographical area.

4 Protecting the Brand and other Intellectual Property

4.1 How are trade marks protected?

The trademark registry in Portugal is not mandatory. However, it is highly advisable. The registration of a trademark is made in the National Institute of Industrial Property ("INPI"). Registration is not an automatic act. As mentioned above, the registration of a national trademark in Portugal shall be carried out by means of filling out a registration form (model), in the INPI. The request is published online in the Bulletin of Industrial Property, followed by a period for objection. An administrative process begins later, the duration of which may be several months, ending with a decision to grant or refuse registration.

If the trademark applied for does not incur any of the prohibitions to its registration, the INPI will grant the same for a period of 10 years from the date of the request, renewable for successive periods of 10 years.

The registration of a trademark obtained in Portugal does not protect the trademark in any other country.

If the aim is to extend the protection of the trademark to other countries, the holder of the trademark may, in each one of them, submit applications directly for its registry. There is also the possibility to apply to the countries of the EU for protection, by means of a European Union Trademark, or to the member countries of the Madrid System, by means of the international Registry of Trademarks.

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

The industrial secret is not exactly a protection system (there is no registry, nor is a certificate of accreditation of any right awarded), but it is a legal obligation on certain persons assigned to a company or group of companies. If a company has its own method of making or developing the activity of production of its products, and if it has developed processes which are not known by others and which provide added value to its business, it is possible to protect them by embedding in all contracts confidentiality clauses of industrial secrecy. Generally, there are also added penalty clauses for non-compliance (which requires the payment of a monetary amount).

The secrets of a business are not to be confused with its know-how. We are in the field, first and foremost, of industrial or production secrets and trade secrets. The secrets of a business are more restricted than its know-how. The strategic options of a company in a specific market may be secret, but not its know-how.

In this way, the franchise agreement shall not imply, as a rule, the transmission of business secrets. One formula of production, for example, may not be transmitted to the franchisee; on the contrary, the raw material (which incorporates the secret) may be provided by the franchisor with a view to the manufacture of the product to be marketed.

In Portugal, trade secrets are protected by the legal regime on unfair competition, pursuant to article 318 of the Industrial Property Code.

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?

Computer software programs that have creative character have a protection similar to that afforded to literary works (Decree-Law 252/94 of 20th October, rectified by the Declaration of Rectification n° 2-A/95 of 31st January, amended by Decree-Law 334/97 of 27th November).

In the absence of any special provision, a copyright extension expires 70 years after the death of the creator. Copyright is acknowledged and fully valid and effective regardless of registry, deposit or any other formality (article 12 of the Code of Copyright and Related Rights). Despite this, for proof of entitlement, the author will still have to proceed with the registry of the work at the General Inspection of Cultural Activities.

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As with industrial property law, there is a considerable level of harmonisation on this subject. In fact, the Portuguese legal system operated, through Decree-Law 252/94 of 20th October, the transposition of Directive 91/250/EEC of 14th May on the legal protection of computer programs; this was, however, revoked by Directive 2009/24/EC of the European Parliament and of the Council of 23rd April. Under this Directive, computer programs are: any type of program, even those which are incorporated into the equipment; as well as the preparatory design work leading to the development of a computer program, provided that the preparatory work is likely to result in a computer program at a later stage.

Directive 2009/24/EC for the establishment of a minimum level of protection and standardisation, provides that Member States shall grant protection for computer programs under copyright as literary works, without prejudice to other forms of protection.

In conjunction with industrial property rights and intellectual property rights – and, in some cases, promoted by these – the franchise agreement usually includes several clauses restricting competition.

5 Liability

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

From the franchisee's perspective, it is recommended that the franchising agreement provides for clauses properly designed to regulate the consequences of a breach of the agreement on the part of the franchisor. General law stipulates that parties can agree freely to the content of contracts, within the limitations of the mandatory provisions of the law; in this regard, parties may agree the legal mechanisms to settle situations where a breach has occurred and the compensation of the non-defaulting party for damages occurred.

Even if such clauses are not expressly written into the agreement, general law provides that a breach of the agreement which, by its seriousness or repetition, jeopardises the continuity of the contractual legal relationship, grants the non-defaulting party the right to terminate the agreement with immediate effect (providing that no other timeframe was contractually settled); however, the non-defaulting party should notify the defaulting party of its intention to terminate the agreement and justify the legal reason(s) for such termination.

On the other hand, general law also stipulates that if actions or omissions constituting the failure of a party cause damage to the other party, the latter has the right to monetary compensation for the damages suffered if such damage cannot be repaired in kind.

5.2 In the case of sub-franchising, how is liability for disclosure non-compliance or for misrepresentation in terms of data disclosed being incomplete, inaccurate or misleading 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 context of the freedom granted to parties to a franchise agreement, such parties may agree on the content of the contractual clauses as they wish, the limitation being that such clauses cannot be contrary to the law. In this sense, the franchisor and the master franchisee are allowed to stipulate the terms of the agreement that governs the legal relationship of master franchising, as well as the consequences of inadequate transmission of information or knowledge from the franchisor when this results in damage to the sub-franchisees. If the parties do not stipulate anything on master franchising in this respect, please see our response to question 5.1.

In principle, there are no legal limitations on the enforceability of an indemnity right granted to the franchisor against the master franchisee; however, despite the fact that Portuguese law prohibits the renouncing of general indemnity rights in advance, it is legally possible to limit in advance the amount of the indemnity to maximum amounts, provided that those amounts do not in fact constitute an advance renunciation of indemnity rights, or establish in advance a minimum amount for the indemnity in a penalty clause.

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

It is not possible to avoid pre-contractual liability, but it is possible to minimise its effects; please see our response to question 5.2.

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

Class actions (*acção popular*) are permitted by Portuguese law in order to defend or punish infringements related to public health, consumers' rights, quality of life, the environment, cultural heritage and the public domain. They are, however, rarely used. These class actions include an opt-out mechanism by default.

Class actions are an expression of the constitutional right of access to the courts and, as such, cannot *a priori* be contractually waived. Such a waiver would be null and void and not enforceable.

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 documents to be governed by Portuguese law, and the assignment of a jurisdiction agreement is accepted by Portuguese law provided it is contractually valid and does not infringe mandatory laws. However, if an analogy of the situation can be drawn from a specific case, as the Supreme Court of Justice and some authors have understood, we may consider the application of article 38 of the Agency Legal Framework (Legislative Decree 178/86 of 3rd July), which establishes that for an agreement that is carried out exclusively or mostly in the national territory, a legal framework which differs from Portuguese law will only be applied with regard to its termination if the same is found to be more advantageous to the franchisee.

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 rogue franchisee to prevent damage to the brand or misuse of business-critical confidential information?

As a general rule, and notwithstanding the specific protective orders established in Portuguese law, it is possible to demand that

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Portuguese courts take conservative or anticipatory measures which are specifically adequate to ensure the effectiveness of a threatened right, provided that the applicant shows itself to have a founded fear that others may cause a serious and possibly irreparable injury to that right.

The decisions issued by a court of another Member State of the EU regarding civil and commercial matters, including provisory measures such as protective orders in accordance with all the applicable requirements, are recognised in Portugal without any formalities and a decision issued by a competent court of a Member State which is enforceable therein may be executed in Portugal without any declaration of enforceability being necessary.

Regarding non-EU countries, and in the case that there is no applicable treaty or convention, any decision issued by the respective courts is only effective in Portugal after having been reviewed and confirmed by the competent Portuguese court.

7 Real Estate

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

Usually, commercial leases have a term of five or 10 years, which can be renewed by agreement of the parties. However, it all depends on the activity the tenant wishes to carry out in the leased premises. In some sectors, when the initial fit-out/investment costs are very significant, the term can be 20 years or more. Portuguese lease law does not allow a term longer than 30 years. Notwithstanding the existence of a term, parties have the liberty to determine the possibility of terminating the lease prior to its term and the rules applicable to such termination.

Although the initial term of the lease cannot be longer than 30 years, it can be renewed several times for periods of up to 30 years. In addition, it is possible to enter into a lease agreement with no term (in such case, both parties can terminate the lease at any time without the need for a justification, by giving prior notice as set out in the 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?

Even though this is not common procedure, it is possible for the franchisor or a third party to step into the franchisee/tenant's shoes under the lease, by means of an assignment of the franchisee/tenant's contractual position to the franchisor or the third party. This assignment, however, requires the authorisation of the property owner, which can be provided in the original lease agreement or when the franchisee/tenant wishes to assign its position. The franchisor or the third party that assumes the tenant's position will assume all the rights, obligations and liabilities of the former tenant to the property owner.

The landlord's authorisation is not required in cases where the franchisee/tenant sells its business, by transfer of its goodwill (including leased premises and everything inside these), and as long as the third party that acquires it continues to carry out the exact same activity in the leased premises that was carried out by the former tenant. Although the property owner's consent is not required in this case, the former is entitled to a pre-emption right in the acquisition of the tenant's goodwill.

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 in the law preventing non-national entities from holding real estate assets or sub-leasing real estate properties. Thus, in order for foreign entities to carry out an activity or to hold a real estate asset in Portugal, they are required to have a Portuguese taxpayer number. In addition, property owners may require additional guarantees in the case of non-compliance with the lease agreement by such entity.

7.4 Give a general overview of the commercial real estate market. Specifically, can a tenant reasonably 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 of a particular location)?

In commercial leases, landlords often demand the payment of several months' rent in advance (the law allows the payment of three monthly rents in advance) and a deposit (with no limit on the amount) to guarantee compliance with the lease by the tenant. However, it is normal to negotiate a rent-free period when the initial fit-out/investment costs of the tenant in the leased premises are very significant. In such cases, it is also usual to negotiate, after the rent free period, an annual increase of the rent which is higher than the one resulting from the applicable annual coefficients, in order to compensate the property owner for the rent-free period.

The negotiation of a rent free period is easier and more common in some parts of Portugal, especially smaller cities, due to the balance of supply and demand. However, in the main cities, such as Lisbon and Porto, and in prime locations, this is becoming more difficult, given the great increase in demand for commercial real estate properties and the growth of the real estate market in such locations. In such cases, property-owners usually require payment of rent in advance and the provision of several guarantees such as the payment of a deposit that regularly goes up to six months' rent (depending on the term of the lease agreement).

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 case described is considered a passive sale, which is the one where the client is located outside the franchisee's territory but approaches the franchisee directly. Conversely, in an active sale the franchisee is the one who actively approaches the client.

European competition law establishes that every franchisee must be allowed to use the Internet to sell its products or offer its services. This is considered by the European Commission to be a form of passive selling. Therefore, if the franchise agreement includes such limit, the entire agreement may be deemed void and unenforceable and the parties can be subject to fines and potential third-party damages procedures.

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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 assignment of local domain names, as long as the parties agree to such assignment and such obligation is expressed in the franchise agreement to remain effective after the termination of the agreement.

9 Termination

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

There are no mandatory laws in Portugal that might override the termination rights in a franchise agreement. Termination rights are usually established by the parties in the franchise agreement; if not, general law will 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 principle, there is no risk, as the franchisee will run an independent business, hiring and managing its own employees.

However, in Portugal, as in other jurisdictions, the qualification of the relationship as an employment or independent services contract will depend, eventually, on the specific circumstances of the situation and the ability to evidence that the franchisor is indeed managing the franchisee's employees directly and acting as their employer.

In order to avoid the risk of qualification of the relationship as an employment contract, the franchisor should not take actions that are usually typical of an employer and the franchise contract should not include any clauses that allow the interference of the franchisor in the recruitment, selection or managing of the 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?

Yes, there is such a risk.

The recent Law No. 28/2016, of 23rd August – which came into force on 22nd September 2016 – amended the Portuguese Labour Code and expanded the joint liability of the contractor (and its managers, administrators or directors, as well as companies with reciprocal corporate interests, in a controlling relationship, or affiliated companies) and the subcontractor, for (i) the compliance with legal provisions and possible infractions committed by the subcontractor who performs all or part of the contract in the contractor's facilities or under his responsibility, and (ii) the payment of the respective fines.

Therefore, a franchisor may be jointly liable for the acts or omissions of a franchisee's employees in the performance of the franchisee's business.

In order to avoid such risk, the franchisor should implement control mechanisms, which allow verifying compliance with the contracts by 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?

There are no restrictions on the Portuguese side. However, Portuguese-domiciled legal entities shall report on a monthly basis to the Bank of Portugal, for statistical purposes, their economic or financial operations entered into abroad, including, amongst others, the transfer of funds to or from a foreign bank account to the extent such transfers reach or exceed, on an annual basis, the amount of €100,000.00. The entity responsible for proceeding with this filing with the Bank of Portugal is the Portuguese-domiciled legal entity, and the filing shall include information about the type of transaction, amount, currency and country of payment. Accordingly, any payment of royalties by a Portuguese-domiciled company to an overseas franchisor is subject to this reporting whenever the same reach or exceed, on an annual basis, the amount of €100,000.00.

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?

Non-resident companies are subject to Portuguese corporate income tax (*Imposto sobre o Rendimento das Pessoas Colectivas*, "CIT") only on Portuguese-sourced income, which comprises income obtained herein through a permanent establishment ("PE"), and certain types of income owed by resident entities or local PEs of non-resident entities, such as income derived from intellectual or industrial property, know-how, technical assistance or from the supply of other services rendered or used within the Portuguese territory (with certain exceptions).

Under domestic tax law, income derived from intellectual or industrial property, know-how, technical assistance or from the supply of other services, obtained by non-residents without a PE herein, is liable to withholding tax, over the income's gross amount, at a rate of 25%. Under certain conditions, this rate may, however, be increased to 35%, notably regarding certain income owed to entities domiciled in "blacklisted jurisdictions".

Withholding tax over said payments may, however, be reduced or avoided pursuant to the provisions of a double tax treaty ("DTT") signed between Portugal and the country of residence of the beneficiary of the income.

Income qualified as royalties for DTT purposes (e.g. income derived from a trademark licence, from other intellectual or industrial property rights or from the transfer of know-how) may benefit from a reduced withholding tax rate that, in general, may be 5% or 10%.

Royalties owed by Portuguese-resident companies to EU-associated companies may further be exempt from withholding tax in Portugal,

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pursuant to domestic rules that transposed the regime of Council Directive 2003/49/EC of 3rd June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States (the "I&R Directive").

Among other requirements, in order for the I&R Directive's regime to apply, the Portuguese company paying the royalties and the EU receiving company should qualify as "associated companies". This condition is met when (i) there is a direct participation between the two companies of at least 25% of the capital of the other, or (ii) when a third company has a direct minimum holding of 25% in the capital of both the company paying the royalties and the company receiving the royalties. In any of these cases, the relevant shareholding should be held for a minimum uninterrupted period of two years. Royalties paid before the two-year minimum holding period has elapsed shall be subject to withholding tax, though the beneficiary of the income may be entitled to a refund of the tax withheld once said period elapses.

A similar withholding tax relief regime is also applicable to the payment of royalties between Portuguese- and Swiss-resident associated companies, pursuant to the terms of the Agreement between the European Community and the Swiss Confederation providing for measures equivalent to those laid down in Council Directive 2003/48/EC on taxation of savings income in the form of interest payments.

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

The financial transactions, including the payment of franchise fees or royalties can be carried out in currencies other than Euros. Regarding other requirements, please see the response to question 11.1.

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 Supreme Court of Justice and some authors have understood that when the situation warrants analogy, the legal regime of the agency agreement (legislative Decree 178/86) can be applied to a franchising agreement, in particular with regard to issues related to the termination of such an agreement.

In this regard, compensation for clientele in particular must be taken into account; this is usually due to an agent after the expiry of the agency agreement, and is based on the principal of keeping the advantages which arose from the customers previously attracted by the agent during their tenure at the agency.

The risk of applying this legal scheme to franchising agreements arises especially in cases where there is a greater integration of the franchisee in the network of the franchisor.

To minimise the risk, it is important to adopt business and legal models which evidence that the franchisor will not obtain any advantage because of customers attracted by the franchisee after the termination of the franchise 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 specific requirement for a franchisor to act in good faith or fairly towards the franchisee. However, there is a general principle that rules the Portuguese legal system, which is the principle of good faith in contractual relationships. Therefore, there is an obligation for both parties in an agreement – including a franchise agreement – to act and deal with each other in good faith and according to the principles of fairness and reasonableness. In addition, under article 2.4 of the European Code of Ethics, both franchisor and franchisee shall act with loyalty and fairness in their contractual relationship and solve their disputes with loyalty and good faith by direct negotiation and communication.

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 are no specific laws regulating the relationship between the franchisee and the franchisor, besides Decree-Law 178/86 of 3rd July, which can be analogously applicable to franchising and provides some rules regarding the relationship between the parties during the execution of the agreement (although not all the provisions are applicable to franchise agreements).

In addition, the Portuguese Civil Code regulates the relationship between the parties in all agreements and contains general principles and obligations that should be respected in the execution of all kinds of agreements, franchise agreements included.

Depending on the type of activity and sector of the franchising, several regulatory rules may be applicable to both the franchisor and the franchisee, in order to be able to legally carry out their activities in Portuguese territory.

Finally, other legislation can be applicable and bind the parties in the execution of the agreement and their activities, including: (i) the Data Privacy Rules; (ii) the Advertisement and Publicity Code; (iii) the Consumer Protection Law; (iv) the General Contractual Clauses Law; and (v) the Selling of Consumer Goods and Related Guarantees Law, among others.

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 additional disclosure obligations applicable to a renewal of an existing franchise, besides those referred to in question 1.4 above; neither are there any which apply at the end of the franchise agreement term. There is, however, an obligation of secrecy and confidentiality of the franchisee at the end of the agreement, regarding the information, documents and know-how provided by the franchisor for the execution of the franchising.

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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 rights for a franchisee or a franchisor in relation to the automatic renewal or extension of the franchise agreement at the end of its initial term or any subsequent term. Renewals or extensions of the term depend upon the agreement of both parties.

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 not entitled to any compensation resulting from a refusal to renew or extend its franchise agreement, unless otherwise established in such agreement. There is, however, a possibility for the franchisee to claim client compensation if there is a similarity between the franchise and the agency agreement and if the franchisee provides a decisive and well-known contribution to the increase and optimisation of the franchisor's clientele. In addition, franchisors usually tend to negotiate the terms of the franchise agreement in order to dispel the applicability of this type of compensation at the end 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?

Restrictions on the selling, assignment or disposal of the franchise business can be imposed on the franchisee; franchising is generally seen as an *intuitu personae* agreement, but these restrictions must be expressly provided for in the franchising 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?

If the franchisor's step-in right in case of termination is validly agreed between the parties it will, in principle, be recognised by Portuguese law; however, in practical terms, to ensure the step-in right's effectiveness, the procedure should be sufficiently detailed in the agreement and a set of ancillary documents should be required, to empower the franchisor to carry on with the transfer even without the cooperation of the franchisee (including powers of attorney, escrow or deposit of shares, etc.).

16.3 If the franchise agreement contains a power of attorney in favour of the franchisor under which it may complete all the 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 country 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 ("PoA") will be valid and recognised by the Portuguese courts if it complies with the local legal requirements. It should be noted that PoAs concluded abroad under foreign law must be legalised under the Hague Convention on the Recognition and Enforcement of Foreign Judgments, to which Portugal is one of the subscribers, or at the Portuguese consulate with jurisdiction over the country or city where the PoA was completed. The PoA does not need to be registered.

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Romania

RUBIN MEYER DORU & TRANDAFIR

Cristina Tararache

1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

According to the Romanian franchise-specific law, i.e. Government Ordinance No. 52/1997 (hereinafter the "Franchise Law"), franchise is defined as "*a trading system based on a continuous collaboration between natural persons or legal entities, each of them financially independent from the other, whereby a person named franchisor grants to another person named franchisee the right to operate or to develop a business, a product, a technology or a service*". A key concept of the franchise system is the franchise network, meaning contractual relations established between the franchisor and one or more franchisee, meant to promote a technology, product or service, as well as to develop their production and distribution.

1.2 What laws regulate the offer and sale of franchises?

In Romania, franchise relations are subject to the national law, namely the Government Ordinance No. 52/1997 (hereinafter the "Franchise Law"). The provisions of the Franchise Law are supplemented with the provisions of the Civil Code. Other laws that have an impact on franchises in Romania are Law No. 21/2996, as further amended and republished on competition relations, and Law No. 84/1998 on trademarks and geographic indications.

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 the purposes of any franchise disclosure or registration laws?

Yes; if the franchisor is proposing to appoint only one franchisee/licensee in a jurisdiction, the respective franchisee/licensee will be treated as a franchisee for the purpose of any franchise disclosure or registration laws.

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

Two potential registration requirements apply in Romania, one with the Competition Council, and one with the Trademark Office. Generally, according to the Romanian Competition Law No. 21/1996 as further amended and republished, franchise agreements need to be field with the Competition Council. If a particular franchise agreement benefits from one of the exemptions specified by the Competition Law, notification with the Competition Council is no longer needed. Trademark protection is awarded through registration with the national authority or through the European Union or international registration.

1.5 Are there mandatory pre-sale disclosure obligations?

The obligation to provide pre-contractual information is specifically regulated by the Franchise Law. According to the Franchise Law, in the pre-contractual phase, a franchisor is required to provide the prospective franchisee with certain information through a "Disclosure Document". The purpose of such disclosure is to enable the franchisee to make an appropriate decision regarding entering into the franchise relationship; the Disclosure Document must be submitted before the franchisee undertakes any legal obligations with respect to the proposed business. No specific penalties are provided by the law in case of failure to provide such pre-contractual information. However, the franchisee has the right to file a lawsuit against the franchisor for damages caused as an effect of such non-disclosure or incomplete disclosure. The burden of proof of any damage is on the franchisee. Theoretically, criminal liability for misrepresentation is also conceivable.

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 pre-contractual information does also apply to contracts concluded with sub-franchisee. The Master Franchisee is required to provide the required disclosure to the sub-franchisees. The Master Franchisee may use the information provided by the franchisor emphasising its own contractual 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 is no format for the Disclosure Document. Nevertheless, the Franchise Law states that such document must include, amongst other things, the following elements: experience gained by the franchisor in the proposed business; information on the financial elements of the franchise agreement, such as the initial fee or royalties; further information enabling the prospective franchisee to join the franchise network in full awareness of the relevant facts; purpose and field

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of application for the exclusivity awarded; and information on the duration, renewal conditions, dispute resolution and termination of the franchise agreement. The above-mentioned conditions are in accordance with the Franchise Law only as minimal information which must be disclosed by the franchisor. Additional information should also be provided, to the extent that such other information is of interest to the franchisee.

The information included in the Disclosure Document needs to be provided prior to the execution of the franchise contract itself, its role being to enable the franchisee to make an appropriate decision regarding its entering into the franchise relation. Therefore, this is only a pre-contractual obligation of the franchisor, and it shall not apply after the execution of the franchise contract.

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

There are no other requirements which must be met before a franchise is offered or sold.

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

Being member of the Franchise Association of Romania is not mandatory, but it is advisable. There is an entrance fee and an annual fee to be paid by any entity becoming member of the Franchise Association of Romania.

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

The Franchise Association of Romania has adopted its own Code of Ethics, in line with the European Code of Ethics, and of course in full compliance with the provisions of the Franchise Law. A verification of the Disclosure Document and franchise contract shall be done by the Association.

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

There is no requirement to have the franchise or disclosure documents translated into Romanian. On the other hand, in the pre-contractual stage, the franchisor is obliged to disclose the pre-contractual information to the franchisee in such a manner so as to allow the latter to make a decision on whether to enter the franchise relation in full awareness. Moreover, as regards the contractual phase, the Franchise Law states that the franchise contract must clearly and with no ambiguity define each party's rights and obligations and liabilities, as well as any other clauses regarding the collaboration between the parties.

Therefore, even though there is no requirement to have the franchise and disclosure documents translated into Romanian, the franchisor should take the required steps to have these documents drafted in a common language and, in case of start-up company franchisees, even in Romanian.

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 are no such restrictions imposed under Romanian law. However, if the franchise business entails the acquisition of land, it should be noted that persons/entities from countries outside the EU/EES may obtain ownership over land in Romania only based on a mutual agreement between Romania and their country of origin. They may of course obtain other real rights over land should the franchise business require it.

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

If the franchisor is based abroad, and it intends to develop its franchise activity in Romania by a locally based entity, the most typical entities used are the branch and the limited liability company.

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 registration requirements in both cases with the Trade Registry where the headquarters of the newly established company/branch will be located. Both types of companies also need to be registered with the tax authorities.

3 Competition Law

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

Franchise networks in Romania need to observe both the European regulation regarding anti-competitive practices (Article 101 of the Treaty on the Functioning of the European Union) and the national Competition Law, i.e. Law No. 21/2996 as further amended and republished. Franchise relations must also comply with the provisions of the Commission Regulation No. 330/2010 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, which provides the conditions under which vertical restraints are exempted from the prohibition on anti-competitive agreements.

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

The Franchise Law does not establish a minimum or maximum duration of the franchise contract. The only requirement set by law refers to the fact that the franchisee needs to be able to amortise the investment. However, according to the Franchise Law, the duration of the franchise contract must be stated in the franchise contract itself. Franchise contracts are not usually longer than five years so that to comply with the provisions of the Commission Regulation No. 330/2010 mentioned above.

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

The limitation under question 3.2 above shall apply.

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

Franchisor's fixing of minimum resale prices on the franchisee, whether direct or indirect, is prohibited under both European, and national legislation, being deemed as hard-core restrictions, and it could be sanctioned with fines of up to 10% of the turnover registered by the company in the year prior to the year when it has been sanctioned. Maximal or non-binding prices may, however, be stipulated. There are also few exceptions on the prohibition to establish/maintain resale prices. According to the European Block Exemption Regulation, fixing resale prices in short marketing actions shall not be subject to the restriction.

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

The Romanian law does not state any minimum requirements for franchisors when appointing franchisees in adjoining territories. However, if franchisees are granted exclusivity, the franchisor must not directly or indirectly compete with the respective franchisees in the area granted under exclusivity.

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

In order to protect its know-how, the franchisor may include an in-term and also post-term non-compete clause in the franchise contract. The post-term non-compete clause shall be valid only if related to the goods or services competing with the goods or services covered by the franchise contract, if limited to the area where the franchisee was active during the contract, if it is indispensable for the protection of the franchisor's know-how, and if limited to one year since the termination of the franchise contract (according to Regulation 330/2010).

4 Protecting the Brand and other Intellectual Property

4.1 How are trade marks protected?

A trademark licence agreement must be registered with the Romanian State Office for Inventions and Trademarks ("OSIM") unless one of the following situations occurs: the respective trademark has been previously registered with OSIM; the trademark has been registered at EU level with the Office for Harmonization in the Internal Market ("OHIM") – Trademarks and Designs, headquartered in Alicante, Spain as a community trademark; or the trademark has been registered internationally and such registration covers Romania. The beneficiary of the licence agreement might be authorised to use the trademark throughout the Romanian territory or only part of it, for all or for some of the products or services, for which the trademark has been registered. The licence may be exclusive or non-exclusive. The trademark's holder may revoke the licensee's right to use the trademark if they are in breach of the provisions of the licence agreement. Third parties are obliged to observe the rights granted to the licensee under the licence agreement, and thus the licensee may seek protection against any fraudulent use by third parties, provided only that the licence agreement is registered with OSIM, it is a community trademark – therefore applicable in Romania – or it is an internationally registered trademark covering Romania. Failure to register the licence agreement with OSIM results in the fact that the licence is not binding upon third parties, meaning that the franchisee cannot enforce the rights under the trademark against third parties.

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 confidential information are not protected as such under Romanian law. However, reference to trade secrets is made in Law No. 298/2001 amending and completing Law No. 11/1991 on unfair competition practices. This law defines a trade secret as information which is not public, nor easily available to individuals acting in a business where such type of information is customarily used, and which becomes valuable by being kept secret by its holder through reasonable measures. The unlawful disclosure, acquisition or use of a trade secret by any person constitutes, as the case may be, a tort or a criminal offence. The enforcement of these provisions will likely remain difficult because of lack of judicial experience.

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?

Romania offers copyright protection pursuant to Law no. 8/1996 (the "Copyright Law"). Romania has a Romanian Office for Copyright Protection that was established in 1997, but copyright enforcement still is fairly burdensome, which is why piracy remains a concern in such areas as computer programs, software, music and books.

5 Liability

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

If the franchisor's mandatory disclosure obligations are contravened, the franchisee may terminate the franchise contract for the franchisor's faulty non-performance of its obligations, and also ask for damages of proving that it had not concluded the contract if the complete or adequate information had been properly disclosed by the franchisor. It is therefore recommended that the franchise contract provides for specific clauses regulating the consequences of breach the contract on the part of the franchisor.

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5.2 In the case of sub-franchising, how is liability for disclosure non-compliance or for misrepresentation in terms of data disclosed being incomplete, inaccurate or misleading 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 corresponding contracting party is liable towards the other contracting party for its breach of the pre-contractual information disclosure. In principle, there are no legal limitations on the enforceability of an indemnity right granted to the franchisor against the master franchisee. However, Romanian law prohibits the renunciation or limitation of the liability for the material damage caused to the other party with intent or gross negligence. It is, however, allowed to limit the indemnity or to establish an amount by way of a penal clause.

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

Franchisors cannot avoid liability for pre-contractual misrepresentation by including disclaimer clauses in the franchise contract. Such a provision would be unenforceable.

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

Class actions are not expressly regulated under Romanian law and they are permitted in areas like consumer protection, employment and insolvency. This does not cover the area of franchises. However, coordinated individual actions may be initiated before the Romanian courts by dissatisfied franchisees.

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 contracts to be regulated by the Romanian law. Moreover, the Rome I Regulation and international legislation allow for the choice of law between contracting parties. The Rome I Regulation, however, states that, in the absence of the parties' choice on the governing law of the contract, the law of the country where the franchisee has its regular residence shall be applicable.

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 rogue franchisee to prevent damage to the brand or misuse of business-critical confidential information?

Decisions issued by courts in other EU Member States on civil and commercial matters are recognised in Romania, no further formality being required, and they may be enforced in Romania, no declaration of enforceability being required. As regards decisions issued by non-EU countries, and where there are no applicable treaties or conventions, the respective decisions firstly need to be recognised by Romanian courts in order to be effective in Romania. Urgent interim relief and conjunction procedures are also allowed under Romanian law.

7 Real Estate

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

According to the Civil Code, the maximum duration of a lease agreement is 49 years. Typically, the lease agreement is concluded for a certain period in consideration of the type of activity to be undertaken. The lease under Romanian law is not a strong right, providing only for the attribute to use the 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?

The concept of an option/conditional lease assignment is possible, although not common practice.

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 such restrictions on non-nationals from EU/EES countries. As regards persons/entities from countries outside the EU/EES, they may obtain ownership over land in Romania only based on a mutual agreement between Romania and their country of origin. There is no restriction with regard to obtaining other real rights on the land, except ownership.

There is no restriction to sub-lease by non-nationals, only provided that sub-leasing is expressly allowed and provided under the main lease agreement.

7.4 Give a general overview of the commercial real estate market. Specifically, can a tenant reasonably 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 of a particular location)?

The real estate market in Romania has faced a severe drop in recession years, but it is now rebalanced. The real estate value, however, substantially differs according to the geographical area of the premises. An initial rent free period is usual in commercial leases, especially since landlords request for the payment of several months' rent in advance (usually three months), and for the submission of a deposit, meant to secure the lessee's performance of obligations under the lease agreement.

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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?

Online distribution is deemed as passive sale, and this cannot be prohibited in principle.

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 is no limitation on the assignment of local domain names, if such assignment has been agreed upon in the franchise contract and it has also been agreed that the obligation shall survive after the termination of the agreement.

9 Termination

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

Termination rights are usually stated in the franchise contract and, if not, general legal provisions shall apply.

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 principle, there is no risk in qualifying the franchisor as joint employer together with the franchisee, since the franchisor and franchisee are independent entities from one another, and the franchisee will manage its business, including its employees, independently from the franchisor. The franchisee relation may, however, be qualified as an employment relation if, regardless of the contractual provisions, the actual circumstances attest that the franchisee – natural person – is not actually independent from the franchisor and there actually is a subordination relation between them.

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?

Since the franchisor and franchisees are independent from one another, the franchisee is the only one liable for the franchisee's employees' acts or omissions in performing within the franchised business.

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 under Romanian law.

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?

According to the Romanian Tax Code, as further amended, royalties paid to a non-Romanian entity are subject to a withholding tax of 16%, unless lower percentages are provided by the Treaties between Romania and other countries for the avoidance of double taxation.

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 restrictions under Romanian 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?

The agency contract is regulated distinctively under Romanian law. In principle, since the franchisee is acting in its own name and on its behalf, independently from the franchisor, while the commercial agents act in the name and on behalf of the principal, in exchange for a commission, there should not be any confusion between the two contracts. However, since the actual content and nature of a contract are relevant for the qualification of a contract, and not the name given by the parties, if circumstances show that the franchisee is actually acting in the name and on behalf of the franchisor, the contract may be reclassified into a commercial agency contract.

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 principle of good faith in contractual relations is governing the entire Romanian legal system. Moreover, according to the provisions of the European Code of Ethics, franchisors and franchisees shall act with loyalty and fairness in their contractual relations and solve their disputes with loyalty and good faith.

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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 are no specific laws regulating the relationship between the franchisor and franchisee once the franchise agreement has been executed. The general principles of civil and commercial law shall, however, 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?

According to the Franchise Law, the conditions of renewal of the franchise contract must be stated in the contract itself. There are no further disclosure obligations applicable in case of renewal of the contract, except for those provided at question 1.4 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 is no such right for a franchisee to be automatically entitled to the renewal or extension of the franchise 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?

This depends on the provisions of the franchise contract on renewal/extension. In case the respective provisions have been breached by the franchisor, the franchisee shall be entitled to compensation or 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?

Such restrictions are possible under Romanian law.

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 franchisor may be granted the right to step into the franchisee's lease at the end of the franchise contract, or it may be given the option to purchase the franchisee's business; however, in order to be effective, the procedure should be detailed in the 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 country 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 will be valid if compliant with the local requirements governing the mandate. According to the applicable legal provisions, a power-of-attorney shall be valid for three years unless a specific duration is stated in the power-of-attorney itself.

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Chapter 19

Russia

GRATA International

Yana Dianova

1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

Instead of a "franchise" or "franchising", the term "commercial concession" is used in the Civil Code of the Russian Federation (the Civil Code) for this type of agreement. Article 1027 of the Civil Code provides that under the contract of commercial concession, one party (the right-holder) undertakes to grant the other party (the user), for a remuneration and for a definite or an indefinite term, the right to use in business a complex of exclusive rights owned by the right-holder, including trademark and/or service mark rights, and other intellectual property rights provided for by the contract, such as trade name rights and trade secret (know-how) rights. The commercial concession contract shall provide for the use of a complex of exclusive rights, the business reputation and commercial know-how of the right holder in a definite scope, with an indication or without indication of the territory of use, with reference to a certain sphere of business activity (sales of goods obtained from the right-holder or produced by the user, other trade activity, performance of works and provision of services).

It follows from the above definition that the subject matter of a commercial concession (franchising) agreement should include a trademark/service mark, otherwise the contract will not be deemed a commercial concession (which is confirmed by the ruling of the Highest Arbitration Court of the Russian Federation (HAC) dated 27.09.2013 No. BAC-10862/13, case No. A40-50960/12-23-457).

As an alternative option, in Russia franchise relations may be established by a licence agreement between a franchisor and a franchisee for certain copyright objects (logos, brand books, corporate styles, etc.) and trade secrets (know-how) combined with consulting services to be provided by the franchisor. Such agreement, unlike the contract of commercial concession, is not subject to state registration as long as the complex of exclusive rights granted by the franchisor to the franchisee does not include registrable rights (i.e. to a trademark or a service mark).

1.2 What laws regulate the offer and sale of franchises?

General provisions regarding commercial concession (franchise) contracts are contained in Chapter 54 of the Civil Code.

Furthermore, the provisions of the Civil Code regulating granting licences to copyright, rights to trademarks, service marks, trade names and other means of individualisation of goods, works and services, as well as know-how (commercial secrets) apply to the relations of the parties under commercial concession contracts.

The Federal Law dated 26.07.2006 No. 135-FZ "On Protection of Competition" (the Competition Law) establishes the restrictions on restricting terms and conditions that are applicable to commercial concession contracts.

Since the granting of a complex of exclusive rights under commercial concession contracts is subject to state registration with the Federal Service for Intellectual Property (Rospatent), the respective administrative regulations apply.

In addition, depending on the subject matter of a commercial concession contract, it may be subject to the laws and regulatory acts in the specific domain, e.g. the hotel, restaurant and catering sector (HoReCa), the retail trade or medicines' circulation.

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 the purposes of any franchise disclosure or registration laws?

A commercial concession contract may provide for the obligation of the right holder (hereinafter – a "franchisor") not to grant other persons with similar complexes of exclusive rights for their use in the territory assigned to the user (hereinafter – a "franchisee") or to refrain from its own similar activity in this territory (Article 1033 p. 1 of the Civil Code). In connection with this, the franchisee will not have a specific status for the purposes of the state registration of the commercial concession contract under Russian laws. According to the Rospatent recommendations approved by the order dated 29.12.2009 No. 186, the documents for the state registration of a commercial concession contract may be filed by the franchisee even if such obligation is not provided for by the respective contract, or by the franchisor even if the contract provides that the application for the state registration shall be filed by the franchisee.

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

Under Article 1028 of the Civil Code, a commercial concession contract shall be made in writing and granting of a complex of exclusive rights under the respective contract shall be registered with Rospatent.

According to the Administrative regulation for the provision by Rospatent of state registration of a contract for disposal of the exclusive right for invention, utility model, industrial design, trademark, service mark, registered integrated circuit topography,

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computer software and databases approved by the order of the Ministry of Economic Development dated 10.06.2016 No. 371 (the Administrative regulation), the application for state registration may be filed by any party to a contract of commercial concession. The Administrative regulation sets forth the exhaustive list of documents to be filed with Rospatent together with the application, the term of 68 days from the date of provision of the application for providing the state registration, and the amounts of state duty to be paid by the applicant.

1.5 Are there mandatory pre-sale disclosure obligations?

Under Article 1031 of the Civil Code, the franchisor shall provide technical and commercial documentation as well as any other information necessary for the franchisee and its employees to be able to carry out the franchising activities under the franchise agreement. As long as no specific term is established for the performance of this requirement, the information may be disclosed either before or after the franchise agreement is concluded; accordingly, pre-sale disclosure obligations are not mandatory.

In order to interest potential franchisees, franchisors often provide, in the course of negotiations with the latter, certain business-related information (e.g. financial results, royalty rates), as well as demonstrate equipment, work techniques and operating principles, at their own discretion. The confidentiality obligations and liability of the franchisee to whom such information is disclosed in such cases is commonly established by a separate confidentiality agreement. In the absence of such an agreement, a potential franchisee – as a party to negotiations – may be held liable for disclosure of the confidential information of the franchisor, or misuse thereof under Article 434.1 p. 4 of the Civil Code.

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

In the event that a franchisor wishes to appoint a master franchisee (i.e. a franchisee granted with an exclusive licence and authorised by the franchisor to make sub-franchising agreements) to develop the franchise network in the country, pre-sale disclosure obligations to sales to sub-franchisees may be provided for in the commercial concession contract with the master franchisee, in accordance with the franchisor's circumstances and wishes.

Unless otherwise is provided for in the commercial concession contract with the master franchisee, the latter shall be jointly and severally liable before the franchisor for the damage caused by sub-franchisees (Article 1029 p. 4 of the Civil Code).

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?

According to Article 1031 p. 2 of the Civil Code, unless otherwise is stipulated by the commercial concession contract, the franchisor shall be obliged to render technical and consultative assistance for the franchisee, including assistance in training and upgrading the skills of its employees. Otherwise, Russian laws neither prescribe any specific format of disclosures nor establish requirements for the disclosure update during the term of the franchise agreement. In practice, however, these conditions are specified in detail in the franchise agreement (commercial concession contract) in order to provide for transparency in the relations between the franchisor and the franchisee.

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

Under Russian law, only profit-making organisations and natural persons registered as individual entrepreneurs may be parties to a commercial concession contract (Article 1027 p. 3 of the Civil Code). This requirement does not apply if the parties choose the alternative option for formalisation of their franchisor-franchisee relations (please see question 1.1 above).

In the event that a commercial concession contract is entered into, the exclusive rights to trademark(s), service mark(s) and any other intellectual property objects that are subject to the registration under Russian law being granted under such contract should be either registered in Russia or enjoy protection in Russia under the Madrid Agreement Concerning the International Registration of Marks.

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

There is the Russian Franchise Association (RFA) established in 1997, which does not have regulatory power but provides for information support and consultation of its members, represents them before government authorities, non-profit and profit-making organisations and individuals, and maintains the National Register of Franchises (the official website is http://www.rusfranch.ru/en/).

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

Members of the Russian Franchise Association are obliged to pay annual contributions and to comply with the Code of Ethics (the Russian version of which is available at: http://rusfranch.ru/chlenstvo/kodeks_etiki/).

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

In the event that a contract of commercial concession is entered into, in order for the granting of a complex of exclusive rights under the respective contract to be registered by Rospatent, the contract should be either in Russian or bilingual, and all the documents filed with Rospatent should be either in the Russian language or, if executed outside Russia, apostilled (or legalised) and translated into Russian, and such translation be notarised.

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?

Federal Law No. 57-FZ "On Procedures for Foreign Investments in Companies of Strategic Significance for National Defence and Security of the Russian Federation" establishes the restrictions and requirements for preliminary approval of transactions involving

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the establishment of control by foreign investors over companies engaged in activities in the sectors which are deemed strategic ("Strategic Companies"), including geological research of subsoil and/or mineral exploration and extraction of federal subsoil; activities in the nuclear industry and the storage of nuclear and radioactive materials; activities in connection with aviation equipment and security; and space activities. Certain transactions involving the acquisition of control by a foreign investor or its agents over Strategic Companies are subject to the preliminary approval of the Government Commission for Strategic Investments.

Restrictions on ownership and/or control by non-nationals are also established in respect of banking, media, insurance, diamond extraction, aviation and private detective and security business.

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

Under Russian law, only profit-making organisations and persons who have the status of individual entrepreneurs may be parties to a commercial concession contract and conduct business activity on a permanent basis.

Most often, in particular in the HoReCa sector, a non-Russian franchisor chooses a partner among Russian market majors and establishes a joint venture to co-own the franchise network with such a partner. This scheme is beneficial because the partner is familiar with the peculiarities of conducting business in Russia.

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?

A business entity is deemed established in Russia from the date of its state registration; that is, the entering of information about such a business entity in the Unified State Register of Legal Entities (USRLE).

A non-Russian franchisor may also engage in business activities in Russia through a branch that is subject to accreditation by the authorised state agency (with respect to branches of foreign credit organisations – by the Bank of Russia; with respect to other representative offices and branches – the Federal Tax Service of the Russian Federation (FTS of Russia)) and registration with the tax authority at the place of its location in Russia.

3 Competition Law

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

Under Article 1033 of the Civil Code, a commercial concession contract may provide for different restrictions and covenants for the parties – for instance, an obligation of the franchisee to sell goods or provide services at prices imposed by the franchisor. However, such restrictions may be rendered invalid if they are found to contravene the antimonopoly laws.

The Competition Law, Article 11, in general prohibits "vertical" agreements (that is, agreements between commercial entities one of which purchases goods and another provides (sells) goods) that provide for an obligation of the purchaser to abstain from selling the goods of an entity-competitor with the seller, except for agreements on organisation of sales of the goods by the purchaser under the trademark, or another means of individualisation of the seller. Article 12 of the Competition Law also permits "vertical" agreements in the form of commercial concession contracts.

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

A commercial concession contract may or may not provide for the term of its effectiveness.

Article 1037 of the Civil Code states that if a commercial concession contract is entered into without limitation of its term, either party may terminate the contract at any time by notifying the other party thereof six months in advance, unless the contract provides for a longer period. If a commercial concession contract is entered into for a definite term or without indication of the term of its effectiveness, either party may terminate the contract at any time by notifying the other party thereof at the latest 30 days in advance, if the contract provides for the possibility of its termination by way of paying a specified break-up fee.

If the right to the trademark, the servicing mark or the commercial designation owned by the franchisor is included in the complex of exclusive rights granted to the franchisor under the commercial concession contract and such right is terminated, without the terminated right's replacement by a new similar right, the commercial concession contract also terminates.

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

Russian law does not establish any limitations on the term of validity of a product supply agreement. As a general rule, it is concluded for the same term as the related franchise agreement (commercial concession contract).

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

According to Article 1033 of the Civil Code, a commercial concession contract may provide for the obligation of the franchisor to sell, in particular to re-sell, commodities which are made and/or bought, to carry out works or render services at the prices fixed by the franchisor. However, in the event the respective condition results or may result in restriction of competition on a certain commodities market, the Federal Antimonopoly Service of the Russian Federation may bring both parties to the commercial concession contract (franchise agreement) to administrative liability and issue a prescription to exclude or modify the respective condition.

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

Under Article 1033 of the Civil Code, a commercial concession contract may provide for an obligation of the franchisor not to offer and sell the same franchises to other persons in the territory allocated to the franchisee, or to refrain from carrying out similar activities within the respective territory.

It may also establish the obligations of the franchisee to sell goods, carry out works or render services solely within the boundaries of a definite territory and not to compete with the franchisor within the designated territory using the exclusive rights granted to the franchisee.

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As a matter of practice, the franchisor and franchisee generally do not openly compete within the same territory, since it contradicts the goals of each of the parties. In the event the franchise agreement does not provide expressly for a non-compete covenant, the franchisee is entitled to refer to general principles of civil law, such as good faith and fairness, as well as to the customary business practice.

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 restrictive covenants are enforceable in a commercial concession contract in Russia (please see question 3.5 above). The general limitation period is three years commencing from the moment when a party to a contract becomes or should have become aware of the violation of the obligation by a counterparty. A non-solicitation of customers covenant is not enforceable because it constitutes a waiver of rights which, according to Article 9 of the Civil Code, as a general rule applicable to a commercial concession contract, does not result in the termination of such rights.

4 Protecting the Brand and other Intellectual Property

4.1 How are trade marks protected?

The following trademarks enjoy legal protection in Russia: (a) trademarks that have been duly registered in the State register of trademarks and service marks of the Russian Federation (the Trademarks Register); and (b) trademarks with an international registration (designating Russia) under the Madrid Agreement and Madrid Protocol, to which Russia is a signatory.

To have a trademark registered in Russia it is necessary to file a trademark application with Rospatent. Russian law allows for registration of a trademark only in the name of a legal entity or an individual entrepreneur. If there is no bilateral international agreement between the Russian Federation and the applicant's country of origin, a non-Russian applicant shall be represented by a Russian authorised trademark attorney.

Within one month from the date of filing the application and the required documents, Rospatent conducts the formal expert examination, in the course of which the experts verify compliance of the application and documents with the established requirements.

Subject to positive results of the formal expert examination, Rospatent proceeds to the expert examination of the claimed designation of the trademark, which lasts about 12 months. The experts examine whether the trademark complies with registrability criteria, and whether prior identical or confusingly similar trademarks have been registered.

Within one month following the registration of a trademark, Rospatent issues a certificate confirming such registration.

Information about registered trademarks is included in the Rospatent database, which is available at the official website: www1.fips.ru/wps/portal/Registers/.

A trademark's registration is valid for 10 years from the filing date. It may be renewed for a further 10 years, an indefinite number of times. To renew a trademark registration, the owner must file a renewal application and pay the corresponding fee to Rospatent within one year before the expiry date.

The date of priority of the trademark shall be the date when all the required documents are filed with Rospatent or, if the applicant claims conventional priority or exhibition priority under the Paris Convention, the date of the first application filing for the trademark registration in a member state of the Paris Convention, or public exhibition of the goods marked with the trademark in such a member state, respectively.

Russian law also allows for protection of a famous (well-known) trademark. Should a person deem a trademark he/it uses to be "a trademark generally renowned in the Russian Federation", a trademark protected in the territory of Russia on the basis of its state registration or under an international treaty to which Russia is a party or designation that does not have legal protection in the territory of Russia, it may be deemed "a trademark generally renowned in the territory of the Russian Federation" by a decision of Rospatent. The benefits of the recognition of a trademark "generally renowned in the Russian Federation" are that the legal protection of such trademark has infinite duration and extends to goods other than those for which the trademark has been declared generally renowned, if the use of this trademark by another person in respect of the said goods is going to be associated by consumers with the holder of the exclusive right to the generally renowned trademark, and it may infringe the lawful interests of the holder.

Currently, there are fewer than 200 generally renowned trademarks currently registered in Russia, and almost all of them were protected as regular trademarks first.

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

Know-how is protected in Russia. A trade secret (know-how) is information of any nature (manufacturing, technological, economic, organisational and other), including information on the results of intellectual activities in the area of science and technology and on the methods of carrying out professional activities that has a real or potential commercial value due to the fact that it is not known by third persons, which is not freely accessible to third persons on legal grounds (Article 1465 of the Civil Code).

Know-how is not subject to registration; however, the owner must take certain reasonable measures to maintain the confidentiality of the relevant information, in particular, by the implementation of the so-called "commercial secret regime" in accordance with the Federal Law on Commercial Secrets which includes a number of technical and legal measures for know-how protection. The owner of confidential information, in particular, must define the list of information constituting commercial secrets, adopt the internal regulations on commercial secrets, affix a "Commercial Secret" classification mark on the documents and keep a record of persons who had access to the confidential information.

The exclusive right to know-how shall remain effective as long as the respective information is confidential. Once the relevant information is no longer confidential, the exclusive right to the trade secret is terminated for all right-holders.

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?

Under Russian law, copyright in the Operations Manual or in proprietary software developed by the franchisor shall arise provided that the respective works have been (a) published for the first time by the author(s), or exist in any objective form in the territory of Russia (irrespective of nationality of the author(s)), or (b) published for the

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first time by the author(s), or exist in any objective form beyond the territory of Russia, if the author(s) are Russian nationals, or non-Russian – in accordance with international treaties of the Russian Federation (Article 1256 of the Civil Code).

Registration or other formal procedures are not required for copyright to arise. Upon discretion of the right-holder, software and databases may be registered with Rospatent.

To protect its copyright, the right-holder may also have a copy of the respective works notarised by a Russian public notary and/or have them deposited in an organisation providing such services, e.g. the Russian Authors' Society (www.rao.ru).

5 Liability

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

In the event that a commercial concession contract is entered into and the franchisor has failed to provide to the franchisee commercial and technical documentation and other information required for exercise of the rights under the contract or to consult the franchisee thereunder, the franchisee may file a lawsuit against the franchisor for rescission of the contract and return of the fees paid to the franchisor.

The franchisee is also entitled to demand compensation of damages sustained by it in connection with a failure by the franchisor to perform its disclosure obligations. Such damages shall be awarded by a Russian court or arbitration provided that a cause-and-effect connection between the sustaining of damages by the franchisee and a breach by the franchisor of its obligations to convey the required information (and/or assistance) to the franchisee and the amount of damages are proved.

5.2 In the case of sub-franchising, how is liability for disclosure non-compliance or for misrepresentation in terms of data disclosed being incomplete, inaccurate or misleading 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, under Russian law a sub-franchisee shall have claims against the franchisee as the sub-franchisor for a disclosure non-compliance or for misrepresentation in terms of data disclosed being incomplete, inaccurate or misleading, and may not have recourse directly to the franchisor. If the court/arbitration satisfies the sub-franchisee's claim for payment of penalties and/or compensation of damages to the former, the franchisee may then take recourse upon the franchisor for reimbursement of the respective costs. The franchise agreement may provide for limitation of the franchisor's liability in such cases.

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

It is possible to limit the liability of the franchisor for pre-contractual misrepresentation, i.e. by the amount of actual losses sustained by the franchisee not exceeding the amount of the fees under the franchise agreement. However, a complete waiver of such liability is not likely to be enforceable in Russia due to the rules of the Civil Code on provision of incomplete or false information in the course of pre-contractual negotiations (Article 434.1) and on representations (Article 431.2).

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

Class actions (i.e. actions brought by a group of legal entities and/or individuals) are possible under chapter 28.2 of the Arbitrazh Procedural Code of the Russian Federation. Such actions are not commonly used in the domain of franchising, however.

A contractual waiver of the right to file a claim with a court does not involve termination of the respective right under Russian civil law, therefore class action waiver clauses will be unenforceable.

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 such requirement, and the parties are entitled to agree on the governing law of a contract on the whole or a part thereof (Article 1210 of the Civil Code). If the parties have not reached an agreement on the applicable law, the contract shall be subject to the law of the country with which the contract has the closest relation. With respect to a commercial concession contract, the law of the country in the territory of which the franchisor is permitted to use the complex of exclusive rights of the franchisor or, if such use is permitted in the territories of several countries simultaneously, the law of the country where the franchisor's principal place of residence or place of business is located, shall apply (Article 1212 of the Civil Code).

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 rogue franchisee to prevent damage to the brand or misuse of business-critical confidential information?

Upon application of a claimant, an arbitrazh (state commercial) court may issue a ruling on an injunction prohibiting a defendant from taking actions with respect to the subject matter of the judicial dispute (Article 91 of the Arbitrazh Procedural Code).

A judgment of a court of another jurisdiction or a foreign arbitral award may be enforced in Russia in accordance with the relevant international treaty to which Russia is a party. Russia is a signatory to many multilateral and bilateral international treaties for the recognition and enforcement of foreign courts judgments and arbitral awards, including the Kiev Convention of 1992 and the New York Convention of 1958.

In the absence of the relevant international treaty, a Russian court may recognise and enforce a foreign judgment or arbitral award on the basis of the international principle of reciprocity and comity (*comitas gentium*).

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7 Real Estate

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

According to Article 651 p. 2 of the Civil Code, an immovable property lease contract, entered into for a term of one year and more, is subject to state registration. In order to avoid this formality, it is a common practice to conclude commercial property lease contracts for a term of less than one year, e.g. 11 months. The major drawback of this approach is that upon expiry of the term, the lessor may not be forced to enter into a new lease contract on the same terms and conditions, unless the parties entered into an option agreement, or the lessor granted to the lessee an option for entering into a new lease contract.

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 general, such a concept is not recognised in Russia. However, a provision on conditional lease assignment may be included in the lease contract based on the provisions of the Civil Code regarding assignment of the contract (Article 392.3) and conditional performance of obligations (Article 327.1).

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

Foreign citizens, persons without citizenship and foreign legal entities may not own land plots located in the border territories recorded in the list approved by the President of Russia, in other territories of Russia specified by the Federal Laws, or within the boundaries of a sea port.

Furthermore, under the Federal Law dated 22.07.2002 No. 101-FZ "On Circulation of Agricultural Land", foreign citizens, foreign legal entities, persons without citizenship as well as legal entities, more than 50% of the charter capital of which is owned by the latter, may possess agricultural land plots only on the right of lease.

7.4 Give a general overview of the commercial real estate market. Specifically, can a tenant reasonably 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 of a particular location)?

As a matter of practice in Russia, franchising and lease issues are very little interconnected; commonly, franchisees enter into lease contracts on their own (provided that the respective premises meet the requirements of the franchisor). An initial rent-free period when entering into a new lease may be granted by a lessor, if renovation of the leased premises is performed by the lessee and the respective improvements shall become the property of the lessor upon termination of the lease contract.

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?

Such provision, if included in a contract of commercial concession, is likely to be unenforceable since, under Article 1033 p. 2 of the Civil Code, the condition obliging the franchisee to sell goods or provide services solely to customers located or residing in the contracted territory, shall be void.

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?

If the franchise agreement contains a provision on mandatory transfer of domain administration right by the franchisee to the franchisor, the latter shall be entitled to demand such an assignment. In the absence of such a provision in the franchise agreement, the franchisor may require a former franchisee to assign local domain names to the franchisor if the domain name in question replicates the wording of the trademark the exclusive right to which belongs to the franchisor, on the basis of Article 1484 p. 2 of the Civil Code. In practice, however, there is no guarantee that the respective claim filed with a court will be successful.

9 Termination

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

Under Article 1037 p.4 of the Civil Code, if the right to the trademark, the servicing mark or the commercial designation belonging to the franchisor is included in the complex of exclusive rights granted to the franchisee under the commercial concession contract and such right is terminated and is not replaced by a new similar right, the commercial concession contract shall also be terminated. The commercial concession contract shall also terminate automatically in the event the franchisor or the franchisee is declared insolvent (bankrupt).

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?

According to the Labour Code of the Russian Federation, an employer is deemed a person that enters into an employment contract or factual employment relations with an employee. Accordingly, as long as the franchisor does not enter into employment relations with the employees of the franchisee, that is, they do not perform any labour duties under the franchisor's management and supervision, the latter may not be deemed their employer.

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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 the event that any harm or damages are inflicted to third parties by actions or omissions of the franchisee's employees, such third parties shall have recourse against the franchisee as their employer, and not the franchisor.

It should be noted, however, that according to Article 1034 of the Civil Code, the franchisor shall bear subsidiary liability for claims against the franchisee in connection with inconsistency in the quality of goods (works, services), sold (performed or rendered) by the franchisee under the commercial concession contract. The franchisor shall be liable jointly with the franchisee for the claims filed against the latter as the manufacturer of the products (goods) 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?

In the event that a commercial concession contract is entered into between a franchisee who is a resident of Russia and a franchisor who is a non-Russian resident, payments may be made without restrictions in foreign currency provided that the franchisee has a relevant currency account opened with an authorised bank in Russia, in accordance with the Federal Law dated 10.12.2003 No. 173-F "On Currency Regulation and Currency Control".

Furthermore, if a commercial concession contract is entered into, granting of the complex of exclusive rights thereunder must be properly registered with Rospatent. Such registration shall be required, in particular, for the franchisee's bank to effect the respective currency transfers.

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 standard rate of companies' income tax in Russia is currently 20%. If a Russian franchisee makes payments under a franchise agreement to a non-Russian franchisor which does not have any permanent subsidiary or branch/representative office in Russia, the Russian franchisee will act as its tax agent and will withhold and remit the relevant amounts of the tax to the budget (Article 310 of the Tax Code of the Russian Federation).

If payments due from the franchisee to the franchisor are structured as management services fees, it does not affect the obligations of the franchisee to withhold companies' income tax.

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

If both a franchisor and franchisee are Russian residents, financial settlements between them should be effected in Russian rubles. Financial settlements between a franchisee who is a resident of Russia and a franchisor who is a non-Russian resident may be made in a foreign currency.

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 Article 184 of the Civil Code, a commercial agent is deemed a person who constantly and independently represents and acts on behalf of businessmen in concluding agreements in the sphere of business activities. A commercial agency relationship generally arises under an agency contract or a commission contract, which is different from a contractual relationship arising under a commercial concession contract under Russian law. Therefore, the risk that a franchisee might be treated as the franchisor's commercial agent is insignificant.

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 Civil Code expressly provides that good faith is one of the basic principles of Russian civil law (Article 1) and obliges the parties to act in good faith and taking into account rights and legitimate interests of one another, by providing the necessary assistance for the purpose of attaining the aim of the obligation and providing to each other the necessary information (Article 307). These provisions apply in the full extent to franchise relationships.

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?

Once the franchise agreement has been entered into, it will be subject to the provisions of the Civil Code regulating use of copyright, rights to trademarks, service marks, trade names and other means of individualisation of goods, works and services, as well as know-how (commercial secrets), as well as the Competition Law, the Federal Law on Advertising, the Tax Code and, depending on the subject matter of the franchise agreement, it may be subject to the laws and regulatory acts in the specific domain, e.g. HoReCa, retail trade or medicines circulation.

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 special disclosure obligations in relation to the renewal of an existing franchise at the end of the franchise agreement term are

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established by Russian law. As mentioned above, there is the general obligation of the franchisor to provide to the franchisee the technical and the commercial documentation, and to supply other information necessary to the latter for exercising the rights granted to him under the contract of commercial concession, and also to instruct the franchisee and its employees on the issues involved in exercising these rights. Special disclosure obligations may be provided for in the franchise agreement if the parties agree so.

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?

Yes, Article 1035 of the Civil Code provides for the franchisee's priority right to enter into a commercial concession contract for a new term upon the expiry of the validity term of the contract, provided that the franchisee has discharged its obligations thereunder properly.

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?

Yes, if the franchisor has refused to enter into a commercial concession contract for a new term with the franchisee and within a year since the date of expiry of the validity term of the contract with the latter entered into a commercial concession contract with another person, granting the same rights as those granted to the franchisee under the terminated contract and under the same terms, the franchisee shall be entitled to file a claim with a court at its discretion either for the transfer to him of the rights and duties under the contract entered into with a third party and compensation of damages caused by the refusal to renew a commercial concession contract with him, or solely for compensation of 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?

If the franchise agreement does not provide for the franchisee's right to transfer or assign or otherwise dispose of the franchised business to a third party, such transfer or assignment shall be subject to a prior written consent of the franchisor. Transfer or assignment of the franchised business will necessitate the respective amendment of the commercial concession contract, which is subject to state registration with Rospatent (Article 1036 of the Civil Code).

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 "step-in" right at termination of a franchise agreement is not expressly recognised by Russian law. A franchise agreement (commercial concession contract) may, however, provide for the obligation of the franchisee to assign to the franchisor the ownership and management of the franchised business upon demand of the latter. In this case, the franchisor shall have to get the relevant amendments to the commercial concession contract registered with Rospatent.

If contracts of the commercial sub-concession have been entered into by the franchisee, unless otherwise is provided for by the commercial concession contract, concluded for a definite term or without limitation of a term, the rights and obligations of the franchisee under such contracts upon termination of the commercial concession contract shall pass to the franchisor unless the latter refuses to assume the respective rights and obligations (Article 1029 of the Civil Code).

16.3 If the franchise agreement contains a power of attorney in favour of the franchisor under which it may complete all the 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 country 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 power of attorney will not be recognised by the Russian courts. In order to enter into the powers of the former franchisee, the franchisor shall have to get the relevant amendments to the commercial concession contract registered with Rospatent.

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GRATA INTERNATIONAL

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South Africa

Smit & Van Wyk, Inc.

Esmari Jonker

1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

The Franchise Association of South Africa (FASA) refers to a "franchise" where one party grants to another party the right to operate a business or licence under specific conditions.

The Consumer Protection Act No. 68 of 2008 defines a "franchise agreement" as 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 trade marks, 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.

1.2 What laws regulate the offer and sale of franchises?

The contractual relationship between a franchisor and a franchisee is subject to the law of contract and regulated by means of the common law.

Since 1 April 2011, franchise agreements in South Africa are also subject to the statutory provisions of the Consumer Protection Act, which states that a franchise agreement must:

(a) be in writing and signed by or on behalf of the franchisee;

(b) include any prescribed information, or address any prescribed categories of information; and

(c) comply with the general requirement to be in plain and understandable language.

All franchise agreements are subject to a statutory cooling-off period in terms of which a franchisee may cancel a franchise agreement with written notice to the franchisor, without costs or penalty within 10 business days after signing of the agreement.

The Regulations of the Consumer Protection Act impose specific contractual and disclosure obligations on a franchisor.

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 the purposes of any franchise disclosure or registration laws?

Every transaction which will fall within the ambit of the statutory definition of a "franchise agreement" as specified in terms of the Consumer Protection Act (regardless of the number of franchisees or licensees), would be subject to the statutory franchise disclosure and contractual provisions.

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

No, franchise agreements are not registered in South Africa as there is no official franchise registry.

1.5 Are there mandatory pre-sale disclosure obligations?

Yes. The Consumer Protection Act states that:

(1) Every franchisor must provide a prospective franchisee with a disclosure document, dated and signed by an authorised officer of the franchisor, at least 14 days prior to the signing of a franchise agreement, which as a minimum must contain:

(a) the number of individual outlets franchised by the franchisor;

(b) the growth of the franchisor's turnover, net profit and the number of individual outlets, if any, franchised by the franchisor for the financial year prior to the date on which the prospective franchisee receives a copy of the disclosure document;

(c) a statement confirming that there have been no significant or material changes in the company's or franchisor's financial position since the date of the last accounting officer's, or auditor's certificate or certificate by a similar reviewer of the company or franchisor, that the company or franchisor has reasonable grounds to believe that it will be able to pay its debts as and when they fall due; and

(d) written projections in respect of levels of potential sales, income, gross or net profits or other financial projections for the franchised business or franchises of a similar nature with particulars of the assumptions upon which these representations are made.

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The disclosure document must also be accompanied by a certificate on an official letterhead from an accounting officer or the auditor, certifying that:

(a) the business of the franchisor is a going concern;

(b) to the best of his or her knowledge the franchisor is able to meet its current and contingent liabilities;

(c) the franchisor is capable of meeting all of its financial commitments in the ordinary course of business as they fall due; and

(d) the franchisor's audited annual financial statements for the most recently expired financial year have been drawn up:

(i) in accordance with South African generally accepted accounting standards;

(ii) except to the extent stated therein, on the basis of accounting policies consistent with prior years;

(iii) in accordance with the provisions of the South African Companies Act and all other applicable laws; and

(iv) fairly reflecting the financial position, affairs, operations and results of the franchisor as at that date and for the period to which they relate.

The disclosure document should also include: (a) a list and specific details of current franchisees and of outlets owned by the franchisor; and (b) an organogram depicting the support system in place for franchisees.

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

The Consumer Protection Act makes it clear that every franchisor should provide a prospective franchisee with a disclosure document (containing the minimum prescribed information), at least 14 days prior to the signing of a franchise agreement. The Consumer Protection Act also states that if a franchise agreement is related to a master franchise, the master franchisor's identity should be disclosed. The definition of a "franchise agreement" in terms of the Consumer Protection Act would include both a master franchise agreement as well as a sub-franchise agreement. In both instances, the party granting the rights to the other party would be required to provide a disclosure document.

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?

Refer to the answer to question 1.5 above. Good business practice would dictate regular updates and revisions of the disclosure document, especially in view of the fact that all information should be accurate when provided to a prospective franchisee. There are no specific requirements regarding continuing disclosure obligations.

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

Refer to the answer to question 1.2 above. The Consumer Protection Act Regulations also prescribes minimum information which should be incorporated in a franchise agreement, including:

- a description of the business system;
- types of goods or services which the franchisee is entitled to deal with;
- obligations of the franchisee and the franchisor;
- initial and ongoing training provided by the franchisor;
- conditions of use regarding the trade mark or intellectual property owned by the franchisor;
- description of premises or location and nature of franchisor's involvement;
- terms and conditions relating to payments, territorial rights, duration, termination, effect of termination, renewal, goodwill and assignment of the franchise;
- details of advertising or marketing funds, (if applicable) as well as additional required reference to financial statements and management accounts obligations of the franchisor;
- full particulars of the financial obligations of the franchisee and total investment required;
- details of the franchisor including the legal name, trading name, addresses, contact numbers, directors and shareholders as well as the master franchisor's identity (if applicable); and
- particulars of any restrictions imposed on the franchisee.

Franchise agreements should also include the following:

- the franchisor will provide to the franchisee a written explanation of any terms or sections not fully understood by the prospective franchisee;
- any deposits paid by the prospective franchisee will be deposited into a separate bank account together with a description of how these deposits will be dealt with; and
- the franchisor is not entitled to any undisclosed direct or indirect benefit or compensation from suppliers to its franchisees or the franchise system, unless the fact thereof is disclosed in writing with an explanation of how it will be applied.

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

The Franchise Association of South Africa is a voluntary organisation. Franchisors who are registered members of FASA undertake to comply with FASA's Code of Ethics and Business Practices which may add to the credibility of the franchisor and the franchise group. FASA promotes ethical franchising and registered members may receive value added services and other related benefits from FASA (www.fasa.co.za).

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

Registered members of FASA should comply with FASA's Code of Ethics and Business Practices. The Code provides guidelines and obligations regarding ethical business practices especially in as far as the franchisor-franchisee relationship is concerned.

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

The general business language in South Africa is English and there are no specific translation obligations to any of the other official languages.

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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 are generally no restrictions on foreign shareholding in South African companies or foreign franchise investments. Foreign entities are, however, advised to consider sector specific legislation and Black Economic Empowerment (BEE) policies, which may impose certain criteria regarding trading activities in specific market sectors.

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

Different entity options are available to conduct business within South Africa, including a sole proprietor, partnership, trust, a South African company or an external company. A South African company would usually be the preferred choice of entity to be used by a franchisor. The South African Companies Act No. 71 of 2008 distinguishes between two types of profit companies, namely a private company and a public company.

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?

Yes, if such entities are companies or trusts. Companies are registered with the Companies and Intellectual Properties Commission (CIPC) and trusts are registered with the Master of the High Court.

3 Competition Law

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

The Competition Act No. 89 of 1998 aims to prevent anti-competitive practices and refers to horizontal and vertical restrictive practices, both of which may apply to the franchise industry. Relevant matters in franchise agreements would typically be:

1. territorial restrictions, exclusive dealings and exclusive territories;
2. price fixing, minimum price maintenance and minimum discounts;
3. contractual obligations to source products and services only from a specific supplier; and
4. tying of products.

The above exclusionary acts by a franchisor may be regarded as anti-competitive, unless the franchisor is able to demonstrate that there is a technological, efficiency or pro-competitive gain which outweighs the anti-competitive effect.

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

Parties would be free to enter into a term of their choice. In terms of the Consumer Protection Act, the duration of a franchise agreement should be disclosed and agreed upon in the franchise 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?

Section 5(2) of the Competition Act prohibits the practice of minimum resale price maintenance. A franchisor may not limit or exclude a franchisee's ability to offer discounts or to sell at lower prices than what the franchisor may impose. A franchisor may, however, provide franchisees with recommended prices.

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

In terms of the Consumer Protection Act, any territorial rights which may be granted by a franchisor to a franchisee, should be specified in detail in the franchise agreement. Section 5(1) of the Competition Act may be infringed if there is an arrangement between a franchisor and franchisor regarding an exclusive territory, especially if the effect of such an arrangement would substantially prevent or lessen competition in the trade. A franchisor may, however, raise a defence based on efficiency, technology or other pro-competitive gains in the event where such elements would outweigh any anti-competitive effect as a result of the territorial restrictions.

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

Such terms would be enforceable provided that the restrictions have been agreed upon between the parties in the franchise agreement. In terms of South African case law, a party would only be entitled to enforce such restrictions if: i) they are reasonable in terms of the duration, area and restrictive actions; ii) they would not deprive the other party from earning a living; and iii) the party who is enforcing the restriction is able to show that it has a protectable interest and legitimate basis for enforcing the restriction.

4 Protecting the Brand and other Intellectual Property

4.1 How are trade marks protected?

Trade Marks are protected in South Africa by means of statute and common law. The South African Trade Marks Act No. 194 of 1993 provides for statutory trade mark protection in terms of which trade marks may be registered for an indefinite period, subject to the renewal thereof every 10 years. Common law trade marks (unregistered marks) are protected by means of the common law and remedies are available in terms of passing off and unlawful competition.

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 confidential information are protected in South Africa under the common law.

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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 regulated and protected under the Copyright Act No. 98 of 1978 which provides protection for: literary works; musical works; artistic works; cinematograph films; sound recordings; broadcasts; programme-carrying signals; published editions; and computer programs. The work that is to enjoy copyright protection must be reduced to a material form. In general, any original work created by a qualified person is eligible for copyright protection. A qualified person refers to any national or resident in South Africa or a Berne Convention country. South Africa is also a party to the Berne Convention and the TRIPS Agreement (Agreement on Trade-Related Aspects of Intellectual Property Rights). Franchisors are advised to identify and draw attention to all copyrighted materials which are provided to franchisees.

5 Liability

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

Regulation 2 of the Consumer Protection Act states that any provision in a franchise agreement which is in conflict with the said regulations would be void to the extent of such a conflict. The Franchisee would also be able to apply common law remedies in terms of the law of contract, which may include cancellation of the agreement and/or a claim for damages.

5.2 In the case of sub-franchising, how is liability for disclosure non-compliance or for misrepresentation in terms of data disclosed being incomplete, inaccurate or misleading 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?

Each party providing the disclosure information should ensure the accuracy thereof, as the party providing the information would be liable regarding the content thereof. A franchisor, as well as a master franchisee, may incur liability if inaccurate information is provided to a sub-franchisee. Regulation 3 of the Consumer Protection Act states that each page of the disclosure document must be qualified in respect of the assumptions contained therein.

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

A franchisor would not be able to avoid liability with disclaimers if representations were made negligently or fraudulently. In terms of common law, the franchisee may institute action against the franchisor based on negligent and/or fraudulent misrepresentations.

In terms of Section 48 of the Consumer Protection Act, no supplier (including a franchisor) may require a consumer (or a franchisee), or another person to whom any goods or services are supplied at the direction of the consumer: (i) to waive any rights; (ii) to assume any obligation; or (iii) to waive any liability of the supplier (including a franchisor), on terms that are unfair, unreasonable or unjust, or impose any such terms as a condition of entering into a transaction.

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

There are no specific franchise class action limitations. In terms of the Consumer Protection Act, it may constitute an unreasonable provision to request a party to waive any legal remedies or rights which it would have been entitled to.

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 to a franchise agreement in South Africa normally elect the local law as choice of governing law. There are, however, no specific restrictions on any other foreign governing law, provided that all transactions concluded between the parties in South Africa and business affairs conducted in South Africa would still be subject to compliance with local legislation and regulations.

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 rogue franchisee to prevent damage to the brand or misuse of business-critical confidential information?

A franchisor conducting business in South Africa may approach South African courts at first instance for interlocutory relief to prevent damage to the brand or misappropriation of confidential information. The enforcement of foreign court orders in South Africa is generally regulated by means of the common law. Foreign court orders may establish a cause of action which may be enforced by South African courts, provided that certain requirements are complied with, including the following:

- the foreign court should have had international competence;
- the enforcement of the judgment should not be contrary to public policy in South Africa;
- the judgment should not have been obtained fraudulently;
- the judgment should not involve the enforcement of a punitive or revenue law of the foreign jurisdiction;
- the judgment should not contravene the Protection of Businesses Act 99 of 1978; and
- the judgment should be final and conclusive (meaning that temporary injunctions from foreign courts would not be enforceable).

7 Real Estate

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

The leasing of commercial property may vary depending upon the specific agreement between the parties and nature of the commercial activities, but generally it ranges between three and 10 years.

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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 concepts are enforceable provided that the parties have made specific provision pertaining to such matters in the franchise agreement and/or 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?

Generally there no restrictions, provided that all local real estate requirements are being complied with.

7.4 Give a general overview of the commercial real estate market. Specifically, can a tenant reasonably 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 of a particular location)?

Prior to the commencement of commercial leases, a landlord would generally provide the tenant with a 'beneficial occupation' period to fit out the premises during which no rent would be payable. Generally, 'beneficial occupation' would be for a period of 30–60 days; however, depending upon the specific premises and type of business, the parties may agree on a longer or shorter period. Premium locations would normally be subject to higher 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?

Although there are no specific statutory limitations regarding the re-direction of products between franchisees within a franchise group, it should be noted that Section 5(1) of the Competition Act may be infringed if there is an arrangement between a franchisor and franchisor regarding exclusive territories, especially if the effect of such an arrangement would substantially prevent or lessen competition in the trade. A franchisor may, however, raise a defence based on efficiency, technology or other pro-competitive gains in the event where such elements would outweigh any anti-competitive effect as a result of the territorial restrictions and territorial re-directions.

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?

Generally, there are no limitations. Should a franchisor require that a former franchisee assign local domain names upon termination of the franchise agreement, it is recommended to regulate the obligation and process in detail in the franchise agreement.

9 Termination

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

Regulation 2 of the Consumer Protection Act states that a franchise agreement must contain provisions which prevent: (i) unreasonable or overvaluation of fees, prices or other direct or indirect consideration; (ii) conduct which is unnecessary or unreasonable in relation to the risks to be incurred by one party; and (iii) conduct that is not reasonably necessary for the protection of the legitimate business interests of the franchisor, franchisee or franchise system.

The above principles would also apply to termination rights regulated in a franchise 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?

In terms of South African employment legislation, a franchisee and its employees would not be regarded as employees of the franchisor (unless there are specific circumstances and other agreement(s) between the parties stating otherwise). It would be advisable to include specific references in a franchise agreement confirming the independent status of the franchisor and franchisee respectively, especially in as far as employment and employees are concerned.

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?

Refer to the answer to question 10.1 above. A franchisor's vicarious liability would be limited to its own employees (which may also be subject to any other liability regarding the franchisor's own wrongdoing or any other liability as a supplier in terms of the supplier accountability provisions of the Consumer Protection Act).

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?

All payments made to foreign entities, including foreign franchisors, would be subject to approval by the South African Reserve Bank, as well as any applicable exchange control regulations.

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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 would be payable in respect of royalty payments to be made to or for the benefit of a non-resident for the right to use intellectual property in South Africa. Generally, a withholding tax of 15% would apply, but this percentage may vary depending upon the different taxation agreements or tax treaties between South Africa and other countries. Alternative payment structures may be considered; however, the South African Revenue Services may at any time investigate payments to determine the actual purpose and intention regarding such payments and structures. No withholding tax on a royalty amount would be payable if the amount is effectively connected to a permanent establishment of the non-resident in South Africa.

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 not.

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?

Generally, it is accepted that the franchisor and franchisee are two separate and independent entities. It would be advisable to include a specific provision in the franchise agreement stating that the franchisee has not been appointed as the franchisor's agent and does not have the authority to act as the franchisor's agent at any given time.

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?

- In terms of the common law, any negligent or fraudulent dealings by a party may result in liability. The Consumer Protection Act incorporates fundamental rights based on fair and honest dealing, as well as fair and reasonable contract terms and conditions.
- Regulation 2 of the Consumer Protection Act also states that provisions in a franchise agreement should prevent:
  - unreasonable or overvaluation of fees, prices or other direct or indirect consideration;
  - conduct which is unnecessary or unreasonable in relation to the risks to be incurred by one party; and
  - conduct that is not reasonably necessary for the protection of the legitimate business interest of the franchisor, franchisee or the franchise system.

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 provisions of the Consumer Protection Act regarding general supply of goods and services between a franchisor and a franchisee would apply to the ongoing relationship between the parties. The relationship between the parties would furthermore be subject to the contractual relationship governed in terms of the law of contract based upon the provisions of the franchise agreement, as well as any other general commercial legislation applicable in the South African trade and market place.

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?

Refer to the answer to question 1.5 above. The Consumer Protection Act does not specifically refer to any disclosure obligations or disclosure requirements at the time of the renewal of 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?

There is no specific overriding right for automatic renewal or extension. The Consumer Protection Act states that the franchise agreement should contain provisions regarding extension or renewal terms, or whether there is an option to renew or extend the agreement or not. There are no statutory obligations regarding renewal rights other than that the renewal procedures should be included and addressed 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?

If the franchisor has reasonable grounds to refuse renewal, based upon the provisions of the franchise agreement, the franchisee would not be entitled to any compensation or 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 a requirement of the Consumer Protection Act that the conditions for transfer of rights and/or assignment of rights be addressed in a franchise agreement. A franchisee may be restricted to transfer its rights and obligations and ownership interest in the franchisee entity, provided that those aspects have been addressed and agreed upon in the franchise agreement.

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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 may be able to exercise a "step-in" right provided that such instances and actions have been specifically agreed upon in the franchise agreement and such requirements are not in contradiction with the general reasonable and equity requirements of the Consumer Protection Act. There are no specific registration requirements to exercise a franchisor's "step-in" right.

16.3 If the franchise agreement contains a power of attorney in favour of the franchisor under which it may complete all the 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 country 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 requirements to exercise a franchisor's "step-in" right. Such provisions would be enforceable provided that they are addressed and agreed upon in the franchise agreement and also, provided that they are not inconsistent with the reasonable and equity provisions of the Consumer Protection Act.

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Switzerland

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1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

There is no statutory definition of the terms 'franchising', 'franchise contract', 'master franchise', 'area development franchise agreement', 'local franchise agreement' or the like. Also, only very few Swiss court decisions deal with franchise systems. In business practice, suitable definitions can e.g. be found in the Ethics Code ('*Ehrenkodex*') of the *Swiss Franchise Association* ('**SFA**').

Under the SFA Code of Ethics, 'franchising' is defined as a 'sales and distributions system under which *goods and/or services and/or technologies are marketed whereby the franchisor grants a franchisee the right, and imposes the obligation, to conduct a business of a certain type or nature in accordance with the franchisor's specific concept, know-how and continuing support in exchange for a direct or indirect financial consideration. In addition, a franchisee is typically granted a licence (and contractually bound) to use the franchisor's intellectual property rights, such as business names, brands, logos, designs, get-up, etc. and the franchisor reserves its right to issue directives and to exercise a certain amount of control over the franchisee's business activities*.

1.2 What laws regulate the offer and sale of franchises?

In the absence of Swiss statutory provisions which would directly govern franchising contracts, general rules of Swiss law applicable to all sorts of businesses are pertinent. Apart from public law provisions which impose e.g. all sorts of insurance obligations, e.g. for a franchisee's employees, and, of course, taxation, the following provisions are of particular relevance:

- *The Swiss Code of Obligations* ('**CO**') and the related Federal Court decisions ('**FDC**') case law under which franchise agreements are characterised as a specific and unique kind of contract not yet standardised and, thus, judged on a case by case basis based on the specific circumstances of a particular case (FDC 118 II 157*ff.*). E.g. CO provisions made for lease agreements and/or partnership agreements could be relevant and for more subordination-like franchise agreements the rules for agency contracts may apply. In an extreme case, an economically weak and dependent franchisee who is strictly supervised and heavily contractually restricted by a single franchise agreement might even be re-characterised as an employee under the CO and, would, as such, then profit from all sorts of mandatory CO provisions which protect such employees.
- *The Swiss Civil Code* ('**CC**') under which there is a general legal obligation to act in good faith (Article 2 CC). This includes, for example, mandatory pre-contractual disclosure obligations of the franchisor (see below) and mandatory obligations of both contracting parties to treat each other fairly throughout their franchise relationship. 'Eternal agreements' are not possible thereunder (Article 27 CC).
- *Swiss Intellectual Property Laws*, in particular the *Trade Mark Act*, the *Designs Act* and the *Copyright Act* but also the *Swiss Penal Code* protecting business and trade secrets and the CO protecting businesses and trade names of commercial ventures in Switzerland.
- The *Swiss Unfair Competition Act*, see question 3.1 below.
- The *Swiss Act on Cartels and other Competition Restraints*, see question 3.1 below.

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 the purposes of any franchise disclosure or registration laws?

Legally, there is no difference between a franchisor appointing one franchisee and multiple franchisees.

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

There are no statutory authorisation or supervision rules governing franchise systems in Switzerland as such. However, various mandatory federal, cantonal and communal general provisions which regulate specific types of business activities and reserve them for people and bodies publicly authorised to exercise such powers must be observed by both the franchisor in its franchise business guidelines and by the franchisee in the exercise of their business, e.g. in banking and insurance, health care, job agencies, casinos, etc. Wherever such professional licences are required, the potential franchisee must obtain a licence before commencing the franchise activities.

1.5 Are there mandatory pre-sale disclosure obligations?

Under Article 2 CC there is a mandatory pre-contractual obligation of the franchisor to disclose all relevant economic and legal information to the franchisee in a true, fair and complete manner to the extent such information is material for the franchisee's decision to accept the franchise agreement. The franchisor must obtain and disclose all relevant information which a potential franchisee is not able to access itself. Further details can be found in the SFA Ethics Code.

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

Yes. If a franchisor appoints a master franchisee with the right to grant sub-franchises in the territory, then the master-franchisee has a mandatory good faith disclosure obligation to its sub-franchisees under Article 2 CC for whatever material information the master franchisee is aware of.

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?

In the absence of statutory legislation, the SFA Ethics Code has stated the following minimum information the franchisor must always provide to the franchisee in writing at least 20 days before the signing of a franchise agreement:

- the relevant market in relation to the franchise business;
- the products and services covered by the franchise business;
- the franchisor's organisation and business activities, particularly in regard to the franchise system;
- the franchise offer (franchise package);
- the potential franchisee obligations (especially an estimate of the necessary financial commitment);
- the franchise agreement and further agreements, guidelines and other terms relating to the franchising activity; and
- alternative distribution channels of the franchisor, if any, for contractual products or services.

This is not intended to be an exhaustive list. Rather, it is necessary to assess on a case-by-case basis, according to the specific circumstances of a case, which information the franchisor must disclose in addition to the above before concluding a franchise agreement. As a result of the general and mandatory legal obligation to act in good faith (Article 2 CC), further mutual and ongoing information obligations apply throughout the franchise term, if and when appropriate for either the franchisor or franchisee. The extent of all of these information obligations may be controversial in the context of a particular case, and therefore mutual information obligations should be contractually clarified in advance.

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

There are no other franchise-specific legal requirements that must be met before a franchise is offered or sold, e.g. it is not required that a franchisor incorporates a subsidiary or sets up a branch within Switzerland or is domiciled here for tax purposes. However, various other mandatory federal, cantonal and communal general provisions which regulate specific types of business activities (see above) must be observed.

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

Membership of the Swiss Franchise Association (SFA) is not mandatory but may be helpful to better prepare the franchisor and franchisee for entry into the Swiss market. This is particularly important as there exists not only a different legal framework here but also further country- or even region-specific features, such as diverse mentalities and consumer preferences. There are also four different languages which make Switzerland an ideal test market for international franchise operations. With its four national languages, Switzerland as a test market may even open the door to France, Germany, Austria and Italy as directly adjacent countries.

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

The SFA is a typical professional service association, i.e. it aims to help its members adhere to best practices in the industry. An SFA membership thus is an opportunity and not a burden.

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

No, there is no such requirement and also it is often not necessary from a business perspective as German, French and Italian are official languages in Switzerland and a good command of English on top is not unusual. However, it is highly advisable for franchisors to check well ahead of the franchise agreement conclusion as to what extent the franchisee understands the contractual terms in practice and – if there are doubts – to have them translated and such translation checked by a Swiss lawyer beforehand.

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, local and foreign investors are treated alike in Switzerland.

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

As mentioned above, a franchisor does not have to incorporate a subsidiary or set up a branch in Switzerland. If the franchisor does, either a company limited by shares (*Aktiengesellschaft* '**AG**' in short) is chosen or simply a branch of a suitable foreign franchisor entity as this may be advantageous for tax reasons under applicable foreign taxation legislation. Franchisees likewise choose either an AG, or sometimes, if funding is scarce, a limited liability company (*Gesellschaft mit beschränkter Haftung* '**GmbH**' in short) or even just an entry in the Commercial Registry as sole enterprise ('*Einzelfimra*').

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 principle, there is no requirement for foreign entities to be registered in Switzerland prior to doing business here.

3 Competition Law

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

There are two different sets of competition law rules also applicable

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to franchise systems in Switzerland:

- The *Swiss Unfair Competition Act*, which e.g. prohibits surprising and unusual contractual clauses which do not regularly exist in contracts of a certain type, to the extent they are not properly brought to the attention of the other contracting party and understood by it well ahead of its contractual agreement. Thereunder, all ambiguous terms and conditions are interpreted against the party which proposed them (which in a franchise system is usually the franchisor), and individually agreed contractual agreements preferable to general terms and conditions imposed by one party only.
- The *Swiss Act on Cartels and other Competition Restraints* ('**Cartel Act**') and the *Notification for the Competition Law Treatment of Vertical Agreements*, which e.g. sanctions all contractual price fixing (also by minimal or maximum price fixing) or even price alignment by conscious parallel behaviour, any prohibition of mere passive (i.e. non-solicited) sales, product tie-ins not justified on the grounds of economic efficiency or suppressing effective competition. In addition, a Swiss court, if it has e.g. jurisdiction under the franchise agreement, may also apply EU competition law rules applicable to franchises irrespective of a Swiss choice of law in the franchise agreement, if such EU competition law rules want to be applicable in Switzerland as a non-EU Member State and, in addition, Swiss law recognises the EU legislation at issue as justified (Article 18 Swiss Private International Law Act).

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

There is no specific limit for contract durations under Swiss law. In cases of a long amortisation of the investment of either party it is not unusual to have a contractual term of 10 years or – in exceptional circumstances – even longer and to foresee that the contract duration even continues beyond that if neither party terminates the contract with e.g. six months' prior notice (see also question 3.3).

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

The only legal barrier for contractual terms is Article 27 CC: thereunder, a very long contractual term may – based on all of the circumstances of a particular case – be characterised as over-restrictive. Again, all circumstances of the particular case are to be taken into account. For example, the Federal Supreme Court once held that a beer supply agreement was invalid to the extent it was longer than 20 years (FCD 114 II 159*ff.*) but in another case the Court upheld an agreement of a beer supplier even though the agreement term was 30 years.

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

Article 5 of the Swiss Cartel Act prohibits contractually binding minimum prices. In any event, prices in Switzerland are traditionally high and therefore franchisees are not able to cover their costs if they are selling too cheaply.

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

There is no statutory legislation or court practice requiring a franchisee to be given a specified contractual territory. However, it is perfectly legal for a franchisor to contractually allocate a specific territory on an exclusive or non-exclusive basis to a franchisee. Thereby, also intra-brand competition between franchisees in adjacent territories may be intensified as passive sales by other franchisees may not be prohibited under the Cartel Act.

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

During the franchise agreement term, a contractual non-compete obligation of the franchisee is valid and enforceable. A post-contractual non-compete clause must be agreed upon and is only valid to the extent it is not too restrictive for the franchisee, e.g. under the *Notification for the Competition Law Treatment of Vertical Agreements* it is often not possible to have more than one year upon termination. It is also only valid if the franchisee indeed profited from valuable business know-how or business contacts of the franchisor (Article 340 CO by analogy), if the clause is adequately limited in time, scope and territory in all circumstances of the particular case (Article 340a (1) CO) and, on top, often only if adequate compensation is paid.

4 Protecting the Brand and other Intellectual Property

4.1 How are trade marks protected?

Under the Swiss Trade Mark Act, any graphically representable sign can be protected, if registered, including words, letter combinations, number combinations, images, three dimensional shapes, slogans and series of tones or colours. Unlike in many other countries, usually only registered trademarks receive protection in Switzerland, i.e. whoever only uses a trademark in commerce here without also registering it, risks losing its rights to the owner of the same trademark that is registered later. Foreign trademarks which are well known in Switzerland could, in theory, receive the same level of protection without registration. However, the burden of proof for the well-known character of a foreign trademark lies on its owner alone. With a view to avoid any uncertainty, we thus strongly advise franchisors to always effectuate trademark registrations in Switzerland prior to starting their franchising here. Irrespective of a registration, the protection of a trade mark can be cancelled if it has not been used for a period of five years. In all other cases, trade marks can be renewed by simply paying the related renewal fee due at each 10 year anniversary of registration or renewal.

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

All relevant business information which is not obvious, generally known or easily accessible is protected under Swiss civil, criminal, administrative and procedural law provisions. For franchisors it is important to understand that there is no formal process to seek protection for trade secrets, i.e. franchise businesses are well advised to take additional organisational and contractual measures to protect their business secrets through suitable means such as e.g. the restriction of access on a need-to-know rule basis as well as the entering into strict confidentiality and non-disclosure agreements with their franchisees.

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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 ('**CA**') protects e.g. works of literature, music, pictures, titles, characters, works of applied art, letters, diaries, photographs and audiovisual works as well as computer programs only as a result of their "unique character". Franchise operation manuals and proprietory software may thus profit from such copyright protection as well. In the absence of a copyright assignment, only the natural person who created a copyright protected work is regarded as the author who profits from copyright protection. Software is directly owned by the employer, i.e. not the employee creating it (Art. 17 CA). The employer is often a legal entity.

5 Liability

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

If the franchisor fails to disclose to the franchisee material information which is relevant and may affect the franchisee's decision as to whether to enter into or to continue the franchise agreement, the franchisee may terminate the agreement and demand damages if it can prove that it would not have concluded or continued the franchise otherwise. Alternatively, the franchisee can uphold the franchise agreement but require its terms and conditions to be renegotiated.

5.2 In the case of sub-franchising, how is liability for disclosure non-compliance or for misrepresentation in terms of data disclosed being incomplete, inaccurate or misleading 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 is responsible for providing the master franchisee with all of the necessary knowledge, and in particular the necessary know-how. If the master franchisee becomes contractually liable to a sub-franchisee for an infringement of this pre-sale information disclosure obligation, then the master franchisee can seek indemnification from the main franchisor, if such main franchisor did not comply with its related pre-contractual information obligations to the master franchisee beforehand and the master franchisee could not pass such information on to the sub-franchisees as a result.

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

No, the liability of the franchisor for gross negligence or unlawful intent regarding the infringement of its pre-contractual information obligations cannot be validly excluded.

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

Class actions are alien to Swiss law. In Swiss legal proceedings each franchisee must act independently and its claims against the franchisor will be examined individually based on all relevant circumstances of the particular case. At best, a franchisee might rely on parallel judgments covering similar issues in similar circumstances.

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?

Franchise systems in Switzerland may have a foreign law applicable to the franchise agreement. A contractual choice of law is in general valid, as long as it has not been imposed in bad faith. However, to the extent e.g. the lease of premises is involved, the lease and the real estate located in Switzerland will mandatorily be governed by Swiss law irrespective of the law applicable to the contract. In addition, the Swiss legal environment is a favourable one for franchising agreements as Swiss law contains far fewer restrictions than many other legal systems. In international business relationships, Swiss law is also regarded as well balanced and 'neutral' in the sense of serving the interests of both contracting parties on the basis of all relevant circumstances of the particular case.

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 rogue franchisee to prevent damage to the brand or misuse of business-critical confidential information?

Injunctions are available and will be enforced if made by the competent court under the franchise agreement. However, they are only interim measures, i.e. they must subsequently be confirmed in ordinary proceedings. Such interlocutory orders can also stop damaging actions of a franchisee, however they cannot remedy the inaction of a franchisee, as specific performance acts can only be enforced in ordinary proceedings.

7 Real Estate

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

There is no typical duration for a commercial property lease or lease agreements. Instead, important commercial leases for franchises are often heavily negotiated, also to ensure that they properly reflect the franchise agreement's relevant 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?

A right of the franchisor to step into the franchisee's/tenant's shoes

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under the lease, or to direct a third party (often a replacement franchisee) which may do so upon the failure of the original franchisee/tenant is, in principle, only enforceable against the lessor with its advance consent to such step-in or replacement or the termination of the franchise agreement). However, even in the complete absence of an advance consent by the real estate owner/lessor to accept the franchisor or its assignor as new tenant in the lease contract of the franchisee, the lessor would only be legally entitled to refuse further assigns of the franchisor/assignor as such new tenants, if the lessor had "important reasons" to do so in the sense of Article 263 CO.

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

Commercial real estate is currently not subject to any such restrictions.

7.4 Give a general overview of the commercial real estate market. Specifically, can a tenant reasonably 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 of a particular location)?

Terms and conditions for commercial lease agreements vary depending on the attractiveness of the relevant location. However, in general, commercial lease prices are higher than abroad as real estate prices in Switzerland have risen sharply. "Key money" is often necessary and initial rent free periods 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?

No, online distribution upon receipt of a non-solicited order is regarded as a passive sale which is mandatorily allowed under the Swiss Cartel Act.

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. To the extent the franchisor profits from trademark protection for the domain at issue, there is also a fast and efficient domain name dispute resolution procedure outside the ordinary courts for '.ch' domains with the World Intellectual Property Organisation in Geneva.

9 Termination

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

Pursuant to the leading case FDC 118 II 157*ff*, a franchisee's claims for compensation may be admissible in the case of an improper or abusive extraordinary termination by a franchisor, e.g. shortly after the franchisee has made a considerable investment. Long term agreements like franchises may only be extraordinarily terminated if there is a good cause ('*Wichtiger Grund*'), if and to the extent their continuation becomes intolerable for the termination party. Any lists of good causes in the franchise agreement serve only as an indication as to what the contracting parties deem intolerable, i.e., such list is not exhaustive in the eyes of the court.

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 are cases where franchisees may be recharacterised as employees (see above) and will then benefit from the mandatory provisions of the CO. Under the applicable Swiss social security legislation, franchisees may also be classified as pseudo-self-employed whereupon social security contributions will become due by both the franchisee and the franchisor in analogy to normal employment relationships. To mitigate these risks it is important that a franchisor does not instruct, monitor or correct franchisees too closely in their daily business, i.e. it is important to grant them a certain freedom to pursue the business as they deem fit.

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?

Under Swiss law, a franchisor may become directly liable under the Cartel Act for acts or omissions of its franchisees, if such acts or omissions are foreseen as contractual obligations in the franchise agreement despite being contrary to the Cartel Act (e.g. if passive sales were prohibited or prices fixed, see 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, Switzerland is one of the few countries which does not impose any withholding taxes on royalties. However, foreign franchisors which incorporate a subsidiary in Switzerland should be aware of the 35% withholding tax, especially with regard to distributed dividends. However, through an extensive network of double taxation treaties, this tax burden can be partly or wholly reduced.

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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?

Under Swiss law, the franchisee is not normally treated as an agent. However, under special circumstances, franchisees can be re-characterised as agents if the franchisee is integrated into the franchisor's sales organisation and is required to transfer its customers to the franchisor at the end of the franchise agreement. In such cases, a franchisor may be held liable to pay compensation for the income losses of the franchisee as a result of the franchise termination (by analogy to Article 418u CO). This risk can be restricted by excluding any obligation of the franchisee to disclose any customers to 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?

As mentioned above, there is a general legal obligation to act in good faith (Article 2 CC). As a result, there are mandatory pre-contractual disclosure obligations of the franchisor as well as mandatory obligations of both contracting parties to treat each other fairly throughout their franchise 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?

In the absence of Swiss statutory provisions which would directly govern franchising contracts, general rules of Swiss law applicable to all sorts of businesses are also relevant for the ongoing business relationships (see question 1.2 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?

As a result of the general and mandatory legal obligation to act in good faith (Article 2 CC), mutual information obligations also apply upon renewal as well as during the term of the agreement whenever specific relevant circumstances newly arise.

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?

Under the freedom of contract of Swiss law, franchisees are not automatically entitled to a renewal or extension of the franchise when the franchise expires. Under certain circumstances, a franchisor which has a particular dominant position may be obliged to renew a franchise agreement with a franchisee under the Cartel 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?

Pursuant to the leading case FDC 118 II 157*ff*., a franchisee's claims for compensation may be admissible in the case of an improper or abusive termination by a franchisor. Likewise, compensation may be due if a franchisee is contractually bound to disclose its clients to the franchisor upon termination (Article 418u CO by analogy).

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?

A transfer of the franchise agreement by the old franchisee to a new franchisee requires the approval of the franchisor, i.e. a franchisee cannot simply get rid of its contractual obligations by selling the franchise business to a third party.

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?

If the franchise requires the franchisee to acquire real estate or to directly enter into a lease agreement, the franchisor's right to take it over upon termination of the franchise agreement must be secured. Contracts confirming the right to purchase real estate require a notarised deed to be valid. The purchase right or option may also be registered in the land registry to make it enforceable against third parties. If the franchisee is only the lessee of the business premises, the approval of the lessor is required for a franchisor to enter into the lease (see above) as a result of which the franchisor is recommended to address this issue with the lessor before the conclusion of the franchise agreement.

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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 country 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?

Powers of attorney are not common in Switzerland in this respect as they may, in extreme cases, be validly withdrawn with immediate effect and in addition require public notarisation in all cases involving the transfer of real estate. It is highly recommended for both franchise parties to contractually agree in advance on such pre-emption or step-in rights in the franchise contract.

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Turkey

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Haşmet Ozan Güner

1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

There is no definition of franchise under Turkish laws. The Turkish 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. Particularly the below laws, among others, 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; and
- 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 the 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 franchisee in this regard.

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

No, there aren't any registration requirements in relation to the franchise system.

1.5 Are there mandatory pre-sale disclosure obligations?

No, there are not any 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 Are there any other requirements that must be met before a franchise may be offered or sold?

No, there are not any other requirements.

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

There is no mandatory membership of any franchise association. Franchisors and franchisees may voluntarily choose to join general franchise or industry-specific associations.

1.10 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 in accordance with its by-laws.

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

This is not applicable in Turkey.

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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. These, however, generally 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 (Tr. *Anonim Şirket*) and limited companies (Tr. *Limited Şirket*) are the most typically used company types in Turkey. Choosing the appropriate entity type requires a detailed legal analysis.

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. Turkish Competition Authority is the general regulatory authority with regard to competition law, and the Competition Board is its management body. Turkish Competition Board's Block Exemption Communiqué on the Vertical Agreements provides a block exemption for vertical agreements fulfilling certain conditions. Furthermore, Guidelines on Vertical Agreements provide details on the Competition Authority's 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 40%).

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 covenants, 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 the Industrial Property Law. This law confers territorial protection for marks which are registered in Turkey. Although infringement of an unregistered mark is actionable under Turkish Commercial Code's unfair competition law rules, 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 Turkish Commercial Code's unfair competition law

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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.

From a criminal law perspective, first, acts of unfair competition that are listed under the Turkish Commercial Code are subject to an 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 an 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?

The copyright is protected under Law No. 5846 on Intellectual and Artistic Works. In order to have protection under the 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 (Article 243 and 244) titled Cyber Crimes.

5 Liability

5.1 What are the remedies that can be enforced against a franchisor for failure 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 misrepresentation in terms of data disclosed being incomplete, inaccurate or misleading 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 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 disclaimer clauses 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.

Note that limitation of liability clauses are invalid also for slight faults if the relevant party's services or operations require expertise and conducted under a governmental permit.

5.4 Does the law permit class actions to be brought by a number of allegedly aggrieved claimants 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 rogue 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 recognition and enforcement of foreign court rulings or arbitral awards (as the case may be). Reciprocity may be established by an international treaty, by law or by practice. Note that, with regard to arbitral awards, Turkey is a party to the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, which provides reciprocity with all contracting parties.

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 shopping mall management companies generally prefer to execute lease agreements for shops for five years.

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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, solely 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 own real estate in Turkey only within the scope of specific laws. These specific laws are 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 located in a prohibited military zone, military security zone or special security zone.

Leasing or sub-leasing a 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 types of commercial activity).

7.4 Give a general overview of the commercial real estate market. Specifically, can a tenant reasonably 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 of a particular 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 months' rental.

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. 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 that 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; 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 a mandatory Turkish law rule, parties are recommended to observe it in order to avoid any discussion on the validity of the 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?

Under Turkish law, the franchisor is not deemed a sub-employer or joint-employer in respect to the franchisee's employees. In order to mitigate the risk, it is recommended to include provisions in the franchise agreement setting out the parties' relations with and obligations *vis-à-vis* the 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?

In a typical franchisor-franchisee relationship, the franchisor would not be considered as a sub-employer or joint-employer in respect to the franchisee's employees. As a result, a franchisor may not be held vicariously liable for the acts or omissions of 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 *vis-à-vis* the franchisee's employees.

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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.

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 at a rate of 15% unless reduced by a relevant double-tax avoidance treaty.

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?

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. However, certain Turkish law provisions on commercial agencies apply to franchise agreements too. Among these, the goodwill compensation rules are the most significant ones.

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 end of the agreement, 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 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 trademarks.

In Turkish law and court precedent, there is no clarity on whether the goodwill compensation rules are overriding mandatory law rules or not. The High Court of Appeals, however, decided in one case that it is not competent over the goodwill compensation dispute due to contractual choice of foreign courts. We believe that this high court decision provides grounds to defend that goodwill compensation rules are not overriding mandatory law rules.

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 dominant position, it is under a no-discrimination obligation.

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.

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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 third parties' consents, such as lease agreements.

16.3 If the franchise agreement contains a power of attorney in favour of the franchisor under which it may complete all the 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 country 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.

Note

The above is a general overview of Turkish laws applicable to franchising and should not be considered as legal advice. The responses are given in accordance with the current laws applicable in Turkey in July 2017, which may change from time to time.

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GUNER | legal is a young and dynamic law firm based in İstanbul. The firm has a team of eight lawyers and a good network of of-counsels. The founder Haşmet Ozan Güner brings in a decade's experience, including many years with one of the largest global law firms.

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Ukraine

Gorodissky & Partners (Ukraine)

Nina Moshynska

1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

Ukrainian law uses the term "commercial concession", instead of "franchise". The Civil Code of Ukraine provides for the definition of "commercial concession agreement" as an agreement according to which the franchisor grants the right of use of the complex of rights upon payment, subject to the conditions of the agreement, with the purpose of the manufacturing and/or sales of goods or the rendering of services.

The subject of a commercial concession agreement is the right to use the objects of intellectual property rights such as trade marks, industrial designs, inventions, copyrighted works, commercial secrets, and the rights to use a franchisor's commercial experience and business reputation.

1.2 What laws regulate the offer and sale of franchises?

The offer and sale of franchises are regulated by the Civil Code of Ukraine and the Commercial Code of Ukraine.

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 the purposes of any franchise disclosure or registration laws?

The Commercial Code of Ukraine defines the person appointed by the rights owner as the "user". According to the Code, the user shall, *inter alia*, keep the "know-how" and other information received from the rights owner confidential. As for the registration of commercial concession agreements, since 2015 the registration requirement for such agreements is no longer effective.

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

Commercial concession agreements should be performed in written form.

According to the Civil Code of Ukraine, commercial concession agreements are not subject to state registration.

The laws of Ukraine do not provide for any additional registration requirements for commercial concession agreements with regard to any specific sectors.

1.5 Are there mandatory pre-sale disclosure obligations?

There are no mandatory pre-sale disclosure obligations provided by the laws of Ukraine.

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

There are no pre-sale disclosure obligations that apply to sales to sub-franchisees.

There are no requirements as to making the necessary disclosures according to the laws of Ukraine and according to trade practice.

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 format of disclosures is not prescribed by the law or other regulations. Accordingly, no obligations are prescribed as to the continuing disclosure to existing franchisees.

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

The laws and other regulations of Ukraine do not provide for specific requirements of the franchise before it is offered or sold.

At the same time, the subject of a commercial concession agreement cannot be rights connected to the use of intellectual property objects that do not enjoy protection in Ukraine.

In order to be the subject of a commercial concession agreement, objects of intellectual property such as trade marks, industrial designs, inventions, utility models and plant varieties should first obtain legal protection in Ukraine.

If the term of validity of intellectual property rights to certain objects subject to a commercial concession agreement lapses during the validity term of the agreement, the agreement is considered terminated with regard to the use of the respective object of intellectual property rights.

Furthermore, in case the term of validity of intellectual property rights to a trade mark lapses during the validity term of the agreement, the agreement should be terminated in full unless the franchisor proposes that the other trade mark be added to the commercial concession agreement and respective amendments are made to it.

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

The membership of any franchise association is not mandatory in Ukraine. In certain cases, such a membership can bring advantages to the franchisors, including assistance in preparing legal and other documents and searching for potential franchisees.

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

The membership of a franchise association may impose certain obligations on the franchisors if such obligations have been agreed between the association and the franchisor, e.g. payment of membership or other fees, etc.

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

According to Ukrainian law, the official language of Ukraine is Ukrainian. It is the main working language for all the state authorities, state bodies and self-governing public authorities.

According to the Law of Ukraine on the Fundamentals of the State Language Policy, contracts between Ukrainian residents and non-residents should be concluded in Ukrainian and the language of the other party to the contract.

In certain cases, it can be acceptable to conclude the bilingual contract in a language other than the official language, if the party to the contract, being a resident of Ukraine, is located in a region where the other language is recognised as the regional language and is the mother tongue for the larger part of the population of a national minority. For instance, concluding contracts in Russian instead of Ukrainian can be 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?

Among the main laws that provide for the procedure of investments by non-nationals, as well as their business operations in Ukraine, are the Law of Ukraine on Investment Activities, the Law of Ukraine on International Business Activity, and other laws and regulatory acts related to various areas of economics and business.

Regarding the restrictions in respect of the ownership or control of a business, the Law of Ukraine on Investment Activities prescribes that limitations on the investment of non-residents of Ukraine may apply to certain territories of Ukraine specified in other laws and/or regulatory acts, for the purposes of national security.

Additional limitations apply in specific areas including building and construction activities, ownership of real estate, land and others.

Except for specific restrictions, the laws of Ukraine provide for equality between nationals and non-nationals as to the registration of business entities and business activities in Ukraine.

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

The form of business entity that is typically used in Ukraine by franchisors is the representative office of the non-national legal entity or the Ukrainian legal entity, mainly in the form of a Limited Liability Company.

The Limited Liability Company remains the most attractive form of business entity among national and non-national franchisors. It offers the following incentives:

- a simple procedure for its incorporation (including the possibility for registration with 100% of its shares belonging to the foreign legal entity);
- a choice of favourable taxation regimes;
- the possibility of receiving incomes and making payments abroad; and
- no personal liability for shareholders for the business activities and obligations of the company.

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 be able to trade, the business should first be registered in Ukraine as a legal entity (or a representative office of the non-national legal entity) or as a private individual entrepreneur.

According to the laws of Ukraine, only a registered legal entity or an individual registered as a private entrepreneur can be parties to the franchising agreement.

Depending on the chosen type of business (i.e. retail sales or wholesales of goods, manufacturing, or rendering of services), additional formalities, such as obtaining the licence or trade patent, or obtaining other permits from the state authorities, may apply.

Additionally, the formalities as to the goods imported or manufactured in Ukraine (on conformity, quality and other standards) may apply.

Carrying out business activities without fulfilling the formalities established by local laws may incur administrative, criminal or civil liability.

3 Competition Law

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

Ukrainian competition laws do not make express reference to franchising agreements or the offer and sale of franchises in Ukraine.

The competition laws, such as the Law of Ukraine on the Protection against Unfair Competition, the Law of Ukraine on the Protection of Economic Competition, and relevant provisions of the Law of Ukraine on International Business Activity, apply with regard to franchise agreements in the same way as to any other commercial contracts.

Among others, the following acts should be considered as acts of unfair competition:

A. Anticompetitive concerted actions (subject to a number of exceptions):
   - Fixation of prices or other terms for buying or selling of goods.
   - Limitation or control of production, markets, technical or technological developments or investments.

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- Sharing of the markets or sources of supply by territory, range of goods, and volume of turnover, by the circle of salespeople, customers or consumers or in any other way.
- Distortion of the results of tenders, auctions, competitions or tenders.
- Removal from the market or restriction of access to the market (or restriction of exit) for other trading parties, consumers or suppliers.
- Applying dissimilar conditions to equivalent transactions with other trading parties, placing them at a competitive disadvantage.
- Concluding contracts subject to acceptance by other parties of supplementary obligations that have no connection to the contracts' subject by their nature or according to commercial usage.
- Substantial limitation of competitiveness of other trading parties in the market without objectively justified reasons.
- Undertaking or nonfeasance of similar actions on the commodity market when such leads to or may result in non-admission, removal or limitation of competition in case the analysis of the market confirms the lack of grounds for the undertaking or nonfeasance of such actions.

Carrying out the previously mentioned actions is unlawful and constitutes liability according to the laws of Ukraine.

The previously mentioned actions should not be considered unlawful in the case of:

- concerted actions of small or medium-sized trading parties when they do not result in substantive limitation of competition and help to increase competitiveness between the small or medium-sized business;
- certain concerted actions related to the supply or the use of the supplied goods; and
- agreements on the assignment of rights or grant of rights to the use of intellectual property objects, when such agreements provide for certain limitations of economic activities of the party that obtained the respective rights, if such limitations do not unreasonably prejudice the legitimate rights of such a party. For example, such limitations may include a limitation as to the scope of the assigned/granted rights, the territory of the use of such rights, and also to the type of activity, sphere of use, minimum production volume, etc.

The concerted actions considered as unlawful can be allowed in certain cases, subject to approval by the bodies of the Antimonopoly Committee of Ukraine in case they are proved to:

- facilitate an advancement of the manufacture, acquisition or sale of the goods;
- enhance technical/technological or economic development;
- help the growth of small and medium-sized businesses;
- stimulate the optimisation of the export/import of the goods; or
- facilitate the efficiency, productivity, development and application of unified technical requirements and standards for the goods.

B. Actions related to abuse of a dominant position in the market (where the abusing dominant position constitutes actions or inactivity of the trading party occupying over 35% of the market, with no competition in the market, if this results or can result in the non-admission, removal or limitation of competition or the restriction of the economic interests of other trading parties or consumers):

- fixing the prices or other terms of acquisition or sales of goods, that would be impossible at the rate of considerable competition at the market;
- applying dissimilar conditions or different prices to equivalent transactions with other trading parties, buyers or sellers, without objectively justified reasons;
- stipulation in agreements of additional obligations which, in nature or according to trade practice, do not relate to the subject of the agreement;
- making limitations on production, markets or technical development, that result or can result in damage to other trading parties, consumers or salespeople;
- partial or complete abandonment of purchasing or sales of the goods in default of alternative sources for purchasing or sales;
- substantial limitation of competitiveness of other trading parties in the market without objectively justified reasons; and
- making obstacles for salespeople, consumers or other trading parties to access the market or removal of such persons from the market.

Actions related to abusing a dominant position in the market are unlawful and constitute liability according to the laws of Ukraine.

C. Anticompetitive actions related to foreign economic activity include:

- the dumping of goods – subject to the antidumping policy;
- the subsidised import of goods – subject to the compensation policy; and
- the creation of an import surplus when such affects or threatens the interests of national manufacturers.

D. Other actions considered as unfair competition according to national laws.

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

There are no statutory limitations as to the maximum permitted term of a franchise agreement.

Under Ukrainian law, the franchise agreement can be concluded for an undefined term and stay valid until the parties agree on its termination.

However, the validity term of the agreement cannot extend the term of legal protection of intellectual property objects that are subject to the franchise agreement.

For instance, if the term of validity of intellectual property rights to certain objects subject to the franchise agreement lapses during the validity term of the agreement, the agreement is considered terminated with regard to the use of the respective object of intellectual property rights.

Furthermore, in the case that the term of validity of intellectual property rights to a trade mark lapses during the validity term of the agreement, the agreement should be terminated in full unless the franchisor proposes that the other trade mark be added to the franchise agreement and respective amendments are made to it.

Additionally, Ukrainian law prescribes for the priority right of the franchisee for the conclusion of the franchise agreement for the new term, on conditions no worse than those provided by the previous agreement.

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

Ukrainian law does not prescribe any maximum permitted term for related product supply agreements.

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

According to the Civil Code of Ukraine, any provisions of the franchise agreement that impose restrictions or prescribe a minimum or maximum price for the sale of goods or provision of services for the franchisee are void. Thus, the franchisor does not have the right to impose minimum resale prices.

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

The laws of Ukraine do not provide for any minimum obligations on the franchisor when offering a franchise in adjoining territories.

The Civil Code of Ukraine and the Commercial Code of Ukraine prescribe that the parties can include the following terms in their franchise agreement:

- the obligation of the franchisor to refrain from granting to other persons the rights to use a similar set of intellectual property rights on the same territory as that prescribed in the franchise agreement;
- the obligation of the franchisee not to compete with the franchisor on the territory specified in the franchise agreement; and
- the obligation of the franchisee to refrain from concluding similar agreements with the franchisor's competitors or potential competitors.

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

The practice of applying restrictive covenants in relationships between the franchisor and the franchisee is becoming more common in Ukraine. The covenants are normally included as restraint clauses in the text of a franchising agreement, or are signed in the form of written undertakings of non-solicitation, confidentiality, non-competition, etc.

The scope and applicability of the restrictive covenants is first of all determined by the Ukrainian legislation in the area of intellectual property and, particularly, provisions related to franchising.

For instance, the Civil Code of Ukraine provides, among the other obligations of the franchisee, the non-disclosure obligation with regard to all confidential information obtained from the franchisor during the term of the franchising agreement.

Additionally, the Civil Code of Ukraine provides the right of the parties to the franchising agreement to include in their contractual documents the following conditions:

- an obligation on the franchisee to refrain from competition with the franchisor on the territory for which the franchising agreement applies; and
- an obligation on the franchisee to refrain from cooperation (obtaining the rights, etc.) with competitors (or potential competitors) of the franchisor.

However, any conditions that restrict the franchisee as to the price of the goods/services and include obligations on the franchisee to sell goods/render services only to consumers that are located within a specified territory, or only to certain categories of consumers, should be considered as void.

The court practice related to enforceability of the restrictive covenants is not well developed. At the same time, enforceability of the covenants first depends on whether such rights or obligations of the parties are provided or prohibited by law.

The procedural laws of Ukraine do not provide for the possibility for the courts to grant preliminary injunctions aimed at preventing the breach of such covenants.

4 Protecting the Brand and other Intellectual Property

4.1 How are trade marks protected?

A person interested in obtaining protection for a trade mark has to file an application with the relevant state authority of Ukraine responsible for maintaining the Ukrainian Trade Mark Register. The application can be filed by a physical person or a legal entity. Foreign persons interested in obtaining Ukrainian registration of a trade mark should be represented before the relevant state authority of Ukraine by a Ukrainian trade mark attorney.

International registration of a trade mark effective in Ukraine provides the same scope of protection as Ukrainian national registration.

A trade mark registration is valid for 10 years. This period is counted from the date of the filing of the application. A trade mark registration is renewed by filing a request for renewal and paying the official fee.

Ukrainian law only provides protection for trade marks that have been registered. The only remedy applicable for an unregistered brand is to file a complaint before the Antimonopoly Committee of Ukraine claiming for unfair competition (in case the infringer started to use the trade mark later than the complainant did).

The absence of a trade mark registration may result in negative consequences in the future, such as unfair actions taken by the third parties, e.g. registration of the other's brand aiming to forbid its use or to sell the trade mark rights. Furthermore, in that case the brand owner has no legal grounds to enforce his business or product name.

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

Ukrainian law provides protection for commercial (trade) secrets, know-how and confidential information. The law provides that the measures for protection of commercial (trade) secrets and of confidential information shall be established by the owner of the secret or information. Thus, protection is granted only in case corresponding measures are established and enforced.

According to Ukrainian law, know-how is a set of unpatented technical, technological, commercial and other knowledge, practical skills and production experience necessary for the organisation of a particular type of production. Special legislation on the protection of know-how has not been adopted yet.

A commercial secret is a piece of information which is treated as secret in case it is, in whole or in part and in the aggregate of its components, unknown and not easily accessed by persons who usually deal with the type of information it belongs to and which, due to this, has a commercial value and has been subject to measures adequate to the existing circumstances to preserve its secrecy, undertaken by the person who legally controls this information. Information of a technical, organisational, commercial, industrial or other nature can be a commercial secret, except for information which cannot be attributed to a commercial secret pursuant to the law.

The affected person may protect its infringed rights via an administrative, criminal or civil procedure.

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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 subsists in original works of authorship fixed in some material form from their creation, without a requirement for registration. Copyright protection covers both published and unpublished works. Copyright can also subsist, *inter alia*, in proprietary software, databases, and compilations of works resulting from creative work.

Copyright provides an owner with the right to use a work, to provide permissions (licences) for the use of a work and to prevent and forbid the unauthorised use of a work. According to the franchise agreement, the franchisee receives the scope of rights which are specified in the agreement. Any actions taken by the franchisee regarding the use of software, or any other protected work in ways that are not mentioned in the franchise agreement, constitute infringement of the franchisor's copyrights.

In order to prevent possible infringement, it is recommendable to include clauses about the franchisee's responsibility for the copyright infringement in the agreement. In case of infringement, the franchisor may protect its infringed rights via an administrative, criminal or civil procedure.

5 Liability

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

According to Ukrainian law, the franchisor is obligated to provide the franchisee with the following information:

- technical and commercial documentation related to the subject of the franchise agreement;
- other information, which is necessary for the execution of rights granted to the franchisee according to the franchise agreement; and
- information for the franchisee and its employees on practical issues related to the execution of rights granted according to the franchise agreement.

Unless otherwise is prescribed by the franchise agreement, the franchisor is also obligated to provide regular technical assistance and consultations, including assistance in staff training and staff qualification procedures.

The laws of Ukraine do not provide for mandatory disclosure obligations on the franchisor.

Thus, the franchisor is not entitled to rescind the franchise agreement and/or claim damages in case of failure to comply with mandatory disclosure obligations.

The franchisee is entitled to rescind the franchise agreement in case of non-performance of contractual obligations by the franchisor in the case that non-performance can be considered as substantial infringement of the agreement, and in certain cases prescribed by the laws of Ukraine that are not related to the performance of mandatory disclosure obligations.

5.2 In the case of sub-franchising, how is liability for disclosure non-compliance or for misrepresentation in terms of data disclosed being incomplete, inaccurate or misleading 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?

Ukrainian law does not provide for mandatory disclosure obligations on the franchisor. Similarly, the issues related to liability for non-disclosure and its allocation between the franchisor and the franchisee, are not envisaged in the laws of Ukraine. Ukrainian law does not provide for such definition as master franchisee.

The issue of allocation of liability between the franchisor and the franchisee as prescribed by the laws of Ukraine relates only to liability for the quality of goods/services sold or rendered by the franchisee and sub-franchisee.

Namely, the franchisor bears subsidiary liability for the quality of goods (works/services) sold (performed/provided) by the franchisee and/or sub-franchisee.

Further, in case the franchisee and/or sub-franchisee are engaged in the manufacturing of the goods under the franchise agreement, the franchisor should bear solidary liability for the quality of the goods manufactured by its franchisee and/or sub-franchisee.

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

Ukrainian legislation does not prescribe any rules or obligations on the parties which are expressly related to the pre-sale or pre-contractual stage. Pre-contractual misrepresentation liability and the possibility of its limitation are, respectively, not prescribed.

The laws of Ukraine provide for a number of general obligations of the franchisor and the franchisee. The obligations of the parties which are prescribed by the law cannot be waived by disclaimers or other written documents. Similarly, the liability prescribed by law cannot be avoided or limited, except under specific circumstances such as *force majeure* or other grounds that do not directly relate to franchise agreements.

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

Ukrainian law does not prohibit class actions that can be filed by a group of claimants. A term in the franchise agreement whereby the franchisee agrees not to participate in a class action lawsuit against the franchisor will not be enforceable, because, according to Ukrainian legislation, nobody can be deprived of the protection of his rights in court.

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?

Ukrainian legislation permits a franchise agreement to be governed

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by foreign law provided that a franchisor or a franchisee is a foreign entity. Foreign law can be chosen for all of the terms of the agreement or for some of them. However, imperative provisions of local law apply regardless of the provisions of foreign law chosen by the parties as governing law (e.g. provisions with regard to the protection of consumers' rights, exclusive jurisdiction of local courts for the disputes connected with the registration of IP rights in Ukraine, etc.).

Provisions of foreign laws that are incompatible with the public order of Ukraine cannot apply. Then the law of Ukraine or law of the country, whichever is more closely related to the contractual relations, should be applicable.

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 rogue franchisee to prevent damage to the brand or misuse of business-critical confidential information?

Seeking urgent injunctive relief is possible by applying to the local courts.

In Ukraine, the courts provide the possibility to claim provisional remedies before and/or within court proceedings. It is important that after filing a motion of provisional remedies before the court proceedings, the respective statement of claim is filed within five days.

Provisional remedies can be, in particular, seizure of the property or monetary funds of the defendant, prohibition of certain actions, a request for evidence, etc.

7 Real Estate

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

The term of a contract of lease is its essential condition and must be stipulated by the parties. It is up to the parties to choose the length of term of a contract of lease. At the same time, if such a contract for the lease of the building (or a part of it) is concluded for a term of three years or more, it requires notarisation.

If the tenant continues holding the tenancy after the end of the contractual term, and provided that the landlord does not object to this, the contract is considered to be renewed for the same term.

The tenant that duly fulfilled its obligations under the contract of lease has the prerogative right to conclude the contract of lease for the new term.

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 case of the insolvency of the franchisee and a termination of lease and/or franchise, the franchisor or the new franchisee will be able to carry on the branded operation from the same premises, provided that there is consent of the landlord, and either the contract of lease is changed stipulating a new tenant (the franchisor or the new franchisee) or a new contract with the landlord is concluded.

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

Under Ukrainian law, non-nationals have the same rights in the purchase and lease of real estate as nationals, with the restriction that non-nationals cannot be owners of farming land.

Entities which are not residents of Ukraine can acquire ownership in non-farming lands in case of acquisition of real estate which is located on this land, or with the purpose of building objects in connection with providing commercial activity in Ukraine. A similar rule concerns the leasing of a building: simultaneously with the right to lease a building or a part of it, the tenant is granted the right to use the plot of land on which the building is located.

Certain restrictions apply in case of the purchase and/or lease of the immovable property and/or land which is state or communal property.

7.4 Give a general overview of the commercial real estate market. Specifically, can a tenant reasonably 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 of a particular location)?

There is such a business practice in commercial real estate market that the landlord can provide the tenant with a free-rent period. Such rent free period is subject to negotiations between the landlord and the tenant, and may be for up to six months.

Landlords do not usually demand "key money" for a particular location. In the case of some particular locations of real estate, the rent price will be higher.

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?

Under the Civil Code of Ukraine, the provision of the franchise agreement is void if it provides that the franchisee is entitled to sell products or render services only to the specific category of customers or only to the customers located on the franchisee's exclusive territory.

Therefore, a requirement binding the franchisee to re-direct orders to another franchisee or the franchisor cannot be included 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?

Ukrainian law does not contain any limitations preventing the parties to the franchise agreement from including in the agreement the provision stating that after termination of the franchise agreement, the franchisee is bound to assign the domain name either to the franchisor or to the replacement franchisee.

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9 Termination

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

Ukrainian law does not contain any specific mandatory provisions which can affect the ability of the franchisor to exercise the right to terminate the franchise agreement.

At the same time, under the Civil Code of Ukraine, a contract can be terminated only upon consent of the parties, unless otherwise provided in the legislation or a contract.

Therefore, if consent of the parties with regard to termination of the franchise agreement is not reached and/or unilateral termination is not provided in the franchise agreement, a party can terminate the franchise agreement only in cases stipulated in the legislation; such cases include the following:

- termination of the right of the franchisor in the trade mark or other designation, which is a subject of the agreement, without its replacement by the analogue right;
- bankruptcy of the franchisee or the franchisor;
- if the term of the franchise agreement is not provided, each party is entitled to terminate the agreement by notifying the other party not less than six months before such termination;
- substantial infringement of the contract by the other party. In this case, an interested party has to file a court action requesting termination of the franchise agreement; and
- other cases stipulated by legislation with regard to the termination of contracts in general.

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?

According to Ukrainian law, a franchisee or its employees cannot be treated as the employees of the franchisor. A franchisor and a franchisee act as independent contractors.

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?

According to the laws of Ukraine, the franchisor and the franchisee act as independent contractors. Respectively, the franchisor cannot be held vicariously liable for the acts or omissions of the franchisee's employees.

At the same time, a franchisor has vicarious liability for claims addressed to the franchisee in connection with non-compliance of the quality of goods or services sold or provided by the franchisee.

Further, the franchisor bears solidary liability with regard to claims addressed to the franchisee in case the franchisee is the manufacturer of the goods under the franchising 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?

Ukrainian law imposes restrictions minimising income taxes on payment of royalties. Namely, royalties paid to a non-resident company in an amount exceeding the sum of the profit gained from royalty plus 4% of the net profit gained from the operating activities in the preceding tax year cannot be considered as deductible expenses.

Among the royalties which cannot be considered as deductible expenses are the royalties paid to a non-resident company in full if the royalties are paid for the benefit of:

- non-residents who are not the actual beneficiary owner of paid sums, except in cases where the actual beneficiary gives consent for receipt of such payments to other persons;
- non-residents using IP objects, the legal protection of which was initially obtained in the name of a Ukrainian resident; and
- non-resident recipients of royalties, where such non-residents do not pay taxes on royalties according to the laws of its country of residence, etc.

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?

According to the Tax Code of Ukraine, profits of non-residents gained in the territory of Ukraine are subject to withholding tax. For the purpose of the said provision, the term "profit" includes:

- royalties, dividends and percentages;
- freight and profits from engineering;
- rent payments, profits gained from the sale of real estate, profits from trading in securities, derivatives, and corporate rights;
- profits from joint-venture operations and other long-term contracts;
- profits from operations in the area of entertainment, sports, culture, education and religious activities;
- donations and charitable contributions; and
- other profits, except for the earnings and other compensations of the price of the goods/services supplied/rendered by a non-resident to residents of Ukraine, including international communication and information services.

Any payments related to profits gained by a non-resident in the territory of Ukraine are subject to a withholding tax of 15%, unless otherwise envisaged by the relevant bilateral agreement on the avoidance of double taxation.

Special rates of withholding tax are prescribed with regard to certain types of profits. These include:

- profits from passive bonds or treasury obligations;
- percentages or profits from state securities, local authorities' bonds or debt securities;

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- profits from freight contracts;
- any payments on the grounds of insurance contracts; and
- profits from advertising services.

Since the earnings and the compensations of the price of the goods/services rendered by a non-resident of Ukraine are not subject to withholding tax, structuring payments due as management services instead of royalties may help to avoid the payment of withholding tax.

At the same time, avoiding payment of withholding tax on royalties by means of applying a bilateral agreement on the avoidance of double taxation, is also advised.

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

According to article 524 of the Civil Code of Ukraine, obligations should be conducted in the national currency of Ukraine – Ukrainian Hryvna. At the same time, the parties can specify an amount in foreign currency as an equivalent of the national currency of Ukraine. The use of foreign currency for the purposes of payment transactions within Ukraine is allowed in some cases and subject to conditions as prescribed by the laws of Ukraine.

For instance, according to the Commercial Code of Ukraine, contracts should be conducted in the national currency, except for international contracts concluded between nationals and non-nationals of Ukraine, where the amount can be specified in a foreign currency.

Specific regulations on matters of payment transactions (such as the Law of Ukraine on the Procedure of Payment Transactions of 4 October 1994, and the Decree of Cabinet of Ministers of Ukraine No. 15-93 of 19 February 1993 On the System of Currency Regulation and Currency Control) prescribe that payment transactions between nationals should be conducted only in the national currency of Ukraine. The obligation to process transactions in the Ukrainian national currency is not imposed in the case of cross-border transactions.

Therefore, if one of the parties to the contract is a non-national of Ukraine, payment transactions can be conducted in a foreign currency (subject to requirements provided by the laws of Ukraine).

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 can be treated as the franchisor's agent if the court recognises the franchise agreement as a fictitious contract.

According to Ukrainian law, an agreement can be recognised by the court as fictitious if there is enough evidence proving the fact that parties made it purposely to hide another agreement that was in fact concluded between them.

In order to prove that the franchise agreement concluded between the parties is fictitious, the complainant (be it a private person or state authority) must prove that the relationship between the parties falls under another type of agreement prescribed by the law.

If the franchise agreement is recognised as fictitious, the payments made according to the agreement will not be considered as royalties. The parties can thereby be obligated to pay the taxes; for example, a value-added tax which is not to be paid from the royalty. Moreover, the state tax authority can penalise the parties for escaping taxation.

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?

Ukrainian law does not provide any special requirements for the franchisor and/or franchisee regarding dealing with each other fairly and in good faith.

The civil law of Ukraine establishes good faith as one of the main principles to be applied in a relationship. This principle means that the parties are obliged to fulfil their rights and obligations diligently and fairly.

It should be mentioned that the principle of good faith is applied by the courts with regard to any dispute.

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?

Relationships between the parties to the commercial concession (franchise) agreement are mostly regulated by the Civil Code of Ukraine and the Commercial Code of Ukraine. The Codes, in particular, provide that the franchisor bears subsidiary liability with the franchisee for the claims concerning the quality of goods and services provided by the latter according to the franchise agreement.

Additionally to the provisions of the Codes, relations between the parties to the franchise agreement are regulated by other Ukrainian laws, particularly:

- the Law of Ukraine on Protection of Personal Data. According to this law, the data on the individual can be processed only upon the respective permission issued by the individual. The law provides for criminal, administrative and civil liability for the unauthorised use of personal data;
- the Law of Ukraine on Protection of Economic Competition and other legislation in the field of protection against unfair competition, which establishes the rules of commercial competition in Ukraine; and
- the Law of Ukraine on Protection of Consumers' Rights.

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?

Ukrainian law does not impose any disclosure obligations which apply in relation to the renewal of an existing franchise at the end of the franchise agreement 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?

The Civil Code of Ukraine provides for the priority right of the franchisee to conclude a commercial concession (franchise)

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agreement for a new term on the same conditions, provided that the franchisee duly performed its obligations.

According to Franchising Code of Ethics developed by Ukrainian NGO Federation of franchising development, hospitality and infrastructure, franchise agreements should contain legal grounds for the renewal of the franchise agreement term.

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 the franchisee duly fulfilled its obligations under the franchise agreement, but is refused a renewal of the agreement, the franchisee is entitled to claim damages including lost profits.

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?

Such a restriction is likely to be enforceable under local law if it is included in the franchise agreement. Further, it should be noted that licences for the use of intellectual property objects can only be granted upon authorisation of the owner of intellectual property rights.

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?

Ukrainian law does not provide for a "step-in" right of the franchisor in case of termination of the franchise agreement. In case of termination of the franchise agreement, the franchisor can continue the franchised business itself, provided that it has a registered representative office in Ukraine or an entity founded by the franchisor, and that it concludes new contracts (e.g. lease contracts) and obtains all the permits necessary for performing business activities.

Replacement of the franchisee with a third entity must be followed by the conclusion of a new franchise agreement, as well as the conclusion of new contracts or making changes to the contracts concluded with the former franchisee (i.e. lease contracts). There is no registration requirement for franchise agreements in Ukraine.

16.3 If the franchise agreement contains a power of attorney in favour of the franchisor under which it may complete all the 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 country 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?

Ukrainian law does not prescribe such power of attorney. Therefore, such power of attorney will not be treated as valid.

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Gorodissky & Partners has been consistently ranked as one of the best firms in Ukraine in the field of IP rights protection in annual international surveys conducted by *Managing Intellectual Property*. *IP Stars* recognised the firm among the leaders in such categories including contention and prosecution of trade marks. According to the *World Trademark Review 1000*, it is among the leading Ukrainian firms providing trade mark protection services.

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1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

Franchising is a heavily regulated industry governed by complex federal and state laws. At the federal level, franchising is regulated by the U.S. Federal Trade Commission ("FTC"). On October 21, 1979, the FTC promulgated 16 C.F.R. Part 436 (the "FTC Franchise Rule"), which was amended on January 22, 2007. Under §436.1(h) of the FTC Franchise Rule, a commercial business arrangement or relationship will be deemed to be a "franchise" if the terms of the contract (whether oral or written) satisfy the following three definitional 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 makes a required payment or commits to make a required payment to the franchisor or its affiliate. According to the FTC's Compliance Guide, the required payment must be at least $500 during the first six months of operations.

Unlike federal law, there is no uniform legal definition of a "franchise" under state law, requiring an analysis of specific state law, where applicable. What constitutes a franchise under federal law may not qualify as a franchise under state law and vice versa. In California, Illinois, Indiana, Iowa, Maryland, Michigan, North Dakota, Oregon, Rhode Island, Virginia, Washington, and Wisconsin, a business arrangement qualifies as a "franchise", if, under the terms of the agreement:

(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.

In accordance with the franchise laws promulgated in Hawaii, Minnesota, Mississippi, Nebraska and South Dakota, a "franchise" is defined as an oral or written contract or agreement, either expressed or implied, in which:

(i) a person grants to another person a licence to use a trade name, service mark, trademark, logotype or related characteristic;

(ii) there is a community interest in the business of offering, selling, or distributing goods or services at wholesale or retail, leasing, or otherwise; and

(iii) the franchisee is required to pay, directly or indirectly, a franchise fee.

Under this definition, "community interest" means a continuing financial interest between the franchisor and franchisee in the operation of the franchise business.

In states like Connecticut, Missouri, New York and New Jersey, the definition of a franchise is only two-pronged, unlike the states discussed above which each have three definitional elements. For example, Connecticut defines a "franchise" as an oral or written agreement or arrangement in which:

(i) a franchisee is granted the right to engage in the business of offering, selling or distributing goods or services under a marketing plan or system prescribed in substantial part by a franchisor; and

(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.

Under New Jersey law, a business arrangement will qualify as a "franchise" if:

(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.

In New York, however, a franchise is established if there is contract or agreement, either expressed or implied, whether oral or written, between two or more persons by which:

(i) a franchisee is granted the right to engage in the business of offering, selling, or distributing goods or services under a marketing plan or system prescribed in substantial part by a franchisor, and the franchisee is required to pay, directly or indirectly, a franchise fee; or

(ii) a franchisee is granted the right to engage in the business of offering, selling, or distributing goods or services substantially associated with the franchisor's trademark, service mark, trade name, logotype, advertising, or other

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commercial symbol designating the franchisor or its affiliate, and the franchisee is required to pay, directly or indirectly, a franchise fee.

1.2 What laws regulate the offer and sale of franchises?

The FTC Franchise Rule obligates franchisors to furnish prospective franchisees with the material terms of the franchise relationship prior to consummating the sale of a franchise. In order to meet this pre-disclosure mandate, franchisors are required to disclose this material information in a prescribed format commonly referred to as a Franchise Disclosure Document ("FDD"). Fifteen (15) states have registration and/or disclosure requirements that must be met before a franchise can be offered and sold in that state. Only eleven (11) of these states require that: (i) a state agency review the FDD; and (ii) the franchisor register its franchise programme with the state. In "registration states", the franchisor and/or the disclosure document must be registered and approved by the appropriate state agency before the franchisor can commence any franchise sales activities in that state. Nineteen (19) states have enacted relationship laws that govern the various aspects of the franchisor/franchisee relationship. These state relationship laws primarily govern the termination, renewal and transfer of the franchisee's rights. Some state relationship laws extend beyond the termination, renewal and transfer of a franchisee's franchise rights, and incorporate provisions that: (i) grant franchisees the right to form an association with other franchisees in the same system; (ii) obligate the franchisor to repurchase inventory, etc. There are twenty-eight (28) states that have unfair trade practice acts (referred to "Little FTC Acts") that grant "consumers" a private right of action if a franchisor engages in unfair trade practices. Under these Little FTC Acts, a violation of the federal FTC Act or related regulations, including the FTC Franchise Rule, constitutes an automatic violation of the state Little FTC Act. Twenty-five (25) states have business opportunity laws which extend the disclosure protections afforded to franchisees to consumers that purchase business opportunities, including franchises. Under these laws, sellers are obligated to prepare and disclose certain information to prospective buyers prior to the consummation of a sale. Typically, the information required to be disclosed by sellers under these business opportunity laws is not as extensive as the information that is required to be disclosed under federal and state franchise laws. Thus, many franchisors tend to be exempt from state business opportunity laws provided that they are in compliance with the FTC Franchise Rule and provide prospective franchisees with a Franchise Disclosure Document.

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 the purposes of any franchise disclosure or registration laws?

Business format franchising is the primary method by which franchisors elect to expand their brand in different consumer markets. While this form of franchising is ideal for nationwide expansion in areas like the United States, it is not the preferred method of franchising for franchisors looking to establish their presence internationally. Franchisors seeking global expansion of their brand will typically partner with a single franchisee/licensee ("master franchisee") to develop, market and operate units under the franchisor's brand within a specified geographic region. This form of expansion is more commonly referred to as master franchising. Under this form of expansion, a master franchisee/subfranchisor pays the franchisor a fee (frequently a significant fee) to recruit, train and support subfranchisees in the target area. While the master franchisee/subfranchisor basically "steps into" the franchisor's shoes to conduct franchise sales activities, training and support, the master franchisee/subfranchisor is treated as a franchisee for the purposes of franchise disclosure and registration laws. Similar to the "typical" franchisee, the master franchisee/subfranchisor is making a substantial investment in the franchisor's system and it is therefore afforded the same franchise disclosure and registration protections.

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

Federal law only imposes a pre-sale disclosure requirement on franchisors; it does not require franchisors to register their FDD with any federal administrative or governmental agency. However, there are states that require a franchisor to register its FDD with that state's administrative or governmental agency. As noted in the response to question 1.2 above, fifteen (15) states have franchise filing or registration laws requiring a franchisor either: (i) to register their FDD; or (ii) to file a notice of intent with the appropriate regulatory authority prior to any offer or sale of a franchise or multi-unit development rights within the state.

1.5 Are there mandatory pre-sale disclosure obligations?

The violation of the pre-sale disclosure requirement imposed by the FTC Franchise Rule is a violation of the U.S. Federal Trade Commission Act. The occurrence of such a violation entitles 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 United States; and (iii) restitution, rescission, or damages on behalf of the affected franchisees. Although the FTC Franchise Rule gives the FTC a private right of action against franchisors who violate the FTC Franchise Rule, no such private right of action is granted to aggrieved franchisees. Despite not having 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 most commonly include actions for rescission of the franchise agreement and/or actions for actual damages (including reasonable attorneys' fees and expenses).

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 using the business format method of franchising, but no such pre-sale disclosure requirement applies to subfranchisees. The FTC Franchise Rule does not directly address master franchising. With the emergence of master franchising after the promulgation of the amended FTC Franchise Rule, the North American Securities Administrators Association, Inc. ("NASAA") adopted a Multi-Unit Commentary (on 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, franchisors are required to prepare a separate FDD for offering and selling subfranchise rights to prospective master franchisees/subfranchisors. NASAA concluded that it would be too confusing to combine the disclosures for single unit franchises and

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multi-unit development arrangements in a single document. This pre-sale disclosure requirement is not only imposed on franchisors offering and selling subfranchise rights to prospective franchisees and multi-unit developers, it is also imposed upon master franchisee/subfranchisors who "step-into" the franchisor's shoes and engage in franchise sales activities and provide training and support to subfranchisees. Therefore, under the NASAA guidelines master franchisees/subfranchisors are responsible for preparing and providing their own FDD in connection with their offer and sale of subfranchises 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 comprise twenty-three (23) categories ("Items") of information regarding: (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 initial investment in order to commence operations; (v) the products (and sources for those products) that the franchisor wants 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 will deem the most vital in analysing the franchise opportunity is provided in Item 19, which addresses the question (albeit indirectly), "How much money can I expect to make?" Under Item 19, franchisors may (but are not obligated to) provide prospective franchisees with financial performance information (such as past or projected revenues or sales, gross income, net income or profits) concerning existing franchised and company-owned units; provided that there is a reasonable basis for the information and that such information is properly disclosed. Depending on the nature of the representation, improper 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. Until recently, there was little guidance concerning the manner in which franchisors made financial performance representations. However, on May 8, 2017, NASAA adopted guidelines regarding how franchisors are to make and substantiate any financial performance representation they disclose under Item 19. The guidelines go into effect 180 days after the date NASAA adopted the guidelines, or 120 days after a franchisor's next fiscal year end, if the franchisor has an effective Franchise Disclosure Document as of the date of adoption by NASAA.

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

Although franchisors must ensure that they strictly adhere to federal and state franchise disclosure laws and regulations, there are other business and legal elements that the franchisor must address prior to engaging in franchise sales activities.

Trademark and Assumed Business Name Registration. As noted in the response to question 1.1 above, in order for a business arrangement to qualify as a franchise, the franchisee must operate its franchised business under the franchisor's trademark. Therefore, franchisors should look to register all trademarks, service marks, trade names, logos, domain names, or other commercial symbols that will be used in connection with the franchise system, prior to offering and selling franchises. Additionally, franchisors should register any assumed 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.

Advertising Materials Related to the Sale of Franchises. Certain registration states, like New York, require that franchisors file any materials that advertise the sale of franchises (such as brochures and websites) prior to the advertisement's first publication in that state.

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. In instances where a franchisor elects to use a franchise sales broker, two states (New York and Washington) require franchisors to file a separate registration form that provides the state with more detailed information about the broker. These states additionally require the broker to have a licence from the state prior to engaging in franchise sales activities in the state. 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.

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

While membership in a national franchise association is not mandatory, it is 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: http://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 (the "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.

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1.10 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 http://www.franchise.org/mission-statementvisioncode-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.

1.11 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 does impose certain restrictions, including for example, disclosure filing requirements and/or imposing actual limits on foreign investment that may apply to certain industries or businesses having a potential impact on national security (e.g., banking, technology, weapons manufacture, maritime, aircraft, energy, etc.). As franchise opportunities do not typically involve these industries, franchisors are often not 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 a corporation or limited liability company ("LLC") as their preferred form of business entity. While each entity type offers "limited liability" to its owners, choosing between the two will depend on the legal, financial and tax needs of the company and its principals. If a franchisor chooses to use the corporate form of entity, usually a "C corporation" is used (as opposed to an "S corporation" which are typically 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) when distributions are made to the company's shareholders. However, over the last 10–15 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, as LLCs offer franchisors greater flexibility in certain areas, including for example, with respect to internal governance requirements, 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 flow through to the company's owners, proportionately to their ownership percentage, who pay taxes on them 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 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 will also have to be included in the U.S. franchisor's "offering prospectus" (called the Franchise Disclosure Document or "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 and several subsidiary operating entities. (This "corporate" structure approach may be used for LLCs as well as corporations.) For example, one operating entity may own the intellectual property rights associated with the franchise system; another might be the "franchisor entity" which would enter into the franchise (and other) agreements with franchisees; another might be a management company which could provide the various "franchisor" services to the franchisees; and yet another could purchase, sell or lease equipment to franchised or company-owned units. Typically, separate entities are 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".

In international franchising, franchisors usually establish a franchise network by utilising either (or sometimes both) the master franchise (or sub-franchisor) method and/or the area development method. Many franchisors, including foreign franchisors, do not rely solely on selling single unit franchises. The more common approach 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 taking on "franchisor" obligations 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 more control over their franchise network and don't wish to share their franchise fees with a master franchisee, will grant territories to "area developers" who obligate themselves to develop their territories, but have no rights to offer sub-franchises to other franchisees. Since the U.S. is a large country with varying demographics and cultures, franchisors may 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 both. However, the "joint venture" approach has not been frequently utilised by franchisors (including foreign franchisors).

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 (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

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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. If the new entity will conduct 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 an appointed "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 programs). 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 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 U.S., "competition law" is generally referred to as "antitrust law". Antitrust laws exist at both the federal and state level. While there are no antitrust laws that directly regulate the offer and sale of franchises, antitrust laws may apply to franchises in certain limited circumstances. The FTC Rule (16 C.F.R. 436 *et seq*.), and statutes in certain states, are not generally considered "antitrust" or "competition" laws, but they do specifically regulate the offer and sale of franchises (discussed in section 1, above).

The major federal 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 Clayton Antitrust Act (15 U.S.C. §§12 *et seq*.), including the Robinson-Patman Act (at 15 U.S.C. §13) (generally prohibiting anticompetitive price discrimination, exclusive dealing, and tying). The Antitrust Division of the U.S. Dept. of Justice and the U.S. Federal Trade Commission ("FTC") cooperate to enforce the federal antitrust laws, while the Clayton Act authorises private rights of action.

Almost every state in the U.S. has enacted its own antitrust laws, which are usually based upon, but are in addition to, the federal anti-trust statutes. However, while these state statutes may be similar, and look to federal law for guidance, there may be differences, and practitioners need to examine both the federal and state laws in the applicable jurisdiction to avoid any potential issues.

The FTC is also 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 ("Unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are hereby declared unlawful"). Many states also have enacted similar statutory schemes prohibiting unfair or deceptive trade practices (sometimes called "Little FTC Acts"). Therefore, 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.

While antitrust was once a major area of interest and litigation for both franchisors and franchisees, courts in recent years have significantly limited the applicability of antitrust laws in the franchise context. Traditionally vexing antitrust claims, such as franchisee complaints of price fixing (e.g. franchisors setting maximum or minimum prices), exclusive dealing requirements (e.g. requiring franchisees to deal only with particular designated suppliers), or tying (e.g. requiring that franchisees purchase products or services not directly related to the trademarked franchised product or service), have dramatically fallen in the last two decades in the wake of court decisions that prevent these claims from being successful in the franchise context. Many courts have narrowly restricted the definition of the applicable "market" for antitrust analysis in ways that effectively exclude franchise relationships. In addition, courts now increasingly employ the "rule of reason" test in circumstances that would once have been considered to be *per se* violations of antitrust laws. In most franchise circumstances, a franchise agreement which clearly provides for (and an FDD which 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.

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

No. However, there is variation with respect to the enforceability of unlimited terms in specific states. Some states may be reluctant to enforce franchise agreements without a limited term. This may apply to 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). At the other end of the spectrum, the New Jersey Franchise Practices Act. (NJ Stat. 56:10-1 *et seq*.), requires 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. Again, the franchise practitioner is well advised to review all applicable state laws in addition to federal law in connection with this issue.

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

No. As noted above, there are some states that may be hostile to enforcing agreements without any stated term, but there is no antitrust statutory restriction. The FDD must adequately disclose any required related product supply agreements, and the franchise agreement must clearly provide for it. 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 (such as the New Jersey Franchise Practices Act, which makes it unlawful "to impose unreasonable standards of performance upon a franchisee", *see* N.J. Stat. §56:10-7(e)).

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

Federal antitrust law will prohibit the use of 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

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unreasonable restraint of trade *concerning competitors*, based upon economic factors). Therefore, under federal law, MRPs are permitted, and courts have been reluctant to find violations where there is an economic justification for them, resulting in most cases being dismissed. However, there are state statutes that differ from the federal standard, and which prohibit the use of MRPs. Indeed, while federal law has generally adopted a "rule of reason" standard, state statutes may still consider MRPs to be *per se* unreasonable restraints of trade, instead of analysing them under the more permissive "rule of reason" test. This area of law is continuing to develop, and state laws may ultimately gravitate towards adopting the federal "rule of reason" analysis. In addition, while not an "antitrust" issue, MRPs may give rise to other claims by franchisees, such as common law claims for good faith and fair dealing, or N.J.'s prohibition against imposing "unreasonable standards of performance" upon franchisees. (N.J. Stat. §56:10-7(e).)

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

In general, federal antitrust laws do not require a franchisor to observe any minimum obligations when offering franchises in adjoining territories (or, for that matter, even when a franchisor itself operates in an adjoining territory). The FTC Rule does mandate that an FDD include a detailed disclosure of the rights conferred in any territorial grant, but there are no required obligations, (other than those that, typically, are provided by the agreement between the parties). Franchisees typically find it difficult to bring antitrust claims on this basis, as the antitrust laws will generally not consider the applicable "market" for antitrust analysis to be competing franchise locations, but rather the market for franchises generally, when the franchisee purchased the franchise. Further, there will generally be sufficient justification for "territory" competition under the "rule of reason" analysis to avoid federal liability under the federal antitrust laws. However, anti-competitive misconduct on the part of a franchisor that impacts *inter*-brand competitors could still result in liability, and more restrictive state anti-trust statutes may also impose liability for anti-competitive conduct within a particular jurisdiction.

However, improper encroachment or unfair allocation of territories could lead to liability outside of antitrust law (*discussed infra*), such as for violation of the implied covenant of "good faith and fair dealing", which many states automatically incorporate by law into every contract. In addition, certain state franchising statutes may restrict or prohibit unfair encroachment activity (*see* e.g. Minnesota's Franchise Statute, MN Stat. §80C.14; and Rule 2860.4400, Unfair and Inequitable Practices).

What many franchise practitioners consider to be the "bottom line" in this regard, is that the provisions in the franchise agreement that address the franchisor's right to operate directly, or to sell franchises, in what may be considered to be the franchisee's "market" from which the franchisee draws its customers, as opposed to any "protected territory" granted to the franchisee, must be crafted with great care.

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

In-term and post-term non-compete and non-solicitation of customer provisions are generally enforceable, and there is no prohibition against them under federal antitrust law. However, some states may prohibit or severely restrict post-termination non-competition clauses. California law, for example, generally voids any post-termination non-competition clauses (*see* e.g. CA B&P Code §§16600 *et seq*.). In states that restrict non-solicitation and non-compete clauses, the enforceability often depends upon factors bearing upon the reasonableness of the restriction, including 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, the scope of business activity being restricted, and the duration of the restriction. For example, a post-term restrictive covenant that only restricts certain activities in direct competition with the franchisor in a small geographic area for one year, is far more likely to be enforceable than a broad covenant seeking to completely restrain a wide range of activities in a large area for many years. In addition, franchise counsel should carefully examine the "choice of law" applicable to a particular agreement or disputes arising therefrom, as many states do not allow their non-competition statutory provisions to be waived (regardless of what the 'choice of law' clause may state in an agreement), and there is significant variation between jurisdictions as to the enforceability of non-compete and non-solicitation clauses.

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 WIPO), which allows 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 "locally" in a member nation, approved, and then submitted to the WIPO for international approval and registration. Once approved at the WIPO level, the mark is submitted to the other member nations in which the mark holder seeks to obtain trademark protection. Each nation then examines the mark to determine whether or not it will grant approval. Each territory in which the mark is being reviewed for approval will issue a decision within either 12 or 18 months, depending upon the territory.

In the United States, at the federal level, the United States Patent and Trademark Office (USPTO) is the agency responsible for registering trademarks. Applicants can file online with the USPTO, and should regularly check the online monitoring system throughout the process. The USPTO will initially determine if the application has met the minimum filing requirements. If so, it 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. Objections are heard by an administrative tribunal within the USPTO called the Trademark Trial and Appeal Board (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

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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). If an application is refused by the examining attorney, or fails to overcome an objections, there is an appeals process to the TTAB.

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 following registration, and a renewal application must be filed 10 years following registration, and every 10 years thereafter (internationally filed marks under the Madrid Protocol follow a slightly different process).

Individual states also have their own trademark registration offices (with their own registration process). While individual state registration is better than either not registering, or relying upon common law trademark rights (discussed below), franchisors are well-advised to seek federal registration of their mark(s).

Significantly, in the United States, unlike 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 prior to the other party's filing 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.

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). Federal law, including the Lanham Act (15 U.S.C. §1051 *et seq*.), also 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.

A trademark holder in the United States is generally required to "police" its mark, by actively monitoring the market in order to discover infringement, and then to take action against infringers so as to protect its 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).

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 law or state common law, or both.

A recent development has been the passage of the federal Defend Trade Secrets Act of 2016 (*see* 18 U.S.C. §1831 *et seq*.) (the DTSA). Previously, trade secret litigation generally had to be brought pursuant to applicable state common law, which varied from state to state. The DTSA provides federal protection for trade secrets, and creates 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 for wilful and malicious violation, double damages and attorneys' fees. Under the DTSA, a party must have provided certain "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, if it wishes to later take advantage of the DTSA's potential award of exemplary damages or attorneys' fees. Therefore franchisors (and franchisees) should incorporate into their agreements, policy manuals, confidentiality agreements, and other confidentiality provisions, such "notice". Under the DTSA, a party may also seek 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 are already taking advantage of this new weapon in their arsenal to restrain former franchisees from misappropriating trade secrets, and in order 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 TRO against former employee to prevent dissemination of trade secrets under DTSA).

Each state's common law trade secret protection also applies. There is some variation between specific states, and some states additionally have statutory protection for confidential information or trade secrets. An important element in establishing common law rights to confidential information is that the party seeking confidentiality must make a significant effort to maintain the secrecy of that information. Franchisors should therefore implement policies and procedures designed to protect against the dissemination of confidential information. Where applicable, franchisors should require franchisees to agree to non-disclosure agreements, and should include strong and inclusive confidentiality provisions in their franchise agreements. These provisions should also be binding on franchisees' agents and employees. Franchisors should also consider utilising other security measures, including password-protected computer systems, so as to maintain the "confidentiality" of information (such as client or customer lists and information) that the franchisor may wish to keep "confidential".

Courts will generally enforce confidentiality agreements, and will grant injunctive relief in appropriate circumstances, to prevent the theft or misuse of confidential information. Therefore, well-crafted franchise agreements will often include injunctive relief clauses 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.

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.

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 U.S. is a signatory to many treaties and conventions concerning copyrights, including those overseen by the World Intellectual

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Property Organization (WIPO). Within the U.S., federal law protects both registered and unregistered copyrighted material. In addition, common law rights (or even statutory rights conferred by states), such as claims for misappropriation or unfair competition, may overlap with copyright law to protect information within publications.

Franchisors should be mindful that a wide variety of different publications and media, including operations manuals, advertisements, menus, or computer programs, may be protectable by copyright. Franchisors should be careful to draft clear agreements with employees, agents or venders that designate "work for hire" copyright ownership to the franchisor for materials that are created for the franchisor (lest, for example, a franchisor inadvertently grants "ownership" of an expensive, custom-designed computer program, to a computer programmer).

The culture of the United States 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. Federal law often provides for additional damages, including exemplary (sometimes treble) damages, and attorney fees, for violations.

However, a recent decision also cautions that copyrighted materials, and generic ideas, 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) (even though the franchise operating manual was copied practically verbatim in sections, those portions were so basic, common, and generic, that they did not qualify for protection).

5 Liability

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

The Federal Trade Commission (FTC) may enforce its franchise disclosure rules by issuing cease and desist orders and, where recalcitrant franchisors still do not comply, by commencing an action in federal court to obtain an injunction and/or civil penalties. However, this is not a frequent occurrence and, importantly, the FTC Rule does not grant a private right of action to franchisees.

It is only under state law, either by virtue of state consumer fraud statutes ("Little FTC Acts") or state franchise statutes that aggrieved franchisees are empowered to commence a lawsuit against a franchisor and its control persons for disclosure violations. If a franchisee prevails in court, it is entitled, under most state statutes, to an award that may include rescission, damages, costs, reasonable attorneys' fees and statutory interest. Rescission, which is designed to restore the rescinding party to the "*status quo ante*" (the condition the franchisee was in before the breach occurred), includes, minimally, the restitution of any money already paid to the franchisor (including the franchise fee and royalty payments), and perhaps any other money invested in the franchise go into the franchised business and keep it operationally afloat, as well. However, while rescission may be a possible remedy, it may only be available under limited circumstances (e.g., where the franchisor's disclosure violation is deemed to be wilful and material). In a few states, courts have discretion to award treble damages to plaintiff franchisees. State enforcement agencies may seek to impose civil and even criminal penalties or obtain an injunction against a non-compliant franchisor. Given the differences amongst states' statutes and the rights provided thereby, it is generally advisable to retain counsel that is knowledgeable in the individual state's franchise law.

5.2 In the case of sub-franchising, how is liability for disclosure non-compliance or for misrepresentation in terms of data disclosed being incomplete, inaccurate or misleading 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?

Pursuant to the FTC Rule and most state franchise statutes, a franchisor and sub-franchisor are jointly and severally liable for one another's disclosure violations. Often, though, a franchisor will seek to shift full liability onto the master franchisee (sub-franchisor) by including an indemnification provision in the Master Franchise Agreement. Such provisions are generally enforceable, except under circumstances where state law may determine them to be against public policy (e.g., for intentional misconduct of the indemnitee). States in which registration is required (and good practice, generally) may require that the master franchisee issue and register its own, separate, FDD, whereas where an Area Development Agreement is utilised, it may be included in the franchisor's FDD and state registration.

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

It depends. The FTC Rule prohibits disclaimer clauses that require franchisees to waive reliance on representations made in the FDD itself. Several states have enacted anti-waiver provisions which render unenforceable any provision in the franchise agreement that purports to waive a franchisee's legal rights to recover damages for a franchisor's pre-contractual misrepresentations. Moreover, if a franchisee is fraudulently induced to execute a franchise agreement, disclaimer clauses are generally unenforceable because the fraud is extraneous to the contract. However, disclaimer clauses may still effect a limited waiver, including with respect to unauthorised representations made by an agent of the franchisor during the pre-sale courtship process. Such provisions may also be useful to the franchisor in contesting a franchisee's claim that it actually relied on the misrepresentation.

Courts are more likely to uphold a "no representation" or "no reliance" clause that disclaims a specific representation, than a general disclaimer or integration clause. For this reason, it is increasingly common for franchisors to require that its franchisees sign, along with the franchise agreement, a detailed questionnaire specifying that certain representations were/were not made prior to the sale. However, to the extent a franchisor may have made misrepresentations by failing to disclose material information prior to the sale of a franchise, disclaimer clauses are likely to be of no avail to the franchisor.

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

Yes, class action lawsuits may be brought. However, franchisees are almost always required to relinquish any right to pursue a

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class action lawsuit against a franchisor by executing a franchise agreement with a class action waiver provision. The enforceability of such a provision varies between states; while some of whose courts may deem such a provision to be unconscionable and, therefore, unenforceable, many states will enforce them. Typically, these provisions also include waivers applicable to class or group arbitrations, as well. Where franchisee groups have challenged class action waivers contained in arbitration provisions, courts, recognising the Federal Arbitration Act's stated policy favouring arbitration as a means of dispute resolution, have enforced such waivers.

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?

Many franchise agreements include choice-of-law provisions designating the laws of the franchisor's home state as the law governing the franchise relationship. For practical reasons, however, it is uncommon for a franchise agreement to be governed by a foreign franchisor's local laws.

Choice-of-law provisions are generally enforceable as long as: (1) there is either a substantial nexus between the chosen state and the parties or the transaction, or there is a reasonable basis for the parties' choice; and (2) the selection does not violate the public policy of the state with the predominant interest. In any event, some U.S. state franchise laws include anti-waiver provisions, which effectively mandate application of the local state franchise laws no matter what the franchise agreement provides. Unless the choice-of-law provision is sufficiently broad, actions sounding in tort (which are extraneous, to and do not arise out of, the contract) are often governed by the law of the state in which the tort occurred or the harm was suffered.

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 rogue franchisee to prevent damage to the brand or misuse of business-critical confidential information?

Federal, state and U.S. common law provide an aggrieved franchisor, whether domestic or foreign, with the right to bring an action for injunctive relief in a local U.S. court and obtain emergency relief to protect its brand. For example, the Lanham (Trademark) Act and the Defend Trade Secrets Act of 2016 each provide a franchisor with the federal right to sue in court for an injunction to protect its trademarks, trade secrets and confidential operations manual. Injunctions will usually be granted only where there is no adequate remedy at law and where, absent an injunction, a party would suffer "irreparable harm". There is no applicable federal law or U.S. treaty regarding foreign judgments. Local courts typically enforce final and valid foreign judgments in accordance with recognised principles of comity, but each state's laws may vary. Though many states have adopted some version of the Uniform Foreign Money Judgments Recognition Act, such provisions only confer recognition upon foreign *money* judgments.

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 is comprised of diverse area types 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 widely depending on a variety of factors including, for example, the area type and specifics of the local market, the type of premises, general economic and market conditions, the particular landlord, lender requirements, franchisor requirements, etc. That being said, in major metropolitan areas and in shopping centres, it is common to have leases for retail spaces that are for ten (10) years or more. While, perhaps, this may not be as prevalent in smaller communities, even there, leases of ten (10) years (or more) can usually be negotiated for well-known franchise brands. Tenants often seek to incorporate one or more option terms into their lease. Some franchisors, and some franchisees (who are represented by experienced counsel) will prefer to have the term of the franchise agreement (with any renewals) coincide 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 rights to "hold over" at the end of the lease's contractual term. In most instances, landlords require that the tenant pay anywhere between 125% and 200% of the base Rent and Additional Rent during any holdover period(s).

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 concept is understood and is often addressed by contractual agreement, both in the Franchise Agreement and, if properly negotiated, in the lease. Sophisticated landlords are generally aware that franchisors may wish to 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, or to take an assignment of the lease in the event that either: (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 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. 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, some landlords may require the franchisor to provide either a full or partial guarantee of the lease as a condition for consenting to such a lease provision.

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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. 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 most franchising opportunities in the U.S. 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. In most instances, foreign investors would acquire U.S. real estate interests, including leases, by utilising single purpose 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. Specifically, can a tenant reasonably 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 of a particular location)?

While the U.S. commercial real estate market is large and varied, it has continued to recover from the "great recession" of 2008 through 2012. In certain metropolitan areas, the real estate market has recovered fairly well and it is not uncommon for landlords to charge premium rents for "class A" and other desirable locations. Notwithstanding this, reasonable construction periods (which vary depending on the location and type of work to be done), landlord contributions to tenant "work letters" and even some "free rent" periods, are usually available. However, in many other areas of the country, including more suburban and rural areas, where the real estate market (and the local economies generally) have not recovered to the same extent, it is 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 the 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 maybe 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 open 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.

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 regulate how online orders are allocated. However, a franchisor should take great care to adequately delineate, in both the FDD and franchise agreement, as well as in any required analogous state disclosure document, how such online orders will be handled. 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 extent of their territory with respect to online orders. Similarly, as e-commerce continues to mature, prospective franchisees who are purchasing a franchise should review the territorial protections and online market provision described in the FDD and 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.

From an antitrust perspective (see section 3, above), unless the franchisor has exerted significant control over the inter-brand market for the relevant product or service, such requirements are unlikely to violate anti-competition laws, since under a "rule of reason" analysis, with the relevant "market" under antitrust analysis generally not being applicable to franchisees, such practices will not be considered to be antitrust violations.

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 within the 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 Internet Corporation for Assigned Names and Numbers (ICANN) regulates the usage of domain names, and franchisors may seek transfer of a domain name under ICANN's Uniform Domain-Name Dispute-Resolution Policy (UDRP) proceedings to effectuate the transfer of a domain name. Notably, 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).

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 ano.*, NAF UDRP Proceeding, Claim No. FA1106001395159 (January 6, 2012) (domain would properly stay with franchisee, as franchisor "acquiesced to the use of its mark in the Respondent's domain name for at least a period of several years")).

Franchisee practitioners should carefully review the franchise agreements' expiration and termination provisions, and the requirements concerning post-termination/expiration domain usage. At the conclusion of a multi-year franchise relationship, a domain name may be an integral part of a business' e-mail addresses, server addresses, and contact information for clients and vendors. If the franchisee seeks to remain in business and rebrand following de-

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identification, the loss of a domain name can present significant hurdles to this process if not adequately prepared for.

9 Termination

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

Yes. While federal law in the United States, e.g., the Amended FTC Franchise Rule, governs the requirements with respect to how franchisors must provide proper disclosure to prospective franchisees, 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 including, for example: restrictions on termination, 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 non-competition 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, as well as 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 separate from the state's disclosure/registration laws. Some states, however, have relationship laws but have enacted no franchise disclosure law.

State relationship laws typically address 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.) 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, the franchisor is required to provide the franchisee with written notice (for example, between 30 and 90 days, which is often significantly longer in duration than what is provided for in the franchise agreement), within which the franchisee may cure the alleged default and avoid termination (although 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, including, for example, a threat to the public's health and safety (often, for example, in a food-related franchise), and/or are otherwise "uncurable" (for example, seriously impairing the reputation of the franchisor's brand), 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.

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 unexpired lease have been properly terminated, such agreement(s) become(s) part of the debtor-franchisee's ("debtor") "bankruptcy estate." While a franchise agreement or lease may be terminated relatively quickly if the debtor (franchisee) rejects them, 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 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 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 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).

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 control over the "terms and conditions" of employment (directly, or even indirectly), so that they will be considered a "joint" employer by law. In the past few years, regulators charged with enforcing various employment laws (particularly the National Labor Relations Board ("NLRB")), have increasingly been applying the "joint employer" doctrine in the franchise context, and finding franchisors jointly liable for employment law violations committed against franchisees' employees. Therefore, the joint employer doctrine can operate as an exception to the general rule that a franchisor and a franchisee are independent contractors, and expose the franchisor to liability for employment law violations. Notably, the joint employer doctrine only applies in connection with violations of employment law (for

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example, violations of 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 doctrine in the franchise context is troublesome, because the franchisor-franchisee relationship, by its very nature, requires a franchisee (and its employees) to adhere to the franchised system or business model, and to follow certain designated procedures. The hallmark of liability under the joint employer doctrine is the exercise of sufficient control over employees so as to be considered an employer. A franchisor may discover that by too closely regulating what the franchisee's employees do, in trying to keep the franchise system uniform, it will be considered liable for employment law violations as a "joint employer". Trouble areas include (but are not limited to) 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 resisting the unionisation of employees.

In 2015, the NLRB found liability against a franchisor as a "joint employer" for NLRA violations. *See Browning-Ferris Industries of California, Inc*., 362 NLRB No. 186 (August 27, 2015). This case, as well as policy statements of the NLRB, indicated that the joint employer doctrine could indeed be applied against franchisors, even for arguably *indirect* control over employees. There was significant concern amongst some in the franchise bar that aggressive federal regulators would apply the joint employer doctrine increasingly in the franchise context, and that would, in turn, significantly impact upon the viability of the franchise business model, generally. Some states went so far as to start passing legislation specifically stating that franchisors could not be "employers" of their franchisee's employees (*see e.g.* Texas 2015 S.B. 652, eff. 9/1/15; Louisiana 2015 HB 464, eff. 8/1/15; Tennessee 2015 SB 475, passed 4/10/15; Wisconsin 2015 SB 422, passed 2/9/16; and Michigan 2015 SB 492, eff. 3/22/16). However, as noted by many practitioners, these state statutes could do little to impact federal enforcement of federal law.

Perhaps it is worth noting that while the NLRB's policy decisions were alarming to some, the application of the joint employer doctrine only really impacted those franchisors who directly or indirectly controlled the fundamental terms and conditions of their franchisees' employment relationships. Regardless, relief for the franchisor bar has come to pass as a result of the new administration. The Trump administration has issued a press release stating it was withdrawing its "informal guidance" on joint employment – and thereby indicated that it was reversing course from the prior administration's position on the joint employer doctrine in the franchise context (*see* U.S. Dept. of Labor, 6/7/17 Press Release, 17-0807-NAD).

Nonetheless, the federal common law federal doctrine of "joint employment" is still alive and well, and even though the current administration may not be actively pursuing its expansion, franchisors are still well-advised, wherever possible, to avoid exerting excessive control over the terms and conditions of employment of their franchisees' employees, while balancing such needs against maintaining system standards. While the joint employer doctrine provides no "bright line" rules, as it utilises a multi-factored test (or "totality of the circumstances"), and the law is still evolving, franchisors can and should take steps to help avoid being considered a joint employer. One good rule of thumb has been for franchisors to continue to maintain system standards and employee practices that have to do with the end product or service (sometimes called "control of outcomes"), but to distance 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 become directly involved in training, hiring, filing, or setting hours and pay rates for the low-level employees producing those sandwiches.

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 be found vicariously liable for the acts or omissions of their franchisees (or their franchisees' employees). However, vicarious liability, as a general rule, 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. Almost every jurisdiction has found that general operational manuals or enforcement of a franchisor's general franchise system will not, by itself, lead to vicarious liability. In contrast, 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.

Franchisors need to balance their needs to provide guidance to their franchisees, including the promulgation of detailed policies and procedures, against exerting so much control over the day-to-day operations of franchisees that they open themselves up to a risk of vicarious liability. Where detailed specific controls are not necessary to maintain quality control or the franchised system, they should be avoided. Franchisors can also seek to minimise potential damages by having an appropriate indemnity provision in their franchise agreement, as well as requiring that franchisees maintain adequate insurance coverage, and naming the franchisor as an insured party, especially where necessary to protect against particular liability concerns.

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?

So long as the overseas franchisor and the franchisor's home country are not subject to any U.S. economic sanctions, U.S. law does not impose any exchange control restrictions on the transfer of money by a U.S.-based franchisee to a foreign 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?

Payments made by a U.S. taxpayer to a foreign franchisor in exchange for the right to use its intellectual property (e.g., trademarks, copyrights) and technology qualify as "royalty" payments for tax purposes and are subject to a 30% withholding tax rate. If the U.S. has an income tax treaty with the franchisor's country of residence, the foreign franchisor will benefit from either

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a reduced withholding tax rate or a full exemption. Management service fees are similarly subject to a 30% withholding tax, except where reduced by tax treaty.

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

Typically, no. It is standard for a U.S. franchisee to operate its business using the local currency. Major banks can usually wire franchise fees or royalties on behalf of a U.S. franchisee to the foreign franchisor using the foreign currency. Notwithstanding this, however, it is typical for a foreign franchisor to conduct its franchise business in the U.S. either 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, there is some risk that an agency relationship (actual or apparent) will be found and that the franchisor will be held vicariously liable for harm caused by the franchisee. In analysing whether an actual principal-agent relationship exists, courts will examine the degree of control exerted by the franchisor over the franchisee's general day-to-day operations and/or over the specific conduct of the franchisee that caused the harm. Courts may find apparent agency if it is determined that a plaintiff: (a) reasonably believed the subject franchisee to be an agent of the franchisor; and (b) reasonably relied upon such belief to its detriment. *See also* section 10, Joint Employer Risk and Vicarious Liability, *supra*.

To minimise possible exposure, the franchise agreement should require the franchisee to conduct its franchised business under its own business name and in a manner such that it directly and independently provides services or goods to customers. The franchisor is generally advised to include in the franchise agreement: (a) a provision stating that the franchisee is an independent contractor and not an agent of the franchisor; (b) an indemnification and contribution clause; and (c) a provision requiring the franchisee to maintain an insurance policy that covers the franchisor as an additional insured. The franchisor can further protect itself by requiring that its franchisee post notices of independent ownership on its store signage, in its advertisements, etc.

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?

Many states incorporate by common law an implied covenant of good faith and fair dealing into every contract, including franchise agreements, within its jurisdiction. The implied covenant of good faith and fair dealing typically means that where one party may be free to exercise its discretion, it should not do so in a manner that deprives the other party of the benefit of the contract. It should not enrich itself unfairly, or act in an overly arbitrary or capricious manner, so as to eliminate the other party's benefit of the bargain.

The implied covenant of good faith and fair dealing cannot conflict with an express contractual term. Therefore, a well-drafted franchise agreement will usually address most significant issues with sufficient particularity to minimise the application of the implied covenant of good faith and fair dealing. However, issues do arise, especially where the exercise of discretion is involved and a franchise agreement is silent on the point in question. However, good faith and fair dealing is a fact-driven analysis, and even well-drawn contracts may not anticipate every contingency.

Requiring good faith and fair dealing is not the same thing as requiring a franchisor to sacrifice its own economic self-interest in favour of the franchisee. The general rule is that parties are free to enter into contractual provisions as they wish, especially if both parties are sophisticated and represented by counsel. Either the franchisor or the franchisee may knowingly enter into an unfavourable economic arrangement, and if the contract is clear, the implied covenant of good faith and fair dealing will not be allowed to contradict the express terms of the agreement.

In addition to common law "good faith" requirements, some states have franchise "relationship" statutes that require good faith conduct on the part of a franchisor (*see* franchise "relationship" statutes, discussed question 9.1, *supra*, and 14.1, below). These specific state statutes can override contractual language, and prohibit, amongst other things, unfair or inequitable conduct by a franchisor, or require "good" reasons for termination, sometimes regardless of what the franchise agreement may say. *See* e.g. MN Stat. §80C.14 (prohibiting unfair or inequitable conduct); NJ Stat. §56:10-7 (e) (prohibiting the imposition of "unreasonable" standards of performance on franchisees); CA Stat. BPC §20020 (requiring a "good faith" reason for termination). Additionally, a franchisor's conduct, if it is sufficiently unfair, may become "unfair and deceptive" under other statutes (such as the FTC Act, discussed *supra* in section 3, and analogous state "Little FTC Acts", *See* §9.1 *supra*).

While there may not be a blanket requirement in the United States that a franchisor conduct itself at all times with fairness and reasonableness, franchise systems that take unfair advantage of their franchisees may find themselves unable to sell new units if their franchisees are unsuccessful or unhappy. In the highly competitive United States franchise marketplace, negative reviews by franchisees can have a real impact upon franchisors, especially since franchisors must disclose (in their FDD) when their units close or fail. Therefore, while there may not be a legal requirement to act fairly and reasonably in every instance, franchisors should think carefully before putting immediate economic gains before the long-term health of the system.

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?

Franchise disclosure and registration laws only govern the franchisor's actions prior to the offer and sale of a franchise; they do not regulate the continuing relationship between the franchisor and franchisee once a franchise relationship has been established. Eighteen states (along with Puerto Rico and the U.S. Virgin Islands) have enacted laws that govern the substantive aspects of the franchise relationship after the offering and sale of a franchise ("relationship laws"). While franchise relationship laws vary from state to state, they share the common goal of trying to balance the unequal bargaining power that franchisors have over franchisees.

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Relationship laws generally: (i) regulate the franchisors' ability to terminate or refuse renewal of the franchise agreement; (ii) impose restrictions on transfer; (iii) grant franchisees the right to form an association with other franchisees in the same system; (iv) prohibit franchisors from treating similarly situated franchisees differently without cause; and (v) obligate the franchisor to repurchase inventory upon termination or non-renewal of the franchise.

In addition to state franchise relationship laws, there are federal and state laws that govern franchise relationships in specific industries, such as: gas station operations; automobile dealerships; hardware distributors; real estate brokerage; 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 without "good cause". Good cause means that the franchisee has not substantially complied with the material terms of the agreement or has engaged in other acts that have damaged the franchisor's reputation, the franchised business or the franchise system. Such acts include, but are not limited to, the franchisee: (i) voluntarily abandoning the franchised business; (ii) becoming insolvent or bankrupt; or (iii) selling competing goods. If there are sufficient grounds for termination then some states may require the franchisor to provide notice of termination to the franchisee and give the franchisee an opportunity to cure such violations. In the event that a franchisor elects not to renew a franchise agreement, the franchisor (under certain circumstances) must either: (i) offer to buy the franchise, if the franchisee owns the station; or (ii) give the franchisee the opportunity to purchase the premises from the franchisor, if the franchisor owns the station.

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?

A franchisee's right to renew its franchise agreement is typically conditioned on a number of factors, including, among other things, the franchisee executing the franchisor's then-current form of franchise agreement. More often than not, the franchisor's then-current form of franchise agreement may contain terms that are materially different than the terms of the franchisee's existing franchise agreement. Under the FTC Franchise Rule, if the renewal franchise agreement contains materially different terms, then the franchisor must adhere to the pre-contract disclosure requirement and provide the renewing franchisee with its then-current FDD.

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 contract as they deem appropriate, including the freedom to negotiate the initial term of the franchise agreement and any renewals thereof. However, this freedom is not absolute; particularly since the scale of bargaining power is tipped in the franchisor's favour. While there is no automatic renewal right under state law, some state franchise relationship laws restrict a franchisor's ability to refuse to renew a franchise agreement. The restrictions on refusing renewal differ state by state, with some states requiring that the franchisor: (i) have "good cause" or "just cause" for refusal to renew; (ii) provide franchisees with at least ninety (90) days' (and in some cases, six (6) months') prior notice of the franchisor's intent to not renew the franchise agreement; (iii) repurchase the franchisee's assets; and/or (iv) waive any non-competition restrictions.

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?

In general, franchisees are not entitled to compensation or damages because a franchisor has refused to renew the franchise agreement. This may not be the case, however, where a franchisor violates a state relationship law that restricts a franchisor's right to refuse to renew a franchise agreement, as described in question 15.2 above. In addition, some states have franchise relationship laws that require franchisors to repurchase a franchisee's business assets, under certain circumstances. The statutory repurchase obligations imposed by states vary on: (i) what must be repurchased; (ii) the calculation of the repurchase price; (iii) whether the repurchase obligation is triggered by the franchisor's wrongful termination; or (iv) if the repurchase obligation applies in the event of termination and non-renewal. In Iowa, for example, a franchisor must repurchase the franchisee's assets at fair market value as a going concern, and in Washington, franchisors must compensate for goodwill, unless the franchisor agrees (in writing) to not enforce the non-competition provision. In Arkansas, Hawaii and Washington, the franchisor is obligated to repurchase the franchisee's inventory, supplies, equipment, and furnishings; while in California, the franchisor is only required to repurchase the franchisor's inventory. Hawaii requires the franchisor to repurchase inventory from the franchisee upon termination, whether or not termination was for good cause.

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 in the ownership interest in the franchisee) without the written consent of the franchisor. Franchisors in the U.S. are permitted to impose reasonable restrictions (typically, referred to as "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, 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 the franchisor as most franchisors are not interested in "taking over" additional locations which are in their system by purchasing them at fair market value.

A few state relationship laws impact on a franchisor's ability to impose restrictions on the franchisee's ability to transfer its

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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 or capricious. 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, the franchisee's spouse or heirs will have a reasonable time to elect to operate or own the franchised business, so long as the individual 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 contain provisions which provide that the franchisor, under certain circumstances, has a right to "step-in" and take over the operation 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. Other times, the franchisor declares that it is terminating the franchise agreement and takes over the franchised business (i.e., asserts "step-in" rights) where a franchisee is failing financially, has abandoned the franchised business, or where the franchisee (or its principal(s)) has engaged in egregious conduct which is likely to negatively affect the brand's reputation or good will, such as knowingly defrauding the franchisor, using the brand's trademarks for unauthorised purposes or being found guilty of a felony or crime of moral turpitude.

While there are no registration requirements or formalities that must be complied with in connection with a franchisor's enforcing "step-in" rights (other than complying with "notice" requirements contained in the franchise agreement), the franchisee and/or the landlord will often 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 seek injunctive relief in the courts. Where the franchisee files for federal bankruptcy protection before a franchisor tries to enforce its "step-in" rights, the bankruptcy filing may result 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 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 the 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 country 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?

Franchisors do not generally use powers of attorney in attempting to enforce "step-in" rights provided for in the franchise agreement, as doing so may lead to an improper (or even illegal) use of "self-help". However, upon the transfer or termination of the franchised business, franchisors are permitted to use powers of attorney in order to provide for the orderly (and peaceful) transfer of telephone numbers, fax numbers, and internet domain names, etc., used by the franchised business.

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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. Mr. Rosen is listed in: *Who's Who in America*; *Who's Who in American Law*; *Who's Who in the World*; *Best Lawyers in America;* "101 Best Franchise Lawyers in America" (*the Franchise Times*); the *Franchise Times'* "Hall of Fame" of Franchise Attorneys (a charter member); *Best Lawyers in the US;* Franchise Attorney of the Year, New York, 2015; *America's Super Lawyers*; *Best Attorneys In America*; *Who's Who Legal*: *Franchise*; and *International Who's Who Legal* (compendium edition), and is a recipient of the Global Award for Franchise Law. Mr. Rosen and his firm are the authors of the section on Franchise Law in the United States which appears in the Third and Fourth Editions of the (International) *Franchise Law Review*. In 2016, Richard Rosen was named Franchise Attorney of the Year for the U.S. by *Lawyer Monthly*.

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The Richard L. 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 franchisees, franchisors 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 and 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, generally. We have represented franchisors and franchisees in virtually all fields, including restaurants, real estate brokerage, health care, fast food, fitness, energy, hospitality, education, health and beauty, telecommunications, senior care, courier services, apparel and more. The Richard L. Rosen Law Firm, PLLC is highest-rated by Martindale Hubbell and amongst franchise law firms in the U.S., generally.

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