ICLG

The International Comparative Legal Guide to:

Franchise 2019

5th Edition

A practical cross-border insight into franchise law

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IFA's Role Shaping the History and Future of Franchising

International Franchise Association

Andrew Parker

Great institutions often begin with a simple idea. The founders of the International Franchise Association were not only visionaries, but also agents of action. They set out with an idea to build an association that would represent the ideas and interests of the business model that helped them achieve success. Today, IFA continues to carry out the mission of protecting, enhancing and promoting franchising as it spreads across the globe.

IFA began as an organisation representing only franchisors. Today, the association represents more than 1,400 franchise systems worldwide. In addition to expanding in the U.S., more than one-third of IFA members are based in international locations.

From the original goal of advancing franchising in the United States came the recognition that as franchising grew, ensuring best practices in franchise management was going to be important internationally. As the world's oldest and largest franchise association, IFA has served for decades as a member of the World Franchise Congress, an international organisation of franchising associations that are dedicated to advance, enhance, protect and support best practices in franchising management the world over.

Early Pioneers

IFA was founded in Chicago in 1960 by a handful of franchise leaders led by William "Bill" Rosenberg, founder of Dunkin' Donuts. Each person attending the inaugural gathering contributed $100 to help finance the start of the association. By the time these leaders had met, modern day franchising had already begun to show its potential for changing the economic vitality of the U.S. by producing jobs, creating small businesses and supporting the rapid development of the middle class in the post-World War II economy. The widespread acceptance of branded products and services in the expanding economy was already providing significant benefits to consumers.

IFA's founders realised that as franchising grew in importance, challenges would undoubtedly arise, as this frequently occurs in any rapidly growing emerging industry and, they anticipated that there would be a movement by the government to regulate franchise practices. Having a strong association that could educate legislators and other government officials about franchising and influence their ideas for a proper regulatory structure, would be essential. From that single meeting, IFA came into being and has, ever since, benefited franchisors, franchisees and consumers worldwide.

Franchisee Inclusion

The importance of franchisee inclusion came into sharp focus when two of IFA's founding franchisee members, Steve Siegel (then with Dunkin' Donuts) and Lawrence "Doc" Cohen, CFE, (Great American Cookie Company) in 2002 and 2006, respectively, took on the role and responsibility of leading IFA. They laid the groundwork for today's Chair, Marriott International's Liam Brown. IFA represents more than 10,000 franchisee-members, with industry-leading single and multi-unit franchisees serving as members of the IFA Board of Directors, Franchisee Forum and on every IFA committee and task force.

Rounding out what former IFA Chairman Russ Frith, CFE, (Lawn Doctor) called IFA's three-legged membership stool are the more than 600 professional advisors and supplier firms that support franchising. Suppliers have played an important leadership role in the organisation since 1968 when attorney Philip Zeidman, a partner of Brownstein Zeidman & Shomer (now DLA Piper), was appointed general counsel when the association moved its headquarters from Chicago to Washington, D.C.

Participation in the IFA leadership is available to all members based on the bottom-up structure designed to encourage our members to contribute and lead through committee and task force membership; Franchisor, Franchisee and Supplier forums; the Franchise Education and Research Foundation; the board of directors; and the Executive Committee.

IFA Foundation

Supporting the membership and contributing to the direction of IFA is its Franchise Education and Research Foundation headed by its President, Mary Heitman. The essential role of the Franchise Education and Research Foundation is to: conduct research, publish position papers, and create a range of publications and courses to provide information about franchising; and advance best practices in the management of franchise systems, small-business operations and franchise relations on a global basis.

One of the most important accomplishments of the IFA Foundation came in 1991 when it established the Certified Franchise Executive (CFE) programme to elevate professional standards in the field of franchise management.

Similar to certification programmes in other professional organisations, the CFE is recognised as an important designation of competence in franchise knowledge and management excellence.

Since 1991, nearly 1,200 franchise professionals have earned the coveted designation of CFE that requires a diverse and rigorous course of study, the successful completion of examinations, and a proven level of contribution and support to franchising. More than 2,000 IFA members are engaged in the programme as CFEs and candidates.

Framework for Franchising

Headquartered in Washington, D.C., IFA supports its membership with more than 45 professional staff led by the President and CEO Robert Cresanti, CFE. Guided by our Code of Ethics and Statement of Guiding Principles, IFA continues to provide a framework for developing and maintaining healthy, productive and mutually beneficial franchise relationships.

Keeping the performance of franchising strong requires a resolute presence on Capitol Hill and at the local level. Through our political action committee, FranPAC, the IFA has raised millions of dollars in support of business-minded congressional candidates. With the leadership of the IFA's Legal-Legislative Committee, members of our legislative staff, professional consultants and the IFA membership at large, IFA has grown to be one of the major voices for free enterprise on Capitol Hill today.

Protecting Franchising

In 1992, IFA began National Franchising Week, the brainchild of past chairman, U.S. Navy Rear Admiral Bernie Browning, the founder of General Business Services. In the ensuing years, National Franchising Week has evolved into the popular Franchise Action Network Annual Meeting, formerly called the Public Affairs Conference, where each fall, hundreds of IFA members meet in Washington D.C. to conduct committee meetings and to be educated on national and international affairs and economic trends.

Through meetings arranged by the IFA's staff, association members meet with their elected officials on Capitol Hill to educate and inform them and the news media about the franchise model, the impact of regulatory changes and key issues facing franchising and small business.

Our work at the grassroots level is equally important to the successful progress of franchising. Through member-sponsored local Franchise Business Network meetings the grassroots Franchise Action Network and working with World Franchise Council member associations, IFA with its members and partners, work to educate officials and the media, making the voice of franchising heard. IFA's Annual Convention, Legal Symposium, Franchise Marketing and Technology Conference, and FRAN-GUARD, our comprehensive programme of franchise sales compliance, provide members with a wide-range of programming to advance franchise management best practices.

As IFA looks forward to a more expansive future, it is important to reflect on the leadership and ideas that have made the franchise community what it is today. Help us spread the positive impacts of franchising across the globe.

For more information about the International Franchise Association, visit www.franchise.org.

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Find out more about IFA at www.franchise.org.

IFA
INTERNATIONAL FRANCHISE ASSOCIATION

Celebrating 58 years of excellence, education and advocacy, the International Franchise Association is the world's oldest and largest organisation representing franchising worldwide. IFA works through its government relations and public policy, media relations and educational programmes to protect, enhance and promote franchising. IFA members include franchise companies in over 300 different business format categories, individual franchisees and companies that support the industry in marketing, law, technology and business development.

The Future is Franchising

British Franchise Association

Emily Price

The UK Perspective

An unregulated environment may seem attractive to companies wishing to start and build a business. On the surface, there are few boundaries, limited regulatory hurdles, and free reign to market however and to whoever they wish. This unfortunately does not bode well for a sector looking to build credibility, strengthen growth opportunities and evidence a commitment to operate in a responsible way to partners and consumers.

Proving the Standards-Based Concept

The British Franchise Association ("bfa"), set up in 1977, is the self-regulatory body for UK franchising and first and foremost promotes a standards-based model to any business looking to franchise. From initial franchise set-up, through to successful franchise operations with significant trading histories, we represent franchisor members of all sizes to ensure the industry remains on an upward trajectory. Our membership categories are developed to ensure that companies adhere to and understand expected standards as their business grows and the bfa operates as a key partner throughout this journey. The transparency and openness instilled amongst member companies enables us to access industry intelligence, identify risks early and offer support mechanisms to assist where required. Most important to the UK industry, the membership lifecycle provides a regulatory framework that helps the bfa protect the industry from malpractice and reputational damage. This lifecycle, until very recently, could only commence once a company had traded for a minimum of 12 months and proved their franchise model. As with all businesses and industries, environments evolve, and the association continually assesses this to ensure it does not stand still in the role of being a UK self-regulatory body. In fact, quite the opposite, the bfa embraces change with agility and pace. In order to deal with the ever-changing UK landscape, we are required to innovate, lead the way with our initiatives and ensure that we enforce standards to continue protecting the brands we represent. This is where the bfa's latest category comes in, one which will see the bfa educate and influence inbound brands.

A Leading Franchise Association

International franchising can be complex, costly and time consuming. Entering a new environment with little knowledge and experience along with a limited professional network can pose difficulties. One of the biggest challenges we see is a lack of trust and often poor advice given to brands that are looking to complete due diligence checks and feasibility studies in the UK. The bfa is keen to work with and support businesses at this very early stage of their development and this is why the *UK Developer* category is particularly relevant. UK Developer is open to any established international business that can prove a successful model and network with excellent support in their country of origin, followed by a willingness to be open and seek guidance during the transitional stages to the UK. The bfa acts as the trusted point of contact, providing valuable UK insights and supporting the introductions of key professional partners for the UK development. Central franchise model documentation requiring alignment to the UK environment will be part of the development criteria. Items such as the franchise agreement, promotional materials featuring disclaimers and operations manuals, not only instructing the day to day business operations but including operational guidance for becoming a business owner and managing finances, HR and taxes, are included. The main reason for franchising becoming a well-recognised and popular growth model for businesses is because a proven concept sits at the heart of every successful network. When expanding internationally, this does not automatically mean replicating the model will generate the same success. Culture, economic conditions and social trends need to be considered. The bfa always recommends piloting the franchise concept first before moving into the recruitment of unit franchisees, whether this is done directly by the international franchisor or in a country with a master franchisee.

The bfa is the first of any franchise association to introduce accreditation standards for brands outside of their home country and goes some way to promote the high standards set for UK franchisors with expectations clearly communicated from the outset for inbound brands. This offers both support and education to inbound brands and further protects the UK from potential habits creeping in which may not be conducive to sustaining the reputation of the industry.

Education is Critical to Success

The bfa's vision is to become the leading educator in franchising. The Franchise Training Academy has been created and provides a framework structure offering support to franchisors, franchisees and prospective franchisors and franchisees. The products and services developed and delivered within the academy add value to franchisor journeys and exist to strengthen knowledge and opportunities for them and their franchisee businesses. Multiple campaigns supported by bfa members and sponsors enable the bfa to reach the UK public outside of franchising, educators and influencers and allow franchising success stories to be shared. The stronger the industry, the better the story and therefore the more people that may be attracted to it; it is a self-fulfilling prophecy

that benefits everyone. Prospect education is key to facilitating a healthy growth environment. The bfa offer services to prospective investors that support their due diligence and ensure they are fully versed in franchising, what they should be considering and how they can narrow their search for the ideal investment. On the flip side, services for prospect franchisors are also offered to provide people with an honest view of what to expect when franchising their business, from costs to challenges to timescales.

An Industry Intelligence Led Curriculum

Products and services delivered by the bfa evolve by way of relevance to the industry and our stakeholders at any given point in time. What are their challenges? What do they need now? What do they need that they may not even know they need yet? We become the eyes and ears. There are many risk areas that we identify and look to raise awareness of so as a collective we learn and strengthen from one another's mistakes. This approach works well for many.

Network churn rates

The bfa keeps a close eye on churn rates within franchise networks. It forms part of any joining member's application criteria and ongoing reaccreditation monitoring. We want to ensure franchisees are being supported correctly but we also want to ensure that franchisees are being recruited correctly too. In some parts of the world, high franchisee recruitment figures are deemed a positive stat – the higher the better. That is not the case in the UK; we know that franchisors should not be making profits on initial fees, we also know that franchisees need the majority of head office resource in their induction and training period, early in their franchisee journey. We need to see that franchisors are geared up to offer the correct level of support to new incumbents and are committed to the long-term partnership required for both franchisee and franchisor to satisfy the franchise investment. Large franchisee recruitment targets are often a red flag and would definitely pose the question of operational structure growth and support to fully embed and sustain the growing network.

Communication and transparency

The bfa offers informal conciliation, mediation and arbitration services to its members and we receive a number of concerns from disgruntled franchisees looking to obtain solutions with their franchisor. More often than not it is simply a case of communication breakdown. With a little clarity on the concerns and transparency to resolve, the majority can and do iron out issues and move forward positively in their partnership. Franchisors however sometimes forget that when making network-wide decisions it is important to involve that network. Franchisee council groups are a popular way of doing this and when set up correctly can also act as a motivational tool to the network. Those that are performing well as business owners are essentially awarded their views and opinions at the table with decision makers. There are a number of franchisors that have yet to see the opportunities to them of leveraging their franchisee network as an extended market research and communication facility. All franchisees have a vested interest for the growth of brand reputation and awareness, along with the ongoing development of products and services to remain competitive and fresh in the marketplace. Using this interest and feeding from it – keeping communication channels open – hold so much more benefit to the franchise network other than monitoring bottom line numbers.

Piloting the model

Whether domestic or inbound, all franchisors should be clear on their financial evidence. If providing projections or claims, there must be disclaimers specifying on what they are based. This is key to facilitating honest recruitment conversations and setting realistic expectations from the outset. Piloting should not stop in year one, two or three. Any change of strategy, the introduction of new products and services, or adjustment to the operational model requires stress tests. It is popular in the UK for a franchisor to facilitate this through a company owned unit or potentially support a franchisee within the network that will trial and feedback. The bfa asks for its members to provide updates if there are changes to operational models that may have significant financial impact, especially if the franchisor is looking to communicate these changes in their recruitment marketing.

Entrepreneurial Trend

In the not so distant past, 'entrepreneur' was a word avoided by franchisors in their search for franchisees. The ideal profile was considered to be someone that would simply follow the franchise business model and not question the *status quo* or norms of the operation. This did work initially, though franchising, like any business model, has evolved. More recently the search for franchisee partners has moved into an entrepreneurial space, with people that have a burning desire and ambition to succeed with no limits. This has also unlocked two new types of franchisee that are proving franchising doesn't have to be small business.

Multi-unit franchising

Multi-unit franchisees are often attracted to the continual growth opportunities presented in networks. The ability to own multiple territories and build teams provides a wealth of long-term value and has brought to the fore a swathe of investors with different motivations, such as people looking to build substantial assets, go into business as a family and create a secure future for their children. With many more franchise concepts on offer today than there were 10 years ago, it also means that a franchisor's fight for franchisee investment is tough, the competition is on and therefore the continual search for network growth has encouraged franchisors to look to the network they currently have. Growth accelerator programmes, professional network coaches and mentors and a new suite of leadership training are strategic support mechanisms being developed to upskill, empower and expand the network performance without adding franchise partners. This approach generates efficiencies for franchisor support resources as ultimately they have fewer partners to engage with directly, without losing brand and service coverage.

Multi-brand franchising

Multi-brand franchisees are well-versed in leading large teams, managing multiple priorities, and promoting different franchise concepts. This model often sees a franchisee with an appetite to invest heavily in a centralised support function employed by a ltd company. This company and its owner (the multi-unit franchisee(s)) then seek to engage different brand opportunities and depending on their strategy this could be franchises operating in similar sectors or, as is more often the case now across different sectors, to spread the risks associated with investment. We often find economic challenges

breed peaks and troughs in franchise sector demands. Most recently, the ageing population and focus on public health to reduce strain on the NHS has meant both domiciliary care and fitness franchises are in high demand. It is not unusual that franchisees residing in this investment category are often representing multi-million pound portfolios and are sought after by franchisors as proven franchisee ambassadors delivering positive results with their chosen franchisor partners.

Growing Pains

As with any industry trend there are some difficulties that need to be managed. The bfa has identified some significant challenges in the last year or two that require action to enable continual positive progression in the sector.

Financial awareness

More often than not, when accrediting businesses applying for membership the franchisor financial projections just do not add up. This isn't necessarily because they are not successful but more due to the fact they are over projecting potential income. The association requires franchisors to market only projections they can evidence and encourages franchisors to be modest with these figures so as not to fall into the trap of false advertising on the earning potential and threat of misrepresentation claims. It is not just the franchisors that need to be familiar with their numbers; it is highly likely that a franchisee will have presented business plans to the bank to obtain funding but also to the franchisor to prove their business abilities during the recruitment process. For many franchisees, investing in a franchise is their first experience of running a business and therefore financial support and training is important. The bfa has developed some financial training for franchisees to help them complete management accounts and manage cash flow. Financial management is critical to the success of business owners and therefore should form part and parcel of the training and support offered by franchisors during the onboarding process.

Commercial property

A large proportion of franchise opportunities depend on property locations to be successful. However, in the UK, securing properties can be difficult. Limited availability on the high street and secondary locations, coupled with slow council approvals for change of use planning where required, is proving challenging for franchisors in their ambition to open new locations. This has resulted in a number of UK networks being stopped in their tracks and having to rethink the early stages of their business model. It is all well and good recruiting 30–40 or even more franchisees, but if not operational and unable to commence income generation, franchisors reap no rewards. In some cases, franchisors are looking to adapt their models to overcome these challenges.

Trusting the team with the vision

Franchising in the early years may seem like the ideal fit for a business as is enables quick brand and service coverage, essentially utilising franchisee money. The founder of the business is often highly engaged during the period and able to keep abreast of the details and performance across the business. As the franchise grows, however, this same level of engagement cannot be sustained and the founder is often forced to make a decision to step away and recruit a management team that can facilitate the continued growth of the business. It is at this point the bfa sees a level of fall out within the membership. The founder sometimes struggles to make this transition or fails to do so and as a result the network struggles. The bfa, within the training academy, has identified a need for leadership training to support this growth challenge.

Failure to launch

By the very nature of franchising presenting a growth opportunity that seems appetising to many small business owners, it does mean the industry is at risk of people looking to franchise their businesses with little information, only really focusing on the financial gains. When the correct frameworks are not in place and qualitative research is not carried out, franchisors can fall into some costly traps. Businesses also fail to realise it is not just a case of selling territories to franchisees and being done with them. Support is critical to the ongoing success and performance of a network which in itself is costly and requires continued commitment. On average, 4% or 5% of the association's membership losses each year can be attributed to the provisionally listed companies residing in this category.

Strength in Numbers

The most recent bfa Natwest Survey headline figures evidenced year-on-year growth within the UK franchising industry, contributing over 15 billion to the UK economy and employing over 600,000 people. Even during the economic downturn of 2008, franchising grew and this recession-proof concept is not just suited to the small businesses looking to grow. Corporate businesses are also looking to franchise. Transferring company-owned stores to franchisees not only provides a cash injection to the business but means the brand is led at ground level by owners committed to making the business work, delivering the best service and working in collaboration with the franchisor to ensure marketplace competitiveness.

Failure rates in franchising remain at below 5% and present a much lower risk opportunity than going into business alone. This also presents a better chance of obtaining the funding required for investors. UK banks are happy to do business in franchising, especially where the brand has an established trading history and the franchisor has a reliable financial background. The bfa strongly recommends building relationships with all financial institutions during the franchise pilot phase and beyond. This relationship enables vital funds to be accessed when investment is most required, whether that is to support research and development, technology and system upgrades or structural growth to buy in and train the right people.

Closing Summary

Overall, the UK franchising landscape is a positive place to do business and business is growing well. The bfa has a close eye on the industry both in the UK and across regions. Our role at both the European Franchise Federation and World Franchise Council level does mean we are well versed and have both knowledge and key relationships at our fingertips to add value and context to our members. The membership continues to thrive and franchising is growing both in quality and reputation, which is something the bfa is very proud of. The bfa welcomes conversations with anyone wanting to get in touch or explore franchising in the UK and we are happy to support and share insights. To find our more, or for an impartial chat, please do contact us at mailroom@thebfa.org or visit our website www.thebfa.org.

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Emily Price is the Head of Operations at the British Franchise Association (bfa). She worked alongside the Senior Leadership Team in HR at Barclaycard on global business transformation projects before joining the Association in 2013. Emily is responsible for the implementation of business strategies, plans and processes at the bfa and has had detailed input into the strategic direction of the Association. Emily is a passionate advocate of great leadership, people development and franchising. She regularly writes on franchising matters both regionally and nationally and recently launched the bfa's 'Future is Franchising' series of articles to provide advice and guidance to franchisors at all levels of growth. Emily was instrumental in developing a UK Developer Category for businesses looking to bring their franchise concepts into the UK market. She is highly respected in franchising for her depth of knowledge, experience and delivery and is a frequent speaker at the National Franchise Exhibitions and other major events in the UK.

The British Franchise Association (bfa) defines and enforces the ethical standards for business format franchising in the UK. Established in 1977, the Association is a self-regulatory body proudly run by its members to champion the growth of the UK franchising sector. Promoting best practice through education and training, the bfa is a passionate advocate of excellence in the whole franchising community.

The vision of the BFA is to empower, promote and connect people in business by becoming the leading educator in franchising. To support this vision the Association has established a Franchise Training Academy to be the fundamental source of key skills and techniques, driving the adoption of best practice in the UK franchising sector. The education of potential franchisees and franchisors is at the heart of what the bfa is and does. Equipping prospects with a crucial understanding of franchising is essential not only to their success, but to the success of the whole sector.

The Future is Bright – the Future is International

DLA Piper UK LLP

Iain Bowler

If you are considering franchising for the first time, or you are looking for information about key issues relevant to franchising in your domestic market – read on! This guide is as much for you as it is for brands that are looking to expand their franchise system into additional geographic markets.

The high street in many of the world's leading economies is becoming increasingly difficult and growth in those economies is often stagnant. Some sectors, including retail and the casual dining sector are facing particularly challenging times at the moment with sales falling and margins becoming thinner. Nevertheless, the requirement for growth is relentless, resulting in brands adopting strategies to increase the rate of growth in terms of increasing the number of new unit openings through multi-unit franchising or joint venturing with credible operators who will commit to a multiple unit development programme, seeking to work their existing infrastructure and assets harder by taking on additional non-competing brands and adopting a multi-brand strategy and by expansion into new overseas markets, particularly in countries where there is a burgeoning middle class hungry for brands and with money to spend. 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 need for growth with the need to mitigate some of these corporate risks often leads businesses that have not previously been franchised to consider whether franchising can give them the opportunity they are looking for. The answer in many case is "*yes, it can*".

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 customers. As a result, new and relatively underdeveloped markets are being targeted by businesses that are finding their established markets saturated and increasingly stagnant in terms of growth. We are also seeing an emergence in the franchising of online pure play businesses, facilitated by the power of the internet and social media platforms to reach millions of potential customers and by consumer demand for high levels of convenience and customer service.

International expansion should be carefully planned; it should be strategic – carried out with the aim of delivering a pre-defined goal, and with the approach being tailored to deliver the commercial objective. International expansion, done right, is not easy, and it requires investment. Take Starbucks' expansion into China as an example. Having entered the Chinese market in 1994, Starbucks encountered nearly five loss-making years while it educated the Chinese people about coffee and the café culture and built the brand's reputation. But by 2020 China will have become Starbucks' largest market, eclipsing the US in terms of numbers of units, with a new unit opening in China every day for the next five years!

There are a number of ways to introduce your brand, products or services to new markets, and modern businesses with international 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 franchising 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, leverage enables the franchisor to replicate successful franchise units time and time again at relatively little cost to the franchisor. However, the costs of setting up the franchise system in the first place, and 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 in developing the system including a workable and palatable (to a franchisee) set of franchise documents will therefore repay you many times over.

Consequently, the first piece of advice I give to a client considering international expansion 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 to deliver your 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, others call it due diligence. Whatever your preferred turn of phrase, the message is always the same, *Proper Planning and Preparation Prevents Poor Performance*.

Part of your evaluation will include an analysis of your supply chain, and how the supply chain can be expanded to support multiple franchisees in multiple countries. Joyce G. Mazero and William W. Sentell look at this subject in greater detail in Chapter 4. Another important aspect of your evaluation will be to balance the

amount of control you want to retain over the franchise network in a particular country against the rate of growth you want to achieve. In franchise terms, there is an inverse relationship between control and rate of growth – the greater the amount of control you retain (for example, by the franchisor entering into direct franchises with overseas franchisees) the slower the rate of growth; whereas if you are prepared to cede more control to another party (be that an area or regional developer, a joint venture partner or a master franchisee), the rate of growth – in terms of a new unit opening – will be exponentially faster than under a direct franchise model.

Let us now imagine we are in your office: the office of the General Counsel of a well-known fashion retailer, "Dyzzy", which has 35 company-owned stores in the UK. Dyzzy also has three third-party-owned stores operating under licence at three UK airports. Recently, Dyzzy's owner Ric Coull appointed a former New York investment banker as Dyzzy's Development Director to oversee the international growth of the Dyzzy brand with a view to creating a means by which Ric Coull will be able to realise some of the equity in the Dyzzy brand in a few years' time. Ric Coull is in his late 40s, and having spent the past 15 years building the Dyzzy 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 value of the brand he created.

Earlier in the year, Ric attended a franchise conference presented by a global law firm and a 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 franchised businesses for significant amounts of cash struck a chord with Ric.

You are in your office. The phone rings and the Development Director asks if you have a minute. A voice in the back of your head says "*Here we go!*". The Development Director explains that he and Ric have been talking and that Ric thinks the Dyzzy brand will go down really well in a number of different countries. He also tells you that he has been researching countries where franchising is a recognised method of business expansion. He talks about rapid growth rates amongst franchise systems over the last few years in Brazil, Mexico, India, China, and South East Asia. He talks about the importance of market penetration and about the need to build the international business rapidly over the next two to three years to ensure that the business will be attractive to a prospective buyer. Then, just as you think your head is about to explode, the Development Director also mentions that he has a vision for introducing Dyzzy brand concessions into a number of leading department stores in the UK, France and Germany, and then possibly the US and Canada if the concessions in Europe go well, under a series of brand licensing deals.

You return to your office. You are excited. You are impressed by the 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 2019*. 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 business people who need to develop an understanding of the key regulatory, legal and practical considerations that need to be considered when contemplating an international business expansion plan through the medium of a franchise system.

But do not 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 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 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 US), corporate law and data privacy compliance and cyber risk (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 Dyzzy Retail plc, you may already be familiar to some degree with a number of these issues, 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 used 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 overseas. 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*" (*Proper Planning and Preparation Prevents Poor Performance*) approach to successfully planning for and implementing your business's international 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 mergers and acquisitions, stock exchange and complex commercial and joint venture work. Between 1998 and 2002, Iain was Director of Corporate Finance at a corporate industrial developer, 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 – consistently ranked Band 1 by *Chambers Global Directory* and recognised as the International Franchise Law Firm of the Year by *Who's Who Legal* for the 14th 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.

Global Supply Chains Supporting International Franchise Expansion: The Impact of Blockchain Technology

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I. Introduction

A successful franchise system relies on the ability of company-owned and franchised outlets operating under the franchisor's brand name and business system to deliver high-quality products and services in the most efficient and sustainable way possible. This is best achieved through strategic and competitive use of a franchise system's supply chain. A broken or compromised supply chain can have deadly consequences on a franchise system including failing to timely deliver products to outlets necessary to meet consumer demand or providing adulterated products for consumer consumption.[1]

Blockchain's reputation as a dynamic delivery system has its origins in cryptocurrency transactions such as Bitcoin.[2] Bitcoin utilises blockchain as its shared ledger to track the movement of any asset and record any transaction.[3] Although Bitcoin is the first "use case" for blockchain, other companies also use blockchain to "manage the flow of goods and related payments, or enable manufacturers to share production logs with original equipment manufacturers (OEMs) and regulators to reduce product recalls".[4] For example, Walmart has utilised blockchain technology to drastically reduce food tracking times.[5] With the use of blockchain, it now only takes seconds to locate the tracking information when it took days of searching through paperwork before.[6]

Moreover, the application of the blockchain to the global supply chain may soon become the "standout" example of how blockchain technology can revolutionise the world's product delivery systems including solving a myriad of problems that plague the international franchise development process.[7] As IBM's Manav Gupta has explained:[8]

> "Supply chains are prime examples of blockchain's potential for transformation that spans industries. Initial blockchain efforts could have quick impact by transforming even a small portion of the supply chain, such as the information used during importing. If import terminals received data from bills of lading earlier in the process, terminals could plan and execute more efficiently and without privacy concerns. Blockchain technology could make appropriate data visible in near real-time (for example, the departure time and weight of containers) without sharing information about the owners or value of the cargo. Costly delays and losses due to missing paperwork could be avoided."

Recognised as the "leading enterprise blockchain provider",[9] IBM's cloud-based IBM Blockchain Platform is helping companies across various industries such as banking, finance, insurance, consumer goods, government, healthcare, automotive, travel and transportation, and media and entertainment to enhance their visibility and add value to their businesses.[10] In addition, the IBM Blockchain Platform allows users to build on a complete blockchain platform as well as develop and operate the blockchain all while counting on the highest level of blockchain security available, IBM Z, to protect against insider attacks and malware.[11]

Furthermore, IBM and Maersk, a Danish global leader in container logistics, have announced plans to create a joint venture that will use blockchain technology to provide more secure and efficient methods for global trade.[12] After the regulatory approvals are granted, the joint venture's goal "will be to offer a jointly developed 'global trade digitization' platform built on open standards and designed for use by the entire global shipping ecosystem".[13]

II. What is Blockchain?

Blockchain is a ledger containing certain attributes that make it attractive for doing business in a digital world.

Unlike most existing ledgers, a blockchain ledger is distributed and shared across a network. There is only one ledger and, thus, only a single source of reliable information. In the world of blockchain, there are no "trusted third parties" or intermediaries such as a bank or a broker. Instead, the network participants themselves essentially police the system and verify transactions through a process called consensus.

The mechanics of the consensus process vary depending on the application. In the Bitcoin example, the system is public and the requirements for verification are more onerous. In other use cases, where the network may be private, the verification process may be less demanding. In each case, the blockchain is designed to reward truth and transparency. Hijacking the blockchain is not easy, because a majority of participants would have to conspire to provide false information. Because the ledger is distributed and shared by an unlimited network of users, there is even greater visibility and auditability.

It is not perfect, but over time there is a snowball effect made possible by the scalability of massive digital networks. Once a series of transactions is committed to a block, the creation of new blocks depends on the accuracy of the previous blocks. That process is repeated *ad infinitum*. In that way, the resulting "blockchain" is said to be virtually immutable and incorruptible. (See figure 1 – refer to end of chapter.[14])

Blockchain's utility in a supply chain supporting an international franchise system is far more impactful than its currency and bookkeeping uses. (See figure 2 – refer to end of chapter.[15])

This chapter will address the key benefits of using a blockchain strategy for international franchising and supply chain purposes as well as key business and legal challenges inherent in such a strategy.

III. Smart Contracts

In a blockchain, smart contracts are computer programs that assume the role of agreements where the terms of such agreement may be pre-programmed with the overall ability to self-enforce and self-execute the terms of each agreement. The primary purpose of a smart contract is to allow multiple anonymous parties to a given transaction to do business with one another. By leveraging this technology, the contract becomes easier to structure and deploy. Smart contracts are autonomous and automatic, eliminating human interference and reducing the potential for human error and increasing a party's access to valuable and timely information.[16]

Specifically, the terms of the contract are written directly into lines of code through a series of "if-then" functions.[17] "If" a certain condition is met, "then" the smart contract proceeds to the next coded step in the transaction with the process repeating until all of the necessary if-then conditions are met.[18] However, the smart contract cannot proceed to the next step until a node confirms and validates that the current transaction satisfies the pending condition.[19] A node is an individual device on a blockchain network that carries out a variety of tasks, including maintaining a copy of the blockchain as well as validating transactions.[20] When determining whether a transaction is valid, the node always independently comes to its own conclusion, irrespective of what the other nodes conclude.[21]

Uniquely, smart contracts enable the parties to observe one another's performance of the contract. Smart contracts can verify if and when a contract has been performed and further guarantee that only those particular details necessary for completion are revealed to the relevant parties. They also save valuable time and resources by possessing the ability to be self-enforcing and therefore making policing the contract less burdensome. Most importantly, smart contracts eliminate the need for a trusted intermediary.[22]

The "smart contracts" concept was originally conceptualised and utilised by Nick Szabo in 1994 through the use of Ethereum:

A smart contract is a computerised transaction protocol that executes the terms of a contract. The general objectives are to satisfy common contractual conditions (such as payment terms, liens, confidentiality, and even enforcement), minimise exceptions both malicious and accidental, and minimise the need for trusted intermediaries. Related economic goals include lowering fraud loss, arbitrations and enforcement costs, and other transaction costs.[23]

Moreover, Ethereum is the most prominent public blockchain platform for smartcontracts.[24] Specifically, it is a programmable blockchain that allows users to create their own operations.[25] Similar to other blockchains, Ethereum is a peer-to-peer network that utilises nodes to maintain and update the database.[26] In the Ethereum blockchain, smart contracts are executed through internal codes in a Contract Account.[27] When a transaction is sent to a Contract Account, programs execute and users are able to create new smart contracts by deploying code to the Ethereum blockchain.[28] For instance, an Ethereum project called Provenance conducted a six-month pilot that used blockchain technology and smart contracts to successfully track "responsibly-caught fish and key social claims down the chain to export".[29] Consequently, projects such as Provenance demonstrate blockchain's success in enhancing visibility in the global supply chain.

Whether domestic or international, the traditional supply chain management system's operations are based on utilising reams of paper. This system requires complex combinations of paper and the need for a third party to update information in the system leads to a party's inability to see and, in some cases, not even have access to the most recent transactions that have occurred in their transaction.

For example, after a company sends a purchase order to the supplier, the company often has no means of tracking the order's status until the shipment is received at the warehouse. As a result, there is "manually intensive and inefficient supply and demand management and reduced order fill rates".[30] In addition, "there is no central repository of data available to enable an analysis of what went wrong and how suppliers, carriers, and other third-party participants performed. This is primarily because the data required is distributed across various systems in warehousing, purchasing, transportation management, supplier systems, and carrier systems".[31] Moreover, in certain cases, the data does not even exist.[32]

In contrast, smart contracts are managed with a decentralised public distributed ledger and therefore are transparent to allow parties to see every detail of their transactions in an instant. Smart contracts integrate payment with blockchain technology as they arrange payments automatically at the same time as deliveries occur, ultimately making the transaction and payment more efficient and transparent. As a result, it is possible to self-monitor terms of agreements, certify transactions and facilitate or evidence certain transfers of payments, and automate the performance of contracts. International franchisors and their franchisees and suppliers would surely appreciate a more transparent and reliable supply chain because finding, negotiating, and enforcing supply contracts across countries can fail to meet even the most humble of expectations, resulting in the demise of a franchise relationship and the franchised business.[33]

Companies across various industries have already begun to utilise smart contracts. For example, French multinational insurance firm, AXA, is the first major insurance group to utilise smart contracts to offer flight delay insurance.[34] When a customer buys the insurance through the "fizzy" platform, the transaction is recorded on the Ethereum blockchain.[35] The smart contract is connected to global air traffic databases and if the flight is delayed for more than hours, then compensation is triggered automatically.[36]

In addition, the company Slock.it is utilising smart contracts to change the sharing economy through automating payments, sharing and rentals.[37] Specifically, the company Share&Charge, uses Slock. it's smart contracts to automate the payment process for renting electric vehicle-charging stations.[38]

Further, smart contracts are also being used for buying and selling real estate. Propy was one of the first companies to do so when a customer purchased an apartment in the Ukraine for $60,000.[39] Both parties to the transaction participated in the smart contract which ensured specific steps were taken to foster fair and legal play despite the challenges of the "across-borders" real estate marketplace.[40]

IV. Tracking and Faster Shipping Times

Franchisors must decide how to best source and assist in establishing sourcing and supply arrangements for its international franchisees. Sometimes these sourcing and supply arrangements can be established regionally in the franchisees' markets, but many times, at least initially, the arrangements must originate in material part from the U.S.[41]

Regarding the shipments of goods, the blockchain can transform the traditional, inefficient shipping protocol inherent in many international franchise systems into a process permitting standardisation and transparency, allowing senders and recipients

to track their orders in real time. One of the primary documents used in the shipping process is the "Bill of Lading". The Bill of Lading refers to the documents that specify the party responsible for a particular obligation in the shipping process at any given point from the time the goods leave the place of origin to the delivery destination. It lays the foundation for the terms for transport and delivery of the goods.[42]

By incorporating blockchain technology into the shipping process, a record of the Bill of Lading and the shipment's transport and transfer history is maintained and transparently available. For example, when a shipping company signs for a particular shipment of goods, accepting that shipment for future transport to its next destination, that signature will be recorded to the blockchain. The blockchain technology possesses the critical transparency necessary for maximised efficiency making that blockchain record available anywhere in the world with an appropriate timestamp. The recipient of the shipment or an invested party could effectively see the information about which company was responsible for transporting the goods at that moment and exactly where they last signed for it.[43]

If a problem arises with the company responsible for the shipment during transit, the traditional (non-blockchain) system steals away valuable time from the sender and recipient to troubleshoot the problem, thereby monopolising resources and incurring expenses that could have been used for a more worthy purpose. In general, shipping agreements are often complex as they may be bundled together or even subcontracted in such a way that the company responsible for the shipment lacks knowledge of anything about the entity who paid for the shipment or where the target destination lies. Because of the transparency protocol that blockchain inherently implements, all parties have the ability to see each and every completed block in the whole chain to successfully identify what issue occurred and how to find the appropriate solution, saving valuable time and resources while the shipment is still in transit.

Finally, blockchain technology has the potential to aid in certification. Currently, a company must place implicit trust in the shipping company to deliver goods safely. The blockchain essentially presents an automated service for the certification of the delivery itself, tamper protection, and certification of the authenticity of a given shipment's contents. This means that a company can have full certainty whether and how a shipment will arrive once it placed its order.

V. Advanced Security Systems and Fraud Reduction

When fraud occurs in a company, the repercussions can be devastating to its integrity, including loss of money, reputational harm to the franchisor's brand or other intellectual property ("IP") issues. Fraud may go undetected for a long time and is often hard to uncover resulting in a loss of valuable time and resources. Blockchain has the ability to minimise these risks and a franchisor's susceptibility to fraud.[44]

The blockchain contains transaction data that is continually reconciled, shared across a peer-to-peer network, and is decentralised.[45] Therefore, there is no single point of failure. Authorisation and management of the transaction data is distributed across the network and therefore there is no "honey pot" for an individual to instigate a fraudulent scheme. Decentralisation increases the transparency and visibility of the transactions completed between members throughout the supply chain. Because of this, parties have the ability to see the transfer of assets and the history of those transfers making fraudulent transactions easier to identify. To successfully tamper with the transaction records, an individual or group acting in collusion would essentially have to control the majority of the system.[46]

The blockchain is also immutable because the transactions recorded cannot be changed or deleted. Before a block of transactions can be completed and attach to the blockchain, the network parties must agree that the transaction is valid through a process known as consensus.[47] After agreement, the block of transactions is given a timestamp secured through cryptography and subsequently linked to the previous completed block in the chain. The benefit of being immutable is that a party can see the provenance of an asset such as the origin location, its history of where it has been, and who at any given point had ownership over it.[48]

Authenticity of a company's products is subject to challenge in a traditional supply chain because they are typically lengthy, complex and ultimately lacking in transparency. Implementing blockchain technology creates an immutable transaction history, which in effect will make it difficult to counterfeit a product.[49]

Franchisors routinely deal with trade secrets and other confidential data and information, the secrecy of which is critical to the brand's success; therefore, security must be maximised to the fullest extent to protect a franchisor's most valuable assets. Blockchain technology can ensure franchisors that unauthorised individuals or entities cannot access, corrupt, or steal their trade secrets, confidential information and other records by ensuring all persons having accesses are "permissioned". Permissioned networks restrict who is allowed to participate in transactions. Even if allowed to participate, permissioned networks can limit the extent of participation. Parties of a permissioned network must be invited and subsequently validated before they can be involved and contribute.[50]

A reoccurring issue that many franchisors face is the lack of adequate protection of IP such as trademarks, copyrights, and patents, which involve much more than simply securing protection for the purpose of attaining their full value. Considerable resources, time, and effort are required to implement an effective IP security protocol. This becomes even more important for non-registrable IP rights including certain copyrights and unregistered designs, since their lack of registration in the context of reconciling transactions results in complications concerning ownership, jurisdiction, creation, and overall usage given the internet's fluidity, and the fact that it is relatively easy to infringe upon IP rights is more complicated.

To help protect against these and other IP issues, projects such as Valutitude utilise blockchain technology as a "notary-like" tool for IP protection.[51] Valutitude is a "browser-based software, which provides users with a clear overview of their IP and helps solve previously-complex issues such as secure storage, proof of authorship suitable for legal proceedings, the safe and easy exchange of confidential information by placing non-disclosure agreements ("NDAs") on the Blockchain and a marketplace for the risk-free selling and licensing of IP".[52] For example, artists using the project can receive proof for the actual application of their copyrights and universities can ensure researchers are capable of protecting their findings.[53]

Currently, IP rights generally remain unharmonised with the exception of European Trademarks and Registered Community Designs.[54] Despite the increasing integration of information and recordation among national and international IP government and quasi-governmental offices, each nation has its own registration offices and systems for registering and protecting trademarks, copyrights and other IP. Particularly, transactions based on IP rights do not require registration to give effect between parties, but only as to third parties in terms of publication. This may imply that the

"registered" owner of a specific IP right (as officially indicated in an IP office database), is not necessarily the actual current owner of that IP right. Conducting a due diligence procedure may also come with complications considering the IP may not necessarily be traced. There is no database for IP rights that are not registrable or simply, not registered.[55]

Incorporating the blockchain system for the purpose of creating a database will address such issues. Because of the blockchain's immutability characteristics and its capability of storing a bullet proof record, the creation of an unalterable "digital certificate of authenticity" is made possible. With a digital certificate, issues such as ownership, evidence, and publication can be addressed. For trademarks, a blockchain database would essentially allow a particular user to gain access to a given product's digital certificate of authenticity, which would show the origin of the trademarked product and who has ownership of the rights to that trademark.[56] As a result of this ability to track an IP right's entire life cycle, the due diligence necessary for IP transactions during mergers and acquisitions could be simplified.[57] In addition, if information on a trademark's use in trade or commerce was collected on a blockchain-based official trademark register, then the relevant IP office could be notified immediately.[58]

VI. Jurisdictional Issues

Currently, there is no concrete regulatory recognition of blockchain technology, which does implicate uncertainty for the blockchain community, as a lack of regulatory recognition may cripple the overall implementation of blockchain technology across various industries and undermine infrastructure conversion of a traditional supply chain to a blockchain model. Given non-existent regulatory guidance, uncertainty over jurisdiction, inconsistent and sparse court decisions, there is an implied sense that the blockchain-user community is generally free of law and therefore of legal enforcement to a certain extent. Therefore, the infrastructure users naturally escape any sense of legal norms as the infrastructure itself does not fall under any form of jurisdiction.[59]

The anonymity of blockchain transactions and the lack of identifiable users create a clear separation between crypto and real-world transactions. Without identifiable parties, subject matter jurisdiction, diversity jurisdiction, personal jurisdiction, and federal question jurisdiction have no effect. Smart contracts contribute to these jurisdictional issues as physical presence, domicile/place of business, minimum contacts, and consent are nearly impossible to use by the courts as none of the above elements to jurisdiction are known by the parties in a smart contract.

The use of smart contracts makes a compelling case for customised dispute resolution mechanisms. Since smart contracts are coded for and contemplate potential breaches, it appears that a substantial number of enforcement situations would be contemplated and dealt with through coding; however, the subjectivity of almost every business relationship including mistakes, intentions of the parties and other intangibles are not contemplated. For enforcement purposes, a blockchain-focused dispute resolution protocol appears needed.[60] If not, the traditional legal system approach to enforcement would interfere with the primary benefits of the blockchain.

One approach receiving attention is "Distributed Jurisdiction".[61] For example, in the Aragon Network,[62] if a user wants to dispute the execution of a contract, the user must post a bond and submit a brief of their argument.[63] Next, five judges who have also posted a bond are randomly selected from all of the users of the network.[64] After the judges read the briefs, they issue their judgments and a majority decision is needed to determine the dispute's outcome.[65] Judges are rewarded monetarily if they voted with the majority and are punished with the loss of their bond if they did not.[66]

In addition, the Aragon Network allows two appeals.[67] If a party disagrees with the initial outcome, the party may appeal by posting a larger bond with their brief.[68] A prediction market is then opened where any user may post a bond and become a judge.[69] Again, briefs are read and all judges issue their judgments with a majority needed to determine the result.[70] Rewards and punishments are then given to judges based on the results.[71] Lastly, after posting a larger bond, a user may make a final appeal to a panel of nine "supreme court" judges who are the most successful judges in the Aragon Network.[72] This is the only form of dispute resolution allowed on the Aragon Network and users are not allowed to opt into different dispute resolution mechanisms.[73]

In contrast, OpenBazaar is a cryptocurrency trading platform that uses a "Distributor Jurisdiction" type of dispute resolution mechanism predicated on use of notaries that have different skill sets and permit the parties to a claim to choose notaries, encouraging notaries to continue developing expertise in legal areas. From the beginning of a transaction, users are able to choose whether to involve the notary.[74] If the users do not choose to use the notary, then there are no transaction fees. However, a transaction without notaries increases a user's risk because no arbitration is possible.[75]

If the users do choose to use the notary, then the parties can agree to choose a particular pool of notaries with a certain expertise before the contract is signed.[76] The notary's primary job in OpenBazaar is to electronically verify that both parties signed the contract and there are available funds in escrow.[77] Next, after confirming that both parties agree the terms of the contract have been fulfilled, the notary releases the funds from escrow and sends it to the vendor.[78] Lastly, if either party is not satisfied with the transaction, then the notary serves as an arbiter in the dispute.[79]

Despite the initial success of Aragon Network and OpenBazaar's dispute resolution mechanisms, improvements to the approaches to Distributed Jurisdiction are inevitable and ongoing with no recognised network or mechanism having worked the bugs out yet.

VII. Next Steps for the International Supply Chain Environment

To enjoy the current and long-term benefits of a more efficient, sustainable and dependable supply chain that reduces the ultimate costs of the finished product while maintaining a high performance and quality levels will require involving technology and legal advisors to assess the client's needs, risks and the ramifications of an evolving and necessarily changing environment. Issues that a client will need advice and direction for include the following:[80]

A. Jurisdiction

Blockchain has the ability to cross jurisdictional boundaries as the nodes on a blockchain can be located anywhere in the world. This can pose a number of complex jurisdictional issues which require careful consideration in relation to the relevant contractual relationships.

The principles of contract and title differ across jurisdictions. Therefore, identifying the appropriate governing law is essential and in a decentralised environment, it may be difficult to identify the applicable rules. Every transaction could potentially fall under the jurisdiction(s) of the location of each and every node in the network. This could result in the blockchain needing to be compliant with an

unwieldy number of legal and regulatory regimes. In the event a fraudulent or erroneous transaction is made, pinpointing its location within the blockchain would be challenging.

The inclusion of an exclusive governing law and jurisdiction clause is essential to ensure that a customer has legal certainty as to the applicable law to determine the rights and obligations of the parties to the agreement and which courts will handle any disputes. Recently the United States District Court for the Southern District of California denied plaintiff Founder Starcoin, Inc.'s motion for preliminary injunction against defendant Launch Labs, Inc.[81] Although the court did not explicitly state why it had jurisdiction, Founder Starcoin, Inc. argued in its Complaint that the United States District Court for the Southern District of California had original jurisdiction under 18 U.S.C. § 1836(c) and 28 U.S.C. § 1331 and supplemental jurisdiction under 28 U.S.C. § 1367(a) because the claims were for breach of contract, trade secret misappropriation, intentional interference with prospective economic advantage and unfair competition.[82] Founder Starcoin, Inc. also argued the venue was proper under 28 U.S.C. § 1391(b)(2) because a substantial part of the event that gave rise to the claims occurred in that district and a substantial part of property at issue is located in that district.[83]

B. Service levels and performance

The willingness of vendors to commit to performance assurances is likely to be inconsistent, with vendors preferring to offer the technology and service on an "as is" basis, with limited service levels, and excluding warranties regarding performance. This can leave customers without any assurance that the technology will function as described or that the service be reliable and available and for any business. Customers are unlikely to accept such a proposal. The balance of performance risk will therefore be a key issue to determining blockchain's use.

C. Liability

The risk to customers of a systemic issue with a trading-related infrastructure such as blockchain could be material if trades are not settled or are settled incorrectly. Likewise, the risk relating to security and confidentiality would be a top risk issue.

One of the main issues of a public blockchain is the inability to control and stop its functioning. In case of a private blockchain, the lack of control of the functioning of the platform does not apply, but whether or not this would be sufficient to trigger the liability of the company managing the platform has not yet been tested. Therefore, the allocation and attribution of risk and liability in relation to a malfunctioning blockchain must be considered carefully, and not just at the vendor-customer level.

D. Intellectual Property

There is inevitable value in the blockchain and ownership of the IP as it will likely form an important consideration notwithstanding limitations on the patentability of software and business processes. Blockchain vendors will have to determine their IP strategy as vendors and they will likely want to capitalise on any other commercial benefits to be generated from the blockchain, including commercialisation of the underlying data, and it will need to be a carefully negotiated area.

Also, a customer may insist on ownership of IP developments or may be willing to 'merely' license them for the agreement term (or perpetually if usable with other networks) or vendor restrictions on use may be acceptable. No matter the approach, there appears to be a realisation that technology will have to be shared in order for value to be gained.

E. Data privacy

Blockchain's immutability characteristics raise serious implications for data privacy, especially where the relevant data is personal data or metadata sufficient to reveal personal information. The transparency of transactions on the blockchain is not easily compatible with privacy needs. Technology-based solutions will need to be found to design privacy-protecting blockchains. This might include limiting who can join the blockchain network to "trusted" nodes and encrypting the data on the blockchain, although this is not without its challenges, especially in an environment in which transparency is prized.

In addition, data privacy implications were further complicated when the General Data Protection Regulation ("GDPR") became effective on May 25, 2018.[84] Although enacted by the European Union ("EU"), the GDPR has an extraterritorial effect and the regulations apply to all companies who process EU residents' and citizens' data, regardless of where the company is located.[85] Some of the GDPR threats to blockchain implementation are the right of access, right to consent, right to be transported, right to minimise data, and the right to be forgotten.[86] Specifically, the right to be forgotten or the "erasure right" is implicated due to the immutability of the blockchain.[87] Therefore, clarification from the GDPR on what "erasure of data" means is needed to help advise clients on how to best comply with the GDPR regulations.[88]

F. Decentralized Autonomous Organizations (DAOs)

DAOs are essentially online, digital entities that operate through pre-coded rules. These entities often need minimal input and are used to execute smart contracts, recording activity on the blockchain. Modern legal systems are designed for participation by actual people (e.g., people have the power to enter into legal contracts, to sue, and to be sued). But the legal status of a DAO makes that difficult to assess since the DAOs "management" is conducted automatically. Courts and regulators are unlikely to allow the wholesale adoption of technology which bypasses established oversight, so much more work needs to done to have a DAO environment in which people have confidence.

Although many users were scared away when coding and security errors in the Original DAO allowed a user to take $55 million worth of Ether, DAO developers have learned from the Original DAO experience and have created more secure and sophisticated structures.[89] For example, DAOstack was launched in spring 2018 and is a step toward DAO adoption. However, due to the recentness of the launch, time will tell whether DAOstack is the future of DAOs and what legal implications there may be.[90]

G. The enforceability of smart contracts

Blockchain makes possible the use of so-called "smart contracts". Smart contracts are blockchain-based contracts which are automatically executed upon certain specified criteria coded into the contract being met. Execution in a blockchain network eliminates the need for intermediary parties to confirm the transaction, leading to self-executing contractual provisions. This also raises significant legal questions in relation to applicable regulation and, therefore, the legal enforceability of smart contracts.

Since smart contracts are prewritten computer codes, how their use works with the traditional "contract" definition and laws of contracts is an open question. This is particularly true where smart contracts are built on permission-less blockchains, allowing for no central controlling authority. Since the point of permission-less blockchains is to decentralise authority, they might not provide for an arbitrator to resolve any disputes that arise over a contract that is executed automatically. It also remains unclear whether basic contract legal elements, such as capacity and apparent or ostensible authority, would apply. Also at issue is how concepts of offer and acceptance, certainty and consideration work in this environment. There are advances in many countries regarding the level of acceptability of electronic contracts so this may end up applying to smart contracts. Meanwhile, customers will need to ensure that smart contracts include a dispute resolution provision to reduce uncertainty and provide for a mechanism in the event of a dispute.

However, states are taking steps toward expanding the enforceability of smart contracts. For example, in March 2018, Tennessee enacted a new law that recognises smart contracts and blockchain signatures as legally binding.[91] Senate Bill 1662 acknowledged a signature secured through a blockchain as an electronic signature.[92] It also acknowledged contracts secured through a blockchain as an electronic record.[93] As a result, the electronic signatures and contracts secured through a blockchain have the same legal standing as a traditional contract and signature.[94] Senate Bill 1662 also states "no contract relating to a transaction shall be denied legal effect, validity, or enforceability solely because that contract contains a smart contract term".[95] Tennessee now joins Colorado, Florida, Nebraska, New York, Wyoming,[96] Arizona, Delaware, Nevada and Vermont in expanding the enforceability of smart contracts.[97]

Moreover, it is likely a smart contract would pass a Statute of Frauds inquiry because smart contracts require parties to use their private keys to authenticate the transaction and private keys verify a party's identity.[98] Therefore, it is likely that using private keys to authenticate satisfies the Statute of Fraud's signature requirements.[99] Nevertheless, as more states and potentially other countries adopt smart contract statutes and regulations, the enforceability of smart contracts will continue to expand and consequently, the applicability of current legal standards to smart contracts will need to be revisited.

H. Compliance with financial services regulation

Many sourcing arrangements, including the use of certain technology solutions, require regulated entities to include in the relevant contracts a series of provisions enabling them to exert control, and seek to achieve operational continuity in relation to the services to which the contracts relate. With blockchain this may well be more of a challenge.

I. Exit

The need for exit assistance will be determined in large part by the specific solution and the extent to which the blockchain vendor holds the customer's data. If the customer does not have its own copy of the data, it will require data migration assistance to ensure the vendor is obliged to hand over all such data on expiration or earlier termination of the agreement and a complete record of all transactions stored on the blockchain.

J. Due diligence on blockchain

Public and private investors have already begun to make significant capital investments in blockchain technology startups. This trend is likely to increase as more use of blockchain technology commercially is made. Transactional lawyers who are tasked with performing due diligence on the buy and/or sell side in connection with these or other business investments utilising blockchain technology will need to adapt more traditional due diligence approaches. This applies, for example, with respect to ownership of data residing on decentralised ledgers and IP ownership of blockchain-as-a-service offerings operating on open source blockchain technology platforms. The assessment will also impact the business value proposition of any investment.

VIII. Conclusion

Blockchain is now recognised as the notorious "disrupter" of commercial contracting, on the verge of revolutionising the nature of commercial contracting in any context but particularly for supply networks where trust and verification are key relationship benchmarks also found in transportation, banking, finance, government, healthcare and energy transactions. Claims about blockchain technology range from praise, as efficient, cost-reducing and disciplined, to dismissive, as over-hyped. It is no doubt evolving and maturing, as are its users and customers. Its key benefits of use – existence, ownership, tracking and storage, particularly for food, apparel, and other goods have improved the ability of supply chains to facilitate payment, trace and track. At this point it seems likely that use of blockchain technology will expand into other industries continuing to drive improvements in quality, cost, service, and customer satisfaction. Determining whether blockchain technology is right for any company will require a keen assessment of business needs, available structure and flexibility, vendor engagement and appetite for risk leading to potential building and testing of the technology. In the supply chain context the drive to try and test should prove as irresistible as the drive to remain competitive. The next edition of this chapter will hopefully focus on the progress made on the important issues such as privacy, confidentiality, protection of intellectual property, jurisdiction and claims enforcement only now being identified and debated so new users of blockchain technology can benefit from practical and improved solutions.

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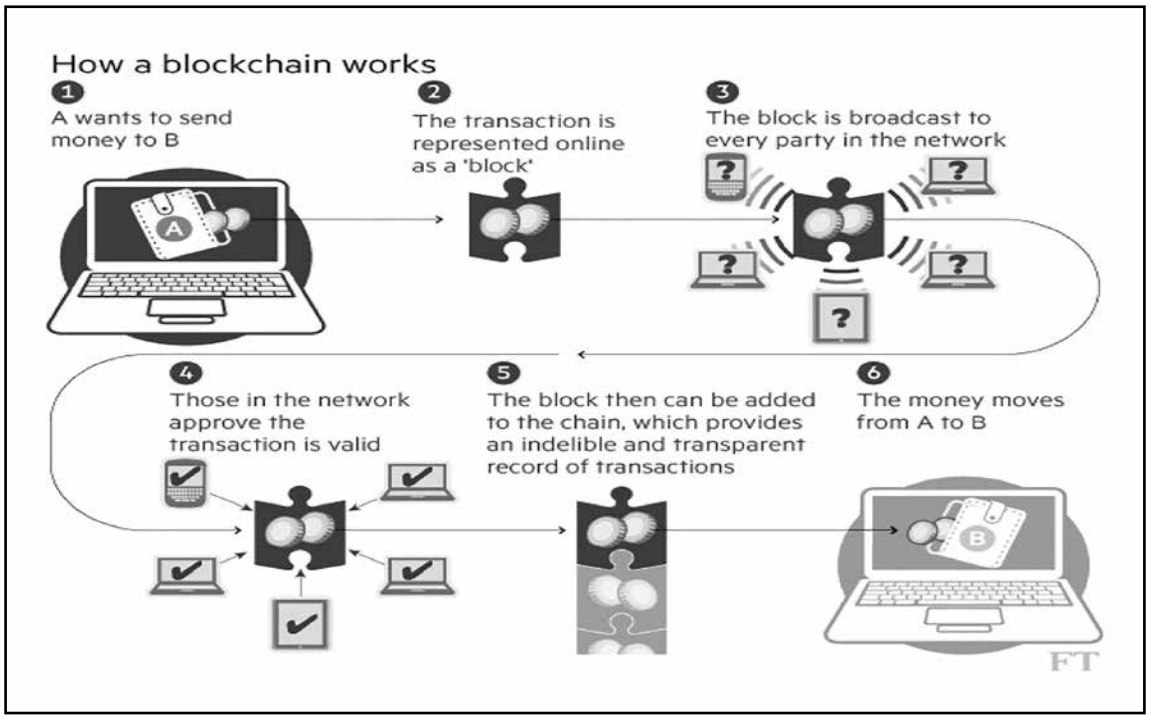

Figure 1

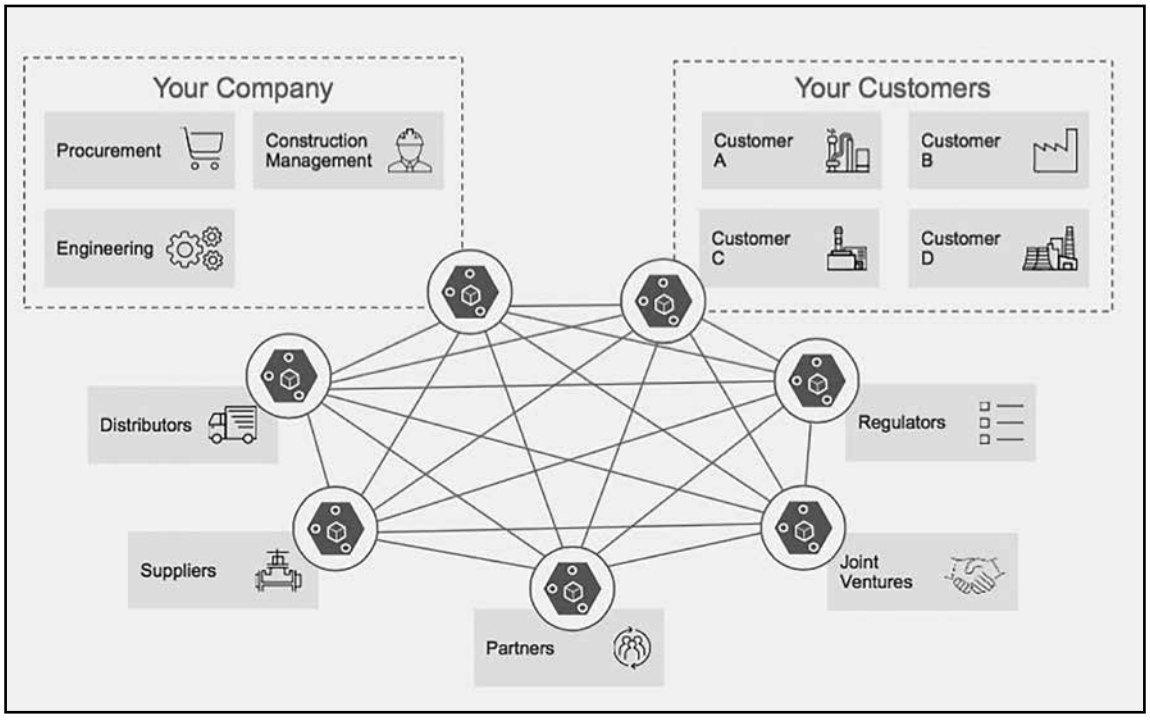

Figure 2

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The Importance of Due Diligence on International Franchisees and Ways to Minimise Risk

TLT LLP

Pauline Cowie

The decision to franchise internationally can come about in a number of ways. An *ad hoc* enquiry may have been received from an overseas business wanting to take a franchise for a country or region, or a strategic decision may have been made to franchise internationally targeting certain countries and possibly potential franchisees.

Whichever route to international franchising is chosen, be it a direct, master or area development franchise, having made a decision to franchise internationally whether in a particular jurisdiction or generally, it is important to ensure that the franchisor complies with all compliance and legal requirements and that so far as possible, steps are taken to maximise the success both initially and for the longer term of the franchise.

One of the key areas to consider is the suitability of a prospective franchisee and this will need to take place on a number of levels. It is by the carrying out of an initial assessment and due diligence investigation that the franchisor will obtain sufficient information to enable a decision to be made in principle whether it has sufficient confidence to move forward to detailed discussions and the signing of a formal franchise agreement. It will also assist a franchisor in evaluating the strengths and weaknesses of a potential franchisee and inform how the franchise agreement may be structured. Franchisors that have already franchised their business whether domestically or internationally will already have an understanding and insight as to how critical it is to get the appointment of the franchisee right. If things go wrong domestically, problems and disputes with a franchisee are much easier to handle than a disruptive and non-compliant franchisee in an overseas jurisdiction.

Before starting the process, an understanding of culture and custom together with preliminary research on how familiar or prevalent franchising is in the target country will inform the approach to due diligence. In some countries, it is important to build the relationship with the prospective franchisee before any detailed due diligence information is requested. Good communications in the initial stages are a means of building rapport and can enable the franchisor to assess whether the parties are in fact able to communicate without a fundamental disagreement.

Whilst franchisors will already conduct due diligence on domestic franchisees, international due diligence will throw up a variety of additional challenges. Language may well be an issue as well as differences in how the parties like to communicate. There could also be cultural issues in that providing information to the level of detail required may be seen as damaging the potential relationship and a sign of mistrust or bad faith. In particular, the more detailed the information required, the more concerned the proposed franchisee may be and therefore reluctant to provide the level of detail required. Clearly, such an explanation could also be used to avoid making disclosures so a sensitive path will need to be taken. Local laws may also limit the availability of information but if this is the case, the franchisee should be upfront and fully transparent and if in doubt, checks should be made to ensure that the franchisee has correctly interpreted applicable rules.

First Steps

Although information under a due diligence exercise is being obtained about the prospective franchisee, this is likely to take place in the context of wider commercial discussions. The franchisor will need to protect the confidentiality of its commercially sensitive information having built up a substantial amount of know-how and brand awareness. Similarly, the franchisee may be concerned about protecting any non-publicly available information. It therefore makes sense that before either party discloses any non-publicly available information, a confidentiality or a non-disclosure agreement should be signed. The franchisor should send this at the earliest opportunity as at the beginning of any discussions, it may not be clear where they may lead and whether a franchise relationship may be established. Leaving it any later may mean that confidential information will be disclosed without a clear set of agreed rules regarding the use of that information. If there are any particular concerns over enforceability it may be wise to have the draft reviewed by local counsel, particularly regarding the duration of any restrictions.

In countries where there are formal disclosure requirements, local advice should be taken as to when disclosures need to be made and if they need to be made before the general due diligence exercise takes place.

Scope of Due Diligence Exercise

The due diligence exercise is not just about obtaining information on ownership structures, management and financial information, but also goes to a deeper level to find out:

- if there is a cultural fit;
- if the management team are easy to get along with and have the right skills and attributes;
- the respective strengths and vulnerabilities of the prospective franchisee;
- the prospective franchisee's level of sophistication (for example, they may already operate as a multi-brand franchisee). The practical skills needed by a master franchisee who will be sub-franchising will include recruiting franchisees, managing

sub-franchisees as well as enforcing the terms of the sub-franchise agreements. These skills are more difficult to assess but may be already in place with multi-brand franchisees;

- local market knowledge and contacts; and
- how the franchisee conducts itself throughout the due diligence process and negotiations.

The due diligence exercise will be a combination of business, financial and legal due diligence including verification against publicly available information and must be approached on a risk-sensitive basis. An important part of the process will also include meeting the owners and operational team. Meetings will need to take place both at the franchisors head office and at a local level with the franchisee. It is inevitable that at this stage the franchisee will be enthusiastic but the franchisor will need to be careful not to equate enthusiasm with competence.

It will also invariably be governed by practicalities such as how easy it is to obtain information, the timetable that the parties are working towards (and any particularly sensitive timelines), the willingness on the part of the proposed franchisee to provide the information which is requested in sufficient detail and in a timely fashion, and the costs and expense involved in verification. Industry knowledge may well also throw up valuable business intelligence.

On a practical level, the franchisor will need to assess the potential franchisee's financial position and obtain comfort that sufficient funds are available to develop the brand in the market in line with the franchisor's expectations. This will be particularly important where sub-franchising is not permitted and the franchisee will be an area developer, as the franchisee will need to use its own resources to open and expand the business. Where sub-franchising is permitted or required, the franchisee may need to open one or more pilot stores and will need to have the infrastructure in place to support the rollout of sub-franchises.

If the franchisee is a company with few assets or a poor credit risk, as well as concerns that it may not be able to maximise the potential of the franchise, there is also the risk that it may not have sufficient assets to meet a claim by the franchisor, in the event that the franchisee breaches the terms of the franchise agreement. The franchisor should therefore consider whether it is appropriate to take additional security such as a guarantee or bond to guarantee the franchisee's obligations from a parent company and/or key individuals who will be controlling and operating the franchise.

If supplies of products, equipment or raw materials are to be made by the franchisor or its suppliers to the franchisee, the franchisor will want to assess the ability of the franchisee to be able to pay for items supplied and consider how best to minimise risk, for example, through letters of credit, shortened payment terms, upfront payments and guarantees.

There may also be particular attributes which the franchisor regards as essential to success such as:

- Can the franchisor lever off the franchisee's existing supply chain and how might this work?
- For retail and leisure franchises, how good are the potential franchisee's contacts in the property market and does it have sufficient enough covenant strength?
- If local market knowledge is important to roll out the franchise does this need to be tested and how?
- If the potential franchisee has raised any particular issues of concern or local or regulatory hurdles how have they suggested that they will be able to overcome them to fit local market needs?

On some occasions the process may seem unnecessarily slow, but bearing in mind the potentially damaging effect on the franchisor's business as well as the disruption and time and expense in attempting to manage a non-compliant franchisee, this should put everything into perspective. In countries where there is a more formalised approach to disclosure and a franchise code of practice, franchisees will invariably be familiar with the process of due diligence without undue concern and have an awareness of what the parties must disclose to one another including an obligation to negotiate in good faith.

Franchise Questionnaire

In order to record and co-ordinate responses a questionnaire will be helpful particularly where information will be obtained from a number of sources. Whilst the amount of publicly available information has expanded, its reliability may be questionable and carrying out a due diligence exercise using traditional means is likely to be more reassuring. The franchisor should ask for the relevant information and consider whether verification is necessary. The franchisor should be aware that it may not be possible to obtain certain information on foreign companies without instructing specialist providers or local law firms.

Using a questionnaire has the advantage of creating a paper trail on the information provided by the franchisee and distinguishing it from information which may have been collated by the franchisor's internal business team. It will also test how serious the proposed franchisee is in proceeding beyond initial discussions.

At the very minimum it is likely to include the following:

- organisation background and registration particulars;
- evidence of necessary licences and registrations;
- group structure;
- details of the owners of the business including details of beneficial owners and anyone who has the ability to exercise any influence over the affairs of the business;
- details of any relationship with government officials;
- details of the management team and officers;
- disclosure of any criminal, regulatory or civil claims and proceedings both current and historic together with confirmation that none are pending;
- anti-bribery and anti-corruption compliance, policies and procedures;
- copies of statutory accounts and *pro forma* performance metrics as well as up to date financial information;
- details of other business activities and interests; and
- references.

When putting together a questionnaire, the franchisor should also consider how the structure of the proposed franchise and supply chain will operate and where it is appropriate to add to the information required.

Further information may also be required depending on the responses and information provided.

More problematic jurisdictions may mean that additional and more detailed due diligence should be undertaken overlaid with the checking against and awareness of sanctions against target countries, groups and individuals which if breached could mean that criminal offences are committed by the franchisor and its officers. The franchisor should take specialist advice on how it is able to meet its regulatory and compliance obligations.

The questionnaire should be completed and signed by an officer of the franchisee who should certify its completeness and accuracy.

Review of Information Received

When information is received, the franchisor should ensure it is properly reviewed and any areas of risk or uncertainty followed up. If there are any areas of concern it should consider how best to approach these and review carefully how the prospective franchisee handles any follow up requests. Verification from an independent source may also be advisable particularly in high-risk situations and where adverse information is received.

The franchisor will also need to bear in mind that the information provided will only be a snapshot at a particular time and may not necessarily remain completely up to date. If there is a long period between receiving replies to the original questionnaire and the signing of the franchise agreement, the franchisor should consider whether confirmation should be obtained that there have been no changes to the information originally provided before signature. Importantly, the due diligence exercise is an ongoing process and to the point of signature informs how the parties will communicate going forward.

The franchisor should usually obtain warranties and representations in the franchise agreement concerning the accuracy and completeness of the information provided and confirmation that there have been no material omissions. At the very least it reinforces the importance of the information provided and the reliance made.

The whole due diligence process is a combination of the franchisor taking a risk-based approach and also exercising judgment based on an assessment of the information received and the conduct of the prospective franchisee. In borderline situations where a potential franchisee falls short of minimum requirements and expectations, it may be tempting to proceed to the signing of the formal franchise agreement, but the better decision may be to walk away and learn from the experience.

Ongoing Due Diligence

In high-risk countries, due diligence will need to be an ongoing process to track changes in ownership structures. Therefore, even after the franchise agreement is signed, it may be necessary for the franchisor to ensure it obtains up to date information concerning the franchisee to comply with the franchisor's legal obligations. The franchisor will therefore need to ensure that it is entitled to require the franchisee to provide details of anticipated and ongoing changes and up to date information in the franchise agreement. This can be a complicated area and the franchisor will need to make sure that it keeps up to date with evolving requirements.

What Can Go Wrong?

In international franchising, it is usual for master franchise or area development agreements to be granted for a significantly longer period than domestic franchise agreements. This is in order to enable the franchisee to recover the benefit of the substantial investment required in setting up the franchise in an overseas territory and to allow enough time for the franchisee to maximise potential particularly where it is necessary for initial pilot operations to be launched to test the market and make any necessary adjustments to the business model. This, coupled with a potential grant of exclusivity means that the parties will be entering into a single substantial long-term franchise relationship.

There is also a not insignificant cost to the franchisor who will incur cost and expense in drawing up the franchise agreement and ancillary documents including the taking of local law advice. There will also be the cost of training, time spent with the franchisee and international travel. Some of these costs may be recouped but selecting the wrong franchisee may ultimately lead to reputational damage.

It will be expensive and time consuming to terminate a franchise agreement or remove a franchisee if things start to go wrong and the international element introduces a new level of complexity. In addition in certain jurisdictions, local laws may make it more difficult to terminate the franchise agreement and there may also be limitations on the enforcement of rights under the franchise agreement including potential difficulties in the enforcement of judgments and arbitration awards. Local counsel can assist in identifying particular issues and exit strategies as well as effective dispute resolution procedures. It may be preferable to have disputes resolved by arbitration but not all local courts will enforce overseas arbitration awards and in some countries the preferred route might be to use the local courts. Local counsel can also advise on how foreign courts approach litigation by foreign parties in the local courts. Failure to address these issues from the outset can result not only in issues in enforcement but also an inability to adequately reclaim the brand as well as fines or criminal convictions if applicable legislation has not been complied with.

The choice of law and jurisdiction will also need to be weighed up in the context of the location of where the franchisees assets are and the possibility of needing to take immediate action such as the obtaining of an injunction. It is unlikely that the franchisee will have significant (if any) assets in the country where the franchisor is based.

The franchisor should also be mindful of any potential liability in relation to the franchisee's employees and any particular consequences of termination such as rights of continued employment for the franchisee's employees where there is a transfer of an undertaking or service back to the franchisor. Other areas of concern include joint liability which is becoming an increasingly common concept depending on the degree of influence or control exercised by the franchisor over the franchisee as well as data protection and security breaches. This means that in some countries, where a franchisor exercises such control or influence, it may be treated as an employer of the franchisee's employees for social security purposes, or specific liabilities may be imposed on the franchisor in relation to the franchisee's treatment of its employees. In the latter scenario, the franchisor will need to put in place a system to prevent franchisees breaching certain local employment laws. It will be appropriate to obtain indemnities against the franchisee's breaches of its obligations and where liability is imposed on the franchisor, but ultimately they may be difficult to enforce and add another layer of complexity.

As with domestic franchising, side-stepping a thorough due diligence exercise could have particularly disastrous consequences and as much care should be taken by the franchisor as if it was establishing its own overseas operations. Having an understanding of how easy it may be to enforce or terminate the franchise agreement for breach and/or exercise step-in rights will inform the procedures which will need to be taken should things go wrong. The franchisor should also look at other ways of mitigating risks.

Business Planning

In a master franchise or area development relationship, it is important for the franchisee to be placed under an obligation to actually establish

the franchise including any pilot operations, and for appropriate criteria to be set out for achieving this. It is also important to set out in writing the requirements and expectations for expansion. Usually, the franchisor will want the franchisee to expand quickly in order to obtain a flow of continuing fees. However, the franchisee may want to be sure of success before making a significant investment and may therefore be reluctant to agree to the setting of minimum targets until the viability of the franchise has been tested. This may be particularly an issue where the franchisor does not require one or more pilot operations and wants the franchisee to rely on the success of the franchise in other countries. Ultimately, this will be a matter for discussion between the franchisor and franchisee as to whether it is feasible or desirable to rely on the successful roll out of operations in other countries.

The potential franchisee should be required to prepare a business plan which will also give valuable insight into its plans and aspirations and whether this aligns with the franchisor's own views for the brand and its expansion. This will also allow further discussions to be held on the proposed franchisee's financial strength and available capital to fund growth as well as other resources necessary to support growth plans and to put in place the necessary infrastructure. These discussions will also assist in putting together minimum performance development criteria to maximise success and any controls which might be prudent to put in place to limit expansion if things are not going to plan with appropriate milestones.

A development schedule will set a target for the number of franchise outlets to be opened by specified dates by agreeing on the number of new outlets opened in each year potentially combined with the number of outlets which must be kept open on an ongoing basis. Failure to meet agreed targets could allow the franchisor to remove exclusivity and/or terminate the franchise agreement.

The franchisee may also need to put an agreed marketing plan in place and both the business plan and marketing plan will need to be updated annually and approved by the franchisor. It would be usual to assess performance against these plans to ensure that the franchisee keeps on track with discussions held with regard to any deviations.

Drafting Tips to Minimise Risk

The franchisor may also consider other controls to be put in place to minimise risk and exposure. Where sub-franchises are to be granted this may be by approval of sub-franchisees prior to the grant of sub-franchise agreements and the obtaining of approval prior to sub-franchise terminations. Where the franchisee has specific requirements regarding the opening of new outlets, the franchisor may require to approve the sites before fit out and opening.

In the event of a serious breach of the franchise agreement, the franchisor may require step-in rights allowing it to step in and operate the franchisee's business on a temporary basis. These can be useful, but in some countries may not be a viable option where it might therefore be better to terminate the franchise agreement. Obviously where the franchisee is not sub-franchising, the number of individual properties may make it an unattractive right. In any event, local advice should be sought to ensure that they cannot be circumvented by property holding requirements. It may also be necessary to obtain the consent of the landlord and so advice may be needed on how this might be best achieved and what documents should be signed to allow step-in rights to be exercised.

As with domestic franchising, the franchisor should also consider controls to be placed on the franchisee, its affiliates and potentially key individuals who will be controlling and operating the franchisee (subject to compliance with local applicable laws) to ensure that competitor concerns are addressed and that the proposed operational structure is maintained. In addition, guarantees and performance bonds where appropriate will all assist in keeping the franchisee on track.

The franchise agreement should also contain a number of specific obligations on the franchisee. In the context of a master franchise where sub-franchising is permitted and required, the franchisee should also be required to:

- comply with targets to develop the business;
- proactively recruit high quality franchisees;
- monitor and ensure compliance by franchisees with their sub-franchise agreements;
- provide support and guidance to franchisees;
- deal promptly with franchisee complaints; and
- comply with the manual and maintain standards.

Similar specific obligations appropriate to an area development agreement will also be required.

Termination

If things start to go wrong, it is important that the franchisor takes action to ensure that the franchisee stays on track. Regular communication and discussing issues before they escalate out of control are essential. However, in certain situations termination may be the only option although it is not a step to be taken lightly, particularly where there are a number of sub-franchisees who will continue to require support and supplies of products, equipment or raw materials. The franchisor will also be keen to ensure that it is able to exercise control over its brand and reputation but without necessarily taking on any liability for previous breaches of the franchise agreement by the franchisee.

The franchise agreement will therefore need to contain effective provisions to enable the franchisor to terminate the franchise agreement where it is necessary to protect the brand and to avoid the franchisor suffering significant damage. The grounds upon which the franchisor is entitled to terminate the contract will need to be clearly set out in the franchise agreement. If the breach is capable of remedy, then if the franchisee is able to remedy the breach it may avoid termination. But where there is a material breach of the agreement which cannot be remedied, then it is likely that local laws will allow immediate termination.

In a master franchise scenario, local advice should be taken when structuring the sub-franchise agreements to anticipate a termination of the franchise agreement with the master franchisee. The franchisor will need to assess how any rights which it may wish to exercise under the franchise agreement might affect the sub-franchise agreements and what its available options might be. In advance of any termination, a strategy to deal with sub-franchisees will need to be formulated as well as how to deal with communications.

The franchise agreement should set out the consequences of termination including the obligation to cease the business and cease continuing to operate as franchisee. Any separate licence to use any registered trademarks will also need to be terminated and the terminations recorded. It is usual to specify in detail exactly what the franchisee must do on termination including steps which must be taken to protect information and confidentiality. If the franchisee has not granted any sub-franchises, there may be a sell-off period for the sale of products purchased, but any orders in the course of being processed may, at the franchisor's discretion, be cancelled.

Any monies due will need to be paid and consideration will need to be given as to whether a claim for damages or other legal action should be taken. This may depend in part with compliance by the franchisee with post-termination obligations including any restrictive covenants. Any guarantees and performance bonds may also be called in.

Upon termination of a franchise agreement, the franchisee generally has no right to compensation. There are exceptions: for example, there could be circumstances which trigger the application of agency laws. Where these are applicable, consideration will need to be given as to their impact and whether a different tactical approach should be adopted.

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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 the 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 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 franchisees").

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 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.

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 of 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 other anti-competitive conduct.

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 the 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. Many Franchise Agreements in the retail sector provide no territory with only an exclusive right to operate from a specified site with a defined 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 anticompetitive and against public policy.

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

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?

Copyright is protected under common law rights and also under the *Copyright Act* 1968 in Australia.

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 failure to provide disclosure is a fundamental breach under the Code which may allow a franchisee to terminate the Franchise Agreement, and recover its costs, expenses and damages. The breach may also be referred to the Australian Competition and Consumer Commission ("ACCC") for an investigation for the 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 pre-contractual misrepresentation allocated between franchisor and master franchisee? If the franchisor takes an indemnity from the master franchisee in the Master Franchise Agreement, are there any limitations on such an indemnity being enforceable against the master franchisee?

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.

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 aggrieved franchisees and, if so, are class action waiver clauses enforceable?

The requirements for bringing a class action in Australia vary between the States and are dependent on the court in which the proceedings are issued. Class action waiver clauses are likely to be unenforceable in Australia under the Franchise Code and recent implementation of the Unfair Contracts provisions.

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. The parties can agree on the Law that is to be applied and the jurisdiction in the event court proceedings are to be brought. There are requirements under the Code mediation that must take place in Australia and the parties must attend mediation.

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*.

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

Arbitration is recognised in Australia. However, the Code provides for mediation and arbitration is rarely if ever used or agreed to.

Mediation is a process for the parties to reach a commercial outcome. Unlike arbitration, a mediator has no power to make findings or to make orders against the parties.

Yes, arbitration is often referred to in overseas Franchise Agreements to resolve franchise disputes; however, the Franchise Code in Australia as stated provides a dispute resolution mechanism via mediation. Australia has been a contracting party to the New York Arbitration Convention since 1975. International arbitration awards provide greater enforcement, as it is more enforceable in foreign jurisdictions as opposed to a judgment made by a court.

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 three to five years with options to renew. In most cases, shopping centres generally do not offer an option or further term.

Often the franchise term and the lease terms are not the same. The Franchisee may have an option for a further term under the Franchise Agreement but the lease may not have a similar option right.

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.

We recommend the franchisor holds the head lease to its Grade primary site and provides a licence to give to the franchisee. This enables the franchisor to retain control of a key site if the franchisee abandons the premises or is 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 in a particular location)?

Landlords and Shopping Centres may provide an initial rent-free period (of one to three months), or a landlord fit-out contribution. This varies between shopping centres, and varies greatly between the States and Territories.

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

For landlords, returns have decreased substantially in the Australian market and although it varies between States, yields to landlords are now in the range of three to five per cent *per annum*.

Key issues for overseas franchisors to consider in the Australian market at present are:

(1) occupancy costs in Australia are quite high and can impact on the viability of the Franchise model;

(2) staff and labour costs are quite high and now regulated with new Vulnerable Workers Laws that aim to protect students and casual workers from under award payments by franchisees and hold the franchisor liable for those breaches by the franchisee;

(3) due to a recent Royal Commission into the Banking sector, the Banks access to funding by proposed franchisees for business finance has been made more difficult; and

(4) the Australian market differs considerably from State to State as do consumer expectations, and franchisors need to consider local market conditions.

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 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 Code seeks to promote transparency, in relation to these issues.

The Franchise Agreement may require the franchisor direct any lead from a customer outside a franchisee's territory to the franchisee's territory, although there is no statutory obligation to do so.

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 the termination or expiry of a Franchise Agreement generally impose obligations on franchisees to deliver 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.

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

The Franchise Code sets out a notice period required to be given by a franchisor to the franchisee for certain breaches where the franchisor cannot terminate without notice. For certain breaches the franchisee must be given an opportunity to remedy the breach before termination by the franchisor.

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 now been addressed in Australia under the recent Vulnerable Workers Bill under the Fair Work Amendment (Protective Vulnerable Workers) Act 2017. Franchisors may now be liable to franchisees staff for a failure by the franchisee to meet their statutory obligations to employees.

This liability arises 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 sufficient training in place to ensure their franchisees meet their workplace obligations to their staff.

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, for example, occupational health and safety requirements that apply to the franchisee and may also apply to franchisors. Where they fail to provide necessary training and support or are aware of breaches by the franchisee, the franchisor and its directors may be found to be vicariously liable. The franchisor may seek an indemnity from the franchisee for any liability and there is no legal restriction from doing so.

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. 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 present these are:

(a) Withholding tax 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.

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 the franchisee is not acting as 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 imposes an obligation on each of the parties to act in good faith, upon 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 the obligation of good faith requires a party to have regard to the rights and interests of the other party, it does not require a party to solely 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 relationship is governed by the Franchise Code, the Australian Consumer Laws and Unfair Contract provisions which regulate the relationship between the franchisor and the franchisee. However, there are State and Local Laws that may need to be considered and met depending on the nature of the business.

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 wishes 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

(b) the Agreement did not allow the franchisee to claim compensation for good will if 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 and these provisions are somewhat untested in Australia at present.

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, so the franchisor can control the site and its brand in the event of a breach, abandoning the business 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 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.

17 Electronic Signatures and Document Retention

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

Agreements that are signed electronically are valid and binding. The United Nations Convention on the Use of Electronic Communications in International Contracts confirms that electronic signatures are a valid method of executing a contract. Although the Convention has not yet been ratified by Australia, it has declared its intention of adopting the Convention by passing legislation to this effect; *Electronic Transactions Act 1999* (Cth) and *Electronic Transactions (Victoria) Act 2000* have been passed by the Federal and State government, respectively.

As electronically signed agreements are more difficult to prove, there are certain requirements that must be met, including:

- consent by the parties to send and receive the information electronically;
- the method of signing must identify the sender of the electronic information; and
- the contract is stored and accessible after execution.

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

Yes. However, it is generally recommended that hard copies be retained.

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1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

According to article 2 of the Brazilian Franchise Law, franchise is defined as the system by which a franchisor grants 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, without being characterised as an employment relationship.

1.2 What laws regulate the offer and sale of franchises?

The main Brazilian legislative bill regulating the offer and sale of franchises is Law n. 8,955 of December 15, 1994 ("Brazilian Franchise Law" or "BFL"). Brazilian Civil Code provisions outline principles and set rules concerning the formation, duration and the performance of contracts, which also applies to franchise agreements. Concerning the international franchise agreements, the Brazilian Patent and Trademark Office's ("BPTO") Normative Act 70/2017 requires their recordation before the BPTO 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 purposes of any franchise disclosure or registration laws?

The BFL does not differentiate franchise chains with one single unit or franchisee from ones with multiple components. Therefore, disclosure obligations are applied to every franchise relationship in Brazil, regardless of the number of franchisees appointed by the franchisor. When it comes to registration, only international franchise agreements need to mandatorily be recorded before the BPTO.

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

Yes. Although the disclosure document does not require registration with any regulator, international franchise agreements on the other hand must be recorded at the BPTO 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, 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 BFL is to give transparency to the future franchise relationship and it does so by obligating the franchisor to provide any prospective franchisee with a franchise disclosure document ("FDD") 10 days before the execution of any binding document/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. The Brazilian Franchise Law does not make any exception when it comes to the obligation of providing the prospective franchisee or sub-franchisee 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 BFL does not specify who is required to make the necessary disclosures to a sub-franchisee, it is common practice to assign to the party directly related to it (normally a master franchisee) the performance of 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 writing, as clear and accessible as possible, to allow the prospect understanding of the franchised business, its rights and obligations. Although not mandatory, we recommend, at least, an annual update of the FDD. 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 necessary that the franchised trademarks must be, at least, filed at the BPTO before a franchise may be offered and/or sold in Brazil. The trademarks do not necessarily have to be granted by the BPTO but rather filed before the Office.

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"), which is the most representative entity for the franchising sector.

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 BFL does not set any specific rule regarding the language of the franchise or disclosure documents. It only sets forth that the disclosure document should be in a language which is precise and clear to the prospective franchisee. Although it is advisable to draft such documents in Portuguese, which is the official language of Brazil, in international franchising it is perfectly normal for the FDD to be written in a foreign language, provided that the Brazilian party is fluent in the respective language and can expressly acknowledge it.

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 a non-national is perfectly capable of owning or controlling a business in Brazil, Brazilian law does impose some legal requirements to be observed by any legal entity (or individuals) domiciled abroad that holds equity interests in a Brazilian company.

For example, foreign entities must be enrolled with the Federal Taxpayer Registry for Corporate Entities and with BACEN. Also, foreign entities must appoint a Brazilian-resident individual to act as its attorney-in-fact and for receiving summonses on its behalf.

Moreover, 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?

The types of companies that are most commonly adopted in Brazil are limited liability companies ("LLC") and corporations, since in both the partner's liability is generally limited regarding the company and third parties.

However, it is noteworthy that the costs of setting up a limited liability company are less significant than the costs of setting up and maintaining a corporation, as the limited liability companies are not subject to the considerable expenses of publishing certain relevant corporate acts, in comparison to a corporation.

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, there are a number of registrations required, at a local, state and federal level. 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., the basic licences and authorisations that companies are required to obtain, regardless of their field of activity, as detailed below:

1. Federal Taxpayer Registry for Corporate Entities of the Foreign Investor (for the foreign partners of the Brazilian company).
2. Registration of the articles of association with the Trade Board that will generate the identification number of the Registry of Companies.
3. Federal Taxpayer Registry for Corporate Entities of the Brazilian Company.
4. State Taxpayer Registry for Corporate Entities.
5. Municipal Registry and Operating Permit.
6. Social Security Registration.

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 anti-competitive 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 in examining and assessing the occurrence of actions that may impair or limit free competition or result in the control of significant market shares.

Anti-competitive 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 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 anti-competitive 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 anti-competitive 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. 9,279/96 (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 term 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?

According to BFL, there are no express provisions restricting the franchisor's ability to impose minimum resale prices. However, said minimum resale prices must be carefully analysed, so that it is not considered abusive under Brazilian law and does not undermine the franchisee's ability to compete in the market. Also, it is important that no particular advantage is given that would unreasonably privilege a specific franchisee to the detriment of the others.

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

There are no legal restrictions related to the offering of franchises in adjoining areas or streets.

That being said though, it is important to stress that the BFL 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. Therefore, if any rights are given to the prospective franchisee in respect to an adjoining territory and the franchisor does not comply with it, this may be considered a breach, which could lead to an early termination of the agreement.

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

Non-compete covenants (which also include the non-solicitation of customers) are very common in franchise agreements in Brazil. Although 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 are 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?

Brazil adopts a first-to-file system. As a consequence of that, 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 unfair competition rules, as per 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. Operations manuals can be subject to protection under Brazilian Copyright Law (Law n. 9,610/1998). Computer programs are also protected by copyright, as expressly established in Brazilian Software Law (Law n. 9,609, dated February 19, 1998).

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 BFL entitles the franchisee to seek the cancellation of the Franchise Agreement and the refund of any and all monies paid by the franchisee to the franchisor, or to any third party indicated by the 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 pre-contractual misrepresentation allocated between franchisor and master franchisee? If the franchisor takes an indemnity from the master franchisee in the Master Franchise Agreement, are there any limitations on such an indemnity being enforceable against the master franchisee?

Our comments in 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 and possibly for pre-contractual misrepresentation in connection with its sub-franchisees in Brazil. Regarding pre-contractual misrepresentation please refer to the comments detailed in question 5.3 below.

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, according to the *bona fide* principle that regulates all relationships, including in the pre-contractual phase.

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

Class actions are only available in Brazil when damages are caused to the general public with respect to issues such as consumers' rights, the environment and public order. Furthermore, only a handful of entities can file such Court actions – mainly Public Prosecutors, the State, the Brazilian Bar Association and Class Associations.

Therefore, class actions cannot be brought to discuss strictly private conflicts, such as those arising out of a franchise agreement.

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?

The choice of forum rules in Brazilian private international law are to be found in Decree-law n. 4,657 of September 4, 1942 (the Law of Introduction to the Civil Code or "LICC") and in the Code of Civil Procedure. According to the LICC, the parties are free to agree on the applicable law, provided that the foreign law complies with the following conditions: (i) it must conform to Brazilian public order and good morals; and (ii) it must not infringe upon questions of national sovereignty. In addition, article 9 of the LICC determines that, if the parties do not specify the applicable law in the contract, obligations are governed by the law of the country where they are created (*lex loci celebrationis*).

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?

Brazilian 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 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 the Brazilian judicial system does recognise the validity of foreign decisions, in order to be locally enforceable, they need to go through a homologation proceeding before the Brazilian Superior Court of Justice, which is rather complex and time-consuming.

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.

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

Brazil ratified the New York Arbitration Convention on July 24, 2002 with Legislative Decree n. 4,311.

Since then, the number of conflicts subject to arbitration is sharply increasing in Brazil over the last decade and even the new Brazilian Civil Procedure Code dated from 2016 now encourages parties to find alternative means of dispute resolution.

The parties are free to elect the set of arbitration rules that better suits their interest, as there is no particular one used in Brazil.

It is noteworthy that the Superior Court of Justice, in a 2016 decision, has recognised that franchise agreements are a "take it or leave it" agreement and ruled that an arbitration clause may be declared invalid if it doesn't comply with article 4, paragraph 2 of Law n. 9,307/96 ("Arbitration Law"), which establishes that, in take it or leave it agreements, the arbitration clause would only be valid if it is written in bold or as an attachment document to the agreement, where the parties can specifically express their consent by inserting their signature or initial next by the arbitration clause.

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.

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?

From a legal perspective, there is no impediment to include a conditional lease assignment in the lease agreement. But, based on our experience, this assignment is seldom negotiated and might be difficult for some landlords (especially in the case of shopping malls).

However, if the parties agreed to such condition in the lease agreement, it would 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?

For properties located in urban areas, with an exception of properties owned by the Federal Government where the authorisation of the President is required, there are no legally established restrictions for non-national entities to hold any interest in them.

However, the same cannot be said about properties located 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 as they establish some restrictions and conditions for a non-national to become the owner of rural properties.

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 in a particular location)?

Since the real estate market boom in Brazil in 2012, prices have significantly dropped and are now facing stagnation. Based on this commercial scenario, although it is not a common practice, some landlords have exceptionally accepted the negotiation of an initial rent-free period, 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 and in the lack of legal impediment, it is possible to establish contractually 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 are no limitations to contractually impose the assignment of local domain names to the franchisor.

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.

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

A different set of rules apply depending on whether the franchise agreement has a fixed term or an indefinite period.

In connection to indefinite term agreements, a 90-day prior notice is required for terminating the agreement.

On the other hand, regarding fixed-term agreements, which is the most common choice in franchising, the franchise agreement will terminate upon expiration of its contractual term. Although the parties may stipulate that it will not be necessary to take any specific action to terminate the franchise agreement in this case, it is advisable to send a proper notice for post-termination obligations.

Also, it is important to stress that article 473 of the Brazilian Civil Code establishes, as a rule for the termination of agreements, that, if any of the parties have made significant investments for the execution of the agreement, the unilateral termination will only be effective after the agreement has been in force for a term compatible with the nature and amount of such investments. If the termination conflicts with such provision, the Brazilian courts may (i) set an additional term for the agreement to remain in force, or (ii) set a specific compensation if the conflict between the parties renders an extension unfeasible.

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 a franchisee's employees to insert the franchisor as a co-defendant in labour actions. However, Labour Courts have consistently ruled 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, from a consumer protection perspective, it is worth mentioning that the Brazilian Consumer Code ("CDC") sets forth a joint and strict liability of all the parties involved directly or indirectly in the supply chain of products and services to consumers.

Hence, the franchisor could be deemed liable towards end consumers for acts of the franchisee.

On the other hand, if the franchisor is held liable and responsible for repairing damages caused by defective goods, 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.

In any event, 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.

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 Brazilian Central Bank ("BACEN") to allow payment of franchise fees and royalties to parties outside Brazil.

As a 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?

Withholding Income Tax ("IRRF") will always apply on royalties paid in consideration for the right to use the whole franchise system, comprising the trademark licence and the technology transfer.

The IRRF 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), and the foreign franchisor is the legal entity responsible for payment (taxpayer).

However, the IRRF is withheld by the BACEN whenever the franchisee remits any royalty abroad. So, in practice, the franchisee collects the IRRF on behalf of the franchisor (taxpayer). However, the financial burden for such tax may be contractually shifted, by means of a gross-up clause.

The abovementioned rule for the 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 franchise agreements to determine that royalties will be paid 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 specific provisions of the Brazilian Civil Code. The main characteristic of agency agreements is the promotion by the agent, who can be either a person without employment ties or a corporate of a third-party business with the purposes of prospecting new clients. In other words, the agent acts on behalf of a company to prospect new clients and receives a commission for its services.

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 have fundamental differences between 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 laid down by the Brazilian Civil Code concerning the negotiation and execution of agreements, including the post-contractual obligations, also apply to franchise agreements.

Articles 113 and 422 of the Brazilian Civil Code disposes that all agreements are subject to the principles of good faith. Beyond the obligation not to harm, according to the principle of good faith, it is legally expected from the parties to cooperate with one another with fairness, mutual trust, transparency and honesty during all phases of the transaction in order to ensure that the other party fully understands what is being negotiated and 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 BFL 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.

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 BFL does not regulate the relationship and, therefore, it does not deal with breaches, 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.

The franchisor is also able to include conditions in the agreement, i.e. the franchisor's prior approval required for the transfer of assets or equity, or even the franchisor's ability to prevent 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 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. However, PoA can be revoked at any time by the grantor. So, from a practical point of view, although it is possible to include in the franchise agreement a PoA in favour of the franchisor, the franchisee has the right to revoke it at any time.

17 Electronic Signatures and Document Retention

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

Yes, although not very much used in franchise agreements, electronic signatures are accepted and used in Brazil in a wide variety of agreements, such as lease agreements, for example.

However, the main issue remains the ability to proof the authenticity of the parties' e-signature. To counter that, despite not being mandatory, it is advisable that the Brazilian party e-signs the agreement by means of a certified digital signature issued by organisms accredited at the Infrastructure of Brazilian Public Keys. This digital signature confers a presumption of validity of the e-signature, as per article 10, paragraph 1 of Executive Order n. 2.200-2/2001.

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

Although most of the Brazilian Courts have adopted an online system, we do not recommend destroying the paper version of agreements because the parties may be requested, during the course of the action, to present the original agreement if the authenticity of "wet ink" signature is challenged and an expert report is required.

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1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

Canada has no franchise legislation at the federal level, but six out of the 13 Canadian provinces and territories have enacted standalone franchise legislation. These provinces are Alberta, British Columbia, Manitoba, New Brunswick, Ontario, and Prince Edward Island. These provincial statutes define a franchise similarly, and generally include the following in their definition:

"Franchise" means a right to engage in a business where the franchisee is required by contract or otherwise to make a payment or continuing payments, whether direct or indirect, or a commitment to make such payment or payments, to the franchisor, or the franchisor's associate, in the course of operating the business or as a condition of acquiring the franchise or commencing operations and:

(a) In which:

(i) the franchisor grants the franchisee the right to sell, offer for sale or distribute goods or services that are substantially associated with the franchisor's, or the franchisor's associate's, trademark, service mark, trade name, logo or advertising or other commercial symbol; and

(ii) the franchisor or the franchisor's associate exercises significant control over, or offers significant assistance in, the franchisee's method of operation, including building design and furnishings, locations, business organisation, marketing techniques or training; or

(b) In which:

(i) the franchisor, or the franchisor's associate, grants the franchisee the representational or distribution rights, whether or not a trademark, service mark, trade name, logo or advertising, or another commercial symbol is involved, to sell, offer for sale or distribute goods or services supplied by the franchisor or a supplier designated by the franchisor; and

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

1.2 What laws regulate the offer and sale of franchises?

In addition to general contract law, the franchise statutes that have been enacted in the six Canadian provinces regulate the offer and sale of franchises. The list below includes the most relevant laws that regulate franchises and are generally consistent among the six provincial standalone franchise statutes:

(i) Disclosure Obligations: Franchisors are required to provide prospective franchisees with a franchise disclosure document containing all material information, such as financial statements, copies of the franchise agreement and all other information as prescribed, at least 14 days prior to any franchise agreement being signed or consideration paid.

(ii) Good Faith and Fair Dealing: Every provincial franchise law imposes a duty of fair dealing on all parties to the franchise agreement. This duty is in respect of the performance and enforcement of the franchise agreement. With the exception of the definition in Alberta's franchise statute, the duty of fair dealing is defined as including the duty to act in good faith and in accordance with reasonable commercial standards.

(iii) Statutory Rights Cannot be Waived: Each provincial franchise law states that any purported waiver or release of a right given under the act is void.

(iv) Right to Associate: Franchisees have been given the statutory right to associate with one another and form organisations amongst themselves.

(v) Rights to Rescind the Franchise Agreement: Franchisees have the right to rescind a franchise agreement up to 60 days after entering into the agreement, if the disclosure received from the franchisor was deficient. If no disclosure was received, the franchisee has up to two years to rescind the franchise agreement. In the event of rescission, the franchisee will also have certain rights to compensation as discussed 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 purposes of any franchise disclosure or registration laws?

Generally, regardless of the number of franchisees or licensees appointed by a franchisor, the disclosure obligations and any other requirements in the six provincial statutes will apply. There are no franchise-specific registration requirements. However, other than in the Alberta statute, each provincial franchise act exempts these obligations when a single licence, with respect to a specific

trademark, trade name, logo or other commercial symbol, is granted, and it is the only one of its type to be granted. The application of this exclusion from the statutes is presently unclear.

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

There are no mandatory registration requirements specifically relating to franchises or franchise systems in Canada. However, if the franchise is one that is subject to other laws, such as employment law, then there may be registration requirements to the extent that it is required by the other laws.

1.5 Are there mandatory pre-sale disclosure obligations?

Yes, every provincial franchise law imposes mandatory pre-sale disclosure obligations on franchisors.

Franchisors are required to provide prospective franchisees with a disclosure document not less than 14 days earlier than (a) the signing by the franchisee of the franchise agreement or any other agreement relating to the franchise, and (b) the payment of any consideration, relating to the franchise, from the prospective franchisee to the franchisor or the franchisor's associate. This disclosure document must be provided all at one time, as one document, and must contain all material facts, financial statements, franchise agreements and any agreements relating to the franchise, and all other information as prescribed by the regulations. These disclosure obligations are quite onerous, so franchisors must ensure that they are complying with the applicable provincial statute and regulations. If there is any material adverse change with respect to the franchise, franchisors must update the franchisees with a written statement as soon as practicable.

There are several exemptions from the disclosure obligations set out in the provincial statutes, including, but not limited to, the transfer of a franchisee, the grant of additional franchises to an existing franchisee and the renewal or extension of the franchise agreement where there have been no interruptions in operations and where there has been no material change. These exemptions are fairly similar across the six provinces that have enacted franchise legislation, but have been narrowly construed by the courts.

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

Yes, pre-sale disclosure obligations apply to sales to sub-franchisees as each of the provincial franchise statutes includes "sub-franchisee" in their definition of "franchise". As a result, the franchisor, or whoever is granting the franchise, is required to make the necessary disclosure to the 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 provincial acts, and their accompanying regulations, each provide for what must be provided in a disclosure document and the format of a disclosure document, though the format and information to be provided does vary across the six provincial statutes. Franchisees are not owed continuing disclosure obligations from franchisors under any of the current six provincial franchise statutes.

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

With the exception of the requirements above and any requirements listed in the franchise legislation, and their accompanying regulations, in the six provinces, there are no additional requirements.

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

There is no mandatory requirement for franchisors or franchisees to join any national franchise association in Canada, however, franchisors and franchisees may benefit from such an association's resources. In Canada, the Canadian Franchise Association, which seeks to protect and enhance the franchise business model in the country, provides resources, such as educational seminars, from which a member may benefit.

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

Membership of a national franchise association usually requires compliance with any codes of that association. For instance, members of the Canadian Franchise Association must comply with its Code of Ethics, and undertake to provide disclosure in all of Canada (not just in the six regulated provinces).

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

Canada has two national languages, English and French. Though English is the predominant language in the six regulated provinces, French is the predominant language in the Province of Quebec. But Quebec has no franchise law. So if the franchise disclosure document is to be used in Quebec, then that is on a voluntary basis and need not be translated. Any contract made in Quebec can be in English, so long as the parties agreed it is to be in English. Otherwise, franchise disclosure documents are usually prepared in 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?

Non-national, or international franchisors, may be subject to the *Investment Canada Act*, which allows for the "review of significant investment in Canada by non-Canadians" to encourage economic growth and to review any potential investment that may have a threat against national security. The minimum threshold for investment to be reviewed under this act is C$5,000,000.

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

Business corporations are the most common business entity used by franchisors to conduct their business. Franchisors will also occasionally use limited partnerships and unlimited liability corporations.

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?

As stated above, there are no franchise-specific registration requirements. However, franchisors and franchisees that are operating as a corporation will be subject to the requirements in relation to formally incorporating their business entity, obtaining business name registrations, as well as registering for licences and tax accounts as required. These licences will vary depending on the type of business being operated.

3 Competition Law

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

Canada's *Competition Act* does not explicitly apply to the offer and sale of franchises, however, franchises may still be affected by the provisions under this act. The *Competition Act* seeks to protect consumers by preventing anti-competitive market practices. Businesses may be reviewed by the Competition Tribunal upon application by the Commissioner under the *Competition Act*. Common reviewable practices include price-fixing, bid-rigging, exclusive dealing and mergers.

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

No, there are no maximum permitted terms for franchise agreements in Canada.

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

No, there are no maximum permitted terms for product supply agreements.

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

A franchisor's imposition of maximum or minimum resale prices on franchisees is acceptable, so long as such practices do not raise concerns under the *Competition Act* as anti-competitive. Due to recent changes in the *Competition Act* such practices are less likely to be seen as anti-competitive. Therefore, many franchisors are imposing resale prices. The *Competition Act* is a federal act in Canada, applicable across the country, and governs most business conduct and aims to prevent anti-competitive practices in the marketplace.

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

There are no minimum obligations that a franchisor must observe when offering franchises in adjoining territories. In many instances, franchises are offered without any territory whatsoever. However, franchisors are required to disclose, as per the regulations under the provincial franchise acts, their policies regarding the proximity between an existing franchise and another franchise, and others using the trademarks.

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

Non-compete and non-solicitation clauses are generally enforceable, and have been upheld as being enforceable by Canadian courts, so long as the clauses are reasonable.

4 Protecting the Brand and other Intellectual Property

4.1 How are trade marks protected?

In Canada, trademarks are protected under the *Trademarks Act*, which is a federal statute that governs matters relating to trademarks and unfair competition. The act gives trademark owners the exclusive right to use the trademark, and provides owners with enforcement measures or rights of action should the trademark be infringed in any way. To ensure the utmost protection, trademarks should be registered.

With respect to franchise legislation, most of the provincial statutes, with the exception of the Alberta statute, requires that the franchise disclosure document includes any information on a franchisor's right to a trademark, logo, trade name or other commercial symbol with which the franchisor is associated.

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

Generally speaking, intellectual property in Canada is protected under various pieces of legislation, including, but not limited to, the *Copyright Act*, the *Trademarks Act*, and the *Patent Act*. In Canada, there is no legislation protecting trade secrets; however, trade secrets can be protected by contract, and in the courts. Not all "know-how" is protected in this way, so carefully drafting a franchise agreement that prohibits such infringement is critical to ensure a franchisor's right of action should such "know-how" be infringed or otherwise misused in any way.

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?

Canadian copyright law is primarily governed by the federal *Copyright Act*, which protects the expression or form of ideas, but not ideas themselves. Registering a copyright is not mandatory, but is beneficial as it makes clear who the owner of the copyrighted work is, and what work is protected. Franchisors can license out copyrighted work to franchisees, and can also restrict the use of a copyright by 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?

A franchisee can bring an action for damages, or can invoke their statutory right to rescind the franchise agreement, if the franchisor

does not comply with their mandatory disclosure obligations. These two remedies are described more thoroughly below. The franchise statute in New Brunswick does provide for mandatory mediation in the event of a dispute. Franchisees can also pursue other remedies provided for in the common law, in addition to the remedies provided for by statute.

Rescission: Franchisees have two statutory rights to rescind a franchise agreement. If deficient disclosure is provided by the franchisor, that is, disclosure that does not meet the standards as prescribed by the statute or regulations, a franchisee has up to 60 days, after receiving the franchise disclosure document, to rescind the franchise agreement. If no disclosure is provided at all, a franchisee has up to two years, after signing, to rescind the franchise agreement. In many cases, courts have held that certain disclosure documents have been so deficient that it is tantamount to no disclosure being given at all, allowing franchisees in such cases to invoke their two-year right of rescission.

Damages: In addition to damages for misrepresentation, if a franchisee suffers a loss because of a franchisor's failure to comply with their disclosure obligations, a franchisee has a right of action for damages against the franchisor, the franchisor's agents, associates, and brokers.

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

Generally speaking, a master franchisee would be liable if they were the ones who contravened the act by not complying with the disclosure obligations. Franchisors are generally not liable if they do not contract with or provide disclosure to the sub-franchisee. An indemnity would only be unenforceable to the extent that it waives any of the provisions of the applicable provincial franchise legislation.

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

Any waiver of any rights provided for in the six provinces that have enacted franchise legislation, including a waiver to avoid liability for pre-contractual misrepresentation in the franchise agreement, is void. The acts all generally indicate that any waiver of the application of the acts, or any provision contained within the acts, is void.

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

Various provinces have laws permitting class actions. Franchisees are provided a statutory right to associate under each of the provincial franchises statutes, and courts have interpreted this right as aiding in the prosecution of class actions. It is an open question whether class action waivers in franchise agreements are enforceable, but they can almost certainly not waive any rights provided for in the applicable provincial statute. A franchise agreement that contains a mandatory alternative dispute resolution clause may impede the ability of franchisees to bring forth 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?

Franchise documents will generally be governed by the law of the province where the franchise operates, and any provision in a franchise agreement that waives the application of such law is void. In the provinces and territories that do not have a franchise statute, the parties are generally free to decide the 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, Canadian courts will enforce orders of foreign courts if it can be demonstrated that there was a "real and substantial connection" between the cause of action and foreign jurisdiction.

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

Franchise agreements will often contain alternative dispute resolution provisions. The courts have found this to be a viable method to resolving disputes, and Canada is a signatory to the New York Arbitration Convention on the Recognition and Enforcement of Foreign Arbitral Awards. In general, businesses can either follow the rules in the local arbitration's statute and/or those of private bodies, such as ADR Institute of Canada's or the International Centre for Dispute Resolution.

7 Real Estate

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

Lease terms for commercial property leases are typically 10 years in length, but can range anywhere between five and 15 years. Commercial leases generally also contain options to extend the lease beyond the initial lease expiry date, and these options usually allow for the extension of the lease by one or two more terms, the length of which is typically the length of the original 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?

Yes, these concepts are generally understood and enforceable under Canadian law.

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 some restrictions on non-Canadian entities holding real estate, or sub-leasing properties, but those restrictions mostly relate to specific types of land such as residential, 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 in a particular location)?

With respect to the commercial real estate market in Canada, it is not common for tenants to secure rent free periods when entering a new lease. Key money is not generally seen in Canada, but lease rates for desirable locations can be at a premium.

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?

Franchise agreements can provide for a binding requirement for an online request to be re-directed to the franchisee, as franchisors are able to grant exclusive territorial rights to franchisees. The scope of these rights is determined by the franchise agreement, and can include online orders.

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 in Canada.

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?

All regulations under the provincial franchise acts require that the franchise disclosure document contain disclosure in regards to the provisions of the franchise agreement relating to termination. In terminating a franchise agreement, a franchisor, as well as a franchisee, must abide by the statutorily imposed duties of good faith and fair dealing.

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

Generally, the courts have held that in circumstances where a business agreement without a fixed term is being terminated by one party, reasonable notice of termination should be given. This reasonable notice varies depending on the circumstances. This generally does not apply to franchise agreements, which are almost always for a fixed term. Apart from having to exercise their discretion in good faith, notice periods can also be agreed upon and set out 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?

No province in Canada would today deem franchisors to be the co-employers of their franchisees' employees. While the argument relating to deemed joint employment has found favour in the media, etc., franchisors should not today be at risk of being considered to be a joint or co-employer with their franchisees if they conduct themselves appropriately. To mitigate against this risk, franchisors should limit the amount of control exerted over their franchisees, especially with respect to employment issues, and any other issues normally dealt with under the franchisee's discretion.

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

There is some risk that a franchisor may be held vicariously liable for the acts or omissions of a franchisee's employees in the performance of the franchisee's franchised business. If a franchisor is found to be exerting significant control over the franchisee in respect of the specific conduct complained of, this will increase the risk of the franchisor being held vicariously liable for the actions of the franchisee. To mitigate this risk, franchisors must limit this type of control, and be clear, both in their words and in their conduct, that the franchisee is an independent contractor 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?

There are no 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?

In Canada, withholding tax applicable to the payment of royalties is generally set at 25%, but the applicable tax treaty between Canada and a subject country can reduce this tax to 10% for foreign franchisors

receiving payment from Canadian franchisees. Generally, structuring payments due from the franchisee to the franchisor as a management fee rather than a royalty will not avoid withholding taxes.

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

There are no such requirements in Canada.

12 Commercial Agency

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

There are no so-called commercial agency laws in Canada. The law of agency is part of the common law. If a franchisee acts on behalf of the franchisor, or is held out by the franchisor that they are authorised as the franchisor's agent, then a franchisee may be treated as the franchisor's agent. To mitigate against this risk, the franchisor should be clear that the franchisee is not the franchisor's agent, both in the written agreements and through their actions.

13 Good Faith and Fair Dealings

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

All six of the provincial laws impose on each party to a franchise agreement a duty of fair dealing in the performance and enforcement of the franchise agreement. And courts in the provinces with no franchise laws have stated that such a duty is part of their common law, or in the case of Quebec, a part of the 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?

With the exception of the franchise agreement itself, after the franchise agreement has been entered into, general contract law governs the relationship between the 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?

The franchise statutes provide an exception to the disclosure requirements for franchise renewals, so long as no material change has occurred since the initial franchise agreement was signed. If a material change has occurred, the franchisor must provide an updated disclosure document upon renewal. Practically, it is almost always advisable to provide disclosure on 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?

There is no overriding right of a franchisee to be renewed beyond the explicit renewal terms, if any, in the franchise agreement, and no such obligations have been created by the franchise laws. In fact, case law has confirmed that the duty of good faith does not create a duty to renew where there is no such right in the 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?

If there is no contractual right for the franchisee to renew the franchise agreement, the franchisee will not be entitled to compensation or damages. If the franchisee has a right to renew, and renewal is denied, the franchisor may be liable for damages under the contract or for having violated their duty of fair dealing or 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, franchisors are entitled to impose such restrictions and will typically set out the terms of such restrictions in the franchise agreement. It is common practice for franchisors to request that the franchisee obtains the consent of a franchisor prior to selling, transferring, assigning or otherwise disposing of 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?

These "step-in" rights will generally be recognised by Canadian law, so long as they do not infringe on any of the other rights provided for in the applicable provincial franchise statutes. There are no registration requirements with respect to a "step-in" right, but franchisors need to comply with their duties of fair dealing and good faith with respect to exercising their "step-in" rights, and generally, deal with any other lien holders.

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?

Such a power of attorney will be recognised, and there are no registration requirements.

17 Electronic Signatures and Document Retention

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

In Canada, the *Personal Information and Electronic Documents Act* generally allows documents to be signed electronically, so long as the signature is unique to the person, the technology used to make the signature is under the sole control of the person making the signature, the technology is capable of identifying the signatory and the technology is able to determine if the document has been changed after the electronic signature was attached. All provinces in Canada have also enacted an electronic commerce law that recognises the validity of most types of electronic signatures.

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

Though an electronic copy of a franchise agreement, that contains no deficiencies and is properly executed, is generally enforceable, it is advisable to keep all original copies of the franchise agreement.

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Cassels Brock has one of Canada's largest and most sophisticated franchise law teams, expertly guiding clients through the growing and ever-evolving world of franchise law. Our dedicated team is recognised both domestically and internationally, offering extensive practical experience in all facets of franchising from assisting local start-ups to working with some of the world's biggest brands on their local and international expansion strategies.

Our franchise lawyers have been consistently recognised by various ratings' publications as leaders in their field. Franchise law group leader Larry M. Weinberg has been ranked by *Who's Who Legal* as among the Most Highly Regarded Franchise Lawyers in Canada and was named the one and only worldwide Franchise Lawyer of the Year for 2014, 2015, 2016 and 2017.

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 which has three elements: (i) a franchisor, through an agreement, grants other operators (franchisees) the right to use the franchisor's business operating resources, including registered trademarks, logos, patents, and proprietary technologies; (ii) the franchisee conducts business under a uniform mode of operation; and (iii) the franchisee pays franchise fees according to the agreement.

In summary, there must be a grant of rights, a 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 purposes of any franchise disclosure or registration laws?

Yes. There is no single-licence exclusion in the PRC franchise regulations (see question 1.2).

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 their compliance with the 2+1 Rule (see question 1.8).

Trademark licences must be recorded with the China Trademark Office.

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 it is not specifically listed, which can be interpreted as a requirement to disclose all material facts.

General contract law provisions also apply to disclosure. Article 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.

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

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

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

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

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

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

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

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

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

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

No, membership with a 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 (http://www.ccfa.org.cn), 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. A translation will also be required for courts if there is a dispute, or by the authorities for an administrative hearing.

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

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

Foreign investment in China is restricted or prohibited in some industry sectors. See the Catalogue of Industries for the Guidance of Foreign Investment, published by the National Development and Reform Commission and the Ministry of Commerce in June 2017, as revised on June 28, 2018. 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 forming a joint venture with the franchisor. However, 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?

WFOEs not operating within restricted industry sectors must register with MOFCOM.

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

The Anti-Unfair Competition Law, revised in 2017, provides statutory protection to trade secrets in addition to contractual obligations of the parties. The statute also prohibits unfair business

practices, such as the fraudulent or misleading use of trademarks, fraudulent advertisement, the unauthorised use of domain names, and commercial bribery.

The 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.

The enforcement authorities and the courts do not see eye to eye on the issue of whether a negative effect on competition is required to secure conviction for a resale price maintenance offence. The price bureaus treat it 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. While the courts used to require proof of a negative effect on competition to uphold a conviction for a resale price maintenance offence, judicial attitudes seem to shift in favour of the government. In a recent case in the Hainan province, the Hainan Higher People's Court decided the administrative appeal on a resale price maintenance conviction in favour of the government.

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

There is no statutory maximum term.

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

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

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

PRC's Anti-Monopoly Law prohibits vertical agreements that fix resale prices or set minimum resale prices. In the last few years, retail price maintenance has become a significant issue for Chinese anti-monopoly authorities (especially in sectors such as pharmaceuticals and auto dealers). Franchise agreements 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 good faith set out in the Contract Law and the General Principles of Civil Law.

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

4 Protecting the Brand and other Intellectual Property

4.1 How are trade marks protected?

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 the 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.

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

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

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 have not been very successfully protected in the PRC courts 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 a clear scope of the information covered, should be considered.

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

Yes. 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 online enforcement is anticipated.

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

5 Liability

5.1 What 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 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 pre-contractual misrepresentation allocated between franchisor and master franchisee? If the franchisor takes an indemnity from the master franchisee in the Master Franchise Agreement, are there any limitations on such an indemnity being enforceable against the master franchisee?

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

With respect to contractual indemnity between the franchisor and the master franchisee for disclosure non-compliance or pre-contractual misrepresentation, 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 negligence or gross 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 aggrieved franchisees and, if so, are class action waiver clauses enforceable?

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

a) 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 the enforcement of foreign judgments and arbitral awards is difficult in China), explaining foreign law to the judge will be expensive and cumbersome. If the judge is unclear as to the effect of the foreign law, the judge will likely apply Chinese law.

Chinese judges have a good track record of enforcing commercial contracts governed by PRC law: China is ranked 5th in The World Bank Group's Enforcing Contracts ranking (http://www.doingbusiness.org/data/exploretopics/enforcing-contracts), while Hong Kong, a popular jurisdiction of choice in international transactions related to China, is ranked 28th.

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

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

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

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

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

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.

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

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

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

7 Real Estate

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

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

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

Yes, a conditional lease assignment is enforceable. However, under PRC law, a foreign legal entity cannot be a tenant, 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 in 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. Market conditions in the so-called "second tier cities" (for example, Hangzhou, Foshan) may be more favourable for tenants.

8 Online Trading

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

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

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

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

9 Termination

9.1 Are there any mandatory local laws that might override the termination rights 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.

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

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

10 Joint Employer Risk and Vicarious Liability

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

This risk is very remote in the PRC.

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

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

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

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

11 Currency Controls and Taxation

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

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

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

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

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

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

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

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

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

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

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

12 Commercial Agency

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

Under PRC law, there is little risk of confusion between franchising and commercial agency. Commercial agency (known as "entrustment contracts" in China) is a nominal contract, i.e., it is regulated by a separate chapter in the 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 6 of the General Principles of Civil Law (中华人民共和国民法总则), 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 the franchise agreement.

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

There is no such statutory right.

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

No, the franchisee is not entitled to any compensation.

16 Franchise Migration

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

Yes, subject to the good faith requirements (see question 13.1), a franchisor can restrict the franchisee's freedom to dispose of the franchised business. 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 the 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 a proper scope of business in its 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 rights.

16.3 If the franchise agreement contains a power of attorney in favour of the franchisor under which it may complete all necessary formalities required to complete a franchise migration under pre-emption or "step-in" rights, will such a power of attorney be recognised by the courts in the 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.

17 Electronic Signatures and Document Retention

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

Electronic signatures which comply with the reliability requirements of the PRC's Electronic Signature Law (中华人民共和国电子签名法, *Zhonghua Renmin Gongheguo Dianzi Qianming Fa*) are recognised as a valid way of signing a franchise agreement. Only legal persons can obtain an electronic signature in the PRC. In practice, however, "wet ink" is still a preferred method of signing franchise agreements.

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

The rules of evidence in the PRC are stricter than in many common law jurisdictions, and uncertified copies of paper documents are generally not admissible as evidence. It is therefore recommended to keep the original paper versions of franchise agreements, in case they are required to be presented to a court or an administrative body.

Acknowledgment

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Jones & Co. is a multilingual law firm in Toronto, Canada. It provides legal advice to international businesses regarding the protection and distribution of their goods and services. It is particularly known for its work in intellectual property, licensing and franchising, and international law. The firm has a well-established China practice and staff include native Chinese speakers.

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Czech Republic

Barbara Kusak

Halka Pohlová

Noerr

1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

There is no statutory definition of a franchise in the Czech Republic. The Czech 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."

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 contractual relationships, i.e. Act No. 89/2012 Coll., the Czech Civil Code (hereinafter the "**Civil Code**") 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 purposes of any franchise disclosure or registration laws?

Yes, this person will be treated as a franchisee. 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.

1.5 Are there mandatory pre-sale disclosure obligations?

Due to the fact that franchise agreements are not seen as a special type of contract, the general pre-sale disclosure regulation applies. The requirements for general pre-sale (pre-contractual) disclosure are contained in the Civil Code. This also affects the negotiation of franchise agreements to the extent that commencing and thereafter breaking off negotiations in bad faith (without a sufficient reason) may give rise to the duty of such party terminating the negotiations to make good any losses incurred by the other party due to having relied on the prospective conclusion of the franchise agreement.

The franchisor must inform the potential franchisee about the franchise concept including information on necessary investments. The franchisor must provide the potential franchisee with all 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. It is not specified by law what concrete information shall be provided to the franchisee. The provided data/information has to always be complete and accurate. The extent of pre-sale disclosure obligations depends on each individual case, especially with regard to the (economical) experience of the franchisee and type of franchise system. The franchisor must present correct figures and data to the potential franchisee, especially information about the profitability of the franchise system and about the necessary investment, and can be held liable for any wrong information that is necessary for the franchisee.

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

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.

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. Nevertheless, it is recommended to have a signed confirmation from the franchisor and franchisee that the disclosure obligation was met.

In respect of the disclosure of financial data, the franchisor is obliged to inform the franchisee about the necessary investments (starting as well as running), about the profitability of the franchise system and about the achievable turnover. He shall also disclose the amount and the type of the franchise fee which will be agreed in the franchise agreement.

There is no statutory obligation to provide continuing disclosure to existing franchisees. As a rule, a franchisor's obligations to provide advice and information relating to system development and updated information about the sales and marketing strategy are incorporated in the contents of the franchise agreement.

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 its own branch/shop (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 Czech Franchise Association is not mandatory but is advisable. The Czech Franchise Association is a platform for the exchanging of experience and business information. The membership is seen as a sign of quality.

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

Members of the Czech Franchise Association are obliged to 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?

From a strictly legal viewpoint, the parties may use a foreign language for the franchise agreement as long as both parties are able to read and understand that language. However, for the avoidance of all doubt concerning good faith and the certainty of drafted documents in general, it is advisable to provide a Czech version. Also, in the event of any disputes before the Czech court, such translation would be necessary.

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 restrictions on non-nationals in respect of the ownership or control of a business under the Czech law.

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

Franchisors tend to use 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?

All the requirements for entrepreneurs, such as registration with the Czech Commercial Register for companies, must be fulfilled. In addition, a trade licence is required depending on the type of business (e.g. restaurants, hotels) and a special licence is required in regulated industries such as the banking or insurance sectors. Furthermore, each business entity has to have a valid VAT number.

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:

- Art. 101 of the Treaty on the Functioning of the European Union (TFEU).
- Commission Regulation (EU) No. 330/2010 of 20th April 2010 on the application of Art. 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices (vertical BER).
- The Czech Competition Act (Art. 143/2001 Coll.).

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

No, there is not a maximum permitted term for a franchise agreement. Usually a franchise agreement is concluded for 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.

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 exclusively from the franchisor, or 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?

Minimum resale prices are forbidden according to the Czech and European competition law.

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

Usually the 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 another's acquisition efforts and is competing in the same territory. However, 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, such clauses are normal in franchise agreements, and are enforceable. These clauses must always comply with the competition law. Post-contractual competitive restrictions are permitted for a maximum of one year after the franchise contract has terminated, and only provided that they relate to contractual or competing goods, or to the business premises. A competitive restriction of a longer duration may only be agreed to protect the franchisor's know-how.

4 Protecting the Brand and other Intellectual Property

4.1 How are trade marks protected?

With respect to the licensing of trademarks, there is a registration obligation according to Czech law. Trademark licence agreements do not become effective *vis-à-vis* third parties until they are entered into a register kept by the Industrial Property Office (*Úřad průmyslového vlastnictví*) in Prague; the licensing is effective between the parties upon execution of the agreement. The entry into the register is made on request and does not require any examination. Other licence agreements concerning other intellectual property rights (e.g. patents, utility models, designs, etc.) are subject to registration as trademark licence agreements.

The failure to register a licence does not result in any consequences other than that it will not be effective against third parties.

Under the Czech law the following remedies against unauthorised interference with trademark rights are available, the respective court may be requested to order the infringing party: (i) to refrain from such unauthorised acting; (ii) to remove the defective situation; further, a claim exists to; (iii) a reasonable compensation that may be paid in money; (iv) compensation for damage; and (v) the surrender of unjust enrichment.

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

Know-how does not of itself enjoy any special protection, but may be protected as a trade secret, subject to its compliance with the conceptual features of a trade secret, or within a scope of unfair competition. Both of these events are regulated by the Civil Code.

The following remedies of unfair competition or breach of a trade secret are available under the Czech law, the respective court may be requested to order the infringing party: (i) to refrain from such unauthorised acting; (ii) to remove the defective situation; further, a claim exists to; (iii) a reasonable compensation that may be paid in money; (iv) compensation for damage; and (v) the surrender of unjust enrichment.

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?

In any case of a breach of pre-contractual disclosure obligations by the franchisor, the franchisee will be entitled to claim damages and under some cases rescind from the contract.

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

The franchisor 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 the 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, a franchisor cannot avoid liability for pre-contractual misrepresentation.

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

Class actions are not regulated under Czech law in general.

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 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. Furthermore, the contract should be checked with respect to Czech mandatory law, because the mandatory regulations of the national law will always apply.

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 can be granted by local courts or those already granted by an EU Member State are recognised in accordance with European law. Injunctions granted by non-EU Member State countries referring to damage to a brand or misuse of business-critical confidential information are recognised only if there is a bilateral agreement between the Czech Republic and the other country which enables such an option.

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

The Czech Republic, as one of the signatories of the UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958 ("**New York Convention**") is bound by arbitral awards made in a foreign country where the minimum requirements set out in the Convention are fulfilled. This implies that the Czech courts must honour the election of international arbitration dispute resolution. Drawing from our experience, the businesses that accept arbitration do not generally favour any particular set of arbitral rules.

7 Real Estate

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

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 agreed 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.

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 in a particular location)?

Both (initial rent free period/key money) is possible. The initial rent free period is more common in respect of the commercial premises.

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 (Art. 101 of the Treaty on the Functioning of the European Union ("**AEUV**") and the Vertical Agreement Block Exemption ("**GVO**") 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?

Assignment of the local domain is generally allowed in the Czech Republic and there are no specific limitations for such assignment to the franchisor. However, the transfer should be agreed in the franchise contract or other document.

If the domain owner initiates the transfer process, this is realised on the basis of the conditions that individual domain registrars adjust according to their own needs and preferences. Some only need a simple electronic confirmation, others require at least a confirmation via SMS and there are also paid assignment services when the domain registrar also has a role in the transfer (e.g. the domain is temporarily transferred to it).

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 specific laws affecting termination of a franchise agreement under Czech law – the general regulation of termination set by the Civil Code applies unless otherwise agreed by the contracting parties.

A franchise agreement may be entered into for a specific or unspecified period of time. A franchise agreement which has been entered into for a specific period of time terminates upon the expiry of the agreed term. A franchise agreement with an unspecified duration may be terminated by either party as specified in the franchise agreement. If the parties do not agree on any modalities for terminating the agreement by notice, any franchise agreement of an unspecified duration may be terminated without providing reasons with three months' notice ending at the end of a calendar quarter.

Generally, as concerns the termination of both fixed-term and indefinite-term agreements, the principle of freedom of contract applies, and the contracting parties can agree on the circumstances in which a franchisor or franchisee can terminate a franchise agreement directly in the franchise agreement.

A franchisor and franchisee may also rescind an agreement if either of the contracting parties has breached its obligations in a material manner. A material breach of an agreement is a breach regarding which the breaching party knew, or could have presumed given the purpose of the agreement stemming from the contents of the agreement or circumstance of its execution, at the time of executing the agreement, that the other party would not be interested in performing the agreement in the event of such breach.

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

No, there are no such rules in respect of the 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 general, there is no risk because the employee of the franchisee have an employment contract with the franchisee and not the franchisor and the franchisor and the franchisee act as independent entrepreneurs. There could be a risk if the franchisor intends to give instructions to the franchisee's employees and determines their working time and place of work. In such a case there is a risk that the franchisor could be seen as a joint employer with the franchisee. It is also the question of the degree of control that franchisor exercises over the franchisee's 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?

No, there is no such risk as long as the franchisor and the franchisee act as independent entrepreneurs (see question 10.1).

11 Currency Controls and Taxation

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

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?

In general, royalties (including trade mark licence fees and fees paid for the use of technology) paid to non-tax residents (which are not attributable to a Czech permanent establishment) are generally subject to 15% withholding tax. A special 35% tax rate applies to payments *vis-à-vis* tax havens. Residents of other EU or EEA countries can file a tax return and claim a deduction for any related expenses. The withholding tax is considered an advance payment and is credited against the tax liability reported in the tax return. This may result in a reduction of the tax burden as withholding tax is levied on a gross basis. The withholding tax on royalties can be reduced or eliminated under the rules resulting from the EU Interest-Royalties Directive or under an applicable double tax treaty. The Czech Republic has concluded double tax treaties with 88 countries, including the US and most European countries.

Under Czech tax law, fees for services provided in the Czech Republic (which are not attributable to a Czech permanent establishment) are subject to 15% withholding tax (35% tax rate applies *vis-à-vis* tax havens). Residents of other EU or EEA countries can file a tax return as described above. Most double tax treaties eliminate the Czech tax on service fees unless the non-resident franchisor has a permanent establishment in the Czech Republic.

If the royalties or fees for services are attributable to a Czech permanent establishment they are (after the deduction of related expenses) subject to Czech income tax levied at the regular tax rate (corporate income tax rate: 19%). The franchisee is generally obliged to withhold a 10% tax security advance from the payments made to the franchisor who is a non-EU/EEA tax resident. The tax security advances is credited against the tax liability reported in the tax return.

The possibility to avoid the withholding tax on royalties by structuring payments due from the franchisee is limited by tax anti-avoidance rules, including the "substance-over-form" provision in the Czech Tax Code. Should the parties design the payments in the contract as management fees but the payments were in fact attributable to the use of trade marks or technology, the Czech tax authorities could additionally assess withholding tax based on this provision.

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?

As the franchisee acts independently and does not sell the goods or provide services on behalf of the franchisor, he will not be treated as

the franchisor's commercial agent. In the Czech Republic, there has not been any courts' rulings yet, which would state that legal rules regarding the commercial agency or some of them shall apply for franchise relationship.

13 Good Faith and Fair Dealings

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

Yes, the principles of *bona fides* and fair business conduct constitute significant legal principles of the Civil Code, and apply to the pre-contractual phase, during the entire term of the franchise agreement and after its termination. This principle means that the parties are obliged to fulfill their rights and obligations diligently and fairly. As franchise agreements are usually standardised contracts, the regulations regarding the adhesive contracts shall apply (§§ 1798–1801 of the Civil Code). These rules protect the franchisee from any particularly disadvantageous arrangements or contractual provisions understandable with difficulties. However, the regulations of adhesive contracts can be contractually excluded if it is supposed that both contractual parties are entrepreneurs.

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?

A franchise agreement is an "unspecified type of contract" under Czech law, which is in general regulated by the Civil Code. There is no special Czech legislation that would regulate the relationship between the franchisor and franchisee after the franchise agreement comes into effect.

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.

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. It can be agreed 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?

In general, a franchisee in this situation 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?

Yes, such restrictions are allowed by law and are common in franchise agreements.

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 franchise agreement, i.e. to take over the ownership and management of the franchised business; however, this right must be explicitly and transparently stated in the franchise agreement and the conditions of the "step in right" must be agreed in detail (e.g. compensation for taking over).

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?

This is not common practice in the Czech Republic.

17 Electronic Signatures and Document Retention

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

Firstly, Czech law does not require the written form for a franchise agreement. That means that the franchise agreement can be concluded orally or by the exchange of "simple" emails. However, in order to avoid the future potential disputes regarding the content of the franchise agreement, it is advisable to agree on the written form.

Under Czech law, there are four types of electronic signatures: (i) plain; (ii) advanced; (iii) advanced based on a qualified certificate; and (iv) qualified. However, the Czech legislation also knows the concept of a "recognised electronic signature", which is an umbrella term for a qualified signature and advanced signature based on a qualified certificate. Qualified certificates, as the basis for recognised electronic signatures, are issued by trust service providers.

Only the recognised electronic signature is able to reliably verify the identity of the individual who uses the signature and the risk for the misuse of these types of signatures is the smallest. Nevertheless, following the adoption of the eIDAS regulation in the EU and the

change of local legislation, all four types of electronic signatures are valid in the Czech Republic in private law relations for the validity of legal transactions, including the simple electronic signature.

In view of the above, we can confirm that if the franchise agreement is concluded in the private sphere, simple electronic signatures are sufficient under Czech law. There are not any specific requirements for applying an electronic signature to a franchise agreement.

Lastly, Czech law does not offer the possibility to conclude franchise contracts in the form of a "deed", it is necessary to use a standard contract.

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

Czech law lays down the need to keep only certain types of documents for a certain period of time (for example, documents necessary for proper accounting or tax documents). Archiving contracts is generally not required by law; however, it is advisable to keep them for a certain proportionate period of time.

However, theoretically the procedure described in this question is possible, since as mentioned above, the franchise agreement does not require the written form according to Czech law.

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The authors would like to thank Dita Šulcová for her invaluable assistance in the writing of this chapter. Dita Šulcová specialises in the tax structuring of M&A transactions and international taxation. She has profound experience in tax structuring cross-border and national projects, project financing and financial services matters. She lectures and contributes to seminars for tax professionals.

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Halka was a member of the administrative board of the Czech Franchise Association ("**CFA**") between 2011–2016 and since March 2016 she has been a member of the supervisory board of CFA and supports CFA by giving expert lectures and seminars.

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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?

The 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 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 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.

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 member 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 to 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 are 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 in a grossly unfair manner, 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 the 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 pre-contractual misrepresentation allocated between franchisor and master franchisee? If the franchisor takes an indemnity from the master franchisee in the Master Franchise Agreement, are there any limitations on such an indemnity being enforceable against the master franchisee?

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).

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 a franchisor's 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 aggrieved franchisees 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, the 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 an interim collection of evidence or to issue an interim injunction.

Danish courts generally do 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.

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

Arbitration is commonly used in Denmark. Arbitration is generally recognised as a viable method for settling disputes.

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

In Denmark, the rules of arbitration procedure by the Danish Institute of Arbitration are widely favoured. Please find the rules in English from the following link: https://voldgiftsinstituttet.dk/wp-content/uploads/2015/01/rules_1_may_2013_-_pdf-uden-logo.pdf.

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 can generally not be entered into only for a fixed term, and that the Lessor only has the rights 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 also in relation to the franchisee's use of 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?

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 in a particular location)?

The real estate market in Denmark's major cities is doing reasonably well and a tenant should not expect an initial rent-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 tenants 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 (online) 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.

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.

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

No Danish rules impose a minimum notice period. However, if a contractual minimum notice period is considered grossly unfair, the contractual notice period might be declared invalid.

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 any 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 a 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 the 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, this does not seem to 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 a 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 this 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.

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, a 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 finds 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 finds 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 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.

17 Electronic Signatures and Document Retention

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

In general, there are no formal requirements to contract formation under Danish law. Thus, electronic signatures are recognised as a valid way of creating a binding and enforceable agreement.

Further, there are no specific requirements for applying an electronic signature to a franchise agreement.

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

If a signed/executed franchise agreement is stored electronically, the paper version can be destroyed. However, destroying the paper version might impose a risk in case a dispute regarding the authenticity of the contract arises.

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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 1.8 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 1.8 below.)

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

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

It is essential 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 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 a "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".

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 continuing disclosure 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 Luxembourg), to take advantage of beneficial tax rates.

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

Once a limited liability company has been duly incorporated at Companies House, the company may begin trading. Information on incorporation requirements 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 two to six 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 requires the franchisee to purchase from the franchisor/franchisor's designated suppliers more than 80% of the franchisee's total purchases – calculated by value or volume depending on the segment of the market.

In general, in-term non-compete obligations are permitted where the duration is limited to five years or less, and there are no obstacles that potentially hinder the franchisee from terminating the non-compete at the end of this period (tacitly renewable obligations that extend beyond five years will not work). Where the franchisee operates from premises and land owned or leased by the franchisor, the non-compete obligation may extend to the period of occupancy of those premises.

Importantly for franchisors, where there is a transfer of know-how and intellectual property rights, non-compete clauses may be permissible for the duration of the franchise agreement (irrespective of length) provided that: they are directly related to the franchised business; the primary object of the agreement is not to transfer such know-how or IPRs; and the 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 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 the registrability of trade marks.

Once any objections are resolved, the application will be advertised in the Trade Marks Journal and objectors may raise objections (generally within a two-month period). In the absence of any successful objections, the trade mark will be registered following the expiry of that period.

If the trade mark is to be used in 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 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 pre-contractual misrepresentation allocated between franchisor and master franchisee? If the franchisor takes an indemnity from the master franchisee in the Master Franchise Agreement, are there any limitations on such an indemnity being enforceable against the master franchisee?

There are no mandatory disclosure requirements in the UK.

In a typical arrangement (where the sub-franchise agreement is made between the master franchisee and sub-franchisee), any liability for misrepresentation would rest with the master franchisee (as the parties 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 aggrieved franchisees and, if so, are class action waiver clauses enforceable?

English law permits class actions, but these are less aggressive than the US equivalent. Class action waivers are enforceable, but are rarely used.

6 Governing Law

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

There is no legal requirement for franchise agreements to be governed by English law. However, to increase the marketability of a franchise system in the UK, the majority of franchise agreements are subject to English law. In some limited cases, franchise agreements in the UK might be subject to the law of one of the US states, for example, but there is no generally accepted norm where English law is not the governing law of the agreement.

6.2 Do the local courts provide a remedy, or will they enforce orders granted by other countries' courts, for interlocutory relief (injunction) against a 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.

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

Arbitration is a common and widely recognised means of resolving disputes, especially in relation to international franchise agreements that operate across geographic borders, whether from the UK to other countries or *vice versa*. The UK is a signatory to the New York

Convention and the Geneva Convention, and so arbitral awards are internationally enforceable in the UK.

There are many different recognised rules of arbitration. Those frequently used in relation to the UK include the London Court of International Arbitration ("**LCIA**") and the International Chamber of Commerce International Court of Arbitration ("**ICC**"). Different organisations impose different procedures and different cost structures, so it is worth taking advice to find the arbitral process that best suits your commercial requirements.

7 Real Estate

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

The typical length of a lease of certain types of commercial property has been falling over recent years. In the retail sector, leases of 10 years (with a right to break after five) or five years are common. In other sectors (such as hotels or licensed premises) where initial fit-out/investment costs are substantial, longer terms are normal – 20/25-year leases at market rent are common for licensed premises/restaurants, and 99/200-year leases with low rents (but with an initial premium) are common for hotels.

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

Although this concept does not tend to be standard in precedent commercial leases, it is reasonably well understood that a franchisor may want rights to step into a failed franchisee's lease, and appropriate wording to cover this issue can be included in the original lease. This 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 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 given by the non-national holding 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 in a particular location)?

The market is currently mixed, with the retail and casual dining sectors experiencing difficult trading conditions at the time of writing. 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 current balance of supply and demand. As already noted, 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, although the full impact of Brexit is probably still to be felt. 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. It may also be worth considering the inclusion of a limited power of attorney in the franchise agreement, entitling the franchisor to effect such assignment if the former franchisee refuses to do so. Under English law, a power of attorney must be executed as a deed, so careful attention needs to be paid to the execution formalities of any agreement which contains a power of attorney.

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.

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

There are no statutorily imposed minimum notice periods that will have the effect of overriding the contractual period notice set out in the franchise agreement. See question 12.1 below relating to minimum statutory notice periods in relation to commercial agency agreements.

10 Joint Employer Risk and Vicarious Liability

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

There is very little English case law addressing the issue of whether a franchisee or a franchisee's employees can be treated as employees of the franchisor. In deciding the issue, typical considerations may include: whether the individual receives any wage or remuneration from the franchisor; the degree of control the franchisor exercises over the individual; and the provisions of the contractual documents. In a franchise network it is unlikely that any employees of the franchisee will receive remuneration from the franchisor, and the income that the franchisee receives tends to be profit from the franchisee's business, rather than remuneration. Further, although the franchisor indirectly may exercise some degree of control over the franchisee's staff, this control tends to be limited to outcomes and not day-to-day control over the actions of individual employees. Nevertheless, the concept of joint employer risk is gaining momentum outside the US where it began, and is now recognised in a number of other common law and civil law jurisdictions. As such, it is not an issue that can be ignored when structuring the terms of franchise agreements and master franchise agreements that are to operate in the UK.

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

It is rare that a franchisor is found vicariously liable for the acts of a franchisee. It is good practice for franchise agreements to contain a clause expressly stating that there is no relationship of partnership, agency or employment between the franchisor and franchisee, which can reduce the likelihood of potential liability. However, it remains a question of fact, and factors that may contribute to a risk of vicarious liability include: the degree of control the franchisor exercises over the franchisee's day to day operations; whether there is common ownership of the franchisor and franchisee; and whether the franchisee was in fact acting as the franchisor's agent (disclosed or undisclosed), notwithstanding any wording to the contrary in the franchise agreement. Controls intended to maintain uniformity of appearance and products are typically considered 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. The ongoing relationship between the UK and the EU with regard to relief from UK withholding tax will be subject to the terms upon which the UK exits the European Union under Brexit.

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 (as amended) ("**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 commercial 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 few years, 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 underwent huge changes on 25 May 2018, when the EU General Data Protection Regulation ("**GDPR**") came into force. As GDPR came into effect in the UK pre-Brexit, GDPR is now having a direct effect on businesses with operations in the UK.

Additionally, the UK Government has recently (on 25 May 2018) enacted a new Data Protection Act 2018. The Act addresses how GDPR applies in the UK, including (i) implementing certain derogations under GDPR that the UK Government negotiated, (ii) applying the new data protection standards to all areas, not just areas of EU competence, and (iii) repealing the Data Protection Act 1998 to avoid inconsistencies with GDPR. It is important therefore that GDPR and the DPA 2018 are read side by side. Of particular significance in the franchise scenario, where franchisors have an vested interest in a franchisee's customer database for a number of valid commercial reasons, it is worth bearing in mind that unlike the previous Data Protection Act 1988 which regulated only "data controllers", GDPR directly regulates "data processors" as well for the first time.

Failure to comply with GDPR and the DPA 2018 will make businesses subject to competition law-style revenue-based fines as well as to private claims by individuals. This new regime represents a fundamental overhaul of the data privacy environment which cannot be adequately summarised in this column.

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 covers advertising to consumers) and the Business Protection from Misleading Marketing Regulations (which covers advertising to traders and comparative advertising). Significant consumer protection reforms are currently proposed to give consumers a direct right of redress.

UCTA: the 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).

16 Franchise Migration

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

The franchise agreement can include an absolute prohibition on the franchisee's ability to transfer the franchise to a third party. However, it is more common for the franchise agreement to include an express assignment clause, setting out a process whereby the franchisee may transfer the franchise subject to the franchisor's prior written consent (which may be conditioned in certain circumstances).

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

English law will recognise any express step-in rights set out in the franchise agreement. There are no registration requirements or other formalities. The use of step-in rights tends to be sector- and context-specific, and may apply particularly in the retail and restaurant sectors if a franchisee has secured the lease of a key location. On the other hand, many franchisors do not want to get involved in commercial property transactions, notwithstanding the relative attraction of any given location as a means of promoting the brand.

16.3 If the franchise agreement contains a power of attorney in favour of the franchisor under which it may complete all necessary formalities required to complete a franchise migration under pre-emption or "step-in" rights, will such a power of attorney be recognised by the courts in the 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.

17 Electronic Signatures and Document Retention

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

Increasingly, agreements are being signed remotely using electronic means rather than being signed in a traditional way in a "completion meeting" attended by all of the parties. This is even more so in connection with cross-border transactions where the parties are geographically remote from each other. Electronic signatures create a way to sign franchise documents in the online world, like one signs with a pen in the offline world. Depending on the type of electronic signature – simple electronic signatures e.g. a scanned copy of a "wet ink" signature, an advanced electronic signature – which is uniquely linked to the signatory and is capable of identifying the

signatory or qualified electronic signatures – which is created using a signature creation device, the process for executing the document will differ.

The EU Electronic Signatures Directive 1993 created a legal framework for electronic signatures. This framework has been implemented into English law by the Regulation on electronic identification and trust services for electronic transactions in the internal market ("**eIDAS**"). The eIDAS Regulation ensures the recognition of electronic signatures in legal proceedings, thus enabling binding legal agreements to be executed in this way.

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

The short answer is "yes", so long as you are confident that you will always have access to the electronic copy of the document, so that it can, if necessary, be produced in evidence if there is a dispute as to its terms or meaning, or if it is to be the subject of an inquiry or due diligence exercise. This then illustrates the need to have an effective, robust and secure document management system on which your digital records can be stored and accessed. Remember also to ensure that your digital records are backed-up and that you have a disaster recovery plan in place to enable you to access your contracts and other critical documents in the event of a cyber-attack or some other disabling interruption to your business.

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Iain qualified as a solicitor in 1988 and specialised in corporate mergers and acquisitions, stock exchange and complex commercial and joint venture work. Between 1998 and 2002, Iain was Director of Corporate Finance at a corporate industrial developer, 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 – consistently ranked Band 1 by *Chambers Global Directory* and recognised as the International Franchise Law Firm of the Year by *Who's Who Legal* for the 14th 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.

France

Cecile Peskine

LINKEA

Clémence Casanova

1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

Under French law, there is no regulation that defines a franchise. The franchise definition has been constructed by the French Courts and authors, and any relationship containing the following elements is considered a franchise agreement:

- a right to use a registered trademark; and
- the transfer of know-how.

Even if the relationship is not qualified by the parties as a franchise agreement, each agreement containing the abovementioned elements might be regarded as a franchise agreement, and implies that the Franchisor provides the Franchisee with support, the final aim being the profitability of the franchise business.

1.2 What laws regulate the offer and sale of franchises?

The offer and sale of franchises is specifically regulated by articles L.330-1 and R.330-3 of the French Commercial Code – which covers in general all exclusive trademark licence relationships.

Franchise operations are also governed by French contract rules which are established in the French Civil Code, as well as by the general rules applying to all commercial relationships in the French Commercial Code.

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

Yes, this person will be regarded as a "Franchisee" and treated as such even if it is the only franchisee in the French territory. However, in case this unique "Franchisee" is entitled to sub-franchise its rights in the French territory, it may be regarded as a "Master-Franchisee".

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

Under French law, the only registration requirement relating to the franchise system is to deposit and register the trademark that will be granted to the Franchisee.

There is, however, no obligation for the Franchisor to register their franchising activity, nor to register the franchise agreements executed with Franchisees. The trademark licence granted to the Franchisee may however be registered before the trademark office that has generated the related trademark (for a national brand, said office is called "INPI"), even if there is no obligation to do so.

1.5 Are there mandatory pre-sale disclosure obligations?

Pursuant to article L.330-3 of the French Commercial Code, the Franchisor must provide the Franchisee with a "Pre-contractual Information Document" (disclosure document) at least 20 days before the signing of a franchise contract, and at least 20 days before the payment of any sum or any investment in relation to the franchise relationship.

This disclosure document shall contain the following information, which is detailed at article R.330-1 of the French Commercial Code:

- the Franchisor's information (company name, registered office, form, capital, manager, registration number);
- their trademark registration number and registration number of the trademark licence agreement if relevant;
- the Franchisor's banking information (bank address, account number);
- the Franchisor's audited financial statements regarding the past two years;
- the history and presentation of the company and of the network;
- the general and local market "statements" (presentation) and development prospects of the general and local market;
- a list of the undertakings of the network, and nature of their relationship with the Franchisor (franchise agreement, subsidiaries, JVs, etc.);
- the address of the franchised undertakings located in France, conclusion and renewal dates of the related franchise contract;
- the number of Franchisees which have left the network the year before the issuance of this document, detailing whether this has resulted from expiry, cancellation or termination of the contract;
- the presence of any undertaking member of the network in the same territory, and distribution of services or products that are the subject of the franchised business in the same territory;
- the most important provisions of the contract: duration; renewal; termination; assignment; exclusive rights; and
- the investments linked to the franchise operation.

The Franchisor shall also deliver any other information that may be relevant in the candidate's decision to enter into the franchise agreement. This general obligation has been implemented in the French Civil Code in 2016.

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

Yes, the obligation to provide a pre-contractual information document complying with articles L.330-3 and R.330-1 of the French Commercial Code also applies to sales performed to Sub-Franchisees. The Master-Franchisee in charge of recruiting the Sub-Franchisees located in France shall thus provide the candidate to a sub-franchise agreement with the precontractual information document at least 20 days prior to the related sub-franchise agreements' execution and at least 20 days before any payment or investment in relation to the sub-franchise relationship.

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

The disclosure document shall contain the information listed at articles L.330-3 and R.330-1 of the French Commercial Code, which are detailed in question 1.5 above. However, there is no format prescribed by the law.

The disclosure document shall be updated for each candidate.

There is no obligation to provide updated information to the current Franchisees during the franchise relationship.

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

French Courts dictate that the Franchisor has a duty to experiment/test the concerned business and concept before franchising it, and will usually request the Franchisor to prove that the concept has been operated in owned operations for at least two years before the franchise development started, and that this experimentation is profitable.

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

No membership of a national franchise association is mandatory. However, membership of the French Federation for Franchising (*Fédération Française de la Franchise*) is advisable, *inter alia*, since the *Fédération Française de la Franchise* provides training regarding franchising in France, and contributes to Franchise Expo Paris, which is a well-known annual French franchise exhibition.

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

The *Fédération Française de la Franchise* will, *inter alia*, verify if the franchise disclosure document and franchise agreements comply with the European Code of Ethics for Franchising.

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

There is no mandatory obligation to translate the documents into French. However, translation is strongly advisable, particularly in order to be able to prove that the Franchisee has been provided with clear and understandable information before signing the franchise agreement.

In the course of a litigation, French Courts will require an official translation of any documents drafted in a foreign language.

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

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

No, there is no such regulation anymore under French law, unless it concerns sensitive sectors that might cause harm to public policies, public security, national defence interests or activities related to the production of weapons. In these limited cases, the related investment shall be subject to the Minister of Economy's prior approval and declared to the French Treasury Tax Department.

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

Private limited liability companies – such as *société par actions simplifiée*, *société à responsabillité limitée* or *société anonyme* – are usually chosen by franchisors. These three types of company are easy to build vehicles to operate commercial activities in France. The Franchisor will choose the most accurate type taking into consideration its resources, social and tax considerations.

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

Even if the Franchisor is operating through a foreign company, there are obligations to be registered before the French "*Répertoire des Entreprises*" (register for undertakings) or before the National Centre for Foreign Companies, as well as before the French law administration.

These obligations are described here: https://www.service-public.fr/professionnels-entreprises/vosdroits/F31191.

3 Competition Law

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

The offer and sale of franchising is regulated by:

- Articles L.420-1 and subsequent of the French Commercial Code, which prohibit anti-competitive practices where they are intended to: fix prices; restrict market access; restrict or control production, opportunities, investment or technical progress; or divide up markets or sources of supplies. However, such anti-competitive practices might become permitted if:

they lead to economic progress; and give final users a fair share of the resulting benefits. But the agreement must not afford the parties the possibility of eliminating competition in respect of a substantial part of the related products. Any abuse of a dominant position or economic dependency, and any predatory pricing that might upset the balance of economic activities, is also prohibited.

- Article L.442-1 and subsequent of the French Commercial Code, which prohibits restrictive trade practices, such as resale below costs and the brutal termination of established commercial relationships.

Franchise networks active in France shall also comply with the European regulation regarding anti-competitive practices. In particular, Commission Regulation EU no. 330/2010 of 20th 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) shall apply, together with the Guidelines on Vertical Restraints 2010/C 130/01.

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

There is no maximum permitted term provided *per se* for franchise agreements. However, exclusive supply agreements are only permitted for a limited duration. See question 3.3 below.

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

Pursuant to article L.330-1 of the French Commercial Code, any exclusive supply agreement shall be limited to 10 years.

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

French and EC regulations prohibit any minimum resale prices imposition.

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

Under French law, the Franchisor has no obligation to provide the Franchisee with an exclusive territory. If he does so, the Franchisor has a duty not to open – directly or indirectly – another point of sale in the Franchisee's exclusive territory.

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

In-term non-compete obligations are enforceable under French law.

Post-term non-compete provisions are regulated by article L.341-2 of the French Commercial Code, under which non-compete provisions are valid only if they are:

- limited to the products and/or services subject to the franchise agreement;
- limited to the location where the Franchisee was operating its activity;
- justified by the need to protect the transfer of a substantial, specific and secret know-how; and
- limited to a one-year duration.

These four conditions must all be satisfied.

In-term non-solicitation of customers obligations are valid only if the Franchisee has been granted an exclusive territory and if it is to prevent the Franchisee performing active sales outside this territory (passive sales outside the Franchisee's territory cannot be prohibited).

Post-term non-solicitation of customer obligations are not valid: the Franchisee is the owner of its clients' database and is entitled to use it after the agreement's termination, under the condition that such use shall not be made with the Franchisor's trademarks or distinctive signs.

4 Protecting the Brand and other Intellectual Property

4.1 How are trade marks protected?

Trademarks must be registered in order to be protected.

The Franchisor is able to register a national French trademark before the French National Register ("INPI") or a European trademark before the European Union Intellectual Property ("EUIPO") at the European level.

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

Know-how, trade secrets and other business critical information are not protected *per se* under French law. However, the Franchisor may request the Franchisee to sign a non-disclosure agreement listing precisely which information and data shall be regarded as confidential and not disclosed to third parties, and shall only be used for the need to perform the franchise agreement.

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

Copyright protection may only apply if the Franchisor is able to demonstrate that the operations manuals or other data are original.

Also, French law does not protect ideas or concepts. Therefore, work needs to be sufficiently materialised in a developed form to be eligible for copyright protection.

5 Liability

5.1 What 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 provide the mandatory disclosure document may incur the cancellation of the contract (i), or the Franchisor's liability (ii).

(i) Cancellation of the contract

Failure to provide the said information may be regarded as fraudulent, this justifying the cancellation of the franchise agreement.

However, the cancellation of a franchise contract is submitted to the demonstration, by the Franchisee, that the incomplete information/

absence of pre-contractual information has invalidated his consent to the contract (*Cour de Cassation, Commerciale, February 10th 1998*).

Therefore, the French Courts analyse if the information provided by the Franchisor is sincere and verify if a part of it has been consciously hidden from the Franchisee in order to make him enter the contract, and/or if a missing information that should have been disclosed would have left the Franchisee not to enter into the franchise agreement. Many decisions state that the Franchisor's presentation is very general and imprecise, or even incorrect, which characterises wilful misrepresentation and justifies cancelling the agreement (e.g. *Cour de Cassation, Commerciale, 6th May 2003*).

On February 11th 2003, the highest French Court specified that the obligation to give a sincere presentation applies not just to the information that is required by articles L.330-3 and R.330-1 of the French Commercial Code but also to any other facultative information voluntarily given by the Franchisor to the Franchisee before it entered into the agreement.

Recently, court cases tend to focus on business plans/figures provided by Franchisors to future Franchisees. Even if the Courts admit that the Franchisee should personally proceed with a precise analysis of the future commercial operation in order to measure the potential of the business, the Franchisor must ensure that the business plans/figures provided to the Franchisee are not unrealistic or over-optimistic.

On October 26th 2006, Orleans Court of Appeal was particularly clear on this:

> "*Even if the Law doesn't oblige the Franchisor to provide local market research or to establish provisional operating accounts, this task being up to the Franchisee who shall, regarding his investment, proceed to this analysis and evaluate the related risks; it is constant that when providing this information and particularly business plans, the observance of article L.330-3 and of the general obligation to act in good faith in contract law require the Franchisor to give a sincere presentation of the local market and to establish reasonable budgets by reference to tangible sales figures*. (…)
>
> *Even if the Franchisor is not due to get the results when establishing a provisional operating account, in consideration of commercial contingencies and hazard inherent to every forecast, he must carry out the statistical, economic and financial tools he can get as a franchise professional in the relevant market as well as conduct sufficient research on the local market to provide a reliable provisional study, as this information could be out of the knowledge of the Franchisee candidate. The significant gap between the forecast and the results testifies to the levity of this study*." (Our translation.)

In the same field, the Court of Appeal of Versailles, on June 7th 2007, judged that a gap of 50% between the Franchisor's forecast and the results is not sufficient to involve the Franchisor's liability, as the provisional plan was based on the average sales figures of the time period for equivalent shops effectively generated in the same geographical area. The Franchisor's obligation to give sincere and loyal information was thus fulfilled, the Court also confirming the Franchisee's obligation to make enquiries on the project's profitability and to verify the information given by the Franchisor, with the assistance of professionals if necessary.

Courts can also be very tolerant of Franchisees' behaviour in case they had no previous experience in the operation of a commercial activity before executing the franchise contract. Thus, the highest French Court disapproved, on April 3rd 2007, the reasoning of the Court of Appeal which limited, without any debate, the amount of damages to be awarded to the Franchisee because it considered that, with non-existent or imprecise pre-contractual information, the Franchisee should have asked about the relevant details before contracting and had been at fault not to do so.

(ii) Franchisor's civil liability

Even if the missing information has not been regarded as justifying the cancellation of the franchise agreement, the Franchisor may be held liable, and ordered to indemnify the Franchisee's damage.

Indeed, the Franchisee may demonstrate that the knowledge of the missing information might have led him to enter into the agreement on different conditions and had caused him damage.

For instance, the Paris Court of Appeal has considered that the Franchisee's damage consisted of the absence of having the opportunity "not to contract" or "to limit its financial obligations" (e.g. Paris Court of Appeal, September 20th 2000, confirmed by the *Cour de Cassation, Commerciale, February 4th 2004*).

However, the Franchisee still has to demonstrate the existence of a direct link between his damage and the Franchisor's failure to provide the Pre-contractual Information Document.

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

Usually, the master-franchise agreement will provide an obligation – for the Master-Franchisee – to comply with all mandatory local regulations and to provide Sub-Franchisees with any required disclosure document. In such a case, the Master-Franchisee will be liable towards its Sub-Franchisees for disclosure non-compliance or pre-contractual misrepresentation, except if such non-compliance or misrespresentation found their origin in the information or element provided by the Franchisor to the Master-Franchisee.

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

No, such disclaimer clauses shall be regarded as unenforceable since the obligation to provide a pre-contractual information complying with articles L.330-3 and R.330-1 is mandatory under French law.

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

To date, there is no class action proceeding open to Franchisees regarding a franchise agreement. Class actions are limited to B-to-C relationships litigation. The class action waiver clauses are, in consequence, purposeless.

6 Governing Law

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

Parties are free to decide to submit the franchise relationship to French or any other foreign law.

However, French mandatory regulations cannot be circumvented by using a "choice of law" clause. In particular, the choice of a foreign

law does not allow the Franchisor to provide the Franchisee with the mandatory disclosure document.

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 French Civil Procedure Code provides for general urgent injunctive relief and injunction, which may be sought by the Franchisor before local courts in order to immediately stop any such damage or misuse.

Orders from foreign courts may also be enforced by the French Courts taking into consideration international treaties and European regulations.

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

In France, arbitration is recognised as a viable means of dispute resolution. France is one of first signatories to the New York Arbitration Convention, and, as such, accepts the enforcement of the foreign arbitral award. It is indeed recommended to insert into the agreement the arbitration rules and bodies that will govern the arbitration proceeding to avoid any debate afterwards in this respect. There are specialised arbitration organisms with their own rules such as the *Fédération Française de la Franchise*, the Marseille Arbitration Chamber for Europe, Africa and Asia, or the Paris Centre for mediation and arbitration ("CMAP").

7 Real Estate

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

Commercial lease agreements are executed for a nine-year duration. However, the tenant has the right to terminate the commercial lease agreement every three years.

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

This concept is enforceable under French law if the franchise agreement, as well as the lease agreement, provides so. Indeed, the Lessor has to expressly agree with that principle.

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

There are no restrictions on non-national entities holding an interest in real estate to our knowledge.

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 in a particular location)?

The answer depends on the location, but the French market is usually known to be a very expensive market regarding real estate costs, in particular concerning "A locations" or mall locations, where key money is indeed generally demanded by landlords.

It is therefore very exceptional to be able to negotiate a rent-free period when entering into a lease agreement, unless specific circumstances justify this free period (such as a need to revamp the location, or a revamping in progress around the location).

8 Online Trading

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

No, pursuant to EU Competition guidelines on vertical restrictions, it is not possible to require the Franchisee to refuse "passive sales" and redirect said sales to another Franchisee.

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

Local domain names deposited by the Franchisee can remain in their ownership after the termination or expiry of the agreement, unless they contain a trademark registered by the Franchisor. In this case, the Franchisor will be allowed to force the Franchisee to transfer the related domain names. It is recommended to anticipate this situation and insert a clause in the franchise agreement prohibiting the Franchisee to deposit any domain name containing any trademark and/or distinctive sign of the Franchisor.

9 Termination

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

French Courts are within their rights not to apply the termination rights provided in the franchise agreement in case the termination has not been caused by a breach of a party and is "brutal". French Courts can thus allocate damages to the party suffering from such brutal termination.

Also, Judges have the right to moderate, reduce or increase a penalty clause.

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

Article L. 442-6,I, 5° of the French Commercial Code provides that:

> "*I.- Calls responsibility of its author and forces him to repair the damage caused does, by any producer, trader, industrial or person registered in the trades:*
>
> *5° To break off abruptly, even partially, a commercial relationship, without written notice having regard to the duration of the business relationship and respecting the minimum period of notice determined by reference to usage of trade, through trade agreements*."

This article has been applied constantly by French Courts in the case where an agreement was providing the prior notice period applicable to the contractual relationship.

Thus, frequently the French Courts increase the prior notice period duration provided in the franchise agreement, taking into consideration the length of the relationship between the parties, the notoriety of the products concerned by the agreement, the dependence of the party victim of the termination towards the other party, the possibility to source rapidly new counter-parts in order to perform the same business, or the fact that there would be some unamortised investments linked to the relationship after the termination of the agreement.

10 Joint Employer Risk and Vicarious Liability

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

There is such a risk if the Franchisor acts as the employer of the Franchisee's employees, in particular if the Franchisor gives them instructions, and is in charge of the labour law duties.

In order to mitigate this risk, it is strongly recommended that the Franchisor has no direct relationship with the Franchisee's employees, except for the training to be provided by the Franchisor directly to the Franchisee's staff regarding the application of know-how.

There is also a risk that the Franchise agreement might be qualified as an employment agreement, if the Franchisee is not independent from the Franchisor.

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

The Franchisee is in essence independent from the Franchisor and alone bears all liabilities related to its employees' acts and omissions.

In order to mitigate the risk of a claim directly brought against the Franchisor, the Franchisee has a duty to inform third parties of the fact that it is acting as an independent Franchisee. Such information shall be indicated in the shop, as well as in all commercial documents of the Franchisee.

11 Currency Controls and Taxation

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

No, there are no such restrictions.

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

Yes, royalties will be taxed at a 33.33% rate, unless a treaty for the avoidance of double taxation is entered into France and the country of origin of the Franchisor. Any arrangement in order to reduce and/or avoid a tax payment may be regarded as fraudulent. Therefore, any specific avoidance strategy shall be subject to the specific advice of a French specialised attorney.

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

There are no specific requirements other than the ones provided by French tax law.

12 Commercial Agency

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

Such a risk does exist in the case that the Franchisee is acting on behalf of the Franchisor. In order to mitigate this risk, it is, *inter alia*, necessary to make sure that the Franchisee is the owner or tenant of his location, and is directly paid by consumers.

13 Good Faith and Fair Dealings

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

All agreements governed by French law are required to be performed complying with a general good faith principle. However, there is not a test of fairness to be done, and Judges will appreciate whether the Franchisor's bad faith has incurred damages to the Franchisee.

14 Ongoing Relationship Issues

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

The relationship between the parties will be governed by the general principles of civil and commercial French laws and regulations.

Furthermore, and even if France is not a case-law jurisdiction as may be the case in common-law countries, French case-law regarding franchise litigations should also be taken into account when drafting and performing a franchise agreement.

15 Franchise Renewal

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

If the renewal is operated though a new franchise agreement, the Franchisor has a duty to provide the Franchisee with the mandatory disclosure document (see question 1.5 above).

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

No, unless the Franchisor has expressly taken such a commitment in the franchise agreement or in a separate document.

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

Yes, if the refusal is abusive or brutal, which could be the case, for instance, if they had requested the Franchisee to operate substantial investments/revamping costs in the concept a few months before the termination that has not been amortised on the expiry date and that the Franchisee would be forced to stop using after the term of the agreement.

16 Franchise Migration

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

Yes, the franchise agreement is considered as executed *intuitus personae*, in consideration of the Franchisee's person.

Consequently, it is possible to provide a first refusal right in favour of the Franchisor.

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

No, there is no such step-in right, the Franchisee being the owner of its business.

16.3 If the franchise agreement contains a power of attorney in favour of the franchisor under which it may complete all necessary formalities required to complete a franchise migration under pre-emption or "step-in" rights, will such a power of attorney be recognised by the courts in the 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 applicable in France.

17 Electronic Signatures and Document Retention

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

The French law recognises and values the electronic signature the same as physically signing, provided that it consists of using a reliable means of identification that guarantees its link with the act it is attached to. The reliability of these means shall be presumed, until proof to the contrary, when an electronic signature is created, when the identity of the signatory is assured and when the integrity of the act is guaranteed, under the conditions laid down by decree of the *Conseil d'État* (Article 1367 of the French Civil Code).

Therefore, the electronic signature may be used by Franchisors, but it is not common, the physical signing being always preferred.

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

French law recognises the reliable copy the same probative value as the original. The reliability of the copy shall be presumed, until proof of the contrary, when the integrity of the act is guaranteed, under the conditions laid down by decree of the *Conseil d'État* (Article 1379 of the French Civil Code). Therefore, for safety reasons it is recommended to keep the original.

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LINKEA is a French law firm specialised in the field of distribution and consumer law, exclusively dedicated to head-of-networks matters (Franchisors, concessionaires).

LINKEA lawyers advise their clients while drafting the contractual elements needed (franchise, affiliation, licence, master-franchise, commercial agreements, general terms and conditions, B-to-C agreements), training them in pre-litigation skills, and representing their clients before the French Courts and arbitration jurisdictions.

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 definition of 'franchise' or 'franchising' in Germany. The German Franchise Association (GFA) (www.franchiseverband.com) provides a definition (recognised in parts by the courts) as follows:

> *Franchising is a sales and distribution system by means of which goods, services or technologies are marketed. It is based on a close and ongoing cooperation between legally and financially separate and independent companies, the franchisor and the franchisees. The franchisor grants its franchisees the right, at the same time as imposing the obligation on them, to conduct a business in accordance with the franchisor's concept. This right entitles and obliges the franchisee, in return for direct or indirect remuneration, to use the system's name, trademark, service mark, copyright and/or other intellectual property rights, as well as know-how, economic and technical methods and the business system of the franchisor, under ongoing commercial and technical support by the franchisor, within the framework and for the term of a written franchise agreement, concluded between the parties for this purpose.*

1.2 What laws regulate the offer and sale of franchises?

In Germany, there are no specific laws or government agencies that regulate the offer and sale of franchises. Therefore, the offer and sale of franchises is only governed by the general provisions of contract law (the Civil Code), consumer law, commercial law (the Commercial Code), competition law and unfair trade law.

In particular, the provisions of the Civil Code concerning standard terms and conditions can be applied where the franchisor uses standard franchise agreements being signed by the franchisee on a take-it-or-leave-it basis (section 305 Civil Code). According to section 307 Civil Code, all standard-term provisions need to be reasonable and may not unduly disadvantage the other party contrary to the requirements of good faith otherwise they are null and void.

Further, according to German consumer credit law, a franchisee that is not organised in the form of a company limited by shares is entitled to withdraw from the franchise contract within a period of 14 days of its conclusion if it thereby establishes an independent business enterprise, the contract contains an obligation to repeatedly take supplies of goods and the total value of the franchisee's investments does not exceed an amount of €75,000.

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

As there are no specific laws on franchising in Germany the same general provisions that would apply to a franchise system with more than one franchisee/licensee apply. However, the application of the same general provisions with regard to disclosure requirements will lead to a reduced amount of information that need to be provided to the franchisee given that the franchisor has less experience and information itself. In order to comply with its disclosure obligations, the franchisor needs to disclose to the franchisee/licensee the fact that he is the first/only franchisee and that therefore the franchisor is not able to provide him with information/experience regarding other franchisees (see also question 1.5).

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

There are no specific government consents or official authorisations required relating to the offer and sale of a franchise.

1.5 Are there mandatory pre-sale disclosure obligations?

Under German law, pre-contractual disclosure in connection with franchise contracts is not regulated by a special statute or monitored by a specific agency. Only the general provisions regarding the opening of contractual negotiations apply, in particular the principle of *culpa in contrahendo*. This principle provides that before the conclusion of a franchise contract, the franchisor must ensure that all relevant facts have been clearly presented to the potential franchisee. The scope and content of the duty depend on each individual case, taking the experience and knowledge of the franchisee into account.

German courts have stressed that, as a general rule, the franchisee is obliged to obtain information at its own initiative about the general market conditions and their impact on the prospective franchise business. However, if there are particular circumstances of which only the franchisor is aware and which are recognisably of importance to the potential franchisee's decision as to whether entering into the franchise contract or not, the franchisor must disclose such information. It also follows from German case law that the franchisor must refrain from providing misleading information on the franchise system and must disclose all relevant

information about it in order to avoid subsequent damage claims. A non-binding guideline for franchisors about disclosure in Germany is the GFA's guideline on pre-contractual disclosure obligations.

It may be derived from German case law that at least the following items should be disclosed:

- information about the franchise concept, including in particular, date of the beginning of the franchise system and the actual number of franchisees, fluctuation rate;
- indication of people in charge to act on behalf of the franchisor;
- the franchise offer, including amongst others: location, performance and experience of the pilot business, required investment and manpower for the franchisee's business;
- information that enables the franchisee to elaborate its own location analysis and profitability calculation of the franchise business;
- information about situations where compulsory statutory pension insurance for the franchisee applies;
- the franchise agreement and the franchise handbook (including all standard appendices);
- memberships in franchise associations;
- information on other distribution channels for the franchise product or service;
- pending lawsuits with a potential impact on the franchisee's business; and
- indication of the initial and ongoing support by the franchisor.

The pre-contractual information should be disclosed within a reasonable period prior to the conclusion of the franchise agreement. This applies also to any (preliminary) binding agreement between the parties. Conversely, the rules of pre-contractual disclosure in connection with franchise contracts shall not apply to reservation agreements between the franchisor and a potential franchisee. As the term of such agreements is shorter, there are minor economic consequences and usually no obligation to enter into a franchise agreement is provided.

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

In case of a sub-franchising structure, it is up to the sub-franchisor to make pre-sale disclosures to sub-franchisees. As a result, the sub-franchisor must provide information about the way the franchise system works and its prospects of success.

However, as there are no statutory provisions with regard to pre-contractual disclosure obligations (see question 1.5), the scope and content of the disclosure requirements depends on the sub-franchisee's need for information and its existing possibilities to obtain information. Therefore, the sub-franchisor must, at least, offer information about the master-franchise and the allocation of tasks between franchisor and sub-franchisor. Moreover, the sub-franchisor must show the extent of the derivation of rights from the franchisor (particularly as to trademarks and know-how).

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

Unlike common law countries, and contrary to the legal situation in, for example, France, Italy and Spain, there is no specific format of disclosure prescribed by German law or under German franchise practice. A written standard compliance procedure does not exist. Nevertheless, it would be advisable for franchisors to expressly disclose to their potential partners in writing all information that is deemed necessary according to German case law and to the non-binding GFA guideline on pre-contractual disclosure obligations (reflecting the actual constitution of the franchise system).

An obligation for continuing disclosure can follow from the principle of good faith that is a basic principle of German law (see question 13.1). By invoking good faith, a court may establish collateral obligations owed between contracting parties. This may include protective obligations, such as information (disclosure) about developments having an impact on the franchisee's business or on the franchise system in general (for example, the franchisor's trademark being challenged by a third party).

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

German statutory law does not provide for special requirements that a franchisor must meet prior to offering franchises. Nevertheless, the German Franchise Association (GFA) lists numerous guiding principles in its code of ethics. *Inter alia*:

- the franchisor must have successfully run a business concept for an appropriate period of time and with at least one pilot project before founding its franchise network;
- the franchisor must be the owner or legitimate user of the company name, trademark or any other special labelling of its network; and
- the franchisor must carry out initial training of the individual franchisee and must assure ongoing commercial and/or technical support to the franchisee during the entire term of the contract.

Observance of the stated principles is obligatory in order to become and remain a member of the GFA and to demonstrate fair business practices.

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

The GFA is a non-government body and membership is not compulsory. Nevertheless, the membership of the GFA is regarded as an indication of quality for a franchise system.

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

Members of the GFA must conduct a severe quality review before being admitted as a full member to the GFA.

In addition, franchisors as members of the GFA must comply with the GFA's code of ethics, which thereby influences franchise relationships at least to some extent. The GFA's code of ethics was adopted on the basis of the European Franchise Federation's code of ethics, which the GFA as a member must comply with.

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

German law does not require an international franchisor to provide the franchisee with pre-contractual information or a franchise agreement drafted in the German language. Nevertheless, in order to avoid misunderstandings and future disputes, it is advisable that the franchisee is at least provided with a translation of the franchise agreement for convenience, as long as it cannot be excluded that

the franchisee might have difficulties with the interpretation of the franchise agreement. Moreover, if the franchise agreement provides for the jurisdiction of a German court, a translation of the agreement will become necessary if it is brought before a court, given that the language in court needs to be German (this applies to all documents involved).

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

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

Under German law there is no difference between franchisors from EU and non-EU Member States.

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

Franchisors wishing to set up business in Germany have a variety of legal forms (partnerships and limited liability companies) from which to choose. Nevertheless, the most common form of corporate vehicle to be established by a typical franchisor in Germany is a private limited liability company (GmbH). This corporate form requires a minimum amount of capital investment (at least €25,000) and offers limited liability, so only the company's assets are liable to the company's creditors. Furthermore, the GmbH offers a great deal of flexibility as regards internal structures and procedures.

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

If the business entity is to be classified as a partnership, its formation is governed by the Civil Code and the Commercial Code. The incorporation of a private limited liability company is subject to the Limited Liability Company Act. Limited liability companies must be registered in the Commercial Register, which is maintained by the local courts.

3 Competition Law

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

In 2005, German antitrust law was completely harmonised with European antitrust law. All forms of competition restraints contained in distribution agreements, such as non-compete clauses, price-fixing, guaranteed exclusive areas and purchasing restrictions, are now treated in full compliance with European antitrust law. European antitrust law (article 101(1) of the Treaty on the Functioning of the European Union (TFEU)) prohibits agreements between undertakings that may affect trade between Member States and that have as their object or effect the prevention, restriction or distortion of competition within the common market. Exemptions are made either on an individual basis or, if applicable, under a block exemption. Vertical restraints such as those typically encountered in franchise agreements can be, to some extent, exempted under the EC Block Exemption Regulation No. 330/2010 (BER).

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

German law is characterised by the principle of contractual freedom that allows the parties to agree on the provisions of a contract at their discretion. Therefore, restrictions on provisions in franchise contracts are an exemption and mainly follow from antitrust law and the laws regarding conditions in standardised contracts (in particular section 307 Civil Code).

The laws regarding standard terms and conditions specify the principle of good faith and ban standardised provisions that unreasonably disadvantage the franchisee in a manner contrary to the requirements of good faith. Against this background, a provision stipulating that the duration of the franchise agreement shall be 30 years would presumably be considered void, given that it unreasonably restricts a franchisee's entrepreneurial freedom. On the other hand, a duration that is too short (for example, one year) could also be regarded as unreasonable, as it would be practically impossible for the franchisee to recover the costs of its investment in setting up the franchise business within the agreed term.

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

It is often agreed in franchise agreements that the franchisee is only allowed to acquire goods from the franchisor and not from other sources, including other franchisees.

The franchisee's obligation to sell only the contract goods is lawful and does not violate competition law if it is essential for maintaining the identity and reputation of the franchise network (European Court of Justice, judgment of 28 January 1986, case No. 161/84, ECR 1986, 353, *Pronuptia*). If a purchase obligation is not essential for the identity and reputation of the franchise network, the BER can still apply. According to article 5 BER, purchase obligations are exempted by the BER where the duration is neither indefinite nor exceeds five years. Contracts with purchase obligations that are tacitly renewable beyond a period of five years are therefore not exempted by the BER. However, if the goods or services are resold by the franchisee from the premises and land-owned by the franchisor or leased by the franchisor from third parties not connected to the franchisee, the non-compete obligation may be of the same duration as the period of occupancy of the point of sale by the franchisee. Please note that the BER only applies to franchise systems with a market share of less than 30 per cent. If the market share is higher than 30 per cent, the block exemption does not apply, but an individual exemption under article 101(3) TFEU might still be possible.

Apart from that, restrictions with regard to the maximum permitted term for a product supply agreement only follow from the laws regarding conditions in standardised contracts (see question 3.2).

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

Basically, every form of direct or indirect price-fixing is prohibited by German and European antitrust law. The franchisee must be free to determine at what price it wants to sell its products or render its services. The exemptions of the BER do not apply to agreements with price-fixing clauses. The franchisor is only entitled to set a maximum for the prices at which the product or service of the franchise system are to be sold. Additionally, the franchisor is entitled to issue non-binding price recommendations. Fixed resale

prices may also be permissible to organise a coordinated short-term low-price campaign in a franchise system (two to six weeks in most cases).

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

Under EU and German antitrust law, a franchisee cannot be provided with a completely exclusive area. Nevertheless, there is a large array of exemptions to that rule. Exclusivity can be provided in the sense that the franchisees can be forbidden to actively distribute outside their exclusive areas. Active distribution is defined as all forms of marketing where the franchisee actively approaches potential customers. In contrast, passive distribution cannot be prohibited; passive distribution being all forms of marketing where the franchisee does not actively approach potential customers, but only responds to their requests. Therefore, the franchisee cannot be forbidden from delivering goods or rendering services at the request of its customer even if this customer is located outside of the exclusive area. The establishment of an internet homepage is expressly deemed by the European Commission to be passive distribution. The franchisee cannot therefore be deprived of the right to present itself on the internet.

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

Obligations not to compete during the term of the franchise agreement are subject to competition law, as they restrict the franchisee's freedom of business activities and prevent other suppliers from distributing their products or services through the franchisee involved. Under competition law, non-compete obligations are treated like purchasing obligations. Consequently, they are lawful if they are essential for maintaining the identity and reputation of the franchise system or to protect the know-how transferred by the franchisor to the franchisee (European Court of Justice, *Pronuptia*, see above). If a non-compete clause is not essential, the BER can still apply. According to the BER, non-compete clauses during the term of the agreement must not be agreed for more than five years.

Under competition law, post-term non-compete clauses may fall under the ban on cartels (article 101(1) TFEU) if they have an appreciable impact on competition. Those post-term non-compete clauses are generally not exempted by the BER. Nevertheless, the BER states an exemption: non-compete clauses can be agreed for one year after termination of the agreement if they only apply to competing products or services, are essential for the protection of know-how and are restricted to the business location of the franchisee during the term of the agreement. Moreover, after the term of the agreement the franchisee can be prohibited from using and disclosing know-how provided by the franchisor that has not entered the public domain. There are no time restrictions for such clauses. Please note that the franchisee may claim reasonable compensation for a post-term non-compete obligation.

Again, the exemptions of the BER are only available to franchisors and franchisees with a market share of less than 30 per cent. If the market share is higher, the block exemption does not apply and the clause is invalid.

Under German procedural law, in-term and post-term non-compete clauses can be enforced by way of an action for injunction (i.e. omission of a certain breach of contract, section 1004 Civil Code) and by way of a court-ordered interim injunction (section 940 Code of Civil Procedure).

In order to obtain such an injunction, the plaintiff has to prove the risk of infringement. This can be done in two different ways: either an infringement already has been committed and can be proven, then the risk of repetition is generally assumed (unless the nature of infringement or unusual circumstances indicate otherwise). The defendant then carries the burden of proof and has to refute this assumption. Harder to prove for the plaintiff is the so called preventive injunction. Here an infringement has not yet occurred but the claimant claims a risk of initial infringement. The burden of proof lies fully with the claimant. The imminent danger of an infringement has to be demonstrated through objective facts.

Such German court-ordered injunction is enforced by levying a coercive penalty payment and, as *ultima ratio*, by coercive penalty detention, for example, of the managing directors of the franchisee (section 888 Code of Civil Procedure).

4 Protecting the Brand and other Intellectual Property

4.1 How are trade marks protected?

Apart from well-known or famous brands, trademark protection in Germany requires registration either with the German Patent and Trademark Office or as a Community trademark with the European Trademark Office (Alicante, Spain) or a designation of international trademarks for Germany. Trademarks such as words, letters, numbers, pictures, sounds, colours and colour combinations are protected by the Trademark Act.

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

Although know-how is part of a franchisor's intellectual property rights, the protection of know-how is not subject to specific statutes such as the Trademark Act or the Copyright Act. As a result there is no registration requirement for licensing know-how. Even so, franchisors' know-how is confidential information under the franchise agreement or other confidentiality agreements and the use of intellectual property rights and know-how is limited to the purpose of the franchise system. Breach of business confidentiality constitutes a breach of those agreements and, moreover, is punishable under the Act Against Unfair Competition.

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

Copyrights are protected under the Copyright Act. In case of a copyright infringement German law offers instruments from civil law, criminal law and competition law. The owner of the copyright may, amongst others, claim removal, omission or damages. Certain conduct that infringes a copyright may also be considered a criminal offence (in this case the owner of the copyright may file a criminal complaint to the Public Prosecutor). In rare cases the infringement of a copyright may also be considered an unfair business practice under the Act Against Unfair 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?

If the franchisor infringes its duty regarding disclosure, the franchisee is entitled to claim damages. The franchisor has to put the franchisee in the position it would have been in if the franchisor had fulfilled its disclosure obligation. As the franchisee may have not agreed to the franchise agreement under full disclosure, he or she may rescind the franchise agreement. The franchisor, therefore, can be ordered to consent to the cancellation of the franchise contract, to pay all obtained franchise fees back to the franchisee and to reimburse the franchisee for all expenses incurred in connection with the franchise business. But income the franchisee earned from the exercise of the franchise business has to be deducted.

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

As sub-franchisors are usually self-employed entrepreneurs who are not allowed to act on behalf and for the account of the franchisor, there is no direct contractual relationship between the franchisor and the sub-franchisees. Sub-franchisees can therefore only claim damages against the franchisor by tort law or by product liability (for example, a defect product manufactured by the franchisor causes a body injury). Consequently, a sub-franchisor is solely responsible for fulfilling the disclosure obligations with regard to the sub-franchisees (see question 1.6). Nevertheless, the sub-franchisor may have a right of recourse against the franchisor if the sub-franchisor has used and relied on the franchisor's disclosure material containing misleading information (breach of duties by franchisor). Because of German law on standard terms it is not possible to exclude liability for injury to life, body or health and in case of gross fault in the franchise agreement. An indemnity that the franchisor takes from the master franchisee would have to comply with German law on standard terms as well. Therefore, an indemnity would have to be reasonable and not unduly disadvantage the master franchisee in order to be valid.

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

Under German law, it is not possible for a franchisor to avoid liability for pre-contractual misrepresentation by including disclaimer clauses in the franchise agreement.

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

German law does not permit class actions by a group of franchisees. German law follows the idea of individual remedy which means that every franchisee needs to bring its claims to court by itself.

6 Governing Law

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

In principle, parties are free to choose the governing law applicable to their contractual relationship (article 3 of Regulation (EC) No. 593/2008, 'Rome I'). Nevertheless, according to the European provisions on conflict of laws, there are certain provisions that cannot be excluded even by a valid choice of law, for instance competition law (see article 9 Rome I), consumer protection law (see article 6 Rome I) and employment law (see article 8 Rome I). Furthermore, German law can apply where provisions of a foreign law interfere with fundamental principles of the German jurisdiction (so-called '*ordre public*', article 21 Rome I). These are, in particular, cases in which the application of such provisions would be incompatible with civil rights.

In cases where all other elements relevant to the situation at the time of the choice are located in a country other than the country whose law has been chosen, the choice of the parties does not prejudice the application of provisions of the law of that other country which cannot be derogated from by agreement. That might be relevant for the choice of law in a sub-franchise relationship if the master franchisee has its registered office in Germany as it is unsure if the connection to the MFA or the place of arbitration alone would be considered a 'foreign element' within the sub-franchise relationship that would lead to the freedom of choice of law according to article 3 Rome I.

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

In order to enforce foreign judgments from a country that is not a member of the European Union in Germany an *exequatur* procedure is necessary. Pursuant to sections 328, 722, 723 Code of Civil Procedure, a final judgment issued by a foreign court will, in principle, be recognised and enforced by the courts of Germany. The judgment will be enforced if an action for judicial enforcement ('*Vollstreckungsklage*') is brought to have the judgment declared enforceable by a court of the Federal Republic of Germany. The judgment of enforcement ('*Vollstreckungsurteil*') will be of the same force and effect as if a material judgment had been originally given by a German court. The courts of Germany will only examine whether the foreign judgment is legally effective and final, and whether there is an impediment to recognition pursuant to section 328 of the Code of Civil Procedure (such as a lack of competence of the foreign court according to international jurisdiction), or whether there are any defenses which have arisen after the date on which the foreign judgment became legally effective and final.

Judgments issued by courts of European Union Member States, which are enforceable in the Member State, in which they were issued, are enforceable in all other Member States including Germany without the need for a declaration of enforceability (article 39 Regulation (EU) No. 1215/2012).

Arbitration in Germany offers a number of advantages, such as significant flexibility (for example, number of arbitrators, place and language of the arbitration proceedings), potential cost and time

efficiencies, greater confidentiality and a binding, enforceable and non-appealable resolution of the dispute. But arbitration proceedings may be more expensive than court proceedings, particularly if the matter in dispute is of relatively low value. In those cases, additionally, the parties may find it difficult to appoint their favoured (meaning highly specialised) arbitrators, given the relatively low arbitrators' fees following on from the low value of the dispute.

Germany is a signatory to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards ('New York Convention') since 1961. Worldwide-known arbitration institutes are amongst others, the ICC International Court of Arbitration, the London Court of Arbitration (LCIA), and the International Centre for Dispute Resolution (ICDR). The parties are free to choose the arbitral rules under which the arbitral proceedings shall be conducted. In Germany, the German Institution for Arbitration (DIS) is the most important organisation for arbitration.

7 Real Estate

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

German law does not provide for any special franchise-related regulations concerning the real estate market or real estate law. Thus, the general rules of the Civil Code apply. Commercial leases and subleases may be freely concluded between lessor and lessee. Usually the lease is made coterminous with the franchise agreement regarding term and expiry.

Unless otherwise agreed, in case of a commercial property lease with no definite term, a notice of termination is admissible at the latest on the third working day of a calendar quarter to the end of the next calendar quarter, leading to a notice period of generally six months.

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

It is a possibility, in order to prevent the occupation of the premises by the franchisee after the franchise agreement has ended, to stipulate in the franchise agreement an obligation of the franchisee/tenant to agree with the landlord on a clause within the lease agreement according to which the franchisor is entitled to enter into the lease agreement upon the termination of the franchise agreement. In order to enforce such right in case the franchisee does not vacate the premises, the landlord would have to sue against the franchisee as its tenant. If the landlord – given that he usually has no self-interest in such proceedings – is not willing to sue against the franchisee, the franchisor would have to sue against the landlord in order to force him to proceed against the franchisee.

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

There are no restrictions on non-national entities holding any interest in real estate, or being able to sublease.

In general, under German law subleasing requires the permission of the landlord. In case of commercial leases the lessee may neither be entitled to the grant of such permission nor claim damages against the landlord. But if the landlord refuses to give his or her consent, the lessee can extraordinarily terminate the lease with the statutory notice period of three months, unless the person of the sub-lessee constitutes cause for the refusal. Such special termination right cannot be excluded within standard terms and conditions. A general permission to sublet may be granted in advance but is limited to the permitted purpose of the lease. On the other hand, it is also possible to contractually prohibit subleasing in general, if residential space is not concerned.

7.4 Give a general overview of the commercial real estate market. 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 in a particular location)?

With regard to commercial leases, German law provides for less restrictions of the parties' freedom to contract than it does for residential leases. For example, it is possible to agree on a fixed term without any reason. In general, a tenant cannot expect an initial rent free period when entering into a new lease but the parties are, of course, free to agree on an initial rent free period. A rent free period is often granted if structural alteration works have to be carried out by the tenant before opening its business. It is possible that landlords demand 'key money' for commercial leases (unlike for residential leases). Whether or not key money is paid is up to negotiation between the parties as well.

8 Online Trading

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

See question 3.5.

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

There are no limitations with regard to the franchisor's ability to require local domain names from its franchisees on the termination or expiry of the franchise agreement given that the parties have agreed on such transfer.

9 Termination

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

Irrespective of the contractual provisions, according to German law neither the necessity nor the requirements for a termination for 'good cause' can be waived within standard terms and conditions (and therefore most franchise agreements). The same applies to the necessity for a formal reminder before termination without notice (see also question 9.2).

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

Franchise agreements can be entered into for a definite or an indefinite term. In both cases the franchise agreement can end by conclusion of an agreement to annul the franchise relationship.

A franchise agreement with a definite term can end as a result of lapse of time or by termination for cause. Under German law, a termination for cause without notice requires good cause and (usually) a warning letter beforehand. That said, only major infringements of the duties of the franchise agreement constitute good cause in this respect, resulting in the right for termination for cause even without notice. Since this right is considered as a last resort (*ultima ratio*), default of payment and the violation of certain contractual provisions alone do not make the continuation of a longstanding franchise relationship unreasonable for the franchisor (*Kammergericht Berlin*, judgment of 21 November 1997, file No. 5U 5398/97, Burger King). There may be circumstances that lead to sudden friction in the relationship between the franchisor and the franchisee, for example, the refusal to pay the franchise fees or the repeated breach of important rules of the franchise system (such as the prohibition on cooperating with competitors). To assess whether an action justifies the termination of the contract for good cause requires an overall evaluation of the circumstances of the individual case and weighing the interests of the franchisor and the franchisee. The termination declaration has to take place within a reasonable time after the occurrence of the activity that led to the friction in the relationship. Please note that neither the necessity nor the requirements for good cause (including the warning letter) can be waived within a pre-formulated standard franchise agreement.

Franchise agreements with an indefinite term can be terminated either for good cause (without notice, as specified above) or without cause. In case of termination without cause, contractual or statutory periods of notice must be considered. German law provides for the following statutory notice periods depending on the duration of the contract: one month within the first year of the term; two months within the second year of the term; three months within the third to fifth year of the term; and five months after five years of the term. The parties may agree on a longer notice period as provided for by the German Commercial Code but may not shorten it. Unless otherwise agreed by the parties, any termination is valid only till the end of a calendar month.

10 Joint Employer Risk and Vicarious Liability

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

Depending on the nature of the relationship between a franchisor and a franchisee, there may be a risk that the franchisee is considered as an employee or a quasi-employee of the franchisor, leading the franchisor to be confronted with employer obligations and employee rights of the franchisee. Whether a franchisee will be classified as an independent businessman or as an employee (or quasi-employee) depends on the scope of the control exercised by the franchisor, and on the extent of the entrepreneurial risk assumed by the franchisee.

In this respect, the courts rely on the criteria of personal dependency (employees) or economic dependency (quasi-employees). Personal dependency will be assumed if the franchisee is excessively bound to the franchisor's instructions regarding the subject matter, conduct, time, length and place of its activity. Self-employment on the other hand will be assumed where the franchisee is mainly free to determine its activity and bears the entrepreneurial risk. A franchisee organised in the form of a company limited by shares will not run the risk of being qualified as an employee (except for the particular case of a one-person company in which the characteristics of dependant employment prevail).

If the franchisee – in the case of self-employment – is considered as a quasi-employee, some employment law provisions are expressly declared applicable (no general application of employment law). This requires, however, the franchisee's economic dependency on the franchisor (i.e., the franchisee's basis of existence must arise out of the franchise business).

In order to avoid the risk of employment law being applicable, the franchisor has to make sure that the franchisee is not personally or economically dependent. This can be achieved by tailoring the franchise agreement respectively as well as the corresponding execution of the agreement.

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

As franchisees are usually self-employed entrepreneurs who are not allowed to act on behalf and for the account of the franchisor, there is no direct contractual relationship between the franchisor and the franchisee. Therefore, the franchisor may not be held liable for the acts or omissions of its franchisees or their employees if the franchisee is not classified as an employee (or quasi-employee) (see question 10.1).

11 Currency Controls and Taxation

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

Germany currently does not enact any exchange controls to an overseas franchisor.

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

A business entity that has its registered office or place of management in Germany is considered tax-resident in Germany. Unless otherwise provided for in an applicable double tax treaty, a tax-resident entity is subject to unlimited tax liability in Germany on its worldwide income. The tax system for corporate entities can be characterised as a combination of corporate income tax and trade tax.

Corporate income tax is payable at a rate of 15 per cent (plus a solidarity surcharge of 5.5 per cent of the corporate income tax,

resulting in an aggregate corporate income tax rate of 15.825 per cent). Individuals who conduct business in Germany or are partners in a partnership in Germany are subject to progressive German income tax rates of up to 45 per cent (plus a solidarity surcharge of 5.5 per cent of income tax), depending on their income.

Trade tax is a municipal tax, individually imposed by local authorities at the company location, and varies between approximately 7 per cent and 18 per cent. The trade tax base is the taxable profit for income tax or corporate income tax purposes, modified by some add-backs and deductions. To mitigate the double burden of income tax and trade tax, income tax on business income is to a certain extent reduced by trade tax (trade tax rate relief allowance). Trade tax cannot, however, be deducted from the total corporate income tax amount.

Non-tax-resident business entities or entrepreneurs are subject to limited tax liability on their domestically sourced income. Income received from a permanent German establishment is regarded as domestically sourced income and is therefore subject to income tax (for individuals not tax-resident in Germany) or corporate income tax (for companies not tax-resident in Germany), as well as trade tax at the normal rate.

Income tax on domestic taxable income from the licensing of know-how or rights of use of non-tax-resident business entities or entrepreneurs not having a permanent establishment in Germany is levied at source by way of a withholding tax, unless otherwise provided for in an applicable double tax treaty. The withholding tax is normally paid by the debtor (the franchisee) on account of the creditor (the franchisor). The tax rate is 15 per cent. The solidarity surcharge amounts to 5.5 per cent of the income tax or the corporate income tax.

Deliveries and services supplied in Germany against consideration by an entrepreneur are generally subject to German value added tax (VAT). Services relating to the licensing of rights or the provision of know-how supplied by an entrepreneur are generally subject to VAT, if the recipient of these services is situated in Germany. Deliveries of goods from abroad are either subject to German VAT on the intra-Community acquisition of goods or to German import VAT. The standard rate is 19 per cent; however, some deliveries are taxed at the rate of 7 per cent and some supplies are tax exempt (for example, financial services).

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

No, there are no such requirements.

12 Commercial Agency

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

A commercial agent is entitled to an indemnity at the end of the agreement pursuant to section 89b of the Commercial Code, if the commercial agent has generated new customers for the principal's business, or has significantly increased the extent of business with already existing customers and the principal continues to derive substantial benefits from business with said customers. This right to claim indemnity cannot be waived in advance. German law provides some exemptions, for example, if the contract is terminated for cause owing to culpable conduct of the commercial agent. As the franchisor or a replacement franchisee can continue to sell to the former franchisee's customers, the franchisee may be entitled to an indemnity as well. Section 89b of the Commercial Code applies analogously in the case of termination of a franchise agreement if two conditions are met:

- the franchisee needs to be included in the franchisor's sales organisation to the extent that it has duties that to a considerable extent are financially comparable to those of a commercial agent; and
- the franchisee needs to be contractually obliged to (directly or indirectly) transfer its customer base to the franchisor no later than at the termination of the agreement.

Regarding this, in order to mitigate the risk of an indemnity payment, franchisors should make sure that the franchise agreement does not stipulate an obligation to transfer the franchisee's customer base to the franchisor – neither directly nor indirectly.

13 Good Faith and Fair Dealings

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

German law stipulates that the parties to a contract effect performance according to the requirements of good faith (section 242 Civil Code). This is a basic principle of German law and a 'general provision', enabling a court to tailor its decision to the circumstances of the particular case. An implementation of this basic principle of good faith is the assessment of standard terms and conditions in terms of its reasonableness pursuant to section 307 Civil Code. The principle of good faith requires that contractual rights are exercised in a manner consistent with good faith. However, the decision whether a certain behaviour violates the principle of good faith depends on the facts of the individual case. Courts make restrained use of the principle of good faith and refrain from introducing new contractual terms that might be regarded as more appropriate by means of this sweeping clause.

14 Ongoing Relationship Issues

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

As well as the offer and sale of franchises, the ongoing relationship between franchisor and franchisee is only governed by the general provisions of the Civil Code, the Commercial Code, competition and antitrust law (see question 1.2). In practice, the laws of the Civil Code concerning standard terms play an important role for the ongoing franchise relationship; for example, regarding franchisees' obligation to effect changes to the franchise system that are introduced by the franchisor during the term of the agreement.

15 Franchise Renewal

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

In relation to a renewal of an existing franchise no specific disclosure obligations apply that exceed the franchisor's continuing disclosure obligations to existing franchisees as described in question 1.7.

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

According to German law, the renewal of a franchise contract is exclusively subject to agreement between the parties. Therefore, a franchisor may refuse to renew the franchise agreement without having to give reasons for its decision.

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

The franchisors' freedom to refuse the renewal of the franchise agreement may be limited under particular circumstances. From the principle of good faith derives a certain protection for investments made by the franchisee at the franchisor's instigation shortly before the termination of the franchise agreement. For example, if a franchisor has announced its intention to renew the franchise contract and thereby encouraged the franchisee to further investments on the verge of contract expiry, the refusal to renew the franchise contract without good reason may entitle the franchisee to claim damages.

16 Franchise Migration

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

It is possible to regulate such restrictions within the franchise contract. Normally, the transfer of the franchise is subject to the franchisor's prior written approval in order to protect the know-how and integrity of the franchise system and to prevent entry of the franchisor's competitors. Likewise, it is possible (and enforceable) to make the franchisee's transfer of ownership (including assignment or pledge) in the franchisee entity subject to the prior approval of the franchisor.

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

A 'step-in' right in case a franchise agreement is terminated by the franchisor due to the franchisee being in breach of the franchise agreement can only be implemented by way of a purchase option of the franchisor. However, in order to be valid such purchase option needs to be drafted very carefully as there is a risk that such purchase option could be considered an undue disadvantage of the franchisee or not clear enough and therefore void.

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?

Given that the implementation of a 'step-in' right/purchase option itself bears a risk of being considered an undue disadvantage of the franchisee, such power of attorney would most likely not be valid.

17 Electronic Signatures and Document Retention

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

German law does not provide for a certain form requirement for franchise agreements. Hence, a franchise agreement could be concluded orally as well as by electronic signature. Form requirements might only arise from a franchisee's right of withdrawal (pursuant to section 513 Civil Code) or a post-term non-compete obligation (pursuant to section 90a Commercial Code).

However, with regard to possible court proceedings and the question of cogency of proof, a signed 'wet ink' version is advisable. According to section 416 Code of Civil Procedure private records and documents shall – to the extent that they are signed by the parties issuing them – establish full proof that the declarations they contain have been made by the parties who prepared such records and documents. According to section 371a para. 1 Code of Civil Procedure the rules concerning the evidentiary value of private records and documents shall be applied only to private electronic documents bearing a qualified electronic signature (as defined in artic 3 (12) Regulation (EU) No. 910/2014: "'*qualified electronic signature' means an advanced electronic signature that is created by a qualified electronic signature creation device, and which is based on a qualified certificate for electronic signatures*"). In case of an electronic signature that does not meet the requirements of a qualified electronic signature, in this sense a franchisee could argue in court that it was not actually him who signed the franchise agreement.

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

For the existence of the franchise agreement it is not necessary to store a paper version but with regard to possible court proceedings it is advisable not to destroy the paper version of the franchise agreement (see question 17.1). Furthermore, scanned documents alone cannot be used for proceedings in which the claimant relies entirely on documentary evidence according to section 591 Code of Civil Procedure.

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1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

Indian law does not have a definition for franchise *per se*. The Black's Law Dictionary defines a franchise as a licence from the owner of a trademark or trade name permitting another to sell a product or service under that name or mark (Blacks Law Dictionary, (6th Ed.) Centennial Edition (1891–1991) at p. 658).

"Franchise" means an agreement by which the franchisee is granted representational right to sell or manufacture goods or to provide a service or undertake any process identified with the franchisor, whether or not a trademark, service mark, trade name or logo or any such symbol, as the case may be, is involved (Section 65 (47) of Finance Act, 1994 as amended).

In a normal franchise agreement, there are at least two parties involved:

(a) the franchisor, who lends his trademark or trade name (or other intellectual property rights) and the business system; and

(b) the franchisee, who pays a royalty and often an initial fee for the right to do business under the franchisor's name and business system.

1.2 What laws regulate the offer and sale of franchises?

In the absence of a franchise-specific legislation in India, a franchise arrangement is governed by various applicable statutory enactments prevailing in India, *inter alia*: the Indian Contract Act, 1872; the Competition Act, 2002; the Consumer Protection Act, 1986; the Trade Marks Act, 1999; the Copyright Act, 1957; the Patents Act, 1970; the Design Act, 2000; the Specific Relief Act, 1963; the Foreign Exchange Management Act, 1999 and other FDI Policies and regulations issued by the Reserve Bank of India from time to time; real estate laws such as the Transfer of Property Act, 1882; the Indian Stamp Act, 1899; the Income Tax Act, 1961; the Arbitration and Conciliation Act, 1996; and the Information Technology Act, 2000. Further, industry-specific and state legislation may apply depending on the relevant industry/sector and the transaction pertaining to the respective franchisee arrangement.

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

In the absence of specific franchising regulations, this aspect is left to the discretion of the franchisor and franchisee, which is governed by the provisions of the franchise agreement.

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

Indian laws do not require the franchisor to be registered with any professional or regulatory body before entering into a franchise arrangement (including offering a franchise, signing up franchisees or taking payments from franchisees).

1.5 Are there mandatory pre-sale disclosure obligations?

This is determined as per the franchise agreement by way of explicitly capturing detailed disclosure requirements in the franchise agreement. However, "***consensus ad idem***" as per the provisions of the Contract Act, 1857 is vital.

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

This is also determined as per the franchise agreement; however, common law principles with respect to entering proposed contractual relations are applicable in such scenarios.

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?

It must be noted that in the absence of any disclosure requirements, there exists no specific format or obligations pertaining to continuing disclosures.

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

In the absence of any franchise-specific legislation, the respective franchises must ensure compliance with the corresponding legislations as under question 1.2 above.

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

Although it is not mandatory to have a membership, it is advisable as this could protect the interests of franchise owners in a way that individual franchisees may not.

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

There is no code of ethics for franchising under Indian laws. However, many franchisors and franchisees are members of franchise associations such as the Franchising Association of India, which has formulated a code of conduct/code of ethics that their members are expected to follow, although it is not binding. Also, India is not a signatory to the European Code of Ethics for Franchising.

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

In the absence of mandatory disclosure requirements, there is no requirement to translate the documents into the local language.

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

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

There are provisions under the Foreign Direct Investments Policy, the Foreign Exchange Management Act, 1999, which prescribe the thresholds and conditions for foreign investments and compliance for the outward flow of foreign exchange, *inter alia*, towards royalty, franchise fees, etc. The franchisee is required to make payments to the foreign franchisor only through the authorised dealer banks in India, by submitting relevant documents.

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

For a typical franchisor, the most relevant business entities in India are a private limited company and a limited liability partnership ("**LLP**"). Both these entities have an independent corporate existence, are well governed by a regulatory regime, are amenable to foreign investment subject to relevant foreign exchange control norms and offer protection from unlimited liability.

While there are other business structures such as sole proprietorship concerns and partnership firms, these options are not available for foreign franchisors as foreign investment is not permitted in these entities.

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?

Any new business entity is governed by the provisions of the respective applicable legislation(s). A private limited company is governed by the provisions of the Companies Act, 2013, a LLP is governed by the Limited Liability Partnerships Act, 2008 and a partnership firm is governed by the provisions of the Indian Partnership Act, 1932. There are no provisions governing a sole proprietorship concern.

3 Competition Law

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

The Competition Act, 2002 prohibits arrangements related to production, supply, distribution, storage, acquisition or control of goods or provision of services that cause or are likely to cause an appreciable adverse effect on competition within India. This is in an effort to ensure that large franchise arrangements do not create a monopoly.

The Competition Act prohibits agreements that directly or indirectly determine a purchase or sale price or that permit or control the production, supply, markets, technical development, investment or the provisions of services and so on, provided that they are likely to cause an appreciable adverse effect on competition within India.

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

Indian laws do not impose restrictions with respect to a minimum or maximum term.

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

Indian laws do not impose any obligation with respect to a maximum permitted term.

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

The provisions of the Competition Act prohibit agreements that directly or indirectly determine a purchase or sale price that are likely to cause an appreciable adverse effect on competition within India, although reasonable restrictions to protect IP rights are not considered as anti-competitive. A franchisor can, thus, require the franchisee to buy products and services, including those for resale to the franchisee's customers, 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 are not any minimum obligations that a franchisor must observe when offering franchises in adjoining territories, although the same may be subject to terms and conditions in the respective franchise agreement.

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

Indian courts have usually been reluctant to enforce post-term non-compete and non-solicitation covenants, viewing them as violative of Section 27 of the Indian Contract Act, 1872 as being in "restraint of trade"; however, in-term covenants are enforceable.

4 Protecting the Brand and other Intellectual Property

4.1 How are trade marks protected?

A trademark is protected under the provisions of the Trademarks Act 1999. On registration, the franchisor gets the exclusive right to use the mark in connection with the goods or services. A trademark registration is valid only for a period of 10 years and must be renewed thereafter. A trademark right is territorial in nature, hence it is very important for a foreign franchisor to get its trademark registered in India as it ensures statutory protection to the trademark of the franchisor in India.

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

Trade secrets exist between parties standing in a contractual relationship, and any disclosure of such trade secret will be actionable. Although trade secrets are not dealt under any particular legislation in India, they are covered under legislation like the Indian Contract Act, 1872, the Copyright Act, 1952, the principles of equity and, at times, the common law action of breach of confidence, which in effect amounts to a breach of contractual obligation. Section 72 of the Information Technology Act, 2000 also provides protection, however, the same is limited to electronic records. Appropriate terms with respect to disclosure and protection of trade secrets may be stipulated in the franchise agreement.

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

While copyright comes into the ownership of the creator as soon as the work is created, certificate of registration of copyright serves as *prima facie* evidence in a court of law in case of a dispute relating to ownership of copyright.

As per Section 2(o) of the Copyright Act, 1957, "literary work" includes computer programs and compilations, including computer databases. The Source Code and Object Code also have to be supplied at the time of registration to the Copyright Office. The protection available to literary works extends to operation manuals and proprietary software.

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 prescribed by any specific legislation in India.

However, it must be ensured that a franchise agreement has to be in consonance with the provisions of the Indian Contract Act, 1872 in which the franchisee can include the disclosure requirements as part of the contract. Therefore, if the franchisor makes any misrepresentation or breaches any warranties under the franchise agreement, the franchisee can commence civil proceedings for damages and/or criminal proceedings for the misrepresentation of facts and criminal breach of trust.

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

Franchise agreements usually expressly cover indemnity rights. Thus, the franchise agreement will contain provisions for indemnification of the parties for any liabilities arising out of the other party's breach of contract. The agreement may also lay down an inclusive list of situations in which parties would be liable for indemnification. However, even in the absence of any express indemnity provision in the contract, the aggrieved party may be able to claim damages.

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

It must be noted that putting disclaimer clauses to avoid liability is a common practice in India. However, if the franchisor makes any misrepresentation under the franchise agreement, the franchisee can commence either or both:

- Civil proceedings for damages.
- Criminal proceedings for the misrepresentation of facts and criminal breach of trust.

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

Filing class action suits with a purpose to protect the interests of large number of people is not prohibited in India; however, the same is not a common practice. It must be noted that class action waiver clauses in the franchise agreement which are considered as a waiver of any law or provisions of law, such clauses might not be considered as reasonable/enforceable by the Indian 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?

It is good practice to mention the governing laws and jurisdiction for the operation of the franchise agreement although, it is not a mandatory requirement. In the case of a franchise agreement between an Indian entity and foreign entity, the parties to the franchise agreement can designate the law of a foreign country as the governing law and submit exclusive or non-exclusive jurisdiction to a foreign court, provided such foreign court has inherent jurisdiction over the dispute.

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

Yes, the courts of law in India provide remedies or relief to the franchisor or the franchisee in accordance with the applicable provisions of law and the franchise agreement (read conjointly). Also, it must be noted that a foreign judgment is also enforceable in India by filing an Execution Petition under Section 44A of the Civil Procedure Code, 1908 (in case the conditions specified therein are fulfilled) or by filing a suit upon the foreign judgment/decree.

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

It is best to agree on alternate dispute resolution mechanisms like arbitration, conciliation or mediation, in the case of a dispute, to ensure speedy and cost-effective resolution of any dispute arising out of the franchise agreement.

For adoption of arbitration as a dispute resolution mechanism, the parties may opt for a separate arbitration agreement to be signed between them or include an arbitration clause in the main contract. Arbitration proceedings in India are conducted as per the provisions of the Arbitration and Conciliation Act, 1996 and the amendments thereto.

Yes, India is a signatory to the New York Arbitration Convention on the Recognition and Enforcement of Foreign Arbitral Awards since 13 July 1960.

7 Real Estate

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

There are no specific legislations governing the length of terms for a commercial property lease. However, the lease term may be fixed for a term between one to 10 years and the same may be renewed further, as per the discretion and mutual agreements between the parties to the commercial lease deed.

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 may be drafted so as to contain provisions pertaining to termination along with provisions relating to vacation and the assignment of rights pertaining to the lease.

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

A foreign company which has established a Branch Office or other place of business in India, in accordance with FERA/FEMA regulations, can acquire any immovable property in India, which is necessary for or incidental to carrying on such activity; however, the same is subject to the provisions of the Foreign Exchange Management Act, 1999 and the RBI regulations, as amended from time to time.

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 in a particular location)?

In India, real estate is the second largest employer and is expected to see a 30 per cent growth over the next decade. This growth can be attributed to favourable demographics, increasing purchasing power, existence of customer-friendly banks and housing finance companies, professionalism in real estate and favourable reforms initiated by the Government to attract global investors.

Landlords may charge high rent depending on the type and area/location of the property. Further, a rent-free period for the fit out may also be provided for under the respective 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?

Provisions pertaining to redirecting the online orders to the franchisee are governed solely by the franchisee agreement. It is pertinent to mention that some franchise agreements state that a franchisor or its affiliate may sell items through other channels of distribution or establish other units under different names and trademarks in direct competition with a franchisee. Because e-commerce sales do not require the establishment of a location, this might not be considered as territorial encroachment. It must be noted that a franchisor or franchisee could theoretically market to the whole world through the internet. Franchisors need to decide whether other franchisees or even the franchisor will be permitted to compete through internet sales.

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 clause to that effect must expressly be stipulated in the franchise agreement to restrict the usage of the domain name on the termination or expiry of the franchise agreement.

9 Termination

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

There are no local laws governing the termination of the franchise agreement and the same is regulated solely by the mutually agreed grounds of termination forming part of the franchise agreement.

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

There are no local rules governing the length of the notice period.

10 Joint Employer Risk and Vicarious Liability

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

Yes, there may be such risks unless the relationship between the parties is specifically mentioned in the agreement governing their relationship. Usually, there exists a principal-agent or principal-principal relationship, between the franchisor and the franchisee in the absence of any specific clause to the same.

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, such risk is in place, unless otherwise put forth or there exists a principal-agent relationship between the franchisor and franchisee.

It is critical that the relevant clause expressly stipulates the relationship of the parties and the limitations regarding the nature and degree of control that a franchisor asserts over a franchisee's day-to-day operations to avoid any unnecessary liability.

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 Foreign Exchange Management Act, 1999 and Reserve Bank of India guidelines regulate the terms of payment under franchise agreements, such as franchise fees, management fees, development fees, administrative fees, royalty fees and technical fees, where one party is an overseas entity including the amount to be paid and procedure for remittance of these payments outside India. As per the guidelines of RBI, the franchisee is required to furnish tax clearances and a certificate from the chartered accountant at the time of remittance of royalty payments by the franchisee to franchisor outside India. Currently, franchise payments made by a resident to a non-resident are allowed under the automatic route, i.e. no approval is required and there is no ceiling on the amounts that can be remitted.

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?

Payment of royalties under the franchise agreement is subject to withholding taxes at a rate prescribed by the relevant Finance Act at the time of payment. Currently, the effective rate is 10% of the gross amount. Tax rates are increased by an additional surcharge, CESS, etc. subject to the benefits available under double tax avoidance treaties. If the PANs of deductees are not available for non-residents, a higher tax withholding rate may be applicable. Further, as per section 90(2) of the Income Tax Act, 1961, a beneficial rate provided under the Income Tax Act or under the Double Tax Avoidance Agreement will prevail, provided the overseas franchisor submits a Tax Residency Certificate.

It is not advisable to avoid the payment of withholding tax by structuring payments from the franchisee as management services fees rather than royalties, for the reason that if and when such payments are scrutinised by the Income Tax authorities, the same may lead to heavy fines.

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

The payment of franchise fees or royalties can be made in any currency and there are no restrictions on the same. The same is required to be done through Authorised Dealer banks recognised by the Reserve Bank of India.

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, the relationship between the franchisor and franchisee is principal-principal and/or principal-agent. The same is further

dependent on the type of control the franchisor exercises over the franchisee. Thus, in order to mitigate the risk of the franchisee being considered as the franchisor's commercial agent, a clause to this effect expressly defining the relationship between the franchisor and the franchisee must be inserted in the franchisee 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?

Though the doctrine of good faith and fair dealing is not expressly defined in the Indian Contract Act, 1872, in every contract there is an implied covenant of good faith and fair dealing, obligating the contracting parties to refrain from doing anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract. The courts in India always apply this fiduciary principle while interpreting the terms of any agreement and deciding upon the same.

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 governing the relationship between the franchisor and franchisee except the franchise agreement. The laws and regulations mentioned in question 1.2 will be applicable in addition to the specific terms of the agreement.

15 Franchise Renewal

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

There are no specific disclosure obligations.

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

The franchisee has no right to a claim of automatic renewal or extension of the franchise agreement unless the same is expressly provided 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?

The renewal of the franchise agreement is entirely governed by the intention of the parties that is captured in the franchise agreement. Unless the franchise agreement provides for compensation or damages to be paid to the franchisee in case of non-renewal or refusal to extend, the franchisee shall not be entitled to claim any such 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 franchisor can impose reasonable restrictions on the franchisee's freedom to sell, transfer, assign or otherwise dispose of the franchised business. However, the same must be clearly defined in the franchise agreement without any ambiguity. Also, the restrictions should not completely restrain the franchisor and/or the franchisee in carrying out his trade, as the same would be held void under the Indian Contract Act, 1872.

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 parties to the franchise agreement are free to negotiate and decide on the "step-in" rights. The courts will generally uphold such provisions. There are no further registration requirements or other formalities that must be complied with to ensure that a step-in is enforceable.

Where a foreign franchisor is stepping in to take over the franchised business through the acquisition of its shares, then the franchisor has to comply with rules laid down by the Reserve Bank of India where the acquisition falls under the automatic route or seeks prior approval of the Reserve Bank of India where the acquisition is covered under the approval route.

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?

There is no restriction of incorporating a power of attorney in favour of a franchisor to carry out all migration formalities with respect to step in rights.

For a Power of Attorney to be valid and effective the same should be duly signed, stamped and notarised in accordance with the laws of the country/state where it is executed. Since the Power of Attorney has separate execution formalities, it is advisable to execute it as a separate document from the franchise agreement.

17 Electronic Signatures and Document Retention

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

Electronic signatures are considered valid in India. There are no specific requirements for applying an electronic signature to a franchise agreement. The Information Technology Act, 2000 ("**IT Act**") recognises the following two types of signature as legal and binding:

(1) E-signatures that combine an Aadhaar identity number with an electronic Know-Your-Customer number.

(2) Digital signatures that are generated by an asymmetric crypto-system and hash function.

For the electronic signatures to be considered valid, the following conditions must be satisfied:

(1) The e-signature must be unique to the signatory.

(2) At the time of signing, the signatory should have control over the data used to generate the e-signature.

(3) Any alteration with the e-signature, or with the document to which it is affixed, must be easily detectable.

(4) There should be an audit trail of steps followed during the signing process.

(5) Signer certificates must be issued by a Certifying Authority as defined under the IT Act.

The aspect of the payment of stamp duty poses a challenge to executing agreements in an electronic manner. In India, stamp duty is payable in respect of specified instruments in accordance with applicable Central or State level stamp duty laws, on a fixed or on an ad valorem basis. Stamp duty is payable in respect of instruments that are physically printed and executed. Currently, there is no law in India that specifically deals with the payment of stamp duty on such documents.

If a franchise agreement involves any sale of immovable property in India or any contract, interest or conveyance in such property, such agreement cannot be electronically signed.

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

The Indian Evidence Act, 1872 recognises electronic records and electronic signatures as admissible pieces of evidence. Once the signed/executed franchise agreement is stored electronically, the paper version of the agreement can be destroyed. It is recommended to preserve the original stamped and executed copy as the same has a higher evidentiary value under the Indian Evidence Act, 1872 in courts of law.

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Ms. Twinky Rampal has vast experience in handling large prosecution work for clients spanning across diversesectors. She mainly deals with trademark prosecution, trademark oppositions, copyright prosecution and renders specialised opinions to Indian and foreign clients. She specialises in conducting trade mark clearance searches, tackling infringement and providing clearance opinions, brand protection across industries, adoption of trademarks and prosecution. Further, she provides opinions in relation to a variety of issues pertaining to trademarks, copyrights, domain names, and cancellation and opposition proceedings.

ANAND & ANAND

Anand and Anand is a full-service IP law firm, providing end-to-end legal solutions covering all cross-sections of Intellectual Property and allied areas. The firm is professionally managed by a Partnership board comprising 27 Partners and four Directors, supported by a management team comprising a CEO, CFO and CIO. The firm currently employs more than 300 people, including over 100 qualified attorneys/engineers.

The firm's expertise is widely acknowledged in addressing complex IP challenges of all types. It regularly deals with protection of IP and contentious matters in different forums including the Courts at all levels, the Patent Offices, the Trademark Offices, the Copyright Office, the Design Office, Intellectual Property Appellate Board, WIPO and National Internet Exchange of India.

The firm balances commercial realities with legal pragmatism and draws on its well-honed expertise and instinct in the field, coupled with a profound understanding of intellectual property management in India. The firm has a keen interest in innovation and offers creative solutions that tackle the root and not merely the symptoms of a problem.

Culturally the firm thrives on challenges, creative thinking and constant improvement of its legal knowledge and skills. The spirited character of the firm is the keystone of its growth and expansion into new areas of IP which have been embraced with ease and zest.

Italy

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1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

According to Act No. 129 of 6 May 2004 (rules on commercial franchise) (the "**Franchise Act**"), a franchise agreement, whatever its form or description, is an agreement between two legally and financially independent parties, whereby one party grants the other party, in exchange for consideration, the right to use a set of industrial or intellectual property rights, related to trademarks, trade names, shop signs, utility models, industrial designs, copyright, know how, patents, technical and commercial support and assistance, in the view of having the franchisee joining a system characterised by a group of franchisees operating in the territory for the purpose of distributing specific goods and services.

1.2 What laws regulate the offer and sale of franchises?

The laws that regulate the offer and sale of franchises are:

- Act No. 129 of 6 May 2004 (rules on commercial franchise), which became effective on 25 May 2004 (the Franchise Act).
- Ministerial Decree No. 204 of 2 September 2005 (regulation on commercial franchise – the "**Franchise Regulation**"), which applies only to franchisors who, before the date of signing the franchise agreement, have operated exclusively abroad.
- Act No. 287 of 10 October 1990 (rules on the protection of competition and the market – "**the Italian Antitrust Law**").
- Commission Regulation ("**EC**") No. 330/2010, issued on 23 April 2010 by the EU Commission on the application of article 101/3 of the Treaty on the Functioning of the European Union to categories of vertical restraints (EU Block Exemption Regulation on vertical restraints), which is also directly applicable in Italy (the previous Regulation No. 2790/1999 expired).
- Act No. 192 of 18 June 1998 (regulation of sub-supply within the production activities), in particular, article 9 on the abuse of economic dependence ("**the Anti-Economic Abuse Law**").

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

The Franchise Act does not provide any specific regulation for the case that the franchisor proposes to appoint only one franchisee/licensee. Therefore, in this case, the sole franchisee should be treated as any other franchisee operating in franchise systems that provides more than only one franchisee.

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

There are no registration requirements in Italy.

1.5 Are there mandatory pre-sale disclosure obligations?

Pursuant to sections 4 and 6 of the Franchise Act, the franchisor must disclose to the franchisee a complete set of information, with the exception of that which is actually reserved or whose disclosure may violate third parties' rights, at least 30 days before the stipulation of the contract.

Different information must be disclosed by the franchisor depending on whether the franchisor operates within or exclusively outside Italy. A franchisor operating exclusively within Italian territory or both in Italy and abroad must provide the franchisee with a copy of the contract to be signed and the following information:

(i) data regarding the franchisor;

(ii) information concerning the trademarks used in the network;

(iii) a summary description of the activities and characteristics of the business concept of the franchise network;

(iv) a list of franchisees operating within the network and the stores of the franchisor;

(v) an indication of the annual variation of the number of franchisees and their relevant location within the past three years, or from the beginning of the franchise activity if it started less than three years ago; and

(vi) a summary description of court or arbitration proceedings, or both, involving the franchise network at issue, which has been started by franchisees, third parties or public authorities against the franchisor and concluded in the past three years, in compliance with data protection provisions.

According to the Franchise Regulation, a franchisor that operates exclusively outside of Italy must provide the franchisee with the information described in (i), (ii) and (iii), along with the following: (a) a list of franchisees operating within the network, and of the stores of the franchisor sorted country by country (if requested by the franchisee, the franchisor will also have to supply the former with a list of at least 20 franchisees operating within the network and their relevant locations); (b) an indication of the annual variation – sorted country by country – of the number of franchisees and their

relevant location within the past three years, or, if it started less than three years ago, from the beginning of the franchise activity; and (c) a summary description of any court proceedings concluded with a final judgment within the three years preceding the stipulation of the contract; also, arbitral proceedings concluded with a final award within the same term as described above. Both the court and arbitration proceedings must concern the franchise system. In this regard, the franchisor will have to provide at least the following information: the parties involved; the judicial or arbitral authority; the claims; and the decision or award.

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

The pre-sale disclosure obligations apply to sales to sub-franchisees, which have the right to receive all the mandatory information and documentation provided by the Franchise Act. The master franchisee is required to make the necessary disclosures, previously provided by the franchisor to the master franchisee, which in turn is required to provide them to the sub-franchisees.

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

The Franchise Act sets no duty on the franchisor to update the information disclosed in the pre-contractual phase. The performance of the contract must be carried out by the parties in compliance with the principle of good faith set forth by section 1375 of the Italian Civil Code. In light of the above, in conformity with the good faith principle, the franchisor may be required by the franchisee to update the information provided in the pre-contractual phase if the update may be considered to be in the interests of the franchisee.

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

The franchisor must have tested his business concept on the market before starting its franchise network. In fact, of considerable importance for the franchisee who intends to evaluate the validity of the commercial formula proposed to him, is the verification of the testing of the same formula by the franchisor, before the launch of the franchise network on the market. It is the law itself that requires the acquiring company to have previously tested its own formula. The testing takes place through one or more pilot units, and must have, although the law does not expressly provide for this, a minimum duration of not less than one year, a period considered sufficient to measure, through the results of the financial statements, the economic results of the activity and therefore the replicability of the formula by third parties, with prospects of profitability.

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

The main Italian franchising associations in Italy are: (i) *Assofranchising*, whose aim is to represent the general interests of franchising in Italy and other countries; (ii) *Confimprese*, an association of free enterprises which specialise in the sale of goods and services through the main distribution channels, namely in franchising and retail; and (iii) *Federazione Italiana Franchising*, that is the only franchising association representing both the franchisors and the franchisees. A membership with the national franchise association is not mandatory, but it may be useful to be part of a group within a franchise association, because it can be beneficial to be part of a group of companies that operate in the same sector, and who finalise their common efforts to the development of franchise networks, to the protection of their interests towards institutions and other market players.

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

Being a member of a national franchise association means that the franchisor should pay the annual membership fee, and comply with the rules imposed by the association, and in particular, by its ethic code, statute and disciplinary rules.

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

According to article 3 of the Franchise Regulation, the franchisor, upon request of the franchisee, is required to provide information concerning the contract and its annexes in the Italian 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?

Natural persons who are citizens of EU Member States can enjoy the contractual capacity provided for Italian citizens and, consequently, set up or participate in Italian companies following the same rules as Italian citizens. The same applies to companies that are nationals of an EU Member State, who may therefore be members of an Italian company. A foreigner legally residing in Italy may participate in an Italian company, unless the law or an international convention expressly requires the verification of the conditions of reciprocity. A foreigner who does not legally reside in Italy, on the other hand, may become a member/shareholder of an Italian company on the condition of reciprocity with the foreign State of which he is a national. The same principle applies to non-EU foreign companies.

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

In general, as with most jurisdictions, Italy has businesses that have limited and unlimited liability. The former is clearly preferred in common commercial practice, particularly in franchise businesses, as limited liability protects shareholders from general business risks and allows a better allocation of funds. Depending on the size of the proposed business, the relationship among shareholders and the types of investments, franchisors typically choose between a company limited by shares (*Società per azioni* – SpA) or a limited liability company (*Società a responsabilità limitata* – Srl). The first entity offers more options regarding agreements among shareholders, the issue of debt notes and the allocation of assets for particular corporate purposes and stock listing.

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?

When a company has been duly incorporated and registered at the competent Chamber of Commerce, there are no further registration requirements or a pre-condition to being able to trade.

3 Competition Law

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

With regard to the franchisees, there is no specific competition law, while the general EU provisions on such topic have to be considered. In brief, the Consolidated versions of the Treaty on the European Union ("**TEU**") and the Treaty on the Functioning of the European Union ("**TFEU**") provide for specific rules on competition and, specifically, on vertical agreements and the restraints deriving from the execution of them. Article 101 of the TFEU expressly prohibits agreements that may affect trade between European Union ("**EU**") countries and which prevent, restrict or distort competition. Among the practices prohibited and referred to under Article 101 above, included, *inter alia*, is the fixing, either directly or indirectly, of the purchase or selling prices or any other trading conditions. Pursuant to Article 101, second paragraph of the TFEU, any vertical agreement, prohibited under Article 101, first paragraph, is considered automatically void. Despite the above, the agreements which create sufficient benefits to outweigh the anti-competitive effects are exempt from this prohibition under Article 101, third paragraph, TFEU. With the Commission Regulation No. 2790/1999 of 22 December 1999 (L. 336/21) (hereinafter, the "**Regulation**"), the EU Commission issued a new legislation aiming to implement the abovementioned exception (Article 101, third paragraph, TFEU) for vertical agreements. Therefore, the above introduced a new principle of balancing the anti-competitive effects of vertical agreements with the benefits, if any. Upon expiration of the Regulation (31 May 2012), on 23 April 2010 the EU Commission issued a new regulation, No. 330/2010 (hereinafter the "**New Regulation**"). The New Regulation, as the Regulation, concerns the applicability of article 101, third paragraph, TFEU to vertical agreements.

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

The Franchise Act does not provide for a maximum permitted term for a franchise agreement. In particular, the franchise agreement can either be an open tem or limited term. Generally, the parties enter into a limited term agreement. It must be noted that according to article 3.3 of the Franchise Act, if the agreement is for a limited term, the Franchisor shall guarantee the franchisee a minimum term related to the period of amortisation of the franchisee's investments; this term shall not be less than three years, except for cases of earlier termination for breach of contract by one of the parties.

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

No, there is not a maximum permitted term.

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

Resale price maintenance ("**RPM**"), is considered by the EU Vertical Restraints Regulation and the Italian Antitrust Law, to be illegal. Article 4.1(a) nevertheless includes an exception for fixing a maximum price level, or recommending a certain price for products or services, provided that "they do not amount to a fixed or a minimum sale price as a result of pressure from, or incentives offered by, any of the parties". Upon the release of the new version of the Commission Regulation (330/2010), the EU Commission issued additional policy guidelines on vertical restraints on 19 May 2010, and introduced new interpretations on the RPM. As a general rule, section 223 and 224 of the guidelines expressly confirm that RPM has to be treated as a hardcore restriction. Section 225, however, gives the possibility to the companies to use the RPM in particular circumstances, insofar as its use generates an increase in the efficiency levels and a positive effect on the market and on the consumer. In any case, such positive effect must be able to set-off and overcome any possible negative effect usually created by vertical agreements.

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

The provision of the exclusive right is not a mandatory clause according to the Franchise Act. However, even if no exclusive zone is agreed in favour of the franchisee, according to the Italian Courts, the franchisor has in any case the obligation to set up the network in a "rational" manner and without obvious overlaps between franchisees. This is in light of the general duty of good faith in the performance of the contract.

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

The non-compete clause is not an essential element of the franchise agreement, therefore, if it is not expressly provided for in the contract it will not operate between the parties. The non-competition agreement is governed by article 2596 of the Italian Civil Code, which provides that this may have a maximum duration of five years and must be limited in time or to a specific activity or area. However, according to the prevailing case law, article 2596 of the Civil Code does not apply to agreements between entities operating at different levels of the line (so-called vertical agreements), as is the case in franchise. Consequently, a non-compete clause included in a franchise agreement is not subject to the limits provided for by article 2596 of the Civil Code; which means that, in principle, the parties (and in principle the franchisor) are free to regulate the non-compete clause in the contract if preferred.

4 Protecting the Brand and other Intellectual Property

4.1 How are trade marks protected?

Franchisors can protect their trademarks in Italy by registration at the Italian Trademarks and Patents Office – based in Rome – or, in case of European or international trademarks, by registering the trademarks respectively at the Office for Harmonization in the Internal Market – based in Alicante (Spain) – and at the World

International Property Organization, which is based in Geneva (Switzerland). The regulation of the trademarks is governed by the Industrial Property Code ("**IPC**"), which was enacted in Italy by the Legislative Decree No. 30 of 10 February 2005. When duly registered, a trademark provides the owner with exclusivity rights for 10 years from the date of the filing of the registration request. From that moment, the owner of the registered trademark has the right to its exclusive use and to prohibit its use to third parties.

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

Sections 98 and 99 of the IPC expressly recognised the protection of know-how and trade secrets. To be eligible for protection, know-how needs to be secret, carry economic value through its secrecy and be kept by the owner in a proper manner to maintain its secrecy. Should the know-how and trade secrets be communicated to third parties or obtained in an illegal or inappropriate manner, the law has established an action for their protection. Know-how and trade secrets are usually protected by the unfair competition rules.

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

Copyright is protected by the local law and in particular by law No. 633 of 22 April 1941, for the Protection of Copyright and Neighboring Rights (as amended up to Legislative Decree No. 154 of 26 May 1997). The law in particular offers protection to creative works of genius belonging to literature, music, the figurative arts, architecture, theatre and cinematography, whatever their manner or form of expression.

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 one party has supplied false information, the other party may ask for the annulment of the agreement under article 1439 of the Italian Civil Code, and can sue the party for damages, if this is appropriate (article 8 of the Franchise Act).

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

In the case of sub-franchise, the master franchisee will be responsible for the disclosure of non-compliance or for pre-contractual misrepresentation towards the sub-franchisees, acting in this sense as the franchisor. In any case, the franchisor's duty of control over the master franchisee cannot be excluded. In fact, whenever the franchisor violates his duty of control, there could be non-contractual liability on the franchisor's part towards the franchisee.

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

Franchise agreements may provide clauses aimed at excluding the franchisor's responsibility in case of alleged misrepresentation by the franchisee of the contract's provisions. Generally, the agreement provides a clause, according to which it is stated that all the provisions of the agreement (especially those that are less favourable for the franchisee, like the payment obligations) have been fully and completely understood by both parties, and are the result of a negotiation. On the other hand, such clauses cannot completely exclude a claim by the franchisee claiming the misrepresentation of one or more clauses, and if grounded, it may also be accepted by local Courts.

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

In Italy, class actions can be promoted only by consumers or consumers associations.

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 Italian law, even if the parties generally choose to have the agreements governed by Italian law. There is no generally accepted norm according to which Italian law is not the governing law of the franchise 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?

Italian Courts enforce orders granted by other countries' courts, for injunctions against a rogue franchisee to prevent damage to the brand or misuse of business-critical confidential information.

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

Italy adhered to the New York Arbitration Convention on the Recognition and Enforcement of Foreign Arbitral Awards on 31 January 1969. According to article 839 of the Italian Civil Procedure Code, anyone wishing to enforce a foreign arbitration decision in Italy, must file a formal request to the President of the Court of Appeal in whose jurisdiction the other party resides, or, if that party does not reside in Italy, the Court of Appeal of Rome shall have jurisdiction. The claimant must produce the original or

a certified copy of the decision, together with the compromise act, or an equivalent document, in the original or a corrected copy. The President of the Court of Appeal, having ascertained the formal regularity of the award, shall declare by decree the effectiveness of the foreign award in the Republic, unless: (i) the dispute could not be settled under Italian law; and (ii) the decision contains provisions contrary to public order.

7 Real Estate

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

In addition to the general rules on leasing provided for in the Civil Code (article 1572) the regulation of the leasing of real estate for commercial use is contained in Law No. 392 of 27 July 1978, specifically from article 27 to 42. The law sets clear limits on the minimum duration of the contract: it must be at least six years if the activity that the lessee will carry out is of a commercial nature in the strict sense, at least nine years in specific cases where the property is used as a hotel or similar (pursuant to article 1786 of the Civil Code) or is used for the exercise of theatrical activity.

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 parties may provide for the franchisor's right to step into the franchisee/tenant's shoes under the lease, but the right should be provided in the lease agreement. In particular, the latter should provide the right of the franchisor to be assigned with 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?

In Italy there are no restrictions on non-national entities holding any interest in real estate, or being able to sub-lease 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 in a particular location)?

It is usual that the parties provide an initial rent free period, or a facilitated rent fee period when entering into a new lease. With respect to the "key money", the presence of points of sale in the most prestigious streets of large cities is strategic for luxury brands, and this is the reason why it is difficult to have the possibility of entering into a new lease with the landlord, because, almost always, the tenants decide to leave the store in advance of the natural expiration of the contract, knowing that in this way they can get the key money from the brand concerned to take over.

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 EU Commission, by means of the guidelines on vertical restraints, stated that the use of the Internet for the purpose of the sale of the products must be allowed to any distributor, assuming the existence of an online site is considered to be a form of passive selling, as it is a reasonable way to enable customers to reach the distributor. Therefore, this type of sales cannot be subject to restrictions. In this respect, the franchise agreement cannot impose a binding requirement for the request to be re-directed to the franchisee for the territory from which the sales request originated.

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?

Such limitation is not provided by the Franchise Act; however, the parties are entitled to expressly provide in the agreement that the clause shall apply also 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?

No there are not. However, in addition to the usual termination clauses provided in a franchise agreement, the general rules on termination provided by the law apply, if not expressly derogated from by the agreement for one party or for both parties.

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

According to article 3 section 3 of the Franchise Act, if the franchise agreement is for a limited term, the franchisor shall guarantee the franchisee a minimum term related to the period of amortisation of the franchisee's investments; this term shall not be less than three years, except in cases of an early termination for breach of contract by one of the parties.

10 Joint Employer Risk and Vicarious Liability

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

According to some rulings, certain labour law rules may also apply

in the franchise sector when it comes to protecting the franchisee's employees, for example, in the event of a transfer of a business. Generally, to avoid the risk that the franchisor may be qualified as a joint employer with the franchisee in respect of the franchisee's employees, the parties must provide a specific clause according to which, in any case, the franchisor shall be considered as an 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?

Membership of a franchise network does not affect the normal criteria for allocating employment relationships. One of the preconditions for the existence of a franchise agreement is the reciprocal legal and economic autonomy of the parties. Therefore, the franchisor and the franchisee are companies that are autonomous from each other, each of which retains exclusive management power over its own personnel and are therefore individually responsible for the obligations and responsibilities with regard to the employment relationships used in their organisations. In any case, sometimes in order to avoid risk, the parties decide to specifically provide in the franchise agreement the exclusion of any responsibility of the franchisor for the acts or omissions of a franchisee's employees in the performance of the franchisee's 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?

With regard to the taxation of foreign franchise businesses and individuals, a preliminary investigation has to be made based on whether the payments qualify as royalties or as services rendered within the franchise agreement, as the relevant tax treatment from an Italian perspective is different. Should the payment be deemed a royalty, all fees paid in connection with a franchise agreement are taxed on the non-resident franchisor in Italy for its Italian source of income. According to article 23.2(c) of Ministerial Decree No. 917/1986, remuneration deriving from the utilisation of intellectual property, trademarks, processes, formulae, and industrial and commercial information in connection with know-how, are deemed as being produced in Italy if they are paid by the state, by entities resident in the state or by permanent establishments of non-resident entities.

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 article 25.4 of Presidential Decree No. 600/1973, cross-border payments of royalties are taxed by the application of a 30 per cent withholding tax (no withholding tax is due if the foreign entity has a permanent establishment in Italy). Withholding tax is applied to 100 per cent of the gross amount of the payment (on a cash basis). However, any relevant tax treaty regarding the double taxation may provide for more favourable tax rates, which in such a case will prevail over the domestic taxation regime described above. Moreover, qualifying payments to EU companies may be exempt under EU directives. In order to enjoy the favourable tax regimes, certain conditions have to be met (i.e. "beneficial owner" principle: the beneficial owner is the legal entity that enjoys the possession and/or benefits of ownership, such as receipt of income, of the right), and some formal documentation (i.e. a tax residency certificate issued by the foreign tax authority) shall be filed with the competent local tax authority. There is not a specific law providing that withholding tax can be avoided by structuring payments due from the franchisee to the franchisor as management services. However, depending on the specific case, it may be evaluated if an exception is possible. Finally, it should be taken into account that the fees recognised in the franchise agreement should be in line with the transfer pricing rules in respect of the arm's length principle.

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 currency restrictions regarding payments by national (local) franchisees of royalties and other payments to non-resident franchisors in their domestic currency. There are, however, certain anti-money laundering requirements that may impose specific restrictions. In principle, payments can be made only through an authorised bank or a financial intermediary (bank wire, cheques, etc.). Cash over a certain amount (€12,500) can, in principle, be carried out of the country only if this is communicated to the competent authority (the Bank of Italy or the Financial Information Unit) and the relevant documentation is obtained.

12 Commercial Agency

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

There is a risk that the franchisee might be treated as the franchisor's commercial agent, even if the legal figures are different. In fact, in franchise, the franchisee assumes and bears the full business risk, whereas this risk is unknown to the agent, who only carries out his activity of promoting the products of the principal, the sale and purchase of which takes place between the principal and the client and not the agent himself. However, in order to avoid the risk of confusion of the franchise agreement as an agency agreement, it is advisable to provide in the agreement a clear disclaimer, according to which the agreement does not constitute an agency 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?

Apart from the provisions set forth under the Franchise Act, any other commercial provisions are left to the contracting parties, franchisor and franchisees. All parties should act in good faith while respecting the general contract and commercial laws, always balancing the interest of the franchisor in developing his uniform franchise network, with the interests of the franchisee who should be protected by the franchisor with respect to their rights as part of the network itself.

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 general principles of law apply to the relationship once the franchise agreement has been entered into. For example, the principle of contractual good faith may apply once the franchise agreement has been entered into according to article 1375 of the Civil Code. Furthermore, the franchise systems must also comply with the Privacy Regulation which has recently become applicable. The text of the New Data Processing Regulation is contained in the European Privacy Regulation EU 2017/679, published in the Official Journal of the European Union. The new Directive 2018 is applicable since 25 May 2018, the date on which companies (including the companies belonging to a franchise system) and public administrations will have the duty to comply.

15 Franchise Renewal

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

If the renewal is subject to the same conditions as the expired contract, no new information must be provided already disposing the franchisee of all the information that he needs, to choose whether to proceed with the renewal.

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

The Franchise Act does not provide that the contract is automatically renewed, except by common will of the parties. At the same time, it is not unclear whether the renewed contract should provide for the same conditions as the original contract. The renewal conditions must be explicitly provided for in the franchise agreement. Therefore, 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 irrespective of the wishes of the franchisor not to renew or extend.

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 right to renewal is not provided for in the franchise agreement, the franchisee will not be entitled to receive any compensation in the event that the franchisor refuses a renewal or extension of its franchise agreement. Conversely, if the franchise agreement provides for renewal, for example, and the franchisor refuses to do so without a justified reason, then the franchisee may take action to obtain damages, unless the parties have already foreseen and quantified this in 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?

Any conditions of assignment of the contract, as well as the transfer and sale or its prohibition, shall be expressly stated in the contract. The contract may in fact provide that the assignment is permitted, subject to the consent of the assigned party or on simple notification, or prohibited contractually.

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 must be expressly provided in the franchise agreement. Furthermore, it should be noted that article 1406 of the Italian Civil Code provides that each party may replace itself with a third party in the relationships deriving from a contract with corresponding services if these have not yet been performed, provided the other party allows it. Therefore, for example, in the case of master franchises, the agreement must contain a clause under which the sub-franchisees give their consent to step-in.

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?

The power of attorney will be valid if it meets the requirements of the law. According to article 1392 of the Italian Civil Code, in fact, the general rule is that the proxy must comply with the formal requirements that the legal system provides for the act or acts that the representative is called upon to perform with it. It is therefore advisable to regulate in detail all the possible hypotheses and the procedure of these "step in" rights in the franchising agreement in order to give the judge the least discretionary power and least possible margins of interpretation.

17 Electronic Signatures and Document Retention

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

The Digital Administration Code, Legislative Decree No. 82 of 7 March 2005 ("**CAD**"), recently amended with the Legislative

Decree No. 217 of 13 December 2017, provides at article 24 the requirements of the digital signature. The digital signature must in particular refer to a single subject and to the document or set of documents to which it is affixed or associated. The digital signature integrates and replaces the affixing of seals, punches, stamps, marks and trademarks of any kind for any purpose provided for by current legislation. A qualified certificate must be used to generate the digital signature which, at the time of subscription, has not expired or has not been revoked or suspended. The franchise agreement signed with an electronic signature (in compliance with the requirements provided by law) is a binding and enforceable agreement.

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

If a signed/executed franchise agreement is stored electronically, it is necessary to distinguish the case in which the contract is signed with an electronic signature (in accordance with the requirements of the law), or if it is signed with "wet ink" and subsequently scanned (and therefore created as a .pdf file). In the first case, in fact, the contract (signed with an electronic signature) will constitute the original document and any paper copy can be destroyed. In the second case, however, the .pdf document saved on the computer will be a simple copy of the contract and therefore it will be necessary to keep the signed original in ink.

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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 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

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 requires 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.

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 the authority to 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 on 1 April 2020. 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 pre-contractual misrepresentation allocated between franchisor and master franchisee? If the franchisor takes an indemnity from the master franchisee in the Master Franchise Agreement, are there any limitations on such an indemnity being enforceable against the master franchisee?

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 aggrieved franchisees 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.

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

In Japan, arbitration is generally recognised as a viable means of dispute resolution. Furthermore, businesses in Japan usually prefer arbitration to litigation in connection with international contracts. This preference is primarily motivated by their interest in ensuring the enforceability of the arbitral award and maintaining their privacy/confidentiality.

On 20 June 1961, Japan acceded to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. The Convention, which took effect in Japan on 18 September 1961, ensures the enforceability in Japan of foreign arbitral awards issued in other signatory countries.

The Japan Commercial Arbitration Association (JCAA) is the most prominent arbitration institution in Japan (www.jcaa.or.jp/e/index.html). The JCAA has its own arbitration rules (JCAA Commercial Arbitration Rules), the latest amendments to which took effect on 10 December 2015. In addition to the JCAA, businesses often agree to arbitrate under the rules of major leading arbitral institutions including the ICC, LCIA, AAA/ICDR, SIAC and HKIAC.

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.

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 in a particular location)?

As of July 2018, 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 sufficient 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.

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

Japanese law does not impose a minimum period for the notice that must be given to bring a franchise agreement to an end due to the expiration of the contract term. The notice period stipulated in the franchise agreement is typically sufficient. However, if a franchise agreement has been repeatedly renewed over the course of many years, the courts tend to deem such practice to constitute a continuous agreement (as discussed in question 9.1). In that case, according to court precedent, the notice period stipulated in the franchise agreement may not be sufficient. If a Japanese court does not find the notice period stipulated in the franchise agreement to be reasonable in light of the circumstances, the court may not permit the non-renewal of the franchise agreement. Alternatively, a Japanese court might issue a judgment finding the franchise agreement to have ended at the expiration of the contract term, but award damages to the franchisee in consideration of its expectations of renewal.

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.

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 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 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.

17 Electronic Signatures and Document Retention

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

Since Japanese law does not stipulate any specific requirements governing the conclusion of a franchise agreement, it is generally possible to validly enter into a franchise agreement through an electronic signature. Moreover, if an electronic signature satisfies the requirements of the Act on Electronic Signatures and Certification Business (Act No. 102 of 2000), the use of such electronic signature in any electromagnetic record creates the presumption that such record was established authentically. This presumption can make the validity and enforceability of the franchise agreement more certain. Currently, public key cryptosystems (e.g., RSA method, ECDSA method and DSA method) have been adopted as a method to apply an electronic signature that satisfies the requirements under the said Act.

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

If a franchise agreement is executed through electronic signatures, it can be stored electronically as long as it meets the requirements of the Act on Special Provisions concerning Preservation Methods for Books and Documents Related to National Tax Prepared by Means of Computers (Act No. 25 of 1998 – Electronic Books Preservation Act). In that case, it is unnecessary to prepare and store the paper version of the agreement.

By contrast, if a franchise agreement is executed through handwritten signatures, it can be scanned and saved as an electronic file as long as it meets the requirements of the Electronic Books Preservation Act. If those requirements are satisfied, the law does not require that the original paper version of the agreement be stored. However, it may be desirable to do so depending on the parties and the likelihood of a dispute. If a dispute arises, the original paper copy of the agreement can be produced during legal proceedings to prove the authenticity of the franchise agreement. From this perspective, caution should be exercised when determining whether to destroy the original paper version of the agreement.

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Anderson Mōri & 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.

Malaysia

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Bustaman

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1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

A "franchise" is defined under the Franchise Act 1998 ("FA") as a contract or an agreement, either expressed or implied, whether oral or written, between two or more persons by which:

(i) the franchisor grants to the franchisee the right to operate a business according to the franchise system as determined by the franchisor during a term to be determined by the franchisor;

(ii) the franchisor grants to the franchisee the right to use a mark, or a trade secret, or any confidential information or intellectual property, owned by the franchisor or relating to the franchisor, and includes a situation where the franchisor, who is the registered user of, or is licensed by another person to use any intellectual property, grants such right that he possesses to permit the franchisee to use the intellectual property;

(iii) the franchisor possesses the right to administer continuous control during the franchise term over the franchisee's business operations in accordance with the franchise system; and

(iv) in return for the grant of rights, the franchisee may be required to pay a fee or other form of consideration.

After an amendment to the FA in 2012, the requirement for the franchisor to provide operations assistance to the franchisee such as providing materials and services, training, marketing and business or technical assistance has been removed from the definition. Another limb of the definition, which previously stated that the franchisee had to operate the business separately from the franchisor and the relationship could not be a partnership, service contract or agency, has been subsumed into another part of the FA.

1.2 What laws regulate the offer and sale of franchises?

The offer and sale of franchises is governed by the FA, as amended by the Franchise (Amendment) Act 2012 which came into force on 1 January 2013, and the Franchise Regulations 1997 (amended by the Franchise (Forms and Fees) (Amendment) Regulations 2007). These laws and registration matters are regulated by the Franchise Development Division ("FDD") of the Ministry of Domestic Trade, Co-Operatives and Consumerism ("MDTCC").

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

Yes (see question 1.4).

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

The FA provides for a multitude of compulsory registrations, and different rules and requirements apply for franchisors (which by definition includes foreign franchisors, local franchisors and master franchisees of foreign franchisors), as well as franchisees (of local and foreign franchisors, and local master franchisees).

A foreign franchisor who wishes to sell a franchise in Malaysia or to a Malaysian citizen must first get approval to do so. Local franchisors and master franchisees of foreign franchisors must register the franchise before they can operate the franchise business or make an offer to sell the business to any party. Failure by a body corporate to comply with this requirement is an offence punishable with a fine from RM 250,000 while non-body corporates face a lesser fine from RM 150,000 and/or imprisonment for a term between one to three years.

Since 2012, franchisees of a foreign franchisor must register the franchise before commencing the franchise business, while franchisees of a local franchisor or local master franchisee must also register the franchise within 14 days from the date of signing the franchise agreement.

Since May 2012, all applications for registration of a franchise can only be made online at myfex.gov.my./portal, operated by the FDD.

1.5 Are there mandatory pre-sale disclosure obligations?

Yes. The FA obligates a franchisor to submit a copy of the franchise agreement as well as the disclosure documents (including any approved amendments to the same) to the franchisee at least 10 days before the parties sign the agreement. Failure to do so is an offence.

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

Yes. It would be the master franchisee who would need to make

the disclosure. Its disclosure document must identify the foreign franchisor who granted the rights to the master 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?

Yes. The format is stipulated in the 1999 Regulations, as amended, and the required information includes the following:

- Background of the Franchisor (name, address, date of incorporation, type of business, trade mark and brand used, business experience of franchisor).
- Details of personnel (organisational chart, names, designation and working experience of board of directors and senior executives).
- Whether there are any past and pending legal actions against the franchisor or board of directors, either criminal or civil.
- Whether the company and board of directors are free from bankruptcy.
- Franchise and other fees payable by the franchisee.
- Other financial obligations of the franchisee, including advertising, training, service and other fees.
- Initial investment of the franchisee, including equipment, fixtures, cost of construction, initial inventory, deposits, bank collaterals.
- Whether the franchisee is required to purchase/lease equipment from a designated source, and if yes, to specify the source, whether specifications of equipment are designated and if modification is allowed.
- Obligations of the franchisor, prior to and during opening and in determining the location and training.
- Territorial rights granted, terms of use of intellectual property.
- Duration of agreement, terms for extension/renewal, termination conditions, parties' obligations upon termination.
- Three years' audited financial accounts and five years' financial forecasts.

Any material changes to the disclosure documents must be amended and filed with the Registrar of Franchises. Franchisors must also submit an annual report to the Registrar including any updated disclosure documents. Disclosure to existing franchisees becomes necessary again prior to the renewal of the franchise, especially if there had been amendments made. Although the definition of "franchisors" include foreign franchisors, thus far foreign franchisors are not obligated to file such annual report.

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

A local franchisor or a master franchisee must be able to show at least three years' experience in the field of the franchise business, if not in the franchise business itself, and be able to provide the audited financial statements to this effect, as a prerequisite to obtaining registration of the franchise. Trade marks to be used by the franchise business must be registered in Malaysia before the application for franchise registration can be made.

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

No, membership of the Malaysian Franchise Association ("MFA") is not compulsory, but it is encouraged for networking benefits.

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

Every MFA member has to abide by a Code of Ethics that governs the relationship between members of the association. Although they do not have the force of law, they do regulate and provide for the responsible business management of members.

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

Yes. Although not required by law, in practice, the FDD requires the franchise agreement to be made available in both English and Bahasa Malaysia versions for purposes of registration, while the disclosure document (information filled in at time of online filing) can be made available in either language.

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

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

Yes. The MDTCC requires foreign business operators engaged in distributive trade services in Malaysia to obtain its prior approval. "Foreign participation" includes: (1) an individual who is not a Malaysian (including a permanent resident); (2) a foreign company or institution; or (3) a local company or institution where non-Malaysian individuals and foreign companies hold more than 50% of the voting rights. "Distributive trade" comprises all linkage activities that channel goods and services down the supply chain to intermediaries for resale or to final buyers, and include wholesalers, retailers, franchise practitioners, direct sellers and suppliers who channel their goods in the domestic market. Conditions for approval include the appointment of Bumiputera directors and the hiring of personnel to reflect the racial composition of the Malaysian population including at management level.

Foreign franchisors do not need to establish a local presence in the country in order to sell a franchise either to a master franchisee or directly to a single franchisee. However, all franchise businesses with foreign equity must be incorporated locally under the Companies Act 1965, as well as comply with the requirements under the FA. Only upon their approval under the MDTCC guidelines will their application for registration of the franchise be considered.

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

The most common business entity used by local franchisors is private limited companies. This form of business protects the owner from personal liability from debts of the entity and limits liability of shareholders to their capital investment. If foreign franchisors do not wish to give rights to or cannot find a suitable master franchisee, they may also consider setting up a joint venture private limited company as a direct franchising or area development option, subject to the MDTCC guidelines on foreign participation in distributive trade, where applicable.

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?

Additional conditions apply to foreign business operators in relation to restaurants under the MDTCC guidelines, whereby only exclusive restaurants qualify, with size and chef's experience requirements to be complied with, among others. Some sectors are barred totally from foreign involvement, including supermarket or mini markets below 3,000 square metres, 24-hour convenience stores, fuel stations with or without convenience stores, and textile and jewellery shops.

For local franchisors or master franchisees, other business licences and permits would be those required from the respective government bodies in the various industries such as education, tourism and transport. For restaurants wishing to be certified "halal", certification from the Department of Advancement of Islam Malaysia ("JAKIM") is additionally required, and can be applied online at http://www.halal.gov.my/v4/index.php/en/.

3 Competition Law

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

The Malaysian Competition Act 2010 ("CA") came into effect on 1 January 2012 with the objectives to promote competition, protect the process of competition and the interests of consumers, and is enforced by the Malaysia Competition Commission ("MyCC"). The CA expressly prohibits anti-competitive agreements which mean horizontal or vertical agreements between enterprises that have the object or effect of significantly preventing, restricting or distorting competition in any market for goods or services. Vertical agreements involve agreements between enterprises, each of which operates at a different level in the production or distribution chain whereas horizontal agreements operate at the same level in the production or distribution chain.

Being a form of a vertical agreement, it is prohibited under the CA if the franchise agreement contains an anti-competitive object or effect which is significant on the market. Even if the anti-competitive object is not found in the agreement, should there be any anti-competitive effect in the same, this is still tantamount to a breach of the CA. Based on the Guidelines issued by the MyCC, the anti-competitive agreements will not be considered "significant" if:

- the parties to the agreement are competitors who are in the same market and their combined market share does not amount to more than 20%; or
- the parties to the agreement are not competitors and individually, each party has less than 25% of shares in any relevant market.

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

No, there is no maximum permitted term for a franchise agreement, though the statutory minimum period is five years.

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

No, there is not.

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

No, there are no restrictions.

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

The FA requires that the territorial rights granted to the franchisee be clearly stipulated in the agreement. No minimum area is provided for but whether or not the franchisor is permitted to operate in the franchisee territorial area should be mentioned, and whether the territorial border can be changed and the conditions for such change should be stipulated, if applicable.

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

The FA specifically makes in-term and post-term non-competition a statutory requirement, during the franchise term and for a period of two years after the expiration or early termination of the same, in respect of any business similar to the franchised business. The franchisee must give a written guarantee to this effect, and it is applicable to him, his directors, the spouses and immediate family members of the directors as well as his employees. Failure to give the guarantee and comply with it is an offence under the FA. A similar mandatory provision applies in relation to confidential information contained in the operation manual or obtained while undergoing training. The non-competition clause in the FA is a statutory exception to the general rule in the Malaysian Contracts Act 1950 that generally prohibits restraints of trade.

4 Protecting the Brand and other Intellectual Property

4.1 How are trade marks protected?

The FA requires trade marks to be registered prior to applying for registration of the franchise. Registration, once obtained, would last for 10 years, and can be renewed for subsequent 10-year periods. While an owner is not entitled to take any infringement action if the mark is not registered, the Trade Marks Act 1976 preserves the common law right of action of passing off for unregistered marks.

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 generally protected by stand-alone non-disclosure agreements or the parties' undertakings against unauthorised disclosure and use in other agreements (e.g. licensing, franchising, manufacturing and distribution agreements) where such items are disclosed. In the absence of such agreements or undertakings, the common law action of breach of confidence may apply, where:

- the information has the "necessary quality of confidence";
- the information was imparted in circumstances importing an obligation of confidence; and
- there is unauthorised use of the information, to the detriment of the party communicating it.

Additionally, under the FA, protection of confidential information is specifically provided for (see question 3.6).

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?

Operations manuals and software are both protected as literary works under the Copyright Act 1987 ("CA 1987"). Literary works created by a Malaysian citizen or permanent resident, which has been published first in Malaysia or made in Malaysia, are automatically afforded copyright protection upon creation. Foreign literary works first published in a Berne Convention country are also given protection in Malaysia.

Since March 2012, voluntary notification of copyright is provided for under the CA 1987. Certified true extracts from the Register of Copyright based on the voluntary notification shall be *prima facie* evidence of the particulars entered therein and shall be admissible in court.

It is nevertheless prudent for the franchisor to employ preventive mechanisms against unauthorised copying or use for both the operations manual and any proprietary software licensed to the franchisee, by restricting access to such information and utilising digital rights management.

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 local franchisor or master franchisee who submits false or misleading information or documents in its disclosure documents when filing with the FDD, commits an offence under the FA. Apart from fines that are payable upon conviction (imprisonment is also an alternative or addition for non-body corporates) the court may declare the franchise agreement between the franchisor and franchisee to be null and void, and order that the franchisor refunds any form of payment obtained from the franchisee or prohibit the franchisor from making any new franchise agreements or appointing new franchisees.

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

A foreign franchisor has no obligations to file disclosure documents with the FDD. This obligation falls on the master franchisee alone. Any misleading information or document that originates from the master franchisee would invite the outcome referred to in question 5.1 above. However, if such misleading information or document originated from the foreign franchisor, then the master franchisee may have recourse against the foreign franchisor, and an indemnity may not be able to fully protect the foreign franchisor for blatant and direct disclosure violations.

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

This is technically possible, but such success would arguably depend on the precise words used as well as the facts of the case.

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

Class actions or representative proceedings as it is called in Malaysia are generally allowed and provided for under the court rules. While any provisions to bind a franchisee to waive compliance with the FA is void, it does not prevent any person from entering into a settlement agreement or executing a general release regarding a potential or actual civil suit filed in respect of the franchise or any arbitration claim. A class action is not specifically provided for under the FA and it follows that any waiver of the same would be technically 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?

Franchise documents are governed by the FA, and compliance with the same is essential for registration purposes. There are, however, no provisions that stipulates that the choice of law must also be Malaysian law. At the same time, the mere fact that parties have agreed that a specific country's law applies over the agreement does not automatically oust the jurisdiction of the Malaysian courts to try an action arising out of the same, provided the conditions for the Malaysian court having such jurisdiction are met.

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?

Injunctive relief is available to a franchisor to prevent damage by former franchisees to the brand under trade mark law, which specifically provides for protection of a well-known mark by injunction if used without the proprietor's consent. Alternatively, if the mark is already registered the proprietor may apply for such interlocutory injunction against infringement of the registered mark directly. Interlocutory injunctions may also avail to the franchisor where the franchisee threatens to misuse confidential information, supported also by the mandatory written guarantees given by the franchisees against non-competition as well as confidential information during the term of the franchise and for two years after expiration or early termination of the same.

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

Yes, commercial arbitration is commonly used in Malaysia as an alternative to litigation in resolving disputes. The Arbitration Act 2005 and AIAC Arbitration Rules 2018 were enacted to govern arbitration proceedings, replacing an earlier arbitration legislation. The Act and the Rules are closely modelled on the UNCITRAL Model Law on International Commercial Arbitration 1985 and UNCITRAL Arbitration Rules (as revised in 2013). Malaysia is a signatory to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Award. Malaysia had acceded to the Convention on 5th November 1985. Malaysia has its own arbitration centre in the newly renamed Asian International Arbitration Centre ("AIAC") (formerly Kuala Lumpur Regional Centre for Arbitration ("KLRCA")) but the Singapore International Arbitration Centre ("SIAC") appears to be the preferred arbitral institution in Asia. They use SIAC Rules (6th Edition, 1st August 2016) and can also adopt UNCITRAL Arbitration Rules (as revised in 2010).

7 Real Estate

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

In Malaysia, tenancy can be divided into two categories, i.e. lease (long-term tenancy) and tenancy (short-term tenancy). Pursuant to the National Land Code 1965 ("NLC"), every lease granted shall be for a term exceeding three years, where the maximum term for which the property can be leased is for a period of 99 years (if it relates to the whole of the property) or 30 years (if the party leases out only part of the property). Unlike a lease, a tenancy normally is created for a term not exceeding three years.

To have a valid lease, it must be registered with the Land Authority using an instrument specified by the NLC whereas for a tenancy, there is no prescribed instrument specified by the NLC. Tenancy, therefore, is subject to mutual agreement (either in writing or orally) between the landlord and tenant.

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 Malaysia, there are no express provisions of law that allow a landlord to restrain an assignment or sublease. But in normal dealings for lease or tenancy, the landlord will impose restrictions on assignment or sublease by stipulating the same in the agreement. Generally, if the lease or tenancy agreement is strictly between the franchisee and the landlord, if the franchise agreement is terminated between the franchisor and franchisee, the franchisor is not allowed to step in or take over the franchisee's business premise and continue the franchise business as there is no privity of contract between them, and third beneficiaries are generally not allowed.

However, it would be possible where such assignment is expressly stipulated for in the lease or tenancy agreement, and there is agreement (either in the lease or tenancy agreement itself, or separately) between the landlord and franchisor in respect of 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?

The Economic Planning Unit, Prime Minister's Department had issued the revised Guideline on the Acquisition of Properties for non-national entities (i.e. (a) an individual who is not a Malaysian citizen, (b) an individual who is a Permanent Resident, (c) a foreign company or institution, (d) a local company or institution whereby the parties as stated in items (a), (b) and/or (c) hold more than 50% of the voting rights of that company) effective from 1st March 2014.

There are a few restrictions imposed under the guideline where the foreign interest is not allowed to acquire properties valued less than RM One Million per unit, residential units under the category of low and low-medium cost as determined by the State Authority, properties built on Malay reserved land, and properties allocated to Bumiputera interest in any property development project as determined by the State Authority. No similar restrictions apply in respect of a lease or tenancy in Malaysia.

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 in a particular location)?

Generally, whether a tenant may secure an initial rent-free period is subject to mutual agreement between the landlord and tenant/lessee. There is also no express legal prohibition against "key money" but this right is still subject to the terms and mutual agreement between the landlord and tenant/lessee, and contract law in general.

8 Online Trading

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

There are no express laws on this matter. So long as both the franchisor and franchisee are agreeable to perform or impose such practice, the request outside the franchisee's territory can be re-directed to the franchisee. However, to avoid any conflicts which may result from this requirement, it is important for both parties to have mutual consent in relation to such practice, and agreement as to any implications which may arise from non-performance of the same.

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?

In Malaysia, the registration of the domain name for .my is administered by MYNIC. While the rights to register, own, use or assign a domain name is not expressly stipulated in the FA, a franchisor usually provides express terms in the franchise agreement over the rights over the domain name of the franchise business, and whatever rights that are given to the franchisee in respect of use of the same. Franchisee ownership of the domain name is rarely allowed, and even if granted in the first place, provisions on termination or expiry of the franchise agreement would normally provide for its transfer or assignment back to the franchisor.

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?

A franchisor or franchisee shall only terminate a franchise agreement before the expiration date for "good cause", and the FA provides non-exhaustive situations which fall under this definition, such as failure to comply with agreement terms and failure to remedy breaches within the minimum written notice period of 14 days, as well assignment of rights for benefit of creditors, abandonment of business, criminal conviction affecting goodwill and repeated failure to comply with terms of the agreement.

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

No. The FA only contains a minimum notice period of 14 days to remedy a breach of the franchise agreement that would apply to all.

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 Employment Act 1955 ("EA") applies to all employees whose monthly wages do not exceed RM 2,000 with the aims among others to protect, maintain relationship and to establish certain rights between employer and employee. The rights of other employees are governed by their employment contract where employees are employed under a contract of service as well as common principles through case law. Generally, the relationship between franchisor and franchisee is governed by the franchise agreement, thus there could be no contention of an employer-employee relationship between them. Under these circumstances, the rights of the franchisee's employees therefore is solely regulated by the employment contract with the franchisee and there shall be no risk a franchisor can be regarded as a joint employer with the franchisee. However, to further minimise the risk, the agreement between the franchisor and franchisee should be expressly worded as to negate any such relationship.

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

Although the risk that the franchisee or its employees being deemed employees of the franchisor is minimal, it is worth taking extra care to prevent there being even an appearance of control by the franchisor over the franchisee's employees, which may be used to suggest vicarious liability on the part of the franchisor for the acts or omissions of the franchisee's employees. Apart from the obligation expressly worded in the franchise agreement, the franchisor should ensure that it does not exert control over the franchisee's employees in matters such as the entitlement of remuneration and benefits, working period, notice of termination, dismissal or supervision, in order to avoid or minimise the franchisor's risk from being deemed to have any liabilities towards the franchisee's employees. Any form of control between the franchisor and franchisee should therefore only be limited to the franchise business system and quality standards.

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?

An overseas franchisor falls within the definition of a non-resident by virtue of the Financial Services Act 2013. Further to this, the Central Bank of Malaysia has issued the Foreign Exchange Administration Rules ("FEAR") in order to support the financial stability for any trade, business and investment activities. Since foreign investors can easily access Malaysian markets, any payments for investment by foreign investors can be made either in Malaysia ringgit ("RM") or foreign currency. Under FEAR, non-residents are free to remit out divestment proceeds, profits, dividends or any income arising from investments in Malaysia. Nevertheless, any repatriation of funds must be made in foreign currency.

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 imposition of tax, including withholding tax, in Malaysia is governed by the Income Tax Act 1967 ("ITA"). There are several types of income that are subject to withholding tax and one of them involves royalty payment to non-residents. Any royalty payments made under the franchise arrangement within Malaysia payable to non-residents is subjected to withholding tax at the rate of 10% where such payment shall be made within one month from paying or crediting the royalty. Since the obligation of paying withholding tax in relation to royalty has been expressly stated in the ITA, therefore, such payment 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?

No. Furthermore, pursuant to the FEAR, Malaysia maintains an open and liberal foreign exchange administration regime. However, to avoid disputes, the parties may choose their preferred currency and explicitly stipulate the same in the franchise agreement.

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 of agency in Malaysia is governed by the Contracts Act 1950. However, the concept of agency does not form any role in the franchise arrangement as the FA expressly stipulates that the franchisee shall operate the business separately from the franchisor, and that the relationship of the franchisee with the franchisor shall not at any time be regarded as a partnership, service contract or agency. Thus, there is no risk that a franchisee would be treated as the franchisor's agent.

13 Good Faith and Fair Dealings

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

The FA expressly requires the franchisor and franchisee to act in an honest and lawful manner and to pursue the best franchise business practice of the time and place. The words "honest" and "lawful manner", however, are not defined. Both the franchisor and franchisee in their dealings with one another are to avoid substantial and unreasonable overvaluation of fees or prices, unnecessary and unreasonable conduct in relation to the risks to be incurred by one party, and also conduct that is not reasonably necessary for the protection of the legitimate business interest of the franchisor, franchisee, as well as 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?

Apart from the provisions of the FA which governs the minimum requirements of the franchise agreement (including prohibition against discrimination between franchisees), the FA also regulates the conduct of the parties (see question 13.1 above), and the obligations of the franchisor and franchisee, namely: in relation to written notice upon breach and time to remedy; payment of fees payable under the franchise agreement; the franchisor's assistance to the franchisee such as supply of materials and services, training, marketing and business or technical assistance; and for both parties to protect the consumer's interests at all times. The parties are also bound by the Contracts Act 1950, in general.

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 the franchise renewal agreement is a franchise agreement, it is governed by the same requirements as the original agreement, and the 10-day prior disclosure period of the franchise agreement and disclosure documents before signing would similarly apply to the renewal. Additionally, if there are any material amendments to the disclosure documents, then the updated and approved version is the one that needs to be submitted to 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?

There is no overriding right for automatic renewal of the franchise agreement or extension of the franchise term. However, there are certain safeguards in place for the franchisee if conditions for non-renewal of the franchise agreement are not met by the franchisor (see question 15.3). It is also an offence for the franchisor to refuse to renew the franchise under those conditions.

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

The franchisee is entitled to compensation through a repurchase or by other means at a price to be agreed between the parties (after considering the diminution in value of the franchised business caused by the expiration of the franchise) where (1) the franchisee is barred from conducting the same business under another mark in the same area, (a) by the agreement, or (b) by the refusal of the franchisor at least six months before the expiration date of the agreement to waive the non-competition provision of the agreement, or (2) the franchisee has not been given a written notice of the franchisor's intention not to renew at least six months before the expiration date of the agreement. Damages based on loss of profits arising from any wrongful non-renewal may also be awarded by the courts if proven.

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 are generally free to impose some restrictions. Consent of the franchisor, although required, would usually be on the basis that it will not be unreasonably withheld, provided the new buyer meets the franchisor's conditions.

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 inevitably included in franchise agreements to safeguard the franchisor's interests, though for the most part they are a temporary management measure and are not meant to be a permanent solution. Whether or not the franchisor can take over ownership of the franchise business would depend on a variety of matters, not the least of which would be the issue of foreign participation in the franchisor business. If the franchisor is a foreign entity, then such takeover of the direct franchisee's business would not be allowed under the MDTCC guidelines. Whether or not a local master franchisee would be allowed to take over the sub-franchise would also depend on the rights and conditions given to it by the foreign franchisor.

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?

Although powers of attorneys are allowed in Malaysia in general, given the answer in question 16.2 above, their effect would similarly be non-permanent and cannot override foreign ownership restrictions.

17 Electronic Signatures and Document Retention

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

There are no specific requirements for applying an electronic signature to a franchise agreement. Generally, section 9(1) of the Electronic Commerce Act 2006 ("ECA") provides that if there is a requirement for a signature of a person on an electronic document, it can be fulfilled by an electronic signature which is: (a) attached to, or logically associated with the document; (b) adequately identifies the signer and his approval of the information to which the signature relates; and (c) as reliable as is appropriate given the purpose and circumstances for which the signature is required. Further explanation is given in relation to section 9(1)(c), where an electronic signature is as reliable as is appropriate if the means of creating the electronic signature is linked to and under the control of that person only; any alteration made to the electronic signature after the time of signing is detectable; and any alteration made to that document after the time of signing is detectable. In Malaysia, an electronic signature is recognised as a valid way of creating a binding and enforceable agreement (except Power of Attorney, the creation of wills and codicils, the creation of trusts and negotiable instruments). With regard to the franchise agreement, the Registrar of Franchises can accept the franchise agreement even though the agreement is executed with an electronic signature, as long as the parties to the agreement had mutually agreed to the same and the signatory can be identified.

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

It is not advisable to destroy the hardcopy version of the franchise agreement which has been executed either using e-signatures or a "wet ink" because in the event that there are any changes or amendments to the franchise agreement, the Registrar of Franchises would require to review the hardcopy agreement for approval purposes. In addition, if there is a dispute between parties to the franchise agreement and they would like to bring the matter to court, it is necessary for the parties to tender the original hardcopy of the franchise agreement in court.

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Founded by the late Dato' Mohamad Bustaman in 1994, Bustaman is a full-service boutique legal firm specialising in intellectual property, technology, sports and entertainment law.

The firm provides an integrated approach to clients by advising and assisting them from advice and assistance at the early stages of creation and protection of their IP Rights which include trade marks, patents, copyright, industrial designs, domain names; to creating business and development opportunities through commercialisation such as licensing and franchising, right through to the prosecution and defence of such rights by way of enforcement and litigation.

Our clients range from inventors, universities and research institutions, to licensees of various intellectual properties; from multinational and international corporations to home-grown establishments, and talented and visionary individuals.

The firm was ranked as among the top five (5) IP law firms in Malaysia in 2009 by "Managing IP" magazine, and is supported by a team of dedicated practitioners, all of whom share the same enthusiasm for intellectual property and the ever expanding range of related rights, nurtured and enabled by our late founder, who turned his passion for the endless possibilities of intellectual property into what the firm is today.

Mexico

Elias Charua García

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1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

According to article 142 of the Mexican Industrial Property Law, a franchise shall exist where, together with the licensing of the use of a mark, granted in writing, technical know-how is transferred or technical assistance provided, so that the person to whom the licence is granted can produce or sell goods or provide services consistently according to the operating, commercial and administrative methods established by the owner of the mark, in order for the quality, prestige and image of the products or services distinguished by said mark to be maintained.

1.2 What laws regulate the offer and sale of franchises?

The following laws regulate the offer and sale of franchises:

- Mexican Constitution.
- Industrial Property Law and its Regulations.
- Mexican Copyright Law.
- Federal Civil Code.
- Federal Commerce Code.
- General Law of Mercantile Corporations.
- Mexican Antitrust Law.
- Federal Consumer Protection Law.
- Federal Tax Code.
- Income Tax Law.
- Federal Labor Law.
- Forgan Investment Law.

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

Yes, the person appointed by the franchisor will be treated as a franchisee.

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

Yes, according to the Mexican Industrial Property Law, all the franchise agreements must contain the following requirements in order to be registered with the Mexican Industrial Property Institute:

I. the geographical area in which the franchisee shall carry out the activities covered by the contract;

II. the location, minimum dimension and characteristics of the investments in infrastructure, with respect to the establishment in which the franchisee will carry out the activities covered by the contract;

III. the inventory, marketing and advertising policies, as well as the provisions relating to the supply of goods and contracting of suppliers, where applicable;

IV. the policies, procedures and deadlines relating to repayments, financing and other considerations borne by the parties under the terms agreed upon in the contract;

V. the criteria and methods applicable to determining the profit and/or commission margins of the franchisees;

VI. the characteristics of the technical and operational training of the franchisee's staff, as well as the method or form in which the franchisor is to provide technical assistance;

VII. the criteria, methods and procedures for supervision, information, evaluation and classification of the performance, as well as the quality of the services for which the franchisor and franchisee are responsible;

VIII. to establish the terms and conditions for sub-franchising, where the parties agree to such;

IX. the clauses for termination of the franchise agreement;

X. the circumstances in which the terms or conditions relating to the franchise agreement may be revised and, where applicable, modified, by a mutual agreement;

XI. the franchisee shall not be under the obligation to transfer ownership of its assets to the franchisor or to anyone designated by the franchisor on termination of the contract, except where it has been agreed to the contrary; and

XII. the franchisee shall not be under the obligation at any time to transfer shares in his company to the franchisor or make it a partner in his company, except where it has been agreed to the contrary.

1.5 Are there mandatory pre-sale disclosure obligations?

The Mexican Industrial Property Law provides that the relevant authority will impose an infringement in case of not providing the franchisee with the information referred to in article 142 of the relevant law related to all the information related to the franchise.

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

The applicable laws are silent in this regard; however, all the obligations, termination, products, intellectual property, term or any other clause applicable to the franchise must be contained in the Franchise Agreement entered between the franchisor and franchisee.

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

Please refer to our answer to question 1.6.

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

The authors are not aware of any.

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

The authors are not aware of any.

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

The authors are not aware of any.

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

Yes, all the documents to be submitted with the relevant authority must be in the local language with the requirements established in the applicable laws.

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 applicable laws on this matter are the Mexican Constitution and the Foreign Investment Law. The purpose of the Foreign Investment Law is to establish rules to attract foreign investment into the country and promote its contribution to national development. It is important to mention the relevant law specified between the economic activities reserved exclusively for the State and the economic activities reserved exclusively for Mexicans or to Mexican companies with foreigner's exclusion clause, such as:

I. domestic land transportation for passengers, tourism and freight, not including messenger or courier services;

II. development banking institutions, under the terms of the law governing the matter; and

III. rendering of professional and technical services set forth expressly by applicable legal provisions. In the economic activities and corporations mentioned hereafter, foreign investment may participate in the following percentages:

  I. up to 10% in: Cooperative companies for production;

  II. up to 25% in: a) domestic air transportation; b) air taxi transportation; and c) specialised air transportation; and

  III. up to 49% in: a) manufacture and commercialisation of explosives, firearms, cartridges, ammunitions and fireworks, not including the acquisition and use of explosives for industrial and extraction activities nor the preparation of explosive compounds for use in said activities; b) printing and publication of newspapers for circulation solely throughout Mexico; c) series "T" shares in companies owning agricultural, ranching, and forestry lands; d) fresh water, coastal, and exclusive economic zone fishing not including fisheries; e) integral port administration; f) port pilot services for inland navigation under the terms of the law governing the matter; g) shipping companies engaged in commercial exploitation of ships for inland and coastal navigation, excluding tourism cruises and exploitation of marine dredges and devices for port construction, conservation and operation; h) supply of fuel and lubricants for ships, airplanes, and railway equipment; and i) broadcasting.

A favourable resolution by the National Foreign Investment Commission is required for foreign investment to participate in a percentage higher than 49% in the economic activities and companies referred to hereafter:

I. port services in order to allow ships to conduct in-land navigation operations, such as towing, mooring and barging;

II. shipping companies engaged in the exploitation of ships solely for high-seas traffic;

III. concessionaire or permissionaire companies of air fields for public service;

IV. private education services of pre-school, elementary, middle school, high school, college or any combination;

V. legal services; and

VI. construction, operation and exploitation of general railways, and public services of railway transportation.

On the other hand, a favourable resolution from the Commission is required for foreign investment to participate, directly or indirectly, in a percentage higher than 49% of the capital stock of Mexican companies when the aggregate value of the assets of such companies at the date of acquisition exceeds the amount determined annually by such Commission.

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

According to Foreign Investment Law and the General Law of Mercantile Corporations, the business entity will depend on the type of commercial business that the franchisor wants to start.

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, according to Foreign Investment Law, an authorisation issued by the National Foreign Investment Commission is required in case of foreign investment.

On the other hand, an authorisation issued by the Ministry of Economy is required in order to initiate operations in Mexico.

3 Competition Law

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

Mexican Antitrust Law is regulated by Article 28 of the Mexican Constitution with the purpose of protecting economic competition, monopolies and free competition, by preventing and eliminating monopolies, monopolistic practices and other restrictions on the efficient functioning of goods and services markets. Monopolistic practices can affect those franchises that have exclusive patented products. In case the products or services offered by the franchisor are considered relevant by this law, there may be restrictions to franchise.

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

The authors are not aware of any.

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

The authors are not aware of any.

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

Please refer to our answer to question 1.6.

In addition, the Federal Antitrust Commission should observe the behaviour of the markets corresponding to the goods and services subject to the franchise in order to determine whether the requirements of free competition are met.

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

The authors are not aware of any.

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

Please refer to our answer to question 1.6.

It is important to mention that Article 142*bis* 2, of the Mexican Industrial Property Law mandates that the franchisee shall, during the term of the contract and after the termination thereof, keep this as confidential, which means that the franchisee cannot disclose any information treated and/or tagged as confidential and/or with a confidential nature said if information is the property of the franchisor, including information concerning the operations and/or activities carried out under the franchise agreement.

4 Protecting the Brand and other Intellectual Property

4.1 How are trade marks protected?

Considering the definition of franchise provided by the Mexican Industrial Property Law, all the trademarks are protected through the Franchise Agreement since such agreement grants a License Agreement in favour of the franchisee in order to use all the trademarks only for the development of the franchise. Once the agreement ends and the franchisee is not able to use the relevant trademarks, all these obligations must be governed in the corresponding contract.

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 is protected by the Mexican Industrial Property Law. The relevant authority will impose a sanction in case a franchisee commits a violation against any industrial property right owned by a franchisor.

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

Yes, the Mexican Copyright Law protects the Operations Manual and the corresponding software owned by the franchisor.

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?

Yes, the Mexican Industrial Property Law provides that the relevant authority will impose an infringement in case of not providing the franchisee with the information referred to in article 142 of the relevant law related to all the information related to the franchise. In addition, the franchisee would also be able to initiate procedures against the franchisor based on applicable laws, which may include cancellation of the agreement and/or claim damages.

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

Each party providing the disclosure information should ensure the

accuracy thereof, as the party providing the information is liable. A franchisor as well as a master franchisee, may incur liability if inaccurate information is provided to sub-franchisees.

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 the Civil Code, the franchisee could initiate any procedure based on negligent or fraudulent misrepresentations.

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

The applicable laws are silent in this regard.

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 Mexico normally elect the local choice of governing laws. There are, however, no specific restrictions on any other foreign governing law, provided that all transactions concluded between the parties in Mexico and business affairs conducted in Mexico would 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?

The authors are not aware of any.

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

Yes, arbitration is recognised as a viable means of dispute resolution, including the New York Arbitration Convention.

7 Real Estate

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

The typical length of a commercial property lease commences from between three to five years, and the maximum period permitted by law to lease a commercial property, is 20 years.

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

Yes, but just in the following scenario: if, in the Franchise Agreement the subrogation between the franchisor and the franchisee is permitted in case of a contractual breach, the first can take over the franchise operation for himself or a third party, and if the subrogation is also allowed in the lease agreement, then the franchisee or a third party can step into the former franchisee/tentant's shoes under the lease.

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

Non-national entities can lease or sub-lease commercial properties, as long as they legalise or apostille the documentation required to enter into an agreement. The non-national, depending on its legal nature and nationality, may have to fulfil additional requirements and/or file additional documentation before the corresponding authority.

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 in a particular location)?

To ensure the lease of a premium location, the soon-to-be-tenant can demand "key money" either by the landlord or the current tenant. In some cases, the landlord authorises the current tenant to demand and keep "key money" from the soon to be tenant as a commission for the transfer of the lease contract to the new tenant.

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, and can be enforced by a contractual fee.

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?

To avoid any complications in cancellation, assignation, change of ownership and/or transfer of a local domain between the franchisor and a former franchisee, either by termination or expiration of the franchise agreement, said transaction must be agreed in the franchise agreement and enforced by a contractual fee.

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 Mexican legal framework, in case of an early termination the following must be fulfilled: (i) agreement by the parties; or (ii) by a legitimate cause stated in the franchise agreement. Failure to fulfil any of the categories may result in the payment of a compensation or damages to the affected party.

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

Not that the authors are aware of.

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 accordance with the Federal Labour Law, it may be construed that the franchisor and the franchisee are separated entities and have a different obligation for their employees. Therefore, the franchisor cannot be considered as a "joint employer".

Notwithstanding the aforementioned, to mitigate this risk it is advisable that the franchisee contracts the services of an "outsource" company.

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 accordance with the Federal Labour Law, there is no "vicarious liability" for the acts or omissions of a franchisee's employees in the performance of the franchisee's 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 restrictions on the payment of royalties to an overseas franchisor, but the Income Tax Law, specifically, must be taken into consideration regarding the withholding of income tax.

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

Yes, there is a mandatory withholding of the income tax that must be calculated in compliance with the Income Tax Law and International Treaties to Avoid Double Taxation, therefore the calculation and withholding of the income tax will vary depending on the county and applicable treaties.

Moreover, the Federal Tax Code in accordance with the Income Tax Law can be construed as considering structuring payments due to the franchisor from the franchisee as a management services fee rather than a royalty.

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

In accordance with the Federal Tax Code and Income Tax Law, the payment of franchise fees or royalties to be payed to the franchisor, first must be calculated in local currency and then converted in accordance with the exchange rate of the currency set two days prior to the transaction.

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?

Not that the authors are aware of.

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 accordance with the Mexican legal framework there is not an objective test of fairness and reasonableness. In this regard, there is not a definition of "good faith" or "fairness" directly tied to the "franchise model" in the Mexican Industrial Property 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?

Yes, the Industrial Property Law and its 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?

According to the Mexican legal framework, there are not any disclosure obligations for the renewal of an existing franchise at the end of the franchise agreement terms.

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

According to the Mexican legal framework, there is not 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.

Moreover, the parties could agree to seat a legal procedure in the franchise agreement to automatically entitle the franchisee to a renewal or extension of the franchise.

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 possibility of an extension is agreed in the franchise agreement, certain requirements are met, and the refusal to extend or renew said agreement is groundless, then the franchisee may be entitled to a compensation or damages if a court rule is his benefit. Likewise, the Industrial Property Law specifies that in case of early termination of the franchise agreement, the affected party may be entitled to a 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 franchisor is entitled to impose restrictions on a franchisee's freedom to sell, transfer, assign or otherwise dispose of the franchised business, as long as is stated in the franchise agreement.

Furthermore, the franchisor and the franchisee can come to an agreement regarding the nature of the franchise agreement; just to mention a few, it could be a development agreement or a master 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?

If a franchisee is in breach and the franchise agreement is terminated by the franchisor, the franchisor may take over the ownership and management of the franchised business if it is stated in the franchise agreement that the franchisor may have to bail out the assets of the former franchisee and subrogate the obligations acquired by the former franchisee.

Regarding the aforementioned, for the franchise agreement to be recognised by any third party, it must be submitted to registration before the Mexican Institute of Industrial Property.

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?

Any power of attorney submitted to registration before the Mexican Institute of Industrial Property must comply with the legal formalities in accordance with the Mexican legal framework. If the power of attorney was granted in accordance with the formalities of a foreign law, it will have to be legalised or apostille.

17 Electronic Signatures and Document Retention

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

There are electronic signatures recognised by the Mexican legal-framework, but in the current state of the implementation of the legislation, we emphatically suggest that any agreement should be in "wet ink".

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

No, any electronic file will be considered as a copy. Therefore, the electronic copy or the printed version of said file will not have legal value.

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New Zealand

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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 franchising in New Zealand.

However, a franchisor that is a member of the Franchise Association of New Zealand (FANZ) must comply with the Code of Practice and Code of Ethics.

Under the Rules of the FANZ, a franchise is defined as a method of conducting business under which the right to engage in the offering, selling or distributing of goods or services within New Zealand includes, or is subject to, at least the following features:

- The grant by a franchisor to a franchisee of the right to use a mark, in such a manner that the business carried on by the franchisee is or is capable of being identified by the public as being substantially associated with a mark identifying, commonly connected with, or controlled by, the franchisor.
- The requirement that the franchisee conducts the business, or a part of the business subject to the franchise agreement, in accordance with the marketing, business or technical plan or system specified by the franchisor.
- The provision by the franchisor to proceed with ongoing marketing, business or technical assistance during the term of the franchise agreement.

1.2 What laws regulate the offer and sale of franchises?

There are no specific laws regulating the offer and sale of franchises in New Zealand. However, many laws have an impact on franchising, including the:

- Commerce Act 1986.
- Commerce (Cartels and other Matters) Amendment Act 2017.
- Companies Act 1993.
- Consumer Guarantees Act 1993.
- Contracts and Commercial Law Act 2017.
- Defamation Act 1992.
- Employment Relations Act 2000.
- Fair Trading Act 1986.
- Health and Safety at Work Act 2015.
- Human Rights Act 1993.
- Personal Property Securities Act 1999.
- Privacy Act 1993.
- Property Law Act 2007.
- Real Estate Agents Act 2008.
- Resource Management Act 1991.
- Trade Marks Act 2002.
- Unsolicited Electronic Messages Act 2007.
- Advertising Standards Authority Codes.

Pyramid selling schemes are illegal in New Zealand (*section 24, Fair Trading Act 1986*). The Financial Markets Conduct Act 2013 is the main statute governing the sale of investments and securities.

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

Yes, but please note that we have no franchise disclosure or registration laws in New Zealand.

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

There are no registration requirements so not all franchisors need to be registered with a professional, regulatory or government body before setting up a franchise system.

However, a franchisor that wishes to join the FANZ must:

- Complete the appropriate application form.
- Pay the prescribed fee.
- Submit its franchise agreement and disclosure document for approval by an independent scrutineer who will check that the documents comply with the FANZ Rules and Code of Practice.

Trade marks must be registered in accordance with the Trade Marks Act 2002. It is prudent to have the IP owned by a company that is not the New Zealand franchisor, and to have an IP licence agreement prepared and executed between the trade mark owner entity and the franchisor.

1.5 Are there mandatory pre-sale disclosure obligations?

There are no franchising laws that require pre-contractual disclosure but great care must be taken to ensure that all representations are true and do not amount to misrepresentations that will fall foul of the Fair Trading Act 1986. However, a member of the FANZ must provide a potential franchisee with its disclosure document at least 14 days before the franchise agreement is executed.

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

If a franchisor is a member of the FANZ then it must disclose all obligations to sub-franchisees. However, this does not apply if a franchisor is not a member of the FANZ.

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 a disclosure document is set out in the Code of Practice (for those that are members of FANZ) and sets out company information, financial information, payments required and a brief outline of the main clauses of the franchise agreement. The disclosure document must be updated at least annually by the franchisor.

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

Before a franchise may be offered or sold, a franchisor requires a franchise agreement which must be in writing. The agreement must comply with contractual law principles. Accordingly, it must:

- Have a clear subject matter.
- Be supported by consideration.
- Be executed by all relevant parties.

A franchise agreement is categorised as a valid and binding contract enforceable under the law of contract in New Zealand.

A franchisor that wishes to sell a greenfields franchise territory will normally find a franchisee itself. However, a franchisee that wishes to sell an existing business will normally employ a business broker to find a new franchisee. The business broker must be registered and comply with the Real Estate Agents Act 2008. This means that any purchasers of the business will deal with a registered business broker.

The FANZ does not impose any requirements in relation to the sale of franchises.

An overseas franchisor that wishes to enter the New Zealand market and sell franchises must comply with New Zealand legislation (as set out in question 1.2 above). There are no other government consents or official authorisations required. However, if an overseas franchisor wishes to take over or merge with a New Zealand franchisor, the consent or authorisation from the Commerce Commission may be required (*Commerce Act 1986*).

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

A membership with the FANZ is not mandatory; however, it is recommended that all franchisors belong to the FANZ and potential franchisees often check to see if a franchisor is a member of the FANZ.

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

The Code of Practice and Code of Ethics published by the FANZ is binding on all members of the FANZ, including franchisors and master franchisees. Each member of the FANZ must (*FANZ Code of Ethics*):

- Operate in accordance with all the requirements of the Rules and Code of Practice of the FANZ, and according to all relevant laws.
- Uphold the Code of Ethics for all members.
- Promote membership of the FANZ and adherence to its Code of Practice.
- Adopt the highest standards of competency, practice and integrity in all matters pertaining to franchising.
- Respect the confidentiality of all information, know-how and business secrets concerning a franchised business with which it is involved.
- Act in an honourable and fair manner in all its business dealings, and in such a way as to uphold and bring credit to the good name of the FANZ.

The Code of Ethics applies to franchisors that are either:

- Members of the FANZ.
- Not members of the FANZ, but wish to comply with the Code, in which case the obligation to comply must be inserted into all franchise agreements to which they are party.

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

All franchise documents in New Zealand are written in 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?

If a foreign business entity holds 25 per cent or more of the shareholding in a company and the company is classed as "large" (i.e. total assets exceed NZ$60 million or total revenue exceeds NZ$30 million as at the balance date of each of the two preceding accounting periods), the company must be audited and must file financial statements pursuant to the Financial Reporting Act 2013. In relation to foreign investment, there are no barriers for funds coming into New Zealand. If a foreign entity wishes to buy land in New Zealand and the land is greater than five hectares in area or will result in overseas investment in other "sensitive" land (e.g., foreshore or seabed, public parks and historic land), an application must be made to the Overseas Investment Office for consent to the purchase before it can proceed.

The corporate tax rate for both resident and non-resident companies is 28 per cent. New Zealand has tax treaties with many countries: for example, in relation to Australia, Singapore, Japan and the United States the rate of the non-resident withholding tax is five per cent for royalties; in relation to the United Kingdom and Canada the rate is 10 per cent; and for Fiji, Indonesia, Malaysia and the Philippines the rate is 15 per cent. The non-resident withholding tax must be deducted from all interest and royalty income before funds are repatriated. The overseas entity will be able to claim a tax deduction in the relevant country because a non-resident withholding tax certificate will be provided. If dividends are repatriated, a non-resident withholding tax of 15 per cent must be deducted.

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

A franchisor would typically use a New Zealand registered company. A new company can be incorporated online at www.companies.govt.nz. The first step is to obtain name approval. Following this, an application to incorporate must be completed, naming all the directors and shareholders of the company, who must sign written consents to act as directors and to become shareholders. The address of the registered office of the company and the address for service must be provided, and both must be New Zealand addresses.

All new companies must be incorporated online. The name approval fee is NZ$11.50 and the incorporation application fee is NZ$120.75. Once an overseas shareholder holds 25 per cent or more of the shares in a company, that company must file financial accounts and be audited. Otherwise, if the shareholders pass a unanimous resolution that no auditor need be appointed then the company does not have to be audited. When incorporating a new company it is wise to have a separate constitution, otherwise the provisions in the Companies Act 1993 will apply. For example, any pre-emptive rights will only exist by way of a separate constitution and not in reliance upon the Companies Act 1993.

A company must comply with the Companies Act 1993 and the Financial Reporting Act 2013. In relation to the formation of a company, there are recent changes as follows:

- all companies incorporated in New Zealand must have a director who lives in New Zealand, or lives in Australia and who is also a director of an Australian-incorporated company; and
- all directors must provide their place of birth and date of birth.

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

No, there are no formalities applicable for new business entities in New Zealand.

3 Competition Law

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

The Commerce Act 1986 provides the regulatory framework relating to anti-competitive conduct. The Commerce Commission is responsible for enforcing that framework.

The Commerce (Cartels and Other Matters) Amendment Act 2017 became law on 14 August 2017 and current franchise agreements and franchising generally have been affected and consequently included within this since 14 May 2018. Therefore, some additional clauses must be inserted into franchise agreements and there must be some clear explanation as to why some of the clauses are necessary.

Consideration must be given as to whether a franchise agreement contains a cartel clause. For example, clauses which set or influence prices, restrict output or allocate markets will be caught. One should also consider whether there are alternative arrangements that can achieve the same or similar commercial outcome to a cartel clause. Another consideration is whether the collaborative activity exemption or vertical activity exemption applies. Expert legal advice should be obtained in relation to the new Act.

There will not be a cartel arrangement in place where parties are not in competition with each other. In most franchise systems the franchisor will not be in competition with its own franchisees, but that is not always the case. For example, a franchisor that owns its own outlet might be found to be in competition with franchisees. Similarly, where a franchisor sells online direct to the end consumer, yet at the same time has franchisees who sell to those consumers, it may also be in competition with its franchisees. There may also be instances where the franchisees are in competition with each other. Where a franchisor is in competition with a franchisee or where franchisees are found to be in competition with each other, there will be a competitive relationship, so the franchisor needs to be aware that there may be provisions in its franchise agreements that amount to cartel provisions.

The new legislation will have significant repercussions on franchising. The Commerce Commission explained that a cartel provision is any provision in an arrangement between competitors that has any of the following purposes, effects or likely effects:

- Fixing prices (for example, an agreement not to compete on price or on any element of price).
- Restricting output (for example, an arrangement to prevent, restrict or limit output, production capacity, supply or acquisition).
- Allocating markets (for example, an agreement not to sell or to buy from certain customers or suppliers, or in particular areas).

The "collaborative activity" exemption under the Commerce (Cartels and Other Matters) Amendment Act 2017 will apply to franchise agreements. This exemption will apply to cartel provisions in any arrangement carried out by two or more people in trade and which is not carried on for the dominant purpose of lessening competition between any two or more of the parties. There are also exemptions available for collaborative marketing and promotions.

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

There is no maximum permitted term for a franchise agreement in New Zealand. A typical term might be five or 10 years, with rights of renewal of five or 10 years (as applicable).

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

There is no maximum permitted term.

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

A franchisor can require franchisees to purchase approved products from the franchisor. However, there is a prohibition on stipulating minimum resale prices in relation to products for resale to customers of the franchisee. Resale price maintenance by suppliers is prohibited and illegal in New Zealand under section 37 of the Commerce Act 1986.

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

The only obligation which a franchisor must observe when offering franchises in adjoining territories is to ensure that any adjoining territories do not encroach or traverse the specific territory of a

franchisee. In other words, a franchisor should act in good faith when dividing the territories and appointing different franchisees.

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

Non-compete obligations are legal and enforceable, and are typically imposed on the franchisee during the term of the agreement and for a defined period following termination of expiration of the agreement. The New Zealand courts will enforce post-term restrictive covenants against the franchisee, in particular non-compete and confidentiality restrictive covenants, provided that their geographical scope and duration are reasonable.

4 Protecting the Brand and other Intellectual Property

4.1 How are trade marks protected?

The Trade Marks Act 2002 is the relevant statute and all trade marks must be registered in New Zealand. The relevant body to deal with is the Intellectual Property Office of New Zealand (IPONZ). Trade mark registrations last for 10 years and must then be renewed.

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 by normal intellectual property laws. Any properly drafted franchise agreement will include know-how and trade secrets in the definition of intellectual property and should contain a robust intellectual property clause.

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

Copyright is protected in New Zealand under the Copyright Act 1994 and trade marks and software can also be protected with a binding Licence Agreement to Use Trade Marks and Intellectual Property granted by the franchisor to the franchisee.

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.

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

Where a franchisor and a master franchisee both enter into a contractual arrangement with a franchisee, the disclosure document must contain material information in relation to both the franchisor and master franchisee (including financial disclosure relating to both the franchisor and the master franchisee).

Where the franchisor is not in a direct contractual arrangement with the franchisee and the franchise is granted only by the master franchisee, the disclosure document must fully disclose the implications for the franchise agreement of the termination of the master franchisee's agreement with the franchisor.

If the franchisor takes an indemnity from the master franchisee in the Master Franchise Agreement then such indemnity should be comprehensive with its main purpose being to protect the franchisor. There are no limitations on such an indemnity being enforceable against the master franchisee.

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

Disclaimer clauses look and sound good but they will not protect a franchisor who has deliberately lied or misled a franchisee. Misleading conduct is governed by the Fair Trading Act 1986 and misrepresentations can be innocent, negligent or fraudulent. Disclaimer clauses may well protect innocent misrepresentations but they will probably not protect negligent or fraudulent misrepresentations.

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

Yes, and class action waiver clauses would be enforceable in New Zealand.

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 Agreements usually have a Governing Law clause which states that they are governed by the laws of New Zealand and are subject to the jurisdiction of the New Zealand Courts.

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

Yes, and any franchisor can apply for interlocutory relief by way of injunction and an application must be made to the High Court of New Zealand.

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

Arbitration is an accepted method of dispute resolution in New Zealand and New Zealand has been a signatory to the New York Arbitration Convention on the Recognition and Enforcement of Foreign Arbitral Awards since 1983. All businesses would accept arbitration as a form of dispute resolution procedure but the preferable method to resolve disputes is by way of mediation, with arbitration a close second.

7 Real Estate

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

There is no usual length of term for a commercial property lease. However, in shopping malls the term offered by landlords such as Westfield is typically six years only with no right of renewal.

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 franchise agreement can provide that the franchisor can acquire the premises at the end of the franchise relationship.

When finalising a franchise agreement, the franchisor should also ensure that special conditions are inserted into any lease between the landlord and the franchisee, which recognise the franchisor's option to take over the lease.

If the franchise agreement has ended either by effluxion of time or by valid termination and the franchisee refuses to vacate the premises, the franchisor will need to consider available legal remedies (including an injunction to prevent the franchisee from continuing to do business on the premises).

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 restrictions on non-national entities holding any interest in real estate and the consent through the Overseas Investment Office (OIO) must be obtained before overseas people invest in the New Zealand sensitive land, significant business assets and fishing quota. Investors who need consent are generally not New Zealand citizens but are bodies, such as companies, trusts and joint ventures, with more than 25 per cent overseas ownership or control; and proposed investments must meet the criteria set out in the Overseas Investment Act 2005.

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 in a particular location)?

Some landlords provide an initial rent-free period which often equates to the fit-out period, but some do not. Most landlords do not currently demand "key money", but in some premium locations key money may be required.

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, but there must be a specific provision 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?

Any properly drawn franchise agreement must contain a robust clause requiring a former franchisee to assign local domain names to the franchisor on the termination or expiry of the franchise agreement. If that requirement is not stated then the agreement is defective.

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 in relation to this area.

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

There are no local laws but nothing lasts forever, so if the term of a franchise agreement is for an indefinite period, it may be possible to argue that there is an implied term – please note that this topic is uncertain.

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 New Zealand the law is very definitive and a franchisor is not regarded as a joint employer together with the franchisee – such is the case in Australia, which is bad.

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

There is no such risk in our opinion.

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 corporate tax rate for both resident and non-resident companies is 28 per cent. New Zealand has tax treaties with many countries: for example, in relation to Australia, Singapore, Japan and the United States, the rate of non-resident withholding tax is five per cent for royalties; in relation to the United Kingdom and Canada the rate is 10 per cent; and for Fiji, Indonesia, Malaysia and the Philippines the rate is 15 per cent. The non-resident withholding tax must be deducted from all interest and royalty income before funds are repatriated. The overseas entity will be able to claim a tax deduction in the relevant country because a non-resident withholding tax certificate will be provided. If dividends are repatriated a non-resident withholding tax of 15 per cent must be deducted.

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

Withholding tax would only be deducted from the payment of royalties in the case of a licensor residing overseas – in that case the non-resident withholding tax must be deducted. The rates vary depending upon the country. Further, it may be possible to avoid the withholding tax by structuring payments due from the franchisee to the franchisor, but expert taxation advice must be obtained in the local 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 but all franchise agreements in New Zealand would normally specify New Zealand dollars.

12 Commercial Agency

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

If a franchise agreement has been properly drafted there would be no such risk, in our opinion.

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 a general legal obligation for parties to deal with each other in good faith, and a good faith clause should always be included in franchise agreements. The courts in New Zealand are moving towards implying a duty of good faith into franchise agreements if no such duty is expressly stated, but this has not happened yet. Both parties should act loyally and in good faith towards each other at all times, as that is the essence of any franchise relationship. The Code of Ethics of FANZ states that each member shall "*act in an honourable and fair manner in all its business dealings…*".

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 specific laws regulate the ongoing relationship between franchisor and franchisee after the franchise contract comes into effect.

15 Franchise Renewal

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

Disclosure obligations will only apply if a franchisor is a member of the FANZ in which case it must comply with the Code of Practice. Paragraph 14.2 of the Code states as follows:

> "*A Disclosure Document is required to be provided to an existing Franchisee in conjunction with the renewal of the franchise agreement within one month of being requested by 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?

A franchisee is not automatically entitled to a renewal or extension of the franchise agreement at the end of the initial term.

A franchisee can usually exercise its right of renewal provided that it:

- Complies with the required notice period.

- Is not in breach of the existing franchise agreement when giving notice of renewal or at the time of renewal of the franchise.

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?

Local law does not guarantee a right of renewal. There are no legal restrictions on fees or charges payable on renewal, provided that these fees or charges are not unreasonable or ridiculous so as to be deemed harsh and oppressive.

If a franchisor refuses to renew a franchise, the franchisee may be able to obtain an order of specific performance from the High Court, which may force the franchisor to renew the franchise. However, in order to have any possibility of obtaining an order for specific performance (which is a discretionary remedy), the franchisee must:

- have validly exercised its right of renewal;
- have done everything required under the franchise agreement; and
- not be in breach of the franchise agreement.

16 Franchise Migration

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

A franchisor may restrict a franchisee's ability to sell, transfer, assign or otherwise dispose of its franchised business provided the franchise agreement contains a right of first refusal clause in favour of the franchisor. Further, any transfer or sale of a franchise by a franchisee is always subject to the consent of a franchisor, who should be able to say no without giving any reasons. The precise wording in any assignment or transfer clause is very important and if a franchise agreement contains such words as "with such consent not to be unreasonably or arbitrarily withheld", then it would be harder for a franchisor to refuse 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?

Any "step-in" right, if it is stated in the franchise agreement, will be enforceable. If it is not stated in the franchise agreement then there will be no such right.

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?

Yes. The only restriction would be if the power of attorney is granted by a company then it must comply with the Companies Act 1993.

17 Electronic Signatures and Document Retention

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

The answer is contained in section 22 of the Electronic Transactions Act 2002 whereby an electronic signature must adequately identify the signatory and adequately indicate the signatory's approval of the information to which the signature relates and it must be reliable in every case.

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

The paper version of the franchise agreement should not be destroyed as it is *prima facie* evidence in any litigation action.

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Stewart Germann is a Barrister and Solicitor of the High Court of New Zealand and also a Notary Public. Stewart has a BCom in accounting and an LL.B. from the University of Auckland. He is the principal of Stewart Germann Law Office (SGL), a boutique franchising law firm in Auckland, New Zealand.

Stewart was Chairman of the Franchise Association of New Zealand (FANZ) 1997–1999 and he has been involved in franchising law for over 35 years. Stewart specialises in franchising, licensing and the sale and purchase of businesses although SGL undertakes a wide variety of work. Stewart is included in the *International Who's Who of Franchise Lawyers 2017* and is also a qualified mediator. In 2001 he was elected to the Board of the Supplier Forum of the IFA and was the first person from outside of the USA and Canada to be elected to that Board, which he served on for six years.

Stewart was previously a member of the Advisory Editorial Board of the *International Journal of Franchising Law* and he has also spoken at franchising conferences in New Zealand, Australia and USA.

SGL
STEWART GERMANN LAW OFFICE
Lawyers, Notary Public

Stewart Germann Law Office (SGL) was founded by Stewart Germann in 1993. Previously, Stewart Germann had been a partner in various law firms and he has been involved in franchising and licensing since 1980.

SGL handles all aspects of property law, commercial law and company law with particular emphasis on franchising, businesses, licensing and distribution agreements. As well as acting for many New Zealand franchisors, the firm acts for a number of Australian franchisors who have entered New Zealand to expand their system. The firm also acts for franchisors in the USA and the United Kingdom.

SGL prides itself in providing expert legal advice in relation to franchising, licensing and small businesses. It also provides advice in the area of intellectual property and the firm has considerable expertise in drafting commercial documentation.

SGL can assist franchisors with the preparation of franchise agreements and related documentation. The firm can also adapt US agreements and agreements in other jurisdictions for New Zealand conditions. SGL has wide contacts in the franchising industry throughout New Zealand, Australia, United Kingdom, USA and Asia.

Nigeria

Davidson Oturu

ÆLEX

Tiwalola Osazuwa

1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

Nigeria does not have a specific franchise law, and as such, there is no legal definition of a franchise. However, the Nigerian International Franchising Association defines franchising as a business arrangement whereby the franchisor grants the franchise operator (the "franchisee") the right to distribute certain products or services in a particular way, at a particular location and for specified periods of time. In return, the franchisee pays the franchisor fees and royalties.

1.2 What laws regulate the offer and sale of franchises?

There is currently no specific law in Nigeria that regulates the offer and sale of franchises.

However, the National Office for Technology Acquisition and Promotion Act, Chapter N62, Laws of the Federation of Nigeria, 2004 ("NOTAP Act") regulates the transfer of foreign technology to Nigeria. A franchise arrangement is regarded as involving the transfer of technology and so is regulated by the provisions of the NOTAP Act.

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

Yes, the franchisee/licensee will be treated as a franchisee under these circumstances.

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

By virtue of the provisions of the NOTAP Act, all agreements for the transfer of technology between a foreign transferor and a Nigerian transferee must be registered with the National Office for Technology Acquisition and Promotion ("NOTAP"). More specifically, Section 4 of the NOTAP Act states that such agreements are registrable if their purpose or intent is, in the opinion of NOTAP, wholly or partially for or in connection with the following:

- use of trademarks;
- use of patented inventions;
- supply of technical expertise in the form of technical assistance of any description whatsoever;
- supply of detailed engineering drawings;
- supply of machinery and plant; and
- provision of operating staff, managerial assistance, and the training of personnel.

As a franchise arrangement involves the transfer of technology, it is required to be registered with NOTAP.

1.5 Are there mandatory pre-sale disclosure obligations?

As a result of the absence of a franchise-specific law, there are no pre-contract disclosure requirements or formalities which apply to a franchise arrangement. Disclosure requirements under the laws of contract will, however, apply. For instance, the principle of misrepresentation under the common law of contract will apply to a franchise relationship.

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

Please refer to our answer 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?

As a result of the absence of a franchise-specific law, there is no prescribed format of disclosure neither is there a legal obligation to make continuing disclosures.

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

No, there are no prescribed requirements that must be met.

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

No, membership of a national franchise association is not mandatory; there is also no commercial benefit derived from belonging to a national franchise association.

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

No, membership of a national franchise association does not impose any additional obligations on franchisors.

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

There is no legal requirement that mandates that documents should be translated into a local language. However, as the official language in Nigeria is English, in practice, all documents are required to be in the English language.

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

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

Yes there are. Generally, under the Companies and Allied Matters Act, Chapter C20 Laws of the Federation of Nigeria, 2004, every person who intends to carry on business in Nigeria must in the first instance, incorporate a local company for that purpose.

Furthermore, the Immigrations Act 2015 and the Nigerian Investment Promotion Commission Act Chapter N1 Laws of the Federation of Nigeria, 2004 provide that a company with non-nationals must ensure that it registers its business and also obtains a business permit, to be able to carry on business in Nigeria.

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

In Nigeria, the business entities typically used by franchisors are limited liability companies which may be either private or public.

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

To commence trading in Nigeria, a new business entity must fulfil the following requirements:

a. incorporate a local company with the Corporate Affairs Commission;

b. register with the Nigerian Investment Promotion Commission (applies only to companies with foreign participation);

c. register with the Federal Inland Revenue Service for tax purposes;

d. open a corporate bank in any commercial bank in Nigeria and import capital; and

e. obtain a business permit and expatriate quota from the Ministry of Interior (applies only to companies with foreign participation and in cases where foreigners are to be employed).

3 Competition Law

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

There are no laws which specifically regulate competition in Nigeria, especially as it relates to the offer and sale of franchises.

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

Yes, the NOTAP Act stipulates that an agreement for the transfer of technology must not exceed a term of 10 years. In practice, however, NOTAP usually approves a franchise agreement for a period of three years and upon its expiration, it may be renewed for further periods of three years.

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

No, there is no maximum permitted term and parties are generally at liberty to agree on a term. However, it should be noted that NOTAP has the power to refuse the registration of a franchise agreement which contains provisions that impose an obligation on the franchisee to acquire equipment, tools, parts or raw materials exclusively from the franchisor or any other person or given source.

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

Yes, NOTAP has the power to refuse the registration of a franchise agreement which contains any provision on resale prices which are in contravention of the Price Control Act or any other enactment relating to prices, imposed for domestic consumption or for exportation.

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

No, there are no such obligations.

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

Under Nigerian Law, non-compete or non-solicitation clauses are generally regarded as covenants in restraint of trade and are generally *prima facie* unenforceable, unless they are reasonable with reference to the interest of the parties concerned and of the public.

4 Protecting the Brand and other Intellectual Property

4.1 How are trade marks protected?

An invented word, device, label, ticket, brand, letter, numeral, company name or any combination of the above can be registered with the Trademarks Registry as a trademark in Nigeria. Marks which are deceptive or scandalous, generic and descriptive, geographical

names in their ordinary signification or chemical substances cannot be registered as trademarks.

Nigeria is a first-to-file jurisdiction; therefore, for a mark to enjoy statutory protection, it must be registered in Nigeria. An application to register a trademark must be made to the Registrar of Trademarks and must contain the specification of goods.

The registration process can currently take up to three years. A trademark is registered for an initial period of seven years but can be renewed for further periods of 14 years.

An unregistered trademark can be protected in Nigeria under the common law tort of passing off. For this purpose, the owner of the unregistered mark must show that:

- The trademark has acquired goodwill.
- Use of the mark by the third party is likely to result in confusion or deception.
- Use of the trademark by the third party is likely to cause damage.

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

Trade secrets and confidential information do not have statutory protection in Nigeria.

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

Yes, operations manuals and proprietary software are protected as literary works by copyright.

Nigerian law does not, however, provide for the registration of eligible works as copyright arises automatically upon the creation of a work. A work is not eligible for copyright protection unless sufficient effort has been expended to give it an original character and it is fixed in a definite medium of expression.

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 a result of the absence of a franchise-specific law, there are no mandatory disclosure requirements or formalities which apply to a franchise arrangement. Disclosure requirements under the laws of contract will, however, apply. For instance, the principle of misrepresentation under the common law of contract will apply to a franchise relationship.

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

Please refer to our answer to question 5.1.

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

There are no statutorily provided restrictions to the inclusion of disclaimer clauses in a franchise agreement.

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

As a result of the absence of franchise-specific laws in Nigeria, there is no law which regulates the institution of class actions by aggrieved franchises. Under Nigerian civil law, however, the institution of class actions by aggrieved persons is permitted.

A franchise agreement may, however, contain provisions which prevent a party from instituting or joining a class action against the other party.

6 Governing Law

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

Yes, NOTAP requires all agreements brought before it for registration to be governed by Nigerian law.

NOTAP also has the power to refuse the registration of a franchise agreement which imposes an obligation on a franchisee to submit to foreign jurisdiction in any controversy arising for decision concerning the interpretation or enforcement in Nigeria of any such contract or agreement or any provisions thereof.

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?

Interim/interlocutory foreign orders/judgments are not enforceable in Nigeria. Nigerian courts will allow the registration and enforcement of a foreign order/judgment only if it is final and conclusive between the parties thereto and there is payable, thereunder, a sum of money, not being a sum payable in respect of taxes or other charges of a like nature or in respect of a fine or other penalty.

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

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

Businesses do not generally favour any particular set of arbitral rules. However, the more commonly used arbitral rules include the Arbitration Rules made pursuant to the Arbitration and Conciliation

Act, Chapter A18 Laws of the Federation of Nigeria; the United Nations Commission on International Trade Law ("UNCITRAL") Rules and the Rules of Arbitration of the International Chamber of Commerce.

7 Real Estate

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

Typically, leases are granted for a term of three to five years and are made subject to renewal by the parties.

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

Conditional leases are not commonly used in Nigeria. However, such a lease may be entered into if agreed upon with 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?

Yes, the Acquisition of Lands by Aliens Law of the various states in Nigeria contain restrictions on the right of non-national entities to acquire interest in real estate.

Under the Acquisition of Lands by Aliens Law of Lagos State for instance, non-national entities are not allowed to acquire any interest or right (for more than three years) in or over any land from a Nigerian, unless the transaction under which such interest or right is being acquired has been previously acquired by the Governor.

7.4 Give a general overview of the commercial real estate market. 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 in a particular location)?

Tenants in Nigeria are typically not granted an initial rent period when entering into a new lease neither do landlords demand key money from prospective tenants.

8 Online Trading

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

Yes, the franchise agreement may contain provisions to this effect.

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

No, there are no such specific limitations.

However, NOTAP has the power to refuse the registration of a franchise agreement which imposes an obligation on a franchisee to assign to the franchisor or any other person designated by the franchisor, patents, trademarks, technical information, innovations or improvements obtained by the franchisee with no assistance from the franchisor or such other person.

9 Termination

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

There are no mandatory laws that might override the termination rights of the parties to a franchise agreement. The terms on which a franchise agreement will be terminated and the consequences of such termination will be as agreed by the parties in the franchise agreement.

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

Please see our response to question 9.1 above.

10 Joint Employer Risk and Vicarious Liability

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

The risk that the franchisor may be regarded as a joint employer will only arise if the franchisor performs, in respect of the franchisee's employees, certain duties of an employer such as paying salaries, carrying out performance evaluations and appointing and terminating employments.

In view of the limited amount of control which a franchisor is permitted to exercise over the operations of a franchisee by NOTAP, it is difficult to see how an employment relationship may be construed as existing between both parties.

It is also common for clauses expressly stating that neither party is an employee, agent or partner of the other to be inserted in franchise agreements.

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

No, this risk will arise where the franchisor and franchisee are regarded as co-employers.

11 Currency Controls and Taxation

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

Yes, one of the consequences of a failure to obtain NOTAP's approval in respect of a franchise agreement is that the franchisee will be unable to make remittances to an overseas franchisor from funds obtained from the official foreign exchange market.

By virtue of the provisions of the Foreign Exchange Manual issued by the Central Bank of Nigeria, offshore franchise fee payments can only be made by a commercial bank, upon presentation of the prescribed documentation. These include:

- a duly completed Form "A";
- a certified copy of the franchise agreement registered by NOTAP;
- a certificate of registration issued by NOTAP;
- a demand note from the franchisor;
- evidence of payment of tax on the amount to be remitted;
- audited account for the relevant period; and
- confirmation of reasonableness of fees from NOTAP.

Payments to an overseas franchisor may be made in any convertible currency including British Pounds, United States Dollars and Euros.

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

Yes, a withholding tax at a rate of 10% will apply to royalty payments made to an overseas franchisor. The tax exposure of the franchisor may be reduced if the franchisor is incorporated in a country with which Nigeria has a double taxation agreement. Some of the countries which Nigeria currently has a double taxation agreement include: Belgium; Canada; China; the Czech Republic; France; Italy; Pakistan; Romania; the Slovak Republic; South Africa; the Netherlands; and the United Kingdom.

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

Yes, all transactions conducted between a Nigerian franchisor and franchisee are to be denominated in Naira which is the official currency in Nigeria.

12 Commercial Agency

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

Under the common law doctrine of privity, it is only the parties to a contract that can enforce this with the aim of seeking its benefits. The contract cannot bind a third party and third parties cannot take or accept the benefits or liabilities under it. On this basis, a third party cannot seek to enforce a franchise agreement to which it is not a party; neither can a third party sue a franchisor for business relations between itself and the franchisee.

An exception to this doctrine is where an agency relationship can be established, as between the franchisor and franchisee and in which case, the franchisee is construed as being the franchisor's agent. In this case, the franchisor may be liable for the actions of the franchisee.

However, in many cases, the franchisee is a distinct business entity from the franchisor and it may be difficult for a third party to prove an agency relationship between the franchisor and the franchisee, i.e. it dealt with the franchisee under the impression that it was in fact dealing with the franchisor.

13 Good Faith and Fair Dealings

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

There are no express or implied obligations imposed on a franchisor under Nigerian law. The obligations of the parties will be determined by the express provisions of the franchise agreement.

14 Ongoing Relationship Issues

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

No, there are no specific laws. The laws of contract will operate to regulate the relationship between a franchisor and franchisee.

15 Franchise Renewal

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

There is no law that imposes disclosure obligations in relation to the renewal of an existing franchise. However, the laws of contract will operate to enforce any contractual terms on renewal, which may be contained in a franchise agreement.

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

Please see our response to question 15.1 above.

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

Please see our response to question 15.1 above.

16 Franchise Migration

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

Yes. It should be noted, however, that NOTAP has the power to refuse the registration of a franchise agreement which imposes such restrictions on a franchisee.

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

Yes, a step-in right will be recognised under Nigerian law. Please note, however, that NOTAP has the power to refuse the registration of an agreement which permits the franchisor to regulate or intervene directly or indirectly in the administration of any undertaking belonging to the franchisee.

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?

Yes, such a power of attorney will be recognised by the courts.

17 Electronic Signatures and Document Retention

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

NOTAP requires all agreements submitted to it for registration to contain the "wet ink" signatures of the parties on every page. Electronic signatures may not be accepted by NOTAP.

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

Yes. Under Nigerian evidence law, copies of a document made from the original by mechanical or electronic processes can be admitted as secondary evidence if the original has been lost.

It is, however, not advisable to destroy the hardcopy of the agreement without cause.

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LEGAL PRACTITIONERS & ARBITRATORS

ÆLEX is a full-service commercial and litigation law firm with one of the largest offices in West Africa. ÆLEX has its head office in Lagos, Nigeria and other offices in Port Harcourt and Abuja in Nigeria and in Accra, Ghana.

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Lawyers in the firm are admitted to practice in several jurisdictions including Nigeria, New York, Ghana, England and Wales and are qualified in disciplines such as political science, economics and engineering.

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Poland

Marta Smolarz

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Noerr

1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

There is no legislative definition of franchise agreement under Polish law, thus it constitutes an "innominate contract", entered into on the basis of the "freedom of contract" principle, stipulated under art. 353[1] of the Polish civil code, which stipulates that the contracting parties may establish a legal relationship at their own discretion, as long as the content or purpose of the agreement does not oppose the nature of the legal relationship, the statutory law or the so-called principles of community coexistence.

Nevertheless, Polish courts recognise certain franchise-specific legal features of the relationship between the franchisor and the franchisee. The Polish Supreme Court on 7 July 2007, in a case no. I CSK 348/06, held (in line with older judgments of the civil, administrative and competition courts) that the essence of the franchise-based method of cooperation lies in the contractual undertaking of the franchisor to permit use by the franchisee of the company's sign, emblem, symbols, patents as well as technical and organisational know-how (concept), while the franchisee undertakes to conduct the indicated business with the use of the right to acquire new customers (new sales outlets), which was granted to him by the franchisor. The Supreme Court further recognised that one of the main aims of franchising is to gather know-how regarding the market on which the franchisee is supposed to develop the franchise business and optimise the sales process. Furthermore, it was also recognised that for the duration of the franchise agreement, the franchisee operates on his own behalf and concludes contracts in his own name, directly with new counterparties and acquires new sales outlets. Finally, the Supreme Court confirmed that franchise is a permanent and mutual type of contract, whereby the mutual undertaking of the franchisor cannot be assessed in terms of equivalencies.

Polish Franchise Organization ("**PFO**"), defines franchise by reference to the European Code of Ethics for Franchising of the European Franchise Federation.

1.2 What laws regulate the offer and sale of franchises?

There is no franchise-specific legislation that specifically regulates franchising agreements. The offer and sale of a franchise is regulated by the general principles of contract law, stipulated in the Polish civil code. There are also no mandatory regulations or codes of practice that apply to franchising.

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

Such person would be treated as a franchisee since there is no requirement according to which a certain number of franchisees should be appointed in order for a franchise relationship to arise. There are no registration requirements and/or mandatory pre-sale disclosure obligations in Poland (regardless of the number of franchisees).

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

There are no franchise-specific registration requirements.

1.5 Are there mandatory pre-sale disclosure obligations?

There are no mandatory (statutory) pre-sale disclosure obligations. In practice, a lot of franchisors do not disclose or disclose very limited information. It is up to the potential franchisee to demand, request and research the relevant information from appropriate sources.

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

Since there are no mandatory (statutory) pre-sale disclosure obligations, there are no such obligations with regard to sales to 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?

Since there are no mandatory (statutory) pre-sale disclosure obligations, the format can be freely prescribed by the contractual terms of the relevant franchise agreement.

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

There are no statutory requirements regarding franchise specifically, but it is advisable to ensure trade mark registration, as well as the adaptation of a franchise concept, marketing materials, advertising

templates to reflect Polish laws and customers, in particular consumer protection laws.

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

A membership with the PFO is not mandatory, but it is recommended. The benefits of a membership with the PFO is, among others, faster and cheaper access to reliable franchisees. Members of the PFO can also enjoy a better reputation among franchisees once they obtain Certificate of Credibility, confirming the quality of their system and compatibility with the European Code of Ethics for Franchising.

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

Members of the PFO must adhere to the European Code of Ethics of Franchising of the European Franchise Federation, which is available at http://franchise.org.pl/code-of-ethics.

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 franchise documents to be translated into Polish.

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 restrictions on the ownership of corporate vehicles by foreigners, except where such corporate vehicles are real estate owners or beneficiaries of perpetual usufruct. All foreign investors may also run branch offices and set up representative offices in Poland, unless the undersigned international treaties state otherwise. However, there are certain restrictions in respect of other forms of conducting business (e.g. sole proprietorship, partnership, etc.). In general, non-EEA citizens must obtain an appropriate permit (e.g. residency) in order to conduct business directly (i.e. not via a corporate vehicle).

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

The most common form of business entity in Poland is by far the limited liability company. Other popular forms are: general partnership; joint-stock company; the limited partnership; and the limited joint-stock partnership. The highest growth was reported in the number of limited partnerships registered over the past few years. This is due to the ability to optimise taxation in the structures of such a partnership as revenues are taxed at the level of the partners in that partnership rather than the partnership itself.

Many natural persons choose to pursue sole proprietorship. In the private sector, these entities account for 73% of all entrepreneurs. Foreign investors also take advantage of the branch office structure, through which they can operate in Poland to the extent they operate in their country of origin.

Although franchise joint venture is not a popular vehicle for establishing a network in Poland, it is also possible. The most common way for foreign investors to set up a franchise network in Poland is via a subsidiary (mostly in the form of a limited liability company) or branch office, which becomes the master franchisor, or with the use of an area development plan and/or external master franchisor.

As more than 80% of the franchising networks in Poland are local (rather than foreign), the most popular seems to be the type of franchising which does not require significant initial investments, i.e. direct unit franchise.

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 exact scope of the formalities depend on the form of business entity, but all new business entities established in Poland (i.e. corporations and partnerships) require a registration in the register of entrepreneurs by the National Court Register (*Krajowy Rejestr Sądowy*), tax identification number and statistical number.

3 Competition Law

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

The Polish act on competition and consumer protection, along with the regulations on relevant block exemptions – the general vertical agreements regulation and the R&D agreements regulation – apply to the offer and sale of a franchise. In addition, corresponding provisions of the European law would also apply to franchising agreements affecting the common market, namely Articles 101 and 102 of the Treaty on the Functioning of the European Union, along with the block exemption regulations on vertical agreements and on technology transfer.

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

The maximum permitted term will depend on whether the agreement contains any clauses restricting competition (e.g. territorial exclusivity clauses). Furthermore, the maximum permitted term of such clauses (if any) would depend on whether the automatic "safe-harbour" of the block exemption applies or whether an individual exemption could be claimed. Thus, individual assessment is required for each such agreement.

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

If the agreement contains a clause obligating the franchisee to purchase at least 80% of the relevant product from the franchisor or supplier designated by him, or other clauses restricting competition, certain provisions of the maximum permitted term might apply under the "safe-harbour" of the applicable block exemption. The relevant automatic "safe-harbour" for non-compete clauses (e.g. exclusive supply clauses) can be contracted between parties holding no more than a 30% market share on any of the relevant markets, for the five-year duration or for the duration of the occupancy by the franchisee of the premises owned by the franchisor (or leased by the franchisor from a third party). Outside the "safe-harbour" individual

exemption could apply as well. Thus, individual assessment is required for each such agreement.

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

In general terms, both under Polish competition law and European competition law, imposing a fixed or minimum resale price constitutes a so-called hard-core restriction and as such is prohibited. However, individual exemption might apply to short-term fixed resale prices, necessary to organise a coordinated short-term low price campaign (two to six weeks in most cases), which will benefit the consumers.

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

There are no statutory minimum obligations, but the parties are free to form corresponding contractual obligations and in most cases there is a clear delimitation of exclusive territories on which each franchisee operates. However, the contractual protection can be enjoyed only with respect to active selling (i.e. where the franchisee makes active attempts at making the relevant sale, including marketing efforts, etc.) and, to a certain extent, also with respect to online sales (depending on the type of goods/services being offered to the consumers).

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

In general, in-term non-compete or non-solicitation covenants in franchise agreements are permissible and as such enforceable under Polish law. A maximum of one-year post-terms non-compete and/or non-solicitation could be enforceable under the following conditions:

(a) it concerns only competing goods and/or services;

(b) the obligation is limited to the premises and land from which the franchisee has operated during the contract period; and

(c) the obligation is indispensable to protect know-how transferred by the franchisor to the franchisee.

4 Protecting the Brand and other Intellectual Property

4.1 How are trade marks protected?

An industrial property right can be protected by registration at the Polish Patent Office ("**PPO**"). Trade mark registration provides protection for the goods and/or services. Within three months from the date of publication in the Bulletin of the PPO of the information about the application, third parties may appeal against the trade mark application.

Protective rights are granted for a 10-year period, which can be extended for successive 10-year periods upon an application submitted before the end of the expiry of the protection period, but not earlier than one year before its expiry. The application may be submitted for an additional fee also within six months after the end of the protection period.

In a worst case scenario, the lack of proper trade mark protection might result in another entity registering an identical or similar mark.

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

Polish law provides for the protection of know-how and trade secrets as well as other critical information under the act on counteracting unfair competition. Unfair competition practices are subject to civil liability and the following remedies:

(a) an injunction (including interlocutory relief);

(b) another appropriate remedy of the effects of the breach;

(c) an appropriate public statement; or

(d) the return of unlawfully obtained benefits.

The violation of any trade secrets could also result in criminal liability – fine, restriction of personal liberty or imprisonment of up to two 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 Polish copyright act sets out provisions regarding the protection of copyright. The personal rights belong only to the author, who may, however, agree with the purchaser of the work that he will not use them. Economic rights, on the other hand, are transferrable or licensable by agreement setting out in detail the fields in which the work may be exploited and economic rights can also be inherited.

The author of the copyrighted works, whose personal rights are threatened or infringed by the action of a third party may claim:

(a) an injunction (including interlocutory relief) on the relevant conduct;

(b) another remedy of the effects of breach; or

(c) an appropriate public statement.

Furthermore, a person whose economic rights have been violated may claim in a court:

(a) an injunction (including interlocutory relief) on the relevant conduct;

(b) any benefits obtained by the infringer;

(c) twice (or, in the event of deliberate violation, three times) the amount of the appropriate remuneration (market-based remuneration paid for relevant rights, e.g. for a two-year licence for a similar computer program) applicable at the time of the assertion of his claim; or

(d) compensation for any prejudice suffered in the event of deliberate violation.

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 Poland. It is permissible to stipulate under the terms of a franchise contract that specified actions (e.g. failure to comply with disclosure obligations) will allow the franchisee to rescind the contract and/or claim a stipulated amount of damages. Otherwise, general principles of loss

would apply and the franchisee would have to prove loss in order to claim damages. In general, it is also possible under the general principles of contract law to rescind a mutual contract (such as a franchise agreement) if the other party fails to perform its obligations.

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

There are no mandatory disclosure obligations and, hence, no limitations on the contractual indemnity by the master franchisee, except for potential unenforceability under general contract law. Contractual indemnity by the master franchisee for pre-contractual misrepresentations or disclosure non-compliance are not a market standard in Poland.

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

Since there are no mandatory pre-sale disclosure obligations in Poland, a standard franchise agreement typically does not include any representations with respect to the data that is disclosed (if any). It is common for franchise agreements to include such a disclaimer which would generally be effective with certain limitations. In a case of misrepresentation of an essential nature, a franchisee could have a statutory basis to free oneself from the franchise agreement. In a case of misrepresentation made deceitfully, a franchisee could have the right to rescind the contract even if the misrepresentation was not of an essential nature. The right to free oneself from the agreement expires after one year from the discovery of the false nature of the relevant disclosure.

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

Yes, Polish law permits class actions to be brought by at least 10 franchisees. A contractual class action waiver is not a market practice and the question of its enforceability has never been examined by the Polish courts. It is very likely that such clause would be enforceable, if it was stipulated upfront in a franchise agreement.

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 parties to the franchise agreement are free to choose the governing law. However, in the case where all other elements of the relevant contract are outside of the jurisdiction of choice, such choice does not prejudice the application of provisions of the Polish law which cannot be derogated from by an agreement. Furthermore, the choice of foreign governing law is ineffective to the extent any specific provisions thereof contradict the basic principles of the Polish legal systems (the so-called *ordre public*).

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 available remedy will depend on the factual circumstances and damage caused to the franchisor (its brand), but in principle injunction is an available remedy for such infringements. In principle, it is also possible to obtain interlocutory (interim) relief, pending the final judgment.

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

It is common practice in Poland to include an arbitration clause in a franchise agreement. However, there is no one particular set of arbitral rules, which are most commonly applied, equally popular are the arbitral rules of London Court of International Arbitration, International Chamber of Commerce, Court of Arbitration of the Polish Chamber of Commerce and Lewiatan Court of Arbitration. Poland is a signatory to the New York Arbitration Convention since 1961.

There is no statutory obligation to engage in mediation prior to arbitration or court proceedings. However, in a statement of claims submitted to the court a claimant must explain what steps have been taken to resolve the dispute amicably.

7 Real Estate

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

A typical length of term for commercial leases is between five and 10 years – shorter terms can also be seen, but are harder to negotiate. The tenant can hold over the tenancy after the lapse of the contractual term or the period specified in the termination notice if he continues to make use of the property with the landlord's consent. In such a case it is deemed that the lease has been extended for an undefined term. If the lease agreement was concluded for a defined term (which is the case in most commercial leases) the statutory notice periods would apply for such extended lease – one month if the rent is paid monthly or three months if it is paid for longer periods.

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

Such assignment is possible, but would have to be clearly stipulated under the terms of both the franchise agreement and the relevant lease. It is also possible for the franchisor to obtain an irrevocable power of attorney from the franchisee to effect the relevant assignment. However, in case of insolvency of the franchisee, any contractual term stipulating automatic termination would be void, while the automatic assignment could also be questioned. A clause

stipulating that a failure to fulfil contractual obligations of the tenant/franchisee will trigger such assignment is more likely to be enforceable in case of insolvency before a Polish court.

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

In general, non-EEA nationals must obtain a permit from the Minister of Internal Affairs in order to acquire Polish real estate and/or shares in a commercial company which has a registered place of business in Poland and is the legal owner or beneficiary of perpetual usufruct of real estate situated in Poland. Certain exemptions might apply, depending on the acquirer and the specific 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 in a particular location)?

An initial rent free period is possible and its duration depends on what the parties agreed in the contract. The exact amount of the reduction depends on many elements, including the current supply of relevant commercial space, the length of the lease period or the costs of adaptation.

Typically any premium paid for a particular (e.g. premium) location would be included in the rent – the concept of "key money" is not common on the Polish real estate market.

Among various retail formats, traditional shopping centres still dominate the Polish market (88%), while the supply of new retail space is decreasing – in 2017 approximately 15% less new retail space was made available than in 2016. Most of it, in the eight largest agglomerations (over 65% of completions). Warsaw – still the biggest and most competitive retail market in Poland, with a total modern retail space estimated at 1.5 million m^2 and a density ratio of 598 m^2 /1,000 inhabitants. The vacancy rate at the end of December 2017 was 2.9% and prime rental rates for 100–150 m^2 premises for the fashion sector stood at EUR 115–120/m^2 a month. Of particular importance for the Polish retail market was the implementation of legislation gradually limiting trade on Sundays (with the total ban to enter into force in 2020).

The hotel sector in Poland continues to develop very dynamically. The increasing supply of new properties is a result of many factors, including: growing demand for hotel services; increasing operational indicators and occupancy rates; as well as the growing interest in this part of Europe of new international hotel brands. Hotel facilities are more often considered by institutional investors as an attractive and alternative investment product enabling them to diversify their portfolios.

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?

Unlike active sales which can be limited or excluded outside of the specified territory, both Polish and European competition laws prohibit restrictions on passive sales (i.e. where the customer approaches the franchisee directly, on his own, without any attempts at making the sale from the relevant franchisee). Online sales are, as such, recognised by Polish and European competition authorities as a form of passive sales and, with certain exceptions regarding luxury goods, cannot be restricted.

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?

Polish domains (.pl) and second-level Polish domains (i.e. com.pl, org.pl, etc.) must be registered with a domain name administrator – a partner of NASK (Polish registry). Currently, there is no single legislative act regulating the use of domain names, rights of owners or the remedies available for infringement. Domain name infringements can be claimed on the basis of general civil law or unfair trading practices, either before a common court or an arbitral tribunal. A judgment or an arbitral award which declares that an infringement has been committed allows for termination of an existing registration agreement with the relevant domain name administrator.

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 art. 83 of the Polish bankruptcy law any contractual provisions providing for the right to modify and/or terminate a contract on the grounds that a petition for bankruptcy has been filed and/or bankruptcy has been declared, is void and unenforceable.

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

There are no legal provisions imposing a minimum notice period, which would override the contractual stipulation of a notice period. Furthermore, in the event that the parties to a franchise agreement did not provide for a notice period, it would be possible for each party to terminate the agreement immediately, i.e. at the moment of submission of a termination notice.

Depending on the factual circumstances of the specific case, too short of a notice period (or immediate termination) could potentially be contested on the basis of the principles of so-called community coexistence (i.e. if it could be claimed that such a termination is substantially unjust).

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 risk that a franchisor may be regarded as a joint employer

(along with the franchisee) in relation to the franchisee's employees. The franchisee acts in his own name and on his own account and bears the risk in his own business. His relation to the organiser of the system is cooperation and not subordination, whereas the latter is necessary to establish the employment relationship under the Polish labour code. The franchise agreement is concluded between two independent entities and each of them is individually responsible for its employees.

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

There is no risk for the franchisor to be held vicariously liable for the acts or omissions of the franchisee's employees, unless he is expressly stipulated to be co-responsible in the relevant employment contract concluded between the franchisee and his employee.

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?

Except for tax-related considerations (addressed below in question 11.2) 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?

Generally, payments made by a Polish franchisee to a foreign franchisor (for a trade mark licence, transfer of know-how, etc.) are subject to withholding tax as royalties. The basic rate applicable is 20%. However, it may be reduced according to applicable double taxation treaties. At the same time, withholding tax is not paid if the franchisor is seated in Poland (which is mostly the case).

Due to an anti-avoidance clause implemented into Polish tax law, structuring payments due to a foreign franchisor as a management fee may be viewed as an apparent (illusive) activity and tax evasion. Thus, withholding tax would be still applicable irrespective of the structure applied. Moreover, such structure could lead to unlawful tax deductions by the franchisee.

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 requirements for financial transactions to be concluded in Polish currency. Specified currency should be stipulated as exclusive under the term of franchise contract, otherwise payment will be permissible in Polish currency as well.

12 Commercial Agency

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

There is no direct risk (i.e. there are no express legal provisions to such effect). There have also been, up to this date, no judgments in favour of treating the relationship between the franchisor and franchisee as a principal-agent relationship. The principal difference is that the agent acts in the name (and sometimes also on behalf) of the principal, while the franchisor always acts on his own name and on his own behalf. As long as this distinction is not blurred by the terms of the franchise contract, the relevant risk is sufficiently mitigated.

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?

Art. 5 of the Polish civil code establishes the so-called "principles of community coexistence" (*zasady współżycia społecznego*), on the basis of which any legal act can be claimed to be null and void to the extent it does not meet the minimum standards of generally accepted honesty and correctness in relationships with other persons and entities (i.e. if it is substantially unjust). With respect to the relations between entrepreneurs, the principles of community coexistence should be understood as principles of "fair dealing" (*zasady uczciwego obrotu*), reliability, decency, trust and loyalty to a contractor. Each entrepreneur should refrain from any action which would be a sign of a lack of respect to their contractors' interests and/or would cause injury in their interests. In practical terms, a judgment which renders a legal act null and void, is based on a court's discretionary power having regard to all of the various circumstances of a given case. Due to this uncertainty, it is commonly referred to as the legal means of a last resort.

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 franchise-specific regulations, however, numerous other (generally applicable) laws might be of relevance. Depending on the circumstances, this could be, in particular: the civil code; consumer protection laws; competition law; unfair completion; unfair trading practices; General Data Protection Regulation; and the labour 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 are no mandatory pre-sale disclosure obligations in Poland. Contractual terms must regulate any disclosure requirements in such cases.

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 under Polish law.

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

There are no such rights to claim compensation for the loss of the franchise agreement and the inability to continue to earn a living trading as a franchisee in the franchisor's network. In theory, a franchisee could potentially claim unjust enrichment or breach of principles of community coexistence (addressed in more detail under question 13.1 above). In practical terms, such a claim could be very difficult to evidence.

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?

Although it is possible to completely exclude such a right, it is more common to have an appropriate procedure for such sale and/or assignment. In a well-organised franchise system, a franchisee would be able to find a replacement relatively easy, e.g. via the Polish Franchising Association. This is typically done in a consultation with the franchisor who often helps to find the buyer among the candidates applying for it.

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 will only be possible if the franchisor has the legal title to the premises in which the franchisee operates. In case the real property is owned by the franchisee, the franchisor will not be entitled to enter the premises and take over the business. In case the real property is owned by a third party and the franchisee uses the real property on the basis of a lease agreement, in order for a franchisor to be allowed to enter the premises and take over the business, consent of the owner will be required. It could be obtained either in a new lease agreement (in case the former one had already expired) or assignment of the franchisee's rights and obligations arising out of the existing lease agreement.

With respect to the basis of valuation of the business/assets, the most common and typically used is a book value, which typically ensures a reasonable estimate of the value of the assets.

There are no registration requirements or other formalities that must be complied with in order for a "step-in" right to be enforceable, except that it should be executed in writing.

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?

In general, a power of attorney may be granted in any form, even orally, and need not be registered. A special form (e.g. notarial) is required only when stipulated under applicable statutory (e.g. in case of a sale of real estate). Irrespectively, it is recommended to execute a written document with the exact scope of the authorisation.

The power of attorney should bear the issue date, the signature of the principal and its personal and/or registration data and the personal data of the person to whom a power of attorney is granted. The power of attorney should unambiguously identify the relevant attorney-in-fact.

There are not many formalities required to complete a franchise migration which would require granting a power of attorney to the franchisor and there is no such market practice.

17 Electronic Signatures and Document Retention

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

There are no specific requirements for applying (digitally secured) electronic signatures ("**a secure digital signature**") to franchise agreements. Bearing that in mind, certain related agreements require special forms e.g. transfer of ownership of real estate (which must be concluded in a notarial deed) and certain clauses which might form part of the franchise contract need to be made in written form (e.g. arbitration clause). It is also noteworthy that a document which bears the electronic signature can be – complying with additional conditions – equivalent in terms of legal consequences with a handwritten signature.

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

Unless the agreement itself or any provision of law requires a written form, such an electronically stored document could be used as evidence. However, it is not an equivalent to an original document and it is not advisable to destroy the original version on purpose.

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Noerr is an international law firm with more than 500 attorneys, tax advisors, notaries, and auditors in offices across Europe (in Alicante, Berlin, Bratislava, Brussels, Bucharest, Budapest, Düsseldorf, Dresden, Frankfurt, Hamburg, London, Moscow, Munich, Prague, Warsaw) and the USA (New York). Noerr is one of Europe's leading law firms in the field of distribution law, advising in all areas of commercial law (e.g. labour law, real estate/property, product liability and corporate law). With highly experienced teams of strong characters, Noerr devises and implements solutions for the most complex and sophisticated legal challenges. Noerr is also a member firm in Poland for *Lex Mundi*, the world's leading network of independent law firms with in-depth experience in 100+ countries worldwide.

Romania

SCA 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 franchisees, 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 Franchise Law, as defined in question 1.1 above. 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 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 filed 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 when 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 the 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 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 a 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 a 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 into 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 usually no longer than five years so that they comply with the provisions of Commission Regulation No. 330/2010, mentioned above.

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?

The 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 a hard-core restriction, and it could be sanctioned with fines of up to 10% of the turnover registered by the company before the year 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 a 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 is still fairly burdensome, which is why piracy remains a concern in areas such 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 of contract on the part of the franchisor.

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

The 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 aggrieved franchisees 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 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 and no declaration of enforceability is 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.

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

Romania has been a signatory to the New York Arbitration Convention on the Recognition and Enforcement of Foreign Arbitral Awards since September 16, 1961. Arbitration is indeed recognised as a viable means of dispute resolution, provided that the parties contractually agree on such clause. No specific set of arbitral rules is preferred in practice, since the selection of the arbitral rules depends on various factors related to the contractual parties' identity, location, major place of activity, etc.

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 in 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.

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 a 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.

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

In case of denunciation of the contract (termination for no fault), there is no rule to determine the minimum notice period. However, in case the parties have not contractually established the notice period and the dispute goes to court, the duration of the notice period shall be analysed from the perspective of its reasonability. In case of termination for fault, if the parties have not contractually established the notice period, the law does not impose a minimum. The Franchise Law also requires that the parties contractually establish the circumstances under which a faulty termination with no prior notice may take place.

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 – the natural person – is not actually independent from the franchisor and there actually is a relationship of subordination 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.

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 in 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.

17 Electronic Signatures and Document Retention

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

Electronic signatures are recognised as a valid way to conclude a franchise agreement, and documents signed by way of electronic signature have the same legal force as the ones physically signed. However, when the franchisor creates a "remote" franchise system, it can be difficult to directly provide services and control the franchisee.

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

In such case, the paper document may be destroyed, but only provided that the electronic version is stored in full compliance with the data protection rules, and also provided that the destruction of the physical document is done in compliance with the applicable legal provisions.

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South Africa

Christodoulou & Mavrikis Inc.

Alex Protulis

1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

"Franchise" is not defined in terms of South African law. However, in terms of the Franchise Association of South Africa, "franchise" is defined as giving an individual the "right" to something – in this case the right to operate a business or licence under specific conditions.

1.2 What laws regulate the offer and sale of franchises?

The Consumer Protection Act No. 68 of 2008 ("CPA"), the CPA Regulations and common law regulate the offer and sale of franchises.

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

No, they will not.

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

No, there are no registration requirements relating to franchise systems.

1.5 Are there mandatory pre-sale disclosure obligations?

Yes, Regulation 3 of the CPA Regulations deals with disclosure documents for prospective franchisees. A franchisor has a duty, at least 14 days prior to the signing of a franchise agreement, to provide a potential franchisee with certain disclosure information. See question 1.7 below for the prescribed format of the 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?

Yes, pre-sale disclosure obligations apply to sales to sub-franchisees as well and such an obligation rests on the master franchisee to comply with.

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?

Regulation 3 of the CPA Regulations states:

(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, 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.

(2) Each page of the disclosure document contemplated in sub-regulation (1) above must be qualified in respect of the assumptions contained therein.

(3) The disclosure document contemplated in sub-regulation (1) above must be accompanied by a certificate on an official letterhead from a person eligible in law to be registered as the accounting officer of a close corporation, or the auditor of a company, as the case may be, 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 Companies Act No. 61 of 1973 (or any legislation which replaces this 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.

(4) The disclosure document contemplated in sub-regulation (1) above must be accompanied by:

(a) a list of current franchisees, if any, and of outlets owned by the franchisor, stating, in respect of any franchisee:

(i) the name under which it carries on business;

(ii) the name of its representative;

(iii) its physical address; and

(iv) its email and office telephone number, together with a clear statement that the prospective franchisee is entitled to contact any of the franchisees listed, or alternatively to visit any outlets operated by a current franchisee to assess the information disclosed by the franchisor and the franchise opportunity offered by it; and

(b) an organogram depicting the support system in place for franchisees.

The financial disclosure obligations listed under sub-regulations (1) to (3) above must be updated on an annual basis. A franchisor is obliged to update sub-regulation (4) on a continual basis, as and when a new franchised business is sold, or when any information changes.

There is no obligation to make continuing disclosure to existing franchisees; only to potential franchisees.

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

There are no compulsory obligations that a franchisor must comply with before a franchise may be offered or sold. However, it would be beneficial for a franchisor to have registered its trade marks or to have lodged an application for the registration of its trade marks with the Companies and Intellectual Properties Commission ("CIPC") prior to marketing the franchise system to potential franchisees.

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

No; membership to the Franchise Association of South Africa ("FASA") is not mandatory but is deemed to be commercially advisable as it aims to promote ethical franchising in South Africa and conforms to international best practices.

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

Yes, all members of FASA, including but not limited to franchisors, franchisees and professional service providers, need to adhere to FASA's Code of Ethics and Business Practices. In addition, franchisors need to comply with FASA's Disclosure Documents Requirements. Both these documents may be viewed at:

- https://www.fasa.co.za/documents/CodeOfEthics20170811.pdf.
- https://www.https://www.fasa.co.za/documents/DisclosureDocumentRequirements14112011.pdf.

It is worth noting that FASA is in the process of reviewing its Code of Ethics and Business Practices in order to simplify its policies.

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

There is no statutory requirement that franchise documents or disclosure documents need to be translated into the local language. However, in terms of FASA's Disclosure Documents Requirements, FASA requires disclosure documents and supporting documents to be in 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.

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

Franchisors most commonly operate through companies (private or public) and close corporations. International franchisors may conduct business in South Africa through external companies (branches).

As international franchisors look to expand into South Africa, franchise joint ventures are growing in popularity as international franchisors are able to establish networks with local partners but still keep control of their brands.

Alternatively, international franchisors are also granting local partners the rights to master franchisees for the whole of South Africa or particular regions in South Africa.

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

All new companies (local and external) need to be registered at the Companies and Intellectual Properties Commission before they commence trading.

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 applies to franchising as it constitutes an economic activity within the Republic of South Africa. However, as franchising appears to "infringe" on several clauses of the Competition Act, the Competition Commission issued a Franchising Notice to clarify the Competition Commission's stance on franchising.

Accordingly, the Competition Commission concluded that: "Franchising agreements are as such not necessarily

anticompetitive. They are used to establish a distribution network and this creates opportunities and benefits to both parties. The franchisor exploits expertise in other markets without substantial capital investment in setting up a retail network. The franchisee, on the other hand, also gets access to trading methods, which have been tried and tested. Therefore, any agreement that is necessary to support the essential features of the franchise relationship should not raise competition concerns, for example, the protection of the know-how, protection of network reputation, or selective distribution clauses which are normally introduced for efficiency reasons."

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

No. In practice, franchise agreements run for a period of five years, with an option to renew for a further five-year period.

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

No, there is not.

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

Yes; in terms of section 5(2) of the Competition Act, the practice of minimum resale price maintenance is prohibited. However, in terms of section 5(3), a supplier or producer may recommend a minimum resale price to the reseller of a good or service, provided:

(a) the supplier or producer makes it clear to the reseller that the recommendation is not binding; and

(b) if the product has its price stated on it, the words "recommended price" appear next to the stated price.

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

There is no statutory protection afforded to a franchisee against its franchisor or second franchisee for competing within the same territory allocated to the said franchisee in terms of its franchise agreement. In terms of the CPA Regulations, any territorial rights granted to a franchisee need to be specifically included in the franchise agreement. Therefore, the franchisee may have a claim against the franchisor for breach of contract.

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

Yes, both in-term and post-term non-compete (restraint of trade) and non-solicitation of customers' covenants are enforceable by our courts provided they are reasonable and not contrary to public policy.

An injunction granted by a foreign court is not directly enforceable in South Africa but constitutes a cause of action. Therefore, in order for a foreign judgment to be recognised and enforced by South African courts, the following conditions need to be fulfilled:

- the foreign court had jurisdiction to hear the case;
- judgment is final and conclusive in its effect and has not become superannuated;
- the recognition and enforcement of the judgment by South African courts would not be contrary to public policy;
- the judgment was not obtained fraudulently;
- the judgment does not involve the enforcement of a penal or revenue law of the foreign state; and
- the enforcement of the judgment is not precluded by the provisions of the Protection of Businesses Act No. 99 of 1978.

4 Protecting the Brand and other Intellectual Property

4.1 How are trade marks protected?

Registered trade marks are protected and defended under the Trade Marks Act No. 194 of 1993, whilst unregistered trade marks may only be defended in terms of common law.

The CIPC administers the Register of Trade Marks in the Republic of South Africa.

Applicants have to file a separate trade mark application for each international class of goods or services for which it would like to use the trade mark. The registration procedure results in a registration certificate which has legal status, allowing the owner of the registered trade mark the exclusive right to use that mark.

Registered trade marks can be protected forever, provided they are renewed every 10 years upon payment of the prescribed renewal fee to the CIPC. The CIPC will notify a trade mark owner/holder six months before a renewal is due, but ultimately the onus to renew rests on the owner/holder of the trade mark.

Failure to protect one's trade mark may result in a third party passing off his goods or services with the goods or services of the trade mark owner.

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 other business-critical confidential information is protected in terms of common law and law of contracts.

A party may launch an application to court in order to interdict a person who has unlawfully used the know-how, trade secrets and confidential information of another.

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 in South Africa is governed by the Copyright Act No. 98 of 1978 and is administered by the CIPC. South Africa is also a party to the Berne Convention and the Agreement on Trade-Related Aspects of Intellectual Property Rights ("TRIPS Agreement"). In addition, South Africa has signed, but not ratified, the World Intellectual Property Organization ("WIPO") Copyright Treaty.

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?

Yes; a franchisee may be entitled to rescind a franchise agreement

and/or claim damages if a franchisor fails to comply with its mandatory disclosure obligations.

In terms of section 52(4)(a)(i)(bb) of the CPA:

(1) If, in any proceedings before a court concerning a transaction or agreement between a supplier (franchisor) and a consumer (franchisee), a person alleges that an agreement, a term or condition of an agreement, or a notice to which a transaction or agreement is purportedly subject, is void in terms of this Act or failed to satisfy any applicable requirements set out in section 49, the court may:

(a) make an order:

(i) in the case of a provision or notice that is void in terms of any provision of this Act:

(aa) severing any part of the relevant agreement, provision or notice, or altering it to the extent required to render it lawful, if it is reasonable to do so having regard to the transaction, agreement, provision or notice as a whole;

(bb) declaring the entire agreement, provision or notice void as from the date that it purportedly took effect; or

(ii) in the case of a provision or notice that fails to satisfy any provision of section 49, severing the provision or notice from the agreement, or declaring it to have no force or effect with respect to the transaction; and

(b) make any further order that is just and reasonable in the circumstances with respect to that agreement, provision or notice, as the case may be.

The National Consumer Tribunal may impose an administrative fine on a franchisor if the franchisor is found guilty of non-compliance, which fine may not exceed the greater of 10 per cent of the franchisor's annual turnover or up to R 1 million (one million Rand).

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

No; in terms of sub-franchising, the master franchisee is responsible for complying with the disclosure obligations. In order to protect itself from any liability due to disclosure non-compliance or pre-contractual misrepresentation, the franchisor should obtain an indemnity from the master franchisee indemnifying itself from this obligation.

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

No; a franchisor may not contract out of the CPA in order to evade liability for pre-contractual misrepresentation.

In terms of section 48(1)(c) of the CPA:

(1) A supplier (franchisor) must not:

(a) require a consumer (franchisee), or other person to whom any goods or services are supplied at the direction of the consumer:

(i) to waive any rights;

(ii) assume any obligation; or

(iii) waive any liability of the supplier,

on terms that are unfair, unreasonable or unjust, or impose any such terms as a condition of entering into a transaction.

Furthermore, in terms of common law, a franchisor cannot contract out of liability for misrepresentation.

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

In terms of section 4(1)(c) of the CPA, class actions are permissible in terms of South African law, and therefore class action waiver clauses would be deemed to be unenforceable as one may not contract out of the CPA. As class actions are still gaining traction in our legal system, class actions by franchisees have not yet tested our 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?

Generally, franchise agreements concluded in South Africa are governed by the local law; however, if a franchisor is located outside of South Africa, there is nothing precluding it from electing its own governing law to govern the franchise agreement. In other words, contracting parties have freedom of choice as to which laws they intend to govern their contracts.

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 may seek urgent injunctive relief against a rogue franchisee by way of an interdict. An interdict is sought by way of a court application and may either be a prohibitory interdict (i.e. prevents the rogue franchisee from doing something) or a mandatory interdict (i.e. requires the rogue franchisee to do something).

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

In South Africa, arbitration has always been considered an expensive alternative to civil litigation. However, the International Arbitration Act No. 15 of 2017 ("the IAAA") recently came into operation on 20 December 2017 and incorporates the United Nations Commission on International Trade Law ("UNCITRAL") Model Law into South African law. As a result, the IAAA ensures that South Africa now has a reformed and modernised international arbitration law which will assist South African businesses to resolve their disputes in a speedy and cost effective manner.

South Africa has acceded to the New York Arbitration Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

There is no mandatory obligation to engage in mediation before commencing formal arbitration or court proceedings.

7 Real Estate

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

The lease term for a commercial property is usually five or 10 years, with an option to renew for a further five- or 10-year period, depending on the performance of the tenant.

There is no statutory right to enable a tenant to hold over the tenancy at the end of the contract term. In the event that a tenant does hold over, the tenancy will continue on a month-to-month basis and the tenant will be obliged to continue to pay its rent, will remain bound by all the terms and conditions of the tenancy and will also be liable to the landlord for any damages that the landlord may suffer as a result of the tenant's continued occupation of the leased 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?

Such a concept will only be enforceable if it is contained in the lease agreement. It is common practice for landlords to specify in a lease agreement that the leased premises are reserved for a particular type of franchise, thus affording the franchisor the opportunity to step into the franchisee's shoes under the lease or to appoint a replacement franchisee to take over the lease.

Franchisors usually include a condition in the franchise agreement that the franchisee must negotiate and include such a clause in its 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?

There are no restrictions on non-nationals (natural or juristic persons) from holding an interest in or sub-letting immovable property in South Africa.

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 in a particular location)?

Whilst the commercial real estate market in urban areas is fairly saturated, there are still major investment opportunities for retail development in highly populated, previously disadvantaged areas of South Africa.

Tenants usually expect to secure an initial rent-free period ("beneficial occupation") when concluding a new lease with a landlord. Beneficial occupation may be anything between one and three months.

Even though it is legal to do so, it is not common practice for landlords to demand "key money" for a specific location.

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, a franchise agreement may impose binding requirements for a request to be re-directed to the franchisee of a particular territory. As franchising is subject to the same competition laws and policies applicable to all other economic activities, the Competition Commission has held that a franchisor is allowed to engage in exclusive territory arrangements if the aim is to achieve efficiencies in distribution.

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, unless such a provision is recorded 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?

There are no mandatory local laws that may override a franchisor's right to terminate a franchise agreement.

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

There are no local rules imposing a minimum notice period to be given to end a business relationship. The notice period will be governed by the time period agreed to in 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 question of when or whether a franchisor may be considered a joint employer of the franchisee's employees centres around the issue of "control". The current law, as stated in *SA Broadcasting Corporation v McKenzie (1999) 20 ILJ 585 (LAC)*, draws a distinction between "employees" and "independent contractors", which are defined as follows:

Employee:

- the object is the rendering of personal services between the employer and employee;
- an employee renders the service at the request of the employer;
- an employer decides whether it wishes to have an employee render the service;
- an employee is obliged to obey lawful, reasonable instructions regarding the work to be done and the manner in which it is to be done;
- a contract of employment is terminated by the death of the employee; and
- a contract of employment terminates on completion of the agreed period.

Independent contractor:

- the object is the production of a certain specified service or the production of a certain specified result;
- an independent contractor is not obliged to perform his work personally, unless otherwise agreed;
- an independent contractor is bound to perform specified work or produce a specified result within a specified or reasonable time;
- an independent contractor is not obliged to obey instructions regarding the manner in which a task is to be performed;
- the contract of work is not terminated by the death of the contractor; and
- the contract of work terminates on completion of the specified work, or on production of the specified result.

When a franchisor crosses the boundary of what defines an independent contractor, then it may be seen to be an employer-employee relationship.

However, in order to prevent a franchisor from being regarded as a joint employer with a franchisee, in respect of the franchisee's employees, a franchisor should insert a "no employer-employee relationship" clause in its 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?

No, a franchisor cannot be held vicariously liable for the acts or omissions of a franchisee and/or the franchisee's employees.

The test to determine whether an employer may be held vicariously liable for the delict (tort) of his employee is as follows:

- there must have existed an employer-employee relationship when the delict was committed;
- the employee must have committed the delict; and
- the employee must have acted within the scope of his employment when the delict was committed.

Therefore, in order to limit the risk of a franchisor being held vicariously liable for the acts or omissions of a franchisee's employees, franchisors should insert a "no employer-employee relationship" clause in their franchise agreements.

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?

South African franchisees are obliged to obtain exchange control approval from the South African Reserve Bank before making any outward royalty payments to non-resident franchisors.

In terms of subsection 10.7 of the South African Reserve Bank Currency and Exchange Guidelines for Business Entities (22-06-2018):

- prior to effecting payment, South Africa franchisees must furnish an authorised dealer (the franchisee's local bank) with a copy of the franchise agreement it concluded with the non-resident franchisor and present invoices verifying the purpose and the amount involved from the non-resident franchisor; and
- where a South African franchisee makes recurring royalty payments, it must present a letter from an independent auditor to the authorised dealer on an annual basis, in respect of the royalty payments, confirming the amount or percentage transferred over a 12-month period.

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

In terms of the South African Revenue Service, Withholding Tax on Royalties ("WTR") is due on any amount of royalty paid to or for the benefit of a foreign franchisor from a source within South Africa.

Royalties paid by a franchisee are taxed at a final withholding tax rate of 15 per cent.

The foreign franchisor is liable for the tax, but the tax must be withheld from the royalty payment by the person paying it to the foreign franchisor (i.e. the withholding agent).

A royalty is any amount that is received or accrues in respect of:

- the use, right of use or permission to use any intellectual property;
- imparting or undertaking to impart any scientific, technical, industrial or commercial knowledge or information; or
- rendering or undertaking to render any assistance or service in connection with the application or utilisation of that knowledge or information.

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 under South African 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?

Yes, it is possible that a franchisee may be treated as a franchisor's commercial agent. Therefore, in order to limit this risk, franchisors should insert a "no partnership or agency" clause in their franchise agreements.

13 Good Faith and Fair Dealings

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

In terms of South African law, the concept of good faith is applicable to all contracts. Furthermore, the following fundamental consumer rights are set out in Chapter 2 of the CPA:

Part F: Right to fair and honest dealing

Section 40: Unconscionable conduct

(1) A supplier (franchisor) or an agent of the supplier must not use physical force against a consumer (franchisee), coercion, undue influence, pressure, duress or harassment, unfair tactics or any other similar conduct, in connection with any:

(a) marketing of any goods or services;

(b) supply of goods or services to a consumer;

(c) negotiation, conclusion, execution or enforcement of an agreement to supply any goods or services to a consumer;

(d) demand for, or collection of, payment for goods or services by a consumer; or

(e) recovery of goods from a consumer.

(2) In addition to any conduct contemplated in subsection (1), it is unconscionable for a supplier knowingly to take advantage of the fact that a consumer was substantially unable to protect the consumer's own interests because of physical or mental disability, illiteracy, ignorance, inability to understand the language of an agreement, or any other similar factor.

Therefore, a franchisor must act fairly and in good faith in its dealings with franchisees.

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; Part G of the CPA deals with a consumer's (franchisee's) right to fair, unreasonable or unjust contract terms and conditions and states:

"Section 48: Unfair, unreasonable or unjust contract terms

(1) A supplier (franchisor) must not:

(a) offer to supply, supply, or enter into an agreement to supply, any goods or services:

(i) at a price that is unfair, unreasonable or unjust; or

(ii) on terms that are unfair, unreasonable, or unjust;

(b) market any goods or services, or negotiate, enter into or administer a transaction or an agreement for the supply of any goods or services, in a manner that is unfair, unreasonable or unjust; or

(c) require a consumer, or other person to whom any goods or services are supplied at the direction of the consumer:

(i) to waive any rights;

(ii) assume any obligation; or

(iii) waive any liability of the supplier;

on terms that are unfair, unreasonable or unjust, or impose any such terms as a condition of entering into a transaction.

(2) Without limiting the generality of subsection (1), a transaction or agreement, a term or condition of a transaction or agreement, or a notice to which a term or condition is purportedly subject, is unfair, unreasonable or unjust if:

(a) it is excessively one-sided in favour of any person other than the consumer or other person to whom goods or services are to be supplied;

(b) the terms of the transaction or agreement are so adverse to the consumer as to be inequitable;

(c) the consumer relied upon a false, misleading or deceptive representation, as contemplated in section 41 or a statement of opinion provided by or on behalf of the supplier, to the detriment of the consumer;

(d) the transaction or agreement was subject to a term or condition, or a notice to a consumer contemplated in section 49(1), and:

(i) the term, condition or notice is unfair, unreasonable, unjust or unconscionable; or

(ii) the fact, nature and effect of that term, condition or notice was not drawn to the attention of the consumer in a manner that satisfied the applicable requirements of section 49."

Regulation 2 of the CPA deals with the minimum requirements of what must be contained in a franchise agreement.

In terms of Regulation 2(3)(m) of the CPA, if a franchise agreement provides that a franchisee must directly or indirectly contribute to an advertising, marketing or other similar fund, the franchisor must:

(i) within six months after the end of the last financial year, provide a franchisee with a copy of a financial statement, prepared in accordance with applicable legislation, which fairly reflects the fund's receipts and expenses for the last financial year, including amounts spent, and the method of spending on advertising and/or marketing of franchisees and the franchise system's goods and services; and

(ii) for every three-month period, make financial management accounts relating to the funds available to franchisees.

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 disclosure obligations applicable to the renewal of existing franchise agreements; only to new franchise agreements. However, it is advisable for franchisors to provide updated

disclosure documents to franchises upon the renewal of an existing franchise agreement.

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

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. Franchisors usually look at the performance of a franchisee during the initial term to determine whether or not to renew the 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?

Yes, a franchisee who is not in breach of its franchise agreement would be entitled to either:

- claim damages; or
- claim specific performance (i.e. renew the franchise agreement in terms of the renewal period) from 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?

Yes, such restrictive provisions are enforceable if recorded in the franchise agreement. Usually a franchise agreement will contain a provision that a franchisee may not transfer the franchised business in any manner whatsoever without the prior written consent of the franchisor.

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

Yes, "step-in" rights are recognised and enforceable by our courts provided that such rights are recorded in the franchise agreement.

There are no registration requirements or other formalities that need to be complied with to enforce such rights.

16.3 If the franchise agreement contains a power of attorney in favour of the franchisor under which it may complete all necessary formalities required to complete a franchise migration under pre-emption or "step-in" rights, will such a power of attorney be recognised by the courts in the 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?

If a franchise agreement contains such a power of attorney, it will be recognised and enforceable in terms of South African law. No registration or other formalities must be complied with in order for the power of attorney to be valid and effective.

17 Electronic Signatures and Document Retention

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

Section 7(1)(a) of the CPA states that a franchise agreement must be in writing and signed by or on behalf of the franchisee.

In South Africa, electronic signatures are regulated by both the common law and the Electronic Communications and Transactions Act No. 25 of 2002 ("ECTA").

ECTA makes provision for two types of electronic signatures, namely "standard electronic signatures" and "advanced electronic signatures".

A standard electronic signature means data attached to, incorporated in, or logically associated with other data and which is intended by the user to serve as a signature.

Advanced electronic signature means an electronic signature which results from a process which has been accredited by an accreditation authority.

Section 13 of ECTA specifically states that where the signature of a person is required by law and such law does not satisfy the type of signature, that requirement in relation to a data message is met only if an advanced electronic signature is used. An electronic signature is not without legal force and effect merely on the grounds that it is in electronic form. Furthermore, where an advanced signature has been used, such signature is regarded as being a valid electronic signature and to have been applied properly, unless the contrary is proved.

Therefore, in order to conclude a valid and binding franchise agreement by way of an electronic signature in South Africa, the franchisee would need to sign the franchise agreement with an advanced electronic signature.

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

The CPA does not prescribe a time period for the retention of a franchise agreement. However, the South African Revenue Service requires a person to keep records, books of account or documents for a minimum period of five years.

Where an original agreement has been lost or destroyed, a person may rely on a copy of an agreement by adducing secondary evidence of its conclusion and terms.

However, it would be prudent to retain the original franchise agreement, even if a version has been scanned and saved as an electronic file, especially for litigation purposes.

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Alex is a Partner at Christodoulou & Mavrikis Inc. and specialises in commercial law, franchise law, commercial litigation and cyber law.

Alex is a dual-qualified lawyer and is admitted in South Africa and England & Wales (non-practising). He began his career as a Candidate Attorney at Christodoulou & Mavrikis Inc. in 2005. Upon qualifying in 2007, Alex moved to London to pursue his legal career in the United Kingdom. During his time overseas, Alex undertook the Qualified Lawyers Transfer Test and was admitted as a solicitor in 2009, and worked for renowned international law firms where he was involved in all aspects of regulatory and legal compliance issues.

Alex rejoined Christodoulou & Mavrikis Inc. in 2012 and represents various franchisors in the food and beverage industry.

Christodoulou & Mavrikis Inc. is a full-service South African corporate and commercial law firm, established in Johannesburg in 1991. The firm is ideally placed to deal with franchise law, both local and international mergers and acquisitions, commercial law, commercial litigation and dispute resolution.

Franchise law services include competition law aspects, confidentiality and non-competition agreements, the Consumer Protection Act and how it affects franchise agreements, drafting of franchise agreements, franchise disputes, licensing agreements, operations manuals and trade mark and intellectual property registrations. Although the majority of our clients are franchisors in the food and beverage industry, due to our extensive knowledge our lawyers are able to provide expert legal advice in all areas of franchising law to all industry participants.

The firm is an approved professional service provider member of the Franchise Association of South Africa.

An international branch office has operated in Athens, Greece since 2004, which is managed by Mr. George Mavrikis.

Spain

Grupo Gispert Abogados & Economistas

Sönke Lund

1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

The franchise agreement was defined for the first time in Spanish legislation, in Act 7/1996 of the Retail Commerce Law (*Ley de Ordenación del Comercio Minorista*), which defined a franchise as "commercial activity under an agreement according to which the franchisor transfers to the franchisee the right of exploiting his own marketing system of products and services".

This definition was improved in later legislation and established the kinds of activity that fit under a franchise agreement as: "activities for the performance of the contract, according to which an entrepreneur – the franchisor – transfers to another – the franchisee – in exchange for economic direct or indirect compensation, the rights to use a franchise, with regard to a business or commercial activity that the franchisor has carried out with enough experience and success to put his products or services into the market, and includes at least: a) use of a name or label or other intellectual property rights, as well as a similar distribution in the franchise premises or transportation aim of the contract; b) disposal of the specific, fundamental and unique knowledge or the know-how by the franchisee; and c) regular technical and economic assistance, carried out by the franchisor during the performance of the contract, without disregarding its potential supervision, which can be agreed in the contract".

This definition sets as the main goal of the agreement the marketing of goods and services, with emphasis on the field of commercial distribution. The Spanish Supreme Court (*Tribunal Supremo*) has, on the other hand, settled by stating that the franchise agreement is the agreement reached by two legally and economically independent parties, pursuant to which the franchisor grants the franchisee the right to use, under certain control conditions, during a certain period of time and in a geographically delimitated area, a technique in the industrial, commercial or services activity, in exchange for recurring payment by the franchisee. This definition, wider than the legal definition, is not focused on the distribution aspect, and therefore lets other kinds of contract fit in; for instance, technology transfer agreements with an obligation of technical support.

The doctrine describes this agreement as the agreement according to which the entrepreneur – the franchisor – in exchange for a recurring payment, makes available to another entrepreneur – the franchisee – the use of his own methods of doing business, experienced beforehand with success, to integrate them into the franchisee's distribution network and cooperate together in the distribution of products or services. According to this definition, the franchise agreement has a concrete and heterogeneous aim: a business model, defined as a pack of organised material and immaterial goods, which reproduces the franchisor's business model.

1.2 What laws regulate the offer and sale of franchises?

The offer and sale of franchises is regulated by the abovementioned Act 7/1996 of the Retail Commerce Law of 15 January. Article 62 is the provision devoted to franchise agreements.

This Act was thereafter complemented by Royal Decree 201/2010 of 26 February on Franchise Agreements and the Franchisors' Register (*Real Decreto por el que se regula el Ejercicio de la Actividad Comercial en Régimen de Franquicia y la Comunicación de Datos al Registro de Franquiciadores*).

The regulatory agency in charge of franchise matters is the Franchisors' Register, which is administered by the State Secretary of Commerce (General Directorate of Internal Commerce Sub-directorate of Internal Commerce) of the Ministry for Economy and Competitiveness. Regional Franchisors' Registers can be created if the regions' respective legislation foresees it.

Patent and trade mark legislation are also applicable, in respect of the use of industrial property elements.

The Competition Act also has an impact through Royal Decree 261/2008 of 22 February, on Defence of Competition (*Reglamento de Defensa de la Competencia*), as well as Commission Regulation (EU) No 330/2010 of 20 April 2010 and European Commission Guidelines on Vertical Restraints (2010/C 130/01).

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

According to the legal regulation and its interpretation by the courts and the doctrine, there is no obstacle to appoint only one franchisee and to treat it as such for disclosure or registration obligations.

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

The Act created a Register at the State level in which the foreign franchisors – not domiciled in Spain – will have to register as well as the Spanish franchisors, who carry out their business in more than one Autonomous Region. Furthermore, it establishes the main guidelines for each Autonomous Region to create their own

Franchisors' Register, with which franchisors whose activity is carried out only in that Autonomous Region should register.

This Register is created only for the purposes of information and publicity. It is a public and administrative body. This Register's functions are mainly as follows:

(a) Registration of franchisors in the Autonomous Region where they have their domicile, or directly by the request of the interested party in case the Autonomous Region does not ask for notification.

(b) To constantly update the records of registered franchisors and franchisees.

(c) Registration of franchisors' cancellations.

(d) To issue the appropriate supporting certifications of the registered franchisors.

(e) To grant the Autonomous Regions' administrative entities access to the Register information as required.

(f) To provide public information about the franchisors, upon the request of the people concerned.

In order to get registered, franchisors must provide the Register with several documents and data, referring mainly to the franchisor, his industrial property rights and copyrights, as well as the purpose of the potential franchise agreements and a description of the business aim of the contract.

A franchisor (and in some cases also a foreign franchisor) should be registered in the Franchisors' Register and must provide certain information. These obligations should be dealt with no later than three months after the franchisor's activities in Spain have begun. Franchisors are also obliged to communicate to the Franchisors' Register any modification of the information already provided. This communication has to be made within three months of any change taking place.

Once a year in January, franchisors are also obliged to communicate to the Franchisors' Register any closing or opening of premises (whether owned or franchised) during the previous year. As an exception, franchisors established in an EU Member State and without a permanent establishment in Spain but acting with freedom to provide services will only be obliged to communicate to the Register the commencement of their activities.

1.5 Are there mandatory pre-sale disclosure obligations?

First of all, information to be disclosed to the Franchisors' Register has to be given to the regional Register or, if the regional legislation does not provide for such obligation, to the central one. Pre-contractual information has to be communicated to the franchisees by the franchisor at least 20 working days before the signature of the franchise agreement or pre-agreement, or before any payment is made to the franchisor by the future franchisee.

The main purpose of this obligation is to protect the potential franchisee – who is seen by the legislator as the "weak" party – by providing the appropriate information for him to be fully aware of the basics of the agreement in order to conclude it. Furthermore, the Royal Decree grants the franchisor protection by enabling him to request from the franchisee an obligation of confidentiality with regard to all the pre-contractual information.

Franchisors must disclose the following specific information in an accurate and non-misleading manner, in writing, to the potential franchisee: identification of the franchisor (name, registered address, information of the commercial registry and stock capital, indicating if it is fully paid up or in what proportion), including details of the entry in the Franchisors' Register; foreign franchisors must disclose information about their registry to the Franchisors' Register according to their national regulations; proof of ownership or licence for the use of any trade mark or similar element; the franchisor's experience, including the date of incorporation and the main steps in its evolution and the development of the franchise network; the contents and characteristics of the franchise and its exploitation, including a general explanation of the business, special characteristics of the know-how and the permanent commercial or technical assistance the franchisor will provide to franchisees; and an estimation of the necessary investments and expenses to start a business. If the franchisor is offering estimates on the volume of sales or results of the placement of the business to the potential franchisee, these should be based on: experience or information that can be fully justified; the structure and extent of the network in Spain, including the way it is organised and the number of establishments opened in Spain (either directly owned or through franchises), indicating the cities; as well as the number of franchisees having left the network in the preceding two years, indicating the reasons; and essential elements of the franchise agreement, including the rights and obligations of the parties, conditions for its termination or renewal, economic obligations, exclusivity clauses and limitations imposed on the franchisee in order to run the business.

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

In a Master Franchise Agreement, the franchisor grants to the master franchisee the right to exploit a franchise in a particular market in exchange for financial compensation (either direct or indirect or both) with the intention of signing franchise agreements with third parties. The master franchisee assumes the position of the franchisor in this particular market or area. In case of a sub-franchising structure, therefore, pre-sale disclosure to sub-franchisees must be made by the master franchisee (sub-franchisor). The information required concerning the franchisor and the contractual relationship between the franchisor and the sub-franchisor is as follows: identification of the franchisor (name, registered address, and information about the entry in the Franchisors' Register); if it is a company, its capital stock in the last balance sheet, indicating what proportion is paid, and the Commercial Register information, if appropriate; if the franchisor was a foreign franchisor, information about its entry in the Franchisors' Register according to its legal obligation; and proof of having obtained a right to use the trade mark and other IP elements of the franchisor (indicating their duration); and any judicial proceedings that could affect the use of the trade mark.

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 specific legal provisions oblige the franchisor to update the information already disclosed to franchisees, but it could be considered that the information disclosed should be updated if anything relevant is modified. Therefore, franchisors are obliged to update this information directly to the Register.

There is no specific obligation for continuing to disclose information to current franchisees once the agreement has been signed, although this could be necessary if some relevant modifications have taken place.

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

There are no further requirements to be met.

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

The principal association of franchisors is the Spanish Association for Franchises, which belongs to the Iberian and American Franchise Federation, the European Franchise Federation and the World Franchise Council. Membership is not mandatory but beneficial, because: it helps franchisors to be represented in international and national trade fairs; it makes available funds for specific commercial missions; it seeks to harmonise franchisor-franchisee relationships; it provides information and training on franchising; and it provides information to potential investors, etc.

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

Remarkably, various associations of franchisors have developed and implemented among their partners Codes of Ethics, which contain commitments the entrepreneur should assume under this kind of agreement. Among others, the Code most worthy of note is the EFF Code of Ethics, first passed in January 1991 (http://www.eff-franchise.com).

The main goal of these Codes is to standardise the conduct of association members, as well as to make a clear distinction of true franchising from other, fraudulent businesses. These Codes are non-legal documents, so they are not legally binding. However, it has been seriously contemplated as doctrine to apply them where the will of the parties is missing, considering that they could be regarded as customary obligations. This theory, however, has not been adopted in Spain. The sentence from the Barcelona Court of Appeal of 16 December 1996 declares that a franchise consists of a contractual relationship of Anglo-Saxon origin, which lacks a specific regulation in Spain, unlike in other European Community countries, where the EFF Code of Ethics is applicable. On the contrary, in Spain its use has its legal basis in the principle of contractual freedom on the basis of Article 1255 of the Civil Code (*Código Civil*) and Articles 51 and 52 of the Code of Commerce (*Código de Comercio*).

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

There is no specific requirement for franchise documents to be in Spanish; however, this might be recommendable for marketing purposes.

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 not.

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

Franchisors may establish their franchise network in the country through different types of entity. The most common types of business entity used by franchisors in Spain are the *sociedad limitada*, the *sociedad limitada nueva empresa* and the *sociedad anónima*.

The *sociedad de responsabilidad limitada* (SRL) or *sociedad limitada* (SL) is a kind of commercial enterprise provided by Spanish legislation, where the capital is divided into shares and the responsibility of the partners is limited by the capital provided and, therefore, if debt is incurred, the partner will not be liable for private assets. This type of enterprise is regulated in the *Ley de Sociedades de Capital*.

The *sociedad limitada nueva empresa* (SLNE), or *sociedad nueva empresa*, is defined in the *Ley de sociedad limitada nueva empresa*, as a field of the *sociedad de responsabilidad limitada*. This type of enterprise will comprise a maximum of five partners.

The *sociedad anónima de capital*, also regulated in the *Ley de Sociedades de Capital*, is divided into shares and it comprises the contribution of all the partners who will not be liable for private assets.

The *empresa conjunta*, also known as the joint venture, is also a common route used to establish a network in the country. The joint venture is not defined in Spanish legislation, but it may be included in Article 1.255 of the Spanish Civil Code, which allows the creation of new contractual modalities, having regard to the principle of contractual freedom.

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 be able to trade in Spain, the entity must fulfil certain requirements that may vary depending on the company's home country and on the specific activity it is going to carry out. For example, if a business is duly registered in a country that is a member of the European Union (EU), the general principle of free trade states that the company will be able to offer its services in any other country in the EU without having to create a new company or branch office.

In spite of this general principle, depending mainly on the frequency, duration and regularity with which the company trades in Spain, it will have to eventually create a company in Spain, or a branch office, according to Spanish law. There are different forms of creating a permanent establishment in Spain, one of them being franchising.

3 Competition Law

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

At a national level, applicable regulation is the Spanish Competition Act 15/2007 of 3 July and Royal Decree 261/2008 of 22 February which approved the Spanish Competition Regulation, developing the Spanish Competition Act.

However, according to Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 101 and 102 of the Treaty and Royal Decree 261/2008, the community regulation regarding "block exemption" shall be directly applicable in Member States' national legal systems and will be directly applicable by national competition authorities and courts.

Franchise agreements may be considered as vertical agreements that contain competitive constraints and therefore all community regulation shall be also considered. It follows that, when analysing

applicable law to franchises, it will also be necessary to take into account the community regulation, i.e. Articles 101(1) and (3) of the Treaty on the Functioning of the European Union, Commission Regulation (EU) No 330/2010 of 20 April 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 ("block exemption" on vertical agreements) and the Guidelines on Vertical Restraints (2010/C 130/01).

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

No; but if the franchise agreement contains non-compete clauses, according to Article 5.1 a) of Commission Regulation (EU) No 330/2010 any direct or indirect non-compete obligation, the duration of which is indefinite or exceeds five years, will not benefit from the block exemption.

The term "non-compete obligation" means any direct or indirect obligation causing the franchisee not to manufacture, purchase, sell or resell goods or services which compete with the contracted goods or services, or any direct or indirect obligation on the franchisee to purchase from the franchisor or from another undertaking designated by the franchisor more than 80% of the franchisee's total purchases of contracted goods or services.

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

As mentioned above, in case the agreement involves a non-compete obligation, according to Article 5.1 a) of Commission Regulation (EU) No 330/2010, any direct or indirect non-compete obligation, the duration of which is indefinite or exceeds five years, will not benefit from the block exemption.

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

Agreements or clauses having as their direct or indirect object the establishment of a minimum resale price or a minimum price level to be observed by the franchisee are considered "hardcore" restrictions and are therefore forbidden by EU regulation. Due to the direct application principle of the European Competition Act in the Member States, these kinds of provisions are also forbidden in the Spanish legal system.

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

According to European antitrust law, the restriction of the territory into which, or of the customers to whom, a franchisee may sell the contracted goods or services is not permitted, except in case of restriction of active sales into the exclusive territory or to an exclusive customer group reserved to the franchisor or allocated by the franchisor to another franchisee, where such a restriction does not limit sales by the customers of the franchisee.

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

Regarding in-term covenants, and according to Article 5.1 a) of Commission Regulation (EU) No 330/2010, any direct or indirect non-compete obligation, the duration of which is indefinite or exceeds five years, will not benefit from the block exemption.

Regarding post-term covenants, any direct or indirect obligation causing the franchisee not to manufacture, purchase, sell or resell goods or services after termination of the agreement are forbidden, unless all the following conditions are fulfilled:

(a) the obligation relates to goods or services which compete with the contracted goods or services;

(b) the obligation is limited to the premises and land from which the franchisee has operated during the contract period;

(c) the obligation is indispensable to protect know-how transferred by the franchisor to the franchisee; and

(d) the duration of the obligation is limited to a period of one year after termination of the agreement.

4 Protecting the Brand and other Intellectual Property

4.1 How are trade marks protected?

There are various means of trade mark protection under Spanish legislation. A trade mark can be protected by industrial property rights as an International Trade Mark, as a Community Trade Mark or as a Spanish Trade Mark under Spanish legislation. As trade marks in Spain can be protected as Community Trade Marks, protection can be achieved even if they are unregistered, although the term of protection would be shorter than if they were indeed registered.

The national protection of trade marks is specified under the Spanish Trade Mark Act (*Ley de Marcas*) and the agency responsible for maintaining their registration is the Spanish Office of Patents and Trade Marks (*Oficina Española de Patentes y Marcas*).

In order to enjoy protection as a Spanish trade mark, it must be registered with the Office, as established in the Trade Mark Act. The registered trade mark will be protected for a period of 10 years starting from the day of the application, and the protection can be renewed at consecutive intervals of 10 years. The renewal will be made by the owner of the trade mark and shall be filed together with proof of payment of the renewal fee, the amount of which shall be determined by the number of classes included in the renewal application.

Such registration is compulsory in the sense that, without registration, the trade mark does not exist. This is particularly noteworthy as regards Article 46.3 of the above-mentioned Act, under which the trade mark will not have the nature of object of property if it is not registered.

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

The franchisor is bound not to act in a manner that damages the business plan of an enterprise under Article 57 of the Commercial Code, which establishes the principle of good faith in the performance and fulfilment of the commercial contract. This includes the obligation to keep the secrecy of the know-how, which is materialised through the prohibition of disclosure. It is a fundamental requirement that is not specifically determined and, since its infringement may cause substantial damages to property, it generates a duty of compensation for damages.

Business entities in Spain, especially medium-sized companies, are more and more aware of the importance of "know-how" and trade

secrets. In cases where knowledge cannot be protected by industrial or intellectual property or when the costs for this kind of protection are simply too high, Spanish legislation also offers protection under the unfair competition legal framework. In this regard, Article 13 of the Spanish Unfair Competition Act (*Ley de Competencia Desleal*) forbids employees from taking and exploiting trade secrets. In absence of a concrete regulation – the Directive (EU) 2016/943 of 8 June 2016 on the protection of undisclosed know-how and business information (trade secrets) against their unlawful acquisition, use and disclosure has not been implemented yet – courts in Spain have construed the notion of trade secrets in light of the definition included in Article 39.2 of the TRIPs Agreement. Accordingly, information: (a) is secret in the sense that it is not generally known among or readily accessible to persons within the circles that normally deal with the kind of information in question; (b) has commercial value because of its secrecy; and (c) has been subject to reasonable measures under the circumstances, by the person lawfully in control of the information, to keep it secret.

Along the same lines, Article 76 of the Patent Act (*Ley de Patentes*) stipulates that the purchaser or licensee to whom the know-how or trade secrets are communicated is obliged to take the necessary measures to avoid their disclosure. However, this is only applicable to the employer who has already entered into the contract and does not show the product before coming to an 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?

All original literary, artistic and scientific creations expressed by any means can be subject to copyright protection under the Spanish Intellectual Property Act (*Ley de Propiedad Intelectual*). This includes books, brochures, pamphlets, correspondence, writings, speeches, lectures, forensic reports, academic explanations and other works of the same nature.

Consequently, the copyright in the Operations Manual or in proprietary software developed by the franchisor and licensed to the franchisee under the franchise agreement will be protected under the Spanish Intellectual Property Act as long as they reach the level of originality and creativity required for this kind of 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 specific regulations applicable to franchises do not state the consequences of failure to comply with mandatory disclosure obligations. Therefore, the general rules contained in the Spanish Commercial Code and the Civil Code apply. These will mainly refer to the validity of the consent given. According to case law, the consequences of such lack of disclosure will depend on whether it can be proven that the franchisee would have not entered into the agreement if it had been provided with all the correct data. In that case, the consent would be deemed defective and, according to Article 1266 of the Spanish Civil Code, the contract could be annulled. Contrarily, if the misrepresentation would not have affected the decision of the franchisee to enter into the agreement, it would not be annullable. Nevertheless, the franchisee could claim damages as a result of the said failure.

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

According to the specific regulation, both the franchisor and the master franchisee must provide the sub-franchisee with the complete data at least 20 days before the signing of the agreement. Case law, since there is no complete regulation of franchising institutions, tends to consider that the master franchisee is assigned the position of the franchisor and therefore is directly liable before the sub-franchisee.

Any clause affecting or limiting third parties' rights cannot be alleged against such third parties, as long as they are not to be considered parties to such an agreement. Therefore, clauses contained in the Master Franchise Agreement stating any kind of liability limitation could not be enforced against the sub-franchisee – as long as such clause had not been included in the sub-franchising agreement.

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

Pursuant to the general principle of contractual freedom, the parties are allowed to introduce in the agreement any clause they deem suitable as long as it is not contrary to public order, good morals or prohibitive law. Therefore, it is possible to introduce a disclaimer clause in the agreement in order to avoid liability for pre-contractual misrepresentation. However, under Spanish law, the scope of said clause is limited as, according to Article 1.102 of the Spanish Civil Code, liability arising from wilful misconduct is enforceable for all obligations, and not previously renounceable. As a result, in case of fraudulent misrepresentation, the disclaimer clause would not be applicable as, according to the above-mentioned provision of the Spanish Civil Code, any waiver of action to enforce liability for wilful misconduct is null and void.

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

In general terms, class actions are limited mainly to entities acting to protect consumers or in defence of gender equality rights. The possibility of class actions being brought by legal entities acting on behalf of professionals or entrepreneurs is only envisaged under the Spanish Act regarding actions against general terms and conditions to be deemed abusive, and only when aiming to remove the provision that is considered unlawful and oblige the drafting party to cease and withdraw the use of such clauses. Therefore, a group defending the rights and interests of franchisees could bring class actions against the franchisor only in order to remove some general terms and conditions of a given contract or cause him to cease and withdraw the use of such clauses, but not to claim damages for the application of the said terms and conditions.

6 Governing Law

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

No, there is no requirement for local law to govern franchise documents. The law of any of the parties and the law of the place of performance of obligations, if different, can also govern.

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, from the moment of lodging the initial complaint, the plaintiff can solicit from the court interlocutory relief to secure the effective judicial protection that is demanded. Generally, there are two main types of proceedings within the civil jurisdiction: verbal proceedings; and ordinary proceedings. The competent courts are generally the courts of first instance (for conflicts related to franchise agreements) or the Commercial Court (for special matters such as bankruptcy, unfair competition, intellectual property, general conditions, transport or commercial undertakings) where the defendant is domiciled, except where parties have agreed otherwise.

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

Yes, arbitration is recognised as a viable means of dispute resolution and Spain signed the New York Arbitration Convention in 1977. In this context, the creation of various franchise arbitration courts, and dispute resolution related to these kinds of agreements is remarkable. The Spanish Franchise Association has created the Spanish Franchise Association Court, which aims at mediating and arbitrating, both on the basis of Acts and equity, in any dispute related to a franchise agreement or matter of non-mandatory law. Obviously, submission to this Court's decisions is voluntary.

7 Real Estate

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

As far as commercial lease agreements are concerned, there are no maximum lease terms under Spanish law. The duration is basically freely negotiable. In the unusual case that no explicit term is agreed, Article 1.581 Spanish Civil Code deems a term of one month if monthly payment is agreed. The same happens if the parties agree a yearly rent payment, etc. The terms of a commercial lease agreement shall be always clearly determined.

The duration of lease agreements, e.g. in the case of Spanish shopping centres, generally depends on the size of the premises. In terms of "mid-sized units", the average term of Spanish retail contracts is currently about 10 years, whereas in regards to "small-sized units" it is five to six years:

- Premises from 50 to 500 sqm: terms of three to five years.
- Premises from 500 to 1,500 sqm: terms of five to 10 years.
- Premises bigger than 1,500 sqm: terms of 10 to 20 years.

On the other hand, another determining factor is the reputation or economic impact which each tenant implies to the shopping centre. The "top five" retailers in the Spanish market (e.g. the Inditex Group) are normally able to agree preliminary rights of termination, which allows them to step out of the lease contract at any time they want, or at least after a rather short initial mutual binding period of one to two years. Unless the parties agree a specific notification modus, there is an automatic or tacit extension (*tácita reconducción*) of the term according to Article 1.566 of the Spanish Civil Code if the retailer continues using the premises for 15 days after the end of the term.

Such extraordinary termination rights of retailers are often connected with the potential right of the landlord to redefine the rent after a certain duration of the contract, e.g. after five or 10 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?

Generally speaking, the concept of an option or conditional lease assignment is understood and enforceable. Special attention has to be paid to contractual clauses that establish the fact of insolvency proceedings as a reason for an (automatic) early termination of the lease agreement. These are null and void due to mandatory legal bankruptcy provisions – Article 61.3 of the Spanish Bankruptcy Act (*Ley Concursal*). In addition, in the event of Spanish bankruptcy proceedings and a situation of non-fulfilment by the tenant, the receivership and/or court in charge of the bankruptcy proceedings shall be notified of, and shall deal with, the termination of the contract, together with possible liability for damages.

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

Apart from zones of special interest, e.g. for reasons of national security or due to coastal protection provisions, etc., there are no limitations at all with regard to foreign investments on acquisitions. As a result, no mandatory process of prior government verification of the investment amount applies, but there exist retroactive obligations to notify the governmental institutions for merely statistical purposes.

In general, rules on investment, except for EU citizens and Swiss citizens due to international treaties, are linked to the place of origin of the investment and not nationality. Nonetheless, there is an obligation to report investments in case the capital inflow originates from so-called tax havens prior to carrying out the investment. In this context, quite severe anti-money laundering legislation, with wide registration and information obligations, needs to be carefully observed.

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 in a particular location)?

With respect to the current situation of the commercial real estate market, it can be said that following the main conclusions of the current market analysis reports for 2017/2018 ("*RETAIL Fundamentals Q2 2018*"), *Jones Lang Lasalle-Madrid* (www.jll.es); "*Informe Retail 2017*", *Gesvalt Sociedad de Tasación* (www.gesvalt.es)), experts see a still ongoing recovery of the Spanish economy in general terms and their main macroeconomic indicators, with GDP expanding by 0.7% for the fourth consecutive quarter in Q2 2018 and estimated at 2.8% for 2018 which represents another year of solid growth, compared to an average of 2.1% foreseen for the EU. For the Consumer Price Index they expect a slightly increasing tendency with positive growth of around 1.8%.

Commercial real estate market

Generally speaking, the actual stock of retail space in Spain stands at 16.6m sqm, with about 615 retail schemes. With a retail density of 353 sqm/1,000 inhabitants, the Spanish retail market is clearly a mature market. New GLA continued to come onto the market in 2017, with the new space primarily focussing on a niche concept. A further 500,000 sqm is expected to be added to the stock in 2018. The rise of e-commerce is heightening competition among shopping centres, which have become omnichannel spaces. The food, beverage and leisure sectors are leading the way in terms of innovation, with pop-up stores and multi-purpose spaces. Retailers are actively looking for new locations and there is a large arrival of international retailers looking to test the Spanish market (Savills Aguirre Newman, "*Market report Spain Retail January 2018*"; http://pdf.euro.savills.co.uk/spain/nat-eng-2018/savills-investment-spain-jan2018-eng.pdf).

Initial rent-free period or "key money"

Both situations are possible and often occur. With respect to tenants' expectations of an initial rent-free period, in case of commercial lease agreements such contractual provisions are quite common in Spain. The number of months concerning the agreed period without rental payment obligations (*carencia*) depends, in the first place, on an economic evaluation related to the necessary modernisations or reform works to be done in order to open the premises to the public. On the other hand, additional "key money" provisions are possible and often dealt with between the previous tenant and the new tenant (*traspaso*) in the event that the landlord is a third party in relation to the franchise 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?

As the European Commission Guidelines on Vertical Restraints pointed out, where there is exclusivity of the franchisee's territory, none of the franchisees can pursue sales in another franchisee's territory. Consequently, active sales out of the allocated territory are forbidden. However, passive sales are admissible. Internet sales have been considered passive sales and any franchisee can make that sale, unless such a franchisee was actively promoting and pursuing that sale.

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

No, such a pact would be admissible according to the contract freedom principle.

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?

This is one of the multiple aspects of the franchise agreement not specifically regulated by Spanish law. In this respect, once again it will be the parties which will have to regulate the termination, as well as the general legal prescriptions referring to contracts, that is, Article 1124. (The right to terminate the obligations is implicit in the reciprocal ones, when one of the obliged parties does not fulfil its obligation.)

The damaged party will be able to choose between demanding fulfilment or compensation for damages, including interests. He will also be able to demand early termination (when, after accepting the fulfilment, it becomes impossible) and Article 1156 of the Spanish Civil Code (obligations are extinguished: by payment or fulfilment; by the loss of the subject matter of the contract; by confusion of the rights from the creditor and debtor; by compensation; or by renewal) will play its part.

The causes of termination of a franchise agreement, as explained below, can be very diverse – by expiration of the duration agreed, by mutual consensus, breach of the contract by one of the parties, etc. Moreover, the termination of the contract entails some consequences which will have to be resolved, such as the destination of the stocks, the potential compensation for clients, prohibition of competition, etc.

Normal termination

Franchise agreements with a limited duration will only terminate by the expiration of the agreed time period, i.e. when the term fixed at the conclusion of the agreement has expired or when the extensions agreed later have also expired.

The law does not foresee a determined term for the franchise agreement; according to the Courts Doctrine the regular contractual relationships must be limited in time. This means, as the doctrine sets out, establishing a limit to the debtor. Otherwise, such a clause would be against the public order. Consequently, according to Article 1255 of the Spanish Civil Code, any clause setting an unlimited duration for a franchise agreement will be considered as null and void.

On the basis of the above, the authors underline that contracts, including franchise agreements, in which the parties have agreed an unlimited duration for the performance of the contract may be unilaterally rescinded by any of the parties. Apart from that, contracts whose performance is limited within a period of time, but which include an automatic extension clause, may also be rescinded by any of the parties at the end of each period agreed.

Exercising the right of rescission presumes, in any case, the term, as long as one has been agreed. Rescission may not be made with abuse of law and must observe the principles of equity and good faith; compensation for damages being the consequence of their inobservance. In this regard, we must take into account the Act on Unfair Competition, which considers the unfair abusive exploitation by an undertaking of the situation of economic dependence in which its affiliates, clients or suppliers which have no alternative to develop their business find themselves, setting as abusive, among others, in the breaking-off, even partially, of the relationship without a written notice, at least six months in advance, unless it is due to serious breaches of the contract clauses agreed by the supplier or for reasons of *force majeure*.

It must also be pointed out that the franchise agreement can be terminated by the mutual consensus of the parties.

Early termination

The early termination of the franchise agreement takes place due to the general reasons for contract termination, which can be classified in two groups:

Causes not dependent on the contract

(1) Death or incapability of the management of the franchisee

The franchise agreement terminates by the death or permanent incapability of the management of the franchisee (natural person). In case of companies, the termination will take place in case of the dissolution and winding-up of a commercial transfer. Anyway, there is consensus that the contract terminates when the agreement is concluded due to a relationship of special confidence or when the personal abilities of the franchisee were relevant to the conclusion of the contract.

(2) Franchise transfer

Since the franchise agreement is a contract concluded due to a relationship of special trust between the parties, parties usually agree on clauses which are intended to avoid the early termination of the contract to create an unjustified cession of the franchise.

(3) Other termination causes on the part of the franchisee

This cause takes place when the franchisee is involved in execution, confiscatory or judicial administration proceedings, or when he does not fulfil his obligations towards his clients, suppliers, employees or other creditors, i.e. when certain circumstances can damage the reputation of the franchise network.

(4) Bankruptcy proceedings of one of the parties

This is traditionally one of the reasons for contract termination; the new Bankruptcy Act has suppressed it as a valid reason for contract termination.

Causes arising from the contract

Early termination takes place when one or more of the obligations under the contract are breached. In this regard, we must point out the most usual causes:

(a) Lack of payment by the franchisee, i.e. of any kind of economic obligations, which are due.

(b) Violation of the prohibition of competition, confidentiality or transfer of the know-how or the other commercial rights, as well as inobservance of the exclusivity obligation.

(c) Insufficient fulfilment of quality in the efficiency of services or distribution of products which are the subject matter of the franchise.

(d) Non-fulfilment of the guidelines regarding maintenance and updating of the company from the franchisor, in order to keep the uniform image of the brand.

Apart from the reasons laid down in the contract, which authorise an early termination of the contract, the same consequences can arise if one of the parties' behaviour meets the requisites established in Article 1124 of the Spanish Civil Code. Provided that it is a reciprocal contract (*do ut des*), like the franchise agreement, in case of breach of contract of the obligations by one of the parties, the other party can proceed with the cancellation of the contract. The damaged party has the choice between requesting its performance or cancellation. In both cases, he can likewise request compensation for damages and accrued interests.

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

No, there a no such specific local rules, see question 9.1 above under "Normal 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?

In principle, the franchisor and the franchisee are not jointly liable. The reason for this is that one of the main characteristics of franchise agreements is the independence of companies, which predates franchisor-franchisee relations. Nevertheless, and according to the Spanish Law, the franchisee's employees might be regarded as employees of the franchisor due to the two following established theories or mechanisms:

(a) Essentially, Article 43 of the Spanish Workers' Statute includes a non-exhaustive list of situations which can constitute an illegal transfer of employees and involve the franchisor being considered as the real employer. These situations are the following: (i) the purpose of the hired service – the franchise – is to make the workers of one company available to another; (ii) the formal employer lacks an independent and stable organisation; (iii) the formal employer does not have the essential means for its activity; or (iv) the formal employer does not exercise its managerial functions.

(b) On the other hand, both franchisor and franchisee could also be considered as a "company group with labour effects", according to Article 42.1 of the Spanish Commerce Code and applicable jurisprudence.

Therefore, the risk of the franchisor being regarded as a joint employer together with the franchisee regarding the employees of the latter will depend on the degree of intervention exercised by the franchisor upon the franchisee and its employees. It is essentially a factual appreciation of the judge, in which the interventionism and functions of the franchisor have to be evaluated case by case. In order to avoid such elements occurring, the franchisee has to be independent from the franchisor from a functional, organisational and material point of view.

As a result, the franchisor must act cautiously and avoid intervening in the employment contracts between the franchisee and its employees. This means that the franchise system should guarantee the franchisee a certain degree of employment, control and managerial capacity towards its employees. In light of this, an emphasis on the independence of the franchisee from the franchisor will help to mitigate risks for the latter.

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?

From the labour law perspective, there is a minimal risk that a franchisor may be held vicariously liable, only in cases where the existence of an illegal transfer of employees or a "company group with labour effects" are declared (please see the answer to question 10.1).

11 Currency Controls and Taxation

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

As regards franchise agreements and other types of operations which involve the obligation to pay royalties overseas, there are no currency control restrictions nowadays. This is due to the fact that Act 19/2003 of 4 July 2003 on the legal regime of capital movements and cross-border financial transactions and prevention of anti-money laundering prevention (*Ley sobre Régimen Jurídico de los Movimientos de Capitales y de las Transacciones Económicas con el Exterior y Sobre Determinadas Medidas de Prevención del Blanqueo de Capitales*) repealed the exchange control regime established by Act 40/1979 of 10 December 1979 (*Ley sobre Régimen Jurídico de Control de Cambios*).

The prohibition of restrictions on payments between Member States or between Member States and Third Countries is also laid down in Article 63 of the Treaty on the Functioning of the European Union.

Nevertheless, Act 19/2003 and Act 10/2010 of 28 April 2010 on the prevention of money laundering (*Ley de Prevención de Blanqueo de Capitales*), together with Royal Decree 304/2014 of 5 May 2014, establish, under certain conditions, reporting obligations with regard to any kinds of transaction/operation between residents and non-residents in Spain.

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?

Income derived from the cession of a trade mark is classified as a "royalty" in the Commentaries on the OECD Model Tax Convention on Income and Capital. Thus, it is necessary to take into account in each case the applicable double taxation agreements in order to establish which State has jurisdiction in taxation matters. The OECD Model Convention includes a general criterion whereby royalties can only be taxed by the recipient State. However, double taxation agreements between Spain and other States include, as a general rule, a "shared taxation" provision, that is to say, Spain has jurisdiction to tax royalties paid to non-residents up to the tax limit laid down in those agreements.

In respect of the transfer of technology, it is understood that this concept includes not only the cession of industrial property but also the cession of "know-how". In this context, Commentaries on the OECD Convention recommend differentiating between "know-how" (passive income) and "technical assistance services" (active income) because of the classification of the income in the field of taxation.

Thus, income earned by way of cession of "know-how" is classified as "royalty" and, consequently, is taxable in Spain up to the tax limit laid down in the corresponding double taxation agreement. Nevertheless, income paid by way of "technical assistance services" is classified as income derived from economic activities ("business profits") and is subject to taxation in the recipient State.

Nearly all of the double taxation agreements concluded between Spain and other States respect this general criterion, that is to say, "technical assistance services" are only subject to taxation in the recipient State. However, a few of them establish an exception with regard to this general rule.

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

Concerning possible restrictions on financial transactions, the Spanish Commercial Code does not establish the obligation to carry out financial transactions in local currency.

Likewise, the Spanish regime governing franchise agreements does not include any particular provision regarding the procedure for the payment of franchise fees and royalties, or the currency which has to be applied. However, the franchisee and franchisor should take into account the foreign currency exchange rate and agree on which party will pay the expenses and commissions.

12 Commercial Agency

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

There is only a residual risk since, according to the Agency Contract Act (*Ley sobre Contrato de Agencia*), the agent acts, under a contract of agency, on behalf and in the interest of the principal, as an independent intermediary.

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?

According to Spanish legislation, any party of any contract has to act in good faith towards the other parties. This obligation is foreseen in Article 7 in connection with Article 1,258 of the Spanish Civil Code and in Article 57 of the Spanish Commercial Code. Furthermore, the franchisor and franchisee may sign codes of good practice, which may contain further provisions regarding the good faith which shall govern their relationship. Additionally, even during negotiations of the franchise contract, the parties have to act in good faith (*buena fe in contrahendo*).

Spanish legislation foresees acting in good faith as a principle, with the aim of parties acting as a "good father" (*buen padre de familia*). This principle, applied to a franchise contract, shall limit the freedom of choice of the parties in order to protect their legitimate expectations during contract negotiations; for example, both parties

may disclose confidential information regarding their business (in order to lay down some ground rules during negotiations of the contract, the parties may sign a non-disclosure agreement (NDA)), as well as during the execution of the franchise contract; for example, that the franchisor holds property of all the intellectual property rights used by the franchisee during the execution of the contract.

As good faith is a principle in the Spanish legal system, the exact meaning of it has to be applied on a case-by-case basis.

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 franchisor and franchisee, but some general rules have some provisions applicable to this topic. As already mentioned in section 13 above ("Good Faith and Fair Dealings"), Article 7 and Article 1,258 of the Spanish Civil Code and Article 57 of the Spanish Commercial Code establish the principle of good faith. The contract holders have the obligation of acting fairly during the validity of the contract, as well as determining fair and reasonable contract terms. This principle also implies the obligation of keeping the secrecy of the know-how, which is materialised through the prohibition of disclosure.

When it comes to company succession, including in the case of franchises, the EU Acquired Rights Directive has played an important role in the reform of the Spanish Statute of Workers' Rights. Specifically, Article 44 of the Statute of Workers' Rights, as the directive intended, safeguards the rights of workers by ensuring that workers are entitled to continue working for the transferee employer on the same terms and conditions as those agreed with the transfer employer.

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 specific disclosure obligations apply.

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. The franchisor can refuse to renew the agreement for any of the reasons listed in the agreement, or simply because the franchisor is not willing to renew it once the agreement expires.

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; except if the non-renewal can be attributable to a breach of contract 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?

Yes. Franchising agreements are considered as *intuitu personae* and, from the perspective of the Antitrust Act, the proportionality of such limitation is commonly admitted in its consideration as "absolutely indispensable to protect know-how and assistance provided by the transferor". (Commission in recital 12 of the Servimaster Decision of 14 November 1988.)

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 franchise agreements are not prohibited under Spanish law. However, the new franchisee must be listed in the official Franchise Register.

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 given in the context of commercial agreements. Furthermore, a power of attorney of this nature will be not recognised by the Spanish courts or public authorities unless it has been granted before a public notary and in a public document.

17 Electronic Signatures and Document Retention

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

The electronic signature allows the franchise agreement to be effective, binding and enforceable. The consent can be given by the parties by an electronic signature, whenever the legal requirements for the contract (consent, object and legal cause) are given. The so-called advanced electronic signature is legally recognised and complies with the standards required by law. By means of the advanced electronic signature the signer can be identified and any subsequent change to the signed data may be detected.

The regulatory framework for advanced electronic signatures in the EU is established by Regulation (EU) No 910/2014 concerning the

electronic identification and trust services for electronic transactions in the internal market (eIDAS Regulation). In Spain, the electronic signature is regulated by Law 59/2003 of 19 December, concerning the electronic signature, which was modified by Law 56/2007 of 28 December, of Measures to Promote the Information Society, and by Law 25/2015 of July 28, of the second chance mechanism, reduction of the financial burden and other measures of social order.

Article 26 of Regulation (EU) No 910/2014 indicates the legal requirements of advanced electronic signatures, requiring that "*it is:*

- *uniquely linked to the signatory;*
- *capable of identifying him;*
- *created using electronic signature creation data that the signatory can, with a high level of confidence, use under his sole control; and*
- *linked to the data signed therewith in such a way that any subsequent change in the data is detectable*".

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

Article 25 of the eIDAS Regulation establishes the probative value of the advanced electronic signature, so that it suffices to store electronically the electronically executed franchise agreement.

When it come to a hand-signed agreement, the original paper version of the agreement should not be destroyed, as the authenticity of the signature and the agreements of the signed franchise contract can only be proven in trial on the grounds of the original.

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Sweden

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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 general legal definition of a franchise. However, the Swedish Franchise Disclosure Act (*Sw: lag (2006:484) om franschisegivares informationsskyldighet*) provides a definition for a *franchise agreement* as an agreement between a franchisor and a franchisee for the use of a business concept, for remuneration, involving marketing and the sale of goods or services. A franchise agreement should also, according to the definition, include an arrangement concerning the use of the franchisor's intellectual property rights, and also an obligation for the franchisee to participate in regular contract compliance reviews.

1.2 What laws regulate the offer and sale of franchises?

Other than the Swedish Franchise Disclosure Act, which provides an obligation for the franchisor to disclose information to the franchisee under certain circumstances (please refer to question 1.5 below), there are no specific laws which specifically regulate the offer and sale of franchises. The principle of freedom of contract as well as other general contract principles, e.g. as provided by the Swedish Contracts Act (*Sw: lag (1915:218) om avtal och andra rättshandlingar på förmögenhetsrättens område*), would apply.

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

Yes, they will be treated as such.

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

There are no requirements under Swedish law to register a franchise with any governmental or administrative authority.

1.5 Are there mandatory pre-sale disclosure obligations?

- According to the Swedish Franchise Disclosure Act, a franchisor is obliged to, within reasonable time (approximately two weeks) before a franchise agreement is concluded, provide to the prospective franchisee clear and comprehensible information of the substance of the agreement and, depending on the circumstances, other relevant information. Such information should at least include:
  - a description of the franchise concept;
  - information about other franchisees that the franchisor has entered into agreements with regarding the same franchise and the magnitude of their business;
  - the remuneration that the franchisee shall pay to the franchisor and other economic conditions for the franchise;
  - the intellectual property rights that are to be licensed to the franchisee;
  - the goods or services that the franchisee is obligated to buy or rent;
  - the prohibition of competition that applies during or after the franchise agreement has expired;
  - details regarding the term of the agreement, the terms applied in respect of changes, extension and termination of the franchise agreement and the economic consequences of a termination; and
  - details concerning the procedure for any future proceeding in connection to the agreement and the cost responsibilities in terms of such proceedings.

As for remedies for failure to comply with these requirements, please refer to question 5.1 below.

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

This question has thus far not been tried by Swedish courts. However, it can be assumed that mandatory pre-sale disclosure obligations provided in the Swedish Franchise Disclosure Act applies to sub-franchisees. The master franchisee, as party to the agreement, should be the one required to make the necessary disclosures to the 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?

Please refer to 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?

No, not according to Swedish law.

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

Membership in the Swedish Franchise Association (SFF) (*Sw: Svenska Franchise*) or *Svensk Franchise* is not mandatory. It is, however, often commercially advisable. A member of the association has the benefit of, *inter alia*, being a part of their professional franchise network and to advertise free of charge on their website when recruiting franchisees or selling businesses. Please visit www.svenskfranchise.se for more information.

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

A member of the SFF undertakes to comply with the SFF's Code of Ethics, which in turn is predominantly based on the European Franchise Federation's (EFF) Code of Ethics. As a member of the SFF, a franchisor or franchisee may also request an independent ethical committee to examine any matter relating to the Code. In addition, the SFF offers mitigation between, for example, franchisors and franchisees.

Even if it is not a member of the SFF, a court may, when relevant, in determining accepted business practices for franchises, take into consideration the provisions of the Code of Ethics.

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

No. Local language requirements provided by law apply only to consumers. In a standard franchise concept, neither the franchisor nor the franchisee is considered as a consumer under Swedish law. However, according to the SFF Code of Ethics (regarding the applicability of the Code of Ethics, please refer to questions 1.9 and 1.10 above), franchise documents should be provided in the local language where the franchisee is established or in a language which the franchisee masters.

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 restrictions on non-nationals in respect of the ownership or control of a business in Sweden. Foreign franchisors may, e.g., own equity or real estate in Sweden.

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

The form of business entity typically used by a franchisor in Sweden is a private or public limited liability company (*Sw: Aktiebolag* or *AB*) with a minimum capital of SEK 50,000 (if private) or SEK 500,000 (if public). The entity is established when a document referred to as a memorandum of association is signed by the founders. Additionally, the company has to be registered within six months after the signing of the memorandum.

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

There are no registration requirements or other formalities applicable as a pre-condition to being able to trade in Sweden. As a member of the European Union (EU), Sweden recognises the principle of right of free movement of goods, persons, services and capital.

3 Competition Law

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

The applicable competition laws include articles 101 and 102 of the Treaty on the Functioning of the European Union (TFEU), the Vertical Agreement Block Exemption Regulation, and the Swedish Competition Act (*Sw: Konkurrenslag (2008:579)*).

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

No. Non-compete clauses valid for longer than five years may, however, be challenged as such clauses fall outside the scope of the Vertical Agreement Block Exemption Regulation.

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

No. However, the Vertical Agreement Block Exemption Regulation applies only on product supply agreements shorter than five years, meaning that such product supply agreements have to be assessed on a case-by-case basis.

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

Yes, it is a violation of article 101 of the TFEU as well as the Swedish Competition Act to impose minimum resale prices.

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

No, this matter falls within the scope of the principle of freedom of contract. It is advisable to make sure that the franchise agreement clearly outlines the terms under which franchises in adjoining territories may be offered.

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

Yes, provided that they are not excessive and to the extent they are permitted under applicable competition law. Please refer to question 3.2 above.

4 Protecting the Brand and other Intellectual Property

4.1 How are trade marks protected?

Under Swedish law, trademarks are protected either by registration or establishment on the market. An application for a trademark registration should be filed with the Swedish Patent and Registration Office (PRV) (*Sw: Patent- och registreringsverket*). To reduce the risk of legal disputes concerning the rights of a trademark, it is advisable to register a trademark rather than relying on protection by establishment on the market through usage of the trademark.

A trademark registration is valid for 10 years but can be renewed.

In addition, a company can register an EU trademark or an international trademark. An application for registration of an EU trademark is filed with the European Union Intellectual Property Office (EUIPO). As regards an international trademark, such registration may be obtained from the World Intellectual Property Organization (WIPO).

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 Swedish Trade Secrets Act (*Sw: lag (2018:558) om företagshemligheter*). Any unlawful acquisition, disclosure or use of trade secrets may give rise to civil and criminal sanctions.

It is often advisable to protect this type of information by, e.g., non-disclosure agreements.

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 that the manual and/or the software constitute an original work of authorship. There is no requirement (nor possibility) to register copyright under Swedish 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?

If a franchisor fails to comply with the Franchise Disclosure Act, a court may issue an order for the franchisor to disclose the information. The order may be subject to a fine.

Additionally, negligence in contract negotiations in general may, in accordance with the concept of *culpa in contrahendo*, lead to an obligation for the negligent party to pay damages.

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

The perception is that the master franchisee, as party to the contract, is subject to disclosure obligations under the Swedish Franchise Disclosure Act in relation to any sub-franchisees. The master franchisee is also liable for any misrepresentation in relation to sub-franchisees. However, the franchisor and the master franchisee are free to contractually allocate the liability, to the extent that such allocation is not considered unreasonable by Swedish courts.

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 Swedish courts, as long as they are reasonable. The subject at hand has not yet been tried by Swedish courts. Such clause must be assessed based on the circumstances in an individual case. An excessive disclaimer of substantial misrepresentation by a party, e.g. due to wilful acts or gross negligence, may very well be deemed unreasonable by Swedish courts and therefore not enforceable.

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

Yes, Swedish law permits class action lawsuits under certain conditions. Such lawsuits are, however, very rare.

Waiver clauses are governed by the principle of freedom to contract. There is no explicit prohibition for a class action waiver under Swedish law. However, a class action waiver clause may be deemed unreasonable and hence not enforceable by Swedish courts as it could be considered excessive.

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, nor is there any generally accepted norm concerning this matter. In general, the parties are free to choose 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?

Under certain conditions, Swedish courts provide remedies against damage to the brand by prohibition under penalty of a fine.

The enforcement of orders granted by courts in EU Member States will be subject to assessment under the provisions of the so-called Brussels-I Regulation and may be enforced under this regulation. The Swedish courts may enforce orders granted by other countries' courts provided that the enforcement is based on treaties, conventions or international agreements with such other countries.

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

Yes, arbitration is recognised as a viable alternative to civil litigation in Swedish courts. Sweden has signed and ratified the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards without any reservations. The Arbitration Institute of the Stockholm Chamber of Commerce's (SCC) rules are the most commonly used.

There is no obligation for the parties to engage in mediation before commencing formal arbitration or court proceedings, unless so agreed in the franchise agreement.

7 Real Estate

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

The length of term for a commercial property lease varies greatly and depends on the type of property. Typically, such contracts provide a fixed period of at least three years.

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

In general, the concept should be enforceable under Swedish law provided that such arrangement is clearly agreed upon and foreseen in the agreement. An assessment on a case-by-case basis has to be made.

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 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 in a particular location)?

In general, a tenant may not reasonably expect to secure an initial rent free period. However, this varies greatly depending on e.g. the market, type of property and geographical location, and is a matter of negotiation with the property owners.

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 agreement may not impose such requirement. The Treaty on the Functioning of the European Union (TFEU) as well as the Swedish Competition Act prohibits such passive sales and 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?

No, such arrangement should be enforceable provided that it is clearly stated and foreseen in the agreement. The usage of local domain names by a former franchisee which includes a trademark of the franchisor may constitute a trademark infringement.

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. Swedish courts might override termination rights in an agreement if the terms are regarded as unfair or unreasonable under the Swedish Contracts Act.

Terms which are regarded as unfair or unreasonable may also be prohibited for future use under the penalty of a fine under the Swedish Terms of Contract between Tradesmen Act (*Sw: lag (1984:292) om avtalsvillkor mellan näringsidkare*).

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

There is no minimum notice period provided in Swedish legislation which applies to franchise agreements. A very short notice period may, however, under certain circumstances be deemed unreasonable and overridden by Swedish courts.

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?

Assuming that the franchisee and franchisor are separate and independent legal entities and that the employment agreements are entered into with the franchisee, the risk that the franchisor shall be considered as a joint employer with the franchisee is unlikely.

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 refer to the answer in 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.

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 withholding tax on interest or royalties, but this is the case in relation to dividends unless reduced or eliminated under tax treaties, domestic rules or EU directives. The most notable exception, much simplified, is that dividends paid to a foreign parent may be entirely exempt from withholding tax if the receiver is comparable to a Swedish limited liability company and the shares are held for business purposes. Furthermore, royalty payments are generally considered business income in Sweden for the receiver and taxed at the corporate income tax rate of 22 per cent. However, the tax liability may be eliminated by tax treaties or under an EU 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 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?

According to the Swedish Commercial Agency Act (*Sw: lag (1991:351) om handelsagentur*) a commercial agent is defined as an independent intermediary which, on a permanent basis, acts on behalf of another person for the sale or purchase of goods by negotiating and forwarding tenders or concluding agreements in the name of the other person. A franchisee that falls under the definition would therefore, in theory, be regarded as a commercial agent. However, in most of the franchise concepts, the franchisee does not act directly on behalf of the franchisor when selling goods or services, and would therefore not be regarded as a commercial agent.

To reduce the risk of the franchisee being regarded as the franchisor's commercial agent, it is advisable to consult local counsel e.g. in drafting 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?

The perception in the legal doctrine is that there is, more or less, a principle of good faith between contractors under Swedish law. It is usually described as a duty to take notice of and look after the counterparty's interests. Good faith, as a general principle, is however, not expressed in any legislation in Sweden.

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 ongoing relationship issues. The relationship between a franchisor and a franchisee would instead be governed by general contract laws and principles.

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 disclosure obligations would generally not apply, unless a renewal of an existing franchise at the end of the franchise agreement term is deemed to be regarded as the conclusion of a new and separate franchise agreement. An assessment should be made on a case-by-case basis.

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?

Not according to Swedish law. Swedish law does not provide such an 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?

In general, that would not be the case, unless the franchisee is entitled to such according to the agreement. Thus, they are not, unless agreed otherwise in 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, provided that such restrictions are reasonable and regulated in the franchise agreement.

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

This falls within the scope of the principle of freedom of contract. To our knowledge, there is, to date, no precedent concerning the status of "step-in" rights under Swedish law. Depending on the circumstances, an excessive "step-in" right might be deemed unreasonable by Swedish courts.

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?

Please refer to the answer in question 16.2 above.

17 Electronic Signatures and Document Retention

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

In general, electronic signatures are recognised as a valid way of creating a binding and enforceable agreement, such as a franchise agreement. There are exceptions that primarily aim at contracts for which the validation requires certain form, e.g. the purchase of real estate. The perception, in those cases, is that an electronic signature does not always meet the legal requirements relating to a specific form.

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

Yes, in general, there are no requirements to store the original version of an agreement. It might, however, be advisable to keep the original version as evidence in the event of legal proceedings.

Nor are there, in general, any requirements to have a "wet ink" version of an agreement. However, some contracts require a certain form (e.g. "wet ink") in order to be valid, e.g. the purchase of real estate, where the perception in most cases is that an electronic version does not meet such requirement.

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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 license (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 mandatory insurance obligations, e.g., for 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 all specific circumstances of the particular case (FDC 118 II 157ff.). E.g., CO provisions made for lease agreements/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 particularly 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). From this result, e.g., 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. Also '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 CO protecting business and trade names of commercial ventures in Switzerland.
- The *Swiss Unfair Competition Act*, see below question 3.1.
- The *Swiss Act on Cartels and other Competition Restraints*, see below question 3.1, as well as *EU Competition Law*, to the extent extraterritorially applicable also in Switzerland under its terms and recognised as a matter of the Swiss Conflict of Law Rules accepting such extraterritorial application under Article 19 Swiss Private International Law Act ('**PILA**') irrespective of the fact that Switzerland is not a Member State of the European Union.
- The *Swiss Data Protection Act*, the *Swiss Data Protection Ordinance* as well as – to the extent extraterritorially applicable also in Switzerland under its terms and recognised as a matter of the Swiss Conflict of Law Rules accepting such extraterritorial application under Article 19 PILA – also the EU General Data Protection Regulation ('**GDPR**').

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

Under Swiss law, there is no difference between the appointment of only one franchisee as opposed to such of multiple different franchisees by a Franchisor. EU competition law and the EU GDPR may likewise become applicable in both cases alike (under Article 19 PILA).

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 to people and bodies publicly authorised to exercise them must be observed by both the franchisor in its franchise business guidelines and by the franchisee in their exercise, e.g., for banking and insurance,

healthcare, job agencies, casinos, etc. Wherever such professional licences are required, the potential franchisee must first obtain them before the franchise activities can be started.

In addition, under the Swiss Trademarks Act, there is an optional registration upon mutual agreement of both parties for any trademark licence included in a franchise with the Swiss Intellectual Property Office to make the trademark licence also enforceable against third parties. The process for registering a trademark licence is simple and involves submitting a copy of the trademark licence agreement for filing. Registering the licence agreement evidences the use of the trademarks, and therefore a claim cannot be made for non-use of the trademarks, even though it is the franchisee rather the franchisor using the trademarks in the country.

1.5 Are there mandatory pre-sale disclosure obligations?

Under Article 2 CC there exists a mandatory pre-contractual obligation for the franchisor to disclose all important economic and legal information, in a true, fair and complete manner, for the consideration of the franchisee on whether to accept the franchise agreement or not. This must happen well before the signing of the relevant franchise. The franchisor must disclose any missing information which is not publicly accessible to the potential franchisee. Further details can be found in the SFA Ethics Code.

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 the 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 with 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, which information the franchisor must disclose in addition to the above before concluding a franchise agreement, in all specific circumstances of the particular case. 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 it is appropriate for either the franchisor or franchisee, based on specific circumstances which newly arise. The extent of all these information obligations may be controversial in some particular cases, so mutual information obligations should be contractually clarified in advance. In addition, it may be advisable for both a franchisor and a franchisee to include material information in the Annexes of the franchise agreement and to update them from time to time.

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 must be observed which regulate specific types of business activities (see above).

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

A Swiss Franchise Association membership may – although not mandatory – be helpful to better prepare the entry into the Swiss market for both the franchisor and the franchisee, as there exists not only a different legal framework here, but also further country- and 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 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 Swiss Franchise Association ('**SFA**'), is a typical professional service association, i.e. it aims to help its members to adhere to the best practices in the industry. An SFA membership is thus 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, and it is often also not necessary from a business perspective as German, French and Italian are the official languages in Switzerland, and a good command of English is also quite common as well. However, it is highly advisable for franchisors to check well ahead of the franchise agreement conclusion 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. Otherwise, a franchisor risks that contractual terms which the franchisee did not properly understand will not be applied at all or at least be interpreted against the franchisor as author of the franchise contract in case of a dispute.

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 to 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 may either choose an AG, or sometimes, if funding is scarce, a limited liability company (*Gesellschaft mit beschränkter Haftung* ('**GmbH**' in short)) or even only an entry in the Commercial Registry as sole enterprise ('*Einzelfirma*'). Unless a GmbH will be treated as a 'look-through entity' for tax purposes in the franchisor's jurisdiction and is, for this reason desirable for the franchisor, a Swiss GmbH should NOT be chosen by the franchisor as it has various impracticalities.

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. However, the international taxation should be carefully assessed by any foreign franchisor as the related optimisation potential may be considerable.

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 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, also all ambiguous terms and conditions are interpreted against their stipulator, which in a franchise system usually is the franchisor, and individually agreed contractual agreements preferable to general terms and conditions are imposed by one party only.
- The *Swiss Act on Cartels and other Competition Restraints* ('**Cartel Act**'), 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 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 consider themselves applicable also in Switzerland as a non-EU member country and, furthermore, Swiss law recognises the foreign legislation purpose at issue as justified (Article 18 Swiss Private International Law Act). Additionally, *EU Competition Law* may also be pertinent to the extent that it is extraterritorially applicable in Switzerland under its terms and recognised as a matter of Swiss Conflict of Law Rules accepting such extraterritorial application under Article 19 ('**PILA**') irrespective of the fact that Switzerland is not a Member State of the European Union.

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 as of then (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 circumstances of the 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 duration was invalid as it was longer than 20 years (FCD 114 II 159ff.). However, only a few years later in another, non-published case, a beer supply agreement was found as acceptable, even though the agreement was for 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. Switzerland traditionally has among the highest price levels in the world, i.e. franchisees could not cover their costs for wages, rentals, etc. if they are selling franchise goods or services 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 Swiss Cartel Act. The same also applies under EU competition law to the extent extraterritorially applicable in Switzerland and recognised to be so under Article 19 PILA in Switzerland, despite the fact that Switzerland is not a member of the European Union or the European Economic Area.

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 that it is not too restrictive for the franchisee. Upon termination, it is only valid if the franchisee indeed profited from valuable business know-how or business contacts of the franchisor (Article 340 CO by analogy), must be adequately limited in time, scope and territory in all circumstances of the particular case (Article 340a (1) CO) and, on top of this, 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 will risk losing its rights to the owner of a later deposit of the same trademark! 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 with its owner alone. 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 trademark can be cancelled if it has not been used for a period of five years. In all other cases, trademarks can be renewed by simply paying the related renewal fee due at each 10-year anniversary of registration or renewal. Finally, it is beneficial to be further assessed on whether a Swiss trademark licence included in a franchise agreement should be registered with the Swiss Intellectual Property Office or not (see above, question 1.4).

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, not generally known and not easily accessible is protected under Swiss civil, criminal, administrative and procedural law provisions. For franchisors it is important to be aware 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.

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 form such copyright protection as well. In the absence of a copyright assignment, only the natural person who created the copyright-protected work is regarded as the author who profits from copyright protection. Only software is directly owned by the employer, i.e. not the employee creating it (Article 17 CA), and such 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 material information to the franchisee, which is relevant to the franchisee's decision to enter into or to continue the franchise, 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 will 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 pre-contractual misrepresentation allocated between franchisor and master franchisee? If the franchisor takes an indemnity from the master franchisee in the Master Franchise Agreement, are there any limitations on such an indemnity being enforceable against the master franchisee?

The franchisor is responsible for providing the master franchisee with all necessary knowledge, and in particular with the necessary know-how, as well as to comply with its pre-contractual and ongoing disclosure obligations (see question 1.5 above). The franchisor cannot validly waive its related liability for fault and gross negligence. The same applies for the franchise agreement between a Swiss master franchisee (and sub-franchisor) with its Swiss sub-franchisee. If the master franchisee becomes directly liable to a sub-franchisee for an infringement of this pre-sale or ongoing information disclosure obligation, then the master franchisee can seek indemnification from the main franchisor, if, and only if, to the extent such main franchisor did not comply with its related pre-contractual or ongoing information obligations to the master franchisee beforehand and the master franchisee could not pass such information on to the sub-franchisees as a result. In all other cases, the sub-franchisee will have to turn to the master franchisee and sub-franchisor instead, i.e. not to the main franchisor (under the assumption, that there is no direct contractual relationship between the main franchisor and the sub-franchisee).

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 or ongoing information obligations cannot be validly excluded even if a foreign law would otherwise govern the franchise agreement between the franchisor and the master franchisee.

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

Class actions are 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 agreements, and a contractual choice of law is in general valid, if not imposed in bad faith. However, to the extent that, e.g., the lease of the 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 base of all relevant circumstances of the particular case. If both a master franchisee and a sub-franchisee are in Switzerland and the sub-franchise is only within the Swiss territory, the 'international element' required as a prerequisite for a valid choice of a foreign law may be regarded as missing in the circumstances of the particular case under the PILA, i.e. a foreign law may then not be validly chosen for the contract between the master franchisee and the sub-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?

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. must subsequently be confirmed in ordinary proceedings. Such interlocutory orders can also stop damaging actions of a franchisee, however, not remedy its inaction as specific performance acts can only be enforced in ordinary proceedings.

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

Arbitration is recognised in Switzerland as the preferred dispute resolution mechanism for international agreements and Switzerland is a signatory to and has ratified the New York Convention in 1965. Foreign arbitral awards of another state which also ratified the New York Convention can be enforced in Switzerland. The grounds for objecting to enforcement of a foreign arbitral award under the New York Convention are similar to the objections which can be raised under PILA against the enforcement of foreign judgment. Furthermore, Switzerland is one of the leading arbitration hubs of the global business world even for international agreements with no business relationship to Switzerland. Arbitration in Switzerland or with Swiss parties in a dispute is often chosen to be governed by the ICC Rules of Arbitration or by the Swiss Rules of Arbitration. Proceedings under the Swiss Rules of Arbitration can be heavily assimilated to common law court procedures under terms of reference to be mutually agreed upon by the parties (i.e. with the cross-examination of witnesses, etc.) whereas ICC Rules of Arbitration proceedings are usually more similar to civil law proceedings, i.e. more arbitration panel controlled and, thus, faster. In general, arbitration proceedings are easier to serve than foreign court proceedings and more confidential, so overall often recommended on an international level.

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 and lease agreements. Instead, leases are normally customised to ensure that they run in parallel with the duration of the franchise agreement.

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/tenant's shoes 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 in a particular location)?

The Swiss commercial real estate market varies sharply from region to region. While commercial real estate property in cities like Basel, Berne, Geneva, Lausanne, Lucerne, Zurich, etc. is expensive,

commercial real estate in rural areas can be significantly cheaper. In city centres, key money and full refurbishments at the cost of the tenant are customary, whereas in remote mountain or rural areas (away from touristic hotspots like St. Moritz, Gstaad, Interlaken, etc.) tenants can be in a better bargaining position.

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 always allowed under the Swiss Cartel Act. Additionally, *EU Competition Law* may also prohibit such a clause to the extent that it is extraterritorially applicable in Switzerland under its terms and recognised as a matter of Swiss Conflict of Law Rules accepting such extraterritorial application under Article 19 ('**PILA**') irrespective of the fact that Switzerland is not a Member State of the European Union.

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 also 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 157ff., franchisee's claims for compensation may be admissible in the case of an improper or abusive extraordinary termination by a franchisor. Long-term agreements like franchises may only be extraordinarily terminated for good cause ('*Wichtiger Grund*'), if and to the extent their continuation becomes intolerable for the termination party. Any enumerations of good causes in the franchise agreement serve only as an indication as to what the contracting parties deem intolerable, i.e. are not exhaustive for the court.

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

No, however, if a franchise is terminated without a 'good cause' by a franchisor, the franchisor may become liable to compensate the franchisee for the damage caused to the franchisee by such franchisor 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?

There are cases where franchisees may be recharacterised as employees (see above) and will then profit from the mandatory provisions of the CO for their protection. 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 for a franchisor to not too closely instruct, monitor and correct franchisees in their daily business, i.e. to grant them a certain freedom to pursue it 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 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?

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.

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 to be conducted in the local 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 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 as liable to pay the 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, there is a general legal obligation to act in good faith (Article 2 CC), e.g., mandatory pre-contractual and ongoing disclosure obligations of the franchisor (and the franchisee) as well as mandatory obligations of both contracting parties to treat each other fairly and reasonably 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 pertinent also for the ongoing relationship issues (see above, 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?

As a result of the general and mandatory legal obligation to act in good faith (Article 2 CC), mutual information obligations apply also upon renewal if and when specific circumstances newly arise beyond what either party already knew beforehand as a result of its operating the franchise as franchisee or franchisor.

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 forced 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 157ff., a franchisee's claims for compensation may be admissible in the case of an improper or abusive extraordinary 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. It is also not unusual to contractually foresee that a franchisee needs a prior written approval of the franchisor for a change of control within the franchisee entity.

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 already.

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 an extreme case, even validly be unilaterally withdrawn

with immediate effect and additionally require public notarisation in all cases involving the transfer of real estate. Instead, it is highly recommended for both franchise parties to contractually agree in advance on such pre-emption or step-in rights.

17 Electronic Signatures and Document Retention

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

Under the *Swiss Electronic Signature Act*, an electronically signed document with a so-called qualified electronic signature can, since 2003, be used as an alternative to a handwritten signature. The electronic signature must be based on a valid Swiss electronic signature certification when it is issued. Qualified electronic signatures are visible on documents, usually on a signature line or block. You can check their validity directly in Adobe Acrobat Reader or through the Federal online service (www.eservice.admin.ch/validator).

In theory, no particular form is required for a franchise agreement under the CO, i.e. not even the written form. For evidence purposes it is, nevertheless, highly advisable to put all franchise terms and conditions in writing, to initial a printout of the franchise agreement on each page and to sign it by hand on the signature page. On top, a foreign franchisor must check the Swiss Commercial Registry for the signature rights of a Swiss counterparty, it is quite common in Switzerland that even C level representatives of a Swiss company are only entitled to sign jointly by two, i.e. not alone, pursuant to their commercial registry entry as signatory.

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

Under Swiss company law, a Swiss business is only required to keep its business files electronically, i.e. it is perfectly fine for the Swiss company to keep any signed originals as a PDF copy only. However, if a counterparty later claims that the electronic version is a fake or has a fake signature, then it may be helpful to have a signed original in storage with the help of which the authenticity of the signature can be proven for evidence purposes. On top, original signatures or even deeds may be required in the jurisdiction of the foreign franchisor or under a foreign law chosen by the parties to govern their franchise agreement.

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Turkey

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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 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.
- Corporate Tax Law.

Additionally, other industry-specific laws and regulations may apply.

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

There are no registration or disclosure requirements to be met for franchising in Turkey. There is also no distinction between a sole franchisee and multiple franchisee in this regard.

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

No, there are not any registration requirements in relation to the franchise system.

1.5 Are there mandatory pre-sale disclosure obligations?

No, there are no pre-sale disclosure obligations.

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

This is not applicable in Turkey.

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

This is not applicable in Turkey.

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

There are no 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 by 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.

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, require a majority Turkish shareholding and control. These industries include weapons and defence, private schools (except for international schools), internal aviation and maritime transportation for commercial purposes.

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

Joint stock companies and limited companies are the most commonly used company forms in Turkey. There are no restrictions or requirements as to which model or form may be used, but as these two company types differ in various aspects, a detailed analysis is required in order to choose the appropriate form.

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

In order to operate a business in Turkey, registration with the Trade Register is required. Further, there may be additional industry-specific registration requirements. Product approvals or registrations may also be required for certain industries.

3 Competition Law

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

In Turkey, Law no. 4054 on the Protection of Competition is the primary legislation dealing with competition law, including anti-competitive agreements and abuse of dominance. It prohibits the agreements and concerted practices between undertakings, and decisions and practices of associations of undertakings which have as their object or effect or likely effect the prevention, distortion or restriction of competition directly or indirectly in a particular market for goods or services. The Turkish Competition Authority is the general regulatory authority with regard to competition law, and the Competition Board is its management body. The 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 the 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 the Turkish Commercial Code's unfair competition

law rules. Those who face an act of unfair competition may request from the court certain remedies, including, but not limited to, the prevention of the unfair competition and indemnification.

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 pre-contractual misrepresentation allocated between franchisor and master franchisee? If the franchisor takes an indemnity from the master franchisee in the Master Franchise Agreement, are there any limitations on such an indemnity being enforceable against the master franchisee?

As stated earlier, Turkish law does not impose any mandatory disclosure obligation on the franchisor. In terms of contractual liability, however, liability for pre-contractual misrepresentation in terms of data disclosed being incomplete, inaccurate or misleading belongs to the party which misrepresents such data, provided that such misrepresentation is due to such party's fault.

5.3 Can a franchisor successfully avoid liability for pre-contractual misrepresentation by including 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 are conducted under a governmental permit.

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

No, class action is not available in Turkey.

6 Governing Law

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

Under Turkish law, contractual relationships that include a foreign element are permitted to be governed by foreign law. Turkish law does not directly define the "foreign element", but it is generally accepted that agreements carry a foreign element if, for example, at least one party is a non-Turkish individual or entity and/or the goods and services are supplied to, or from, abroad.

6.2 Do the local courts provide a remedy, or will they enforce orders granted by other countries' courts, for interlocutory relief (injunction) against a 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 enforcement, of foreign court rulings or arbitral awards (as the case may be). The reciprocity may be established by an international treaty, by law or by practice.

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

Turkey is party to the 1958 New York Convention on the Recognition and Enforcement of Arbitral Awards (the "New York Convention"). Therefore, the conditions under the New York Convention apply for the recognition and enforcement of foreign arbitral awards in Turkey. Note, however, that Turkey has ratified the New York Convention with the reservation that, for a foreign arbitral award to be recognised or enforced in Turkey, it must be made in the territory of another contracting state.

The businesses that accept arbitration as a form of dispute resolution procedure does not favour any particular set of arbitral rules.

7 Real Estate

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

Under Turkish law, there is no mandatory minimum or maximum term for a commercial property lease. However, in particular, the shopping mall management companies generally prefer to execute lease agreements for shops for five years.

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

Under Turkish law, the assignment of a lease to a third party is only possible when there is a provision authorising such assignment in the lease agreement. In other words, unless otherwise provided in the lease agreement, a tenant cannot assign the lease to a third party, including the franchisor, without the landlord's consent unless the agreement explicitly permits such assignment. Therefore, the failure of the original tenant or termination of the franchise agreement shall not suffice for a lease assignment to the franchisor.

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

Under Turkish law, non-national entities can 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 in 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 month's rental fee.

Landlords generally do not demand "key money" for leases in particular locations. In some cases, however, the former lessees demand key money to terminate their lease agreement and exit the leased premises. This is also common if the former lessee has made non-removable investments in the leased property.

8 Online Trading

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

No. Online orders for products or request for services from a potential customer outside the franchisee's exclusive territory are deemed passive sales. A contractual obligation on the franchisee to re-direct such orders are deemed a ban on passive sales. The prohibition of passive sales in vertical agreements is generally prohibited.

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

No, there is no limitation on a franchisor to require a former franchisee to assign local domain names to the franchisor on the termination or expiry of the franchise agreement. It is, however, recommended to regulate the assignment of domain names upon expiry or termination in the agreement.

9 Termination

9.1 Are there any mandatory local laws that might override the termination rights 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 (Turkish) notary public; registered mail; or telegraph or registered email using secure e-signature. Among these, the recommended method, due to its practicality and power of proof, is notary public. Although it is not clear whether the foregoing is a mandatory Turkish law rule, parties are recommended to observe it to avoid any discussion on the validity of the termination.

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

No. However, in light of the good faith rules, it is recommended to grant notice periods that would enable the other party to reorganise its business due to termination. For a franchise agreement, such notice period is recommended to be three to nine months, depending on the particulars of the case.

10 Joint Employer Risk and Vicarious Liability

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

Under Turkish law, the franchisor is not deemed a sub-employer or joint-employer in respect to the franchisee's employees. In order to avoid doubts, it is recommended to include provisions in the franchise agreement setting out the parties' relations with and obligations *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.

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 agency 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 agreement's end, unless (i) the agent terminates the agreement without legitimate cause attributable to the principal, or (ii) the principal terminates the agreement with legitimate cause due to the agent's fault.

Turkish law also stipulates that this rule applies to other continuous contractual relations where exclusive rights are granted, such as exclusive distribution and franchise.

Turkish law sets out the upper limit of the goodwill compensation for the agents. The amount of goodwill compensation awarded may not exceed the average annual commission paid to the agent for the previous five years. If the agency relationship existed for less than five years, the average of the entire term serves as the basis for calculation. By way of analogy, it is generally accepted that the upper limit for an exclusive franchisee's goodwill compensation entitlements may be the average annual profits of the distributor. It is, however, unclear whether this profit is the gross or net profit.

Court precedent, moreover, indicates that calculation of an "appropriate" amount, as determined by a court-appointed expert, should take into consideration: (i) the term of the contractual relationship; (ii) the franchisee's market share; (iii) the franchisee's efforts to market the goods or services; (iv) the nature of the goods or services; and (v) the quality and reliability of the goods or services and trade marks.

In Turkish law and court precedent, there is no clarity on whether the goodwill compensation rules 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 a 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.

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 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.

17 Electronic Signatures and Document Retention

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

Under Turkish law, "secure electronic signatures" supported by government-accredited secure electronic signature service providers are deemed valid and binding as wet ink signatures, unless legal transactions subject to other formal requirements. Franchise agreements, not being subject to any specific formal requirements, may theoretically be executed through a "secure electronic

signature". The use of secure electronic signature, however, is still not common in Turkey except for certain specific fields. Therefore, signing a franchise agreement electronically is theoretically possible, though it does not seem practical yet.

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

A franchise agreement signed/executed by secure electronic signatures can be stored electronically and used as evidence when necessary. Therefore, their paper version may be destroyed.

With regards to the wet ink version of franchise agreements, the originals should be kept and stored; storing solely their electronic versions should be avoided. Electronic copies of wet ink documents are not deemed as evidence before the courts particularly if the other party claims that the signatures are fake.

Disclaimer

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 June 2018, which may change from time to time.

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Pehlivan & Güner is a young and dynamic law firm based in Istanbul. The firm has a team of nine lawyers and a good network of of-counsels. The founders Vedat Pehlivan and Haşmet Ozan Güner bring in a decade of experience. Vedat Pehlivan has more than 25 years' experience and Haşmet Ozan Güner has 10 years' experience including many years with one of the largest global law firms.

Pehlivan & Güner has a broad network of of-counsels bringing together many academics and practitioners from the legal and other professions. They focus on commercial law advisory and disputes, administrative law, competition law, pharmaceuticals & healthcare regulations, real estate law and employment law.

They also regularly work with other law firms located in other cities of Turkey, cooperating with Pehlivan & Güner on the local operations.

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1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

In this article we shall limit our reply with regards to the UAE law but not in respect of the Dubai International Financial Centre or Abu Dhabi Global Markets law.

There is no specific legal definition of franchise in the UAE law, however, franchise is commonly used to refer to a grant of the right to operate and share in the profits of a business or sell goods or services under a brand or chain name. Additionally, franchise may mean the right granted to a person to operate a store or sell goods or services under a franchise agreement. The owner (the franchisor) will license outlets to others (the franchisees) to operate using business concepts, property, trademarks and tradenames owned by the franchisor.

1.2 What laws regulate the offer and sale of franchises?

The UAE has no specific laws specifically governing franchising. As a result, certain contracts and commercial law are applicable to franchise agreements in the UAE. In particular, the articles found in the commercial agency, distribution and Intellectual Property (IP) laws/sections of the law would commonly be referred to when resolving a franchise dispute. There are several laws which can apply to franchising relationships including the following:

1. Federal Law No. 18 of 1981 on the Organization of Commercial Agencies (as amended by Law No. 14 of 1998) and Law No. 13 of 2006.
2. Federal Law No. 18 of 1981 on Organising Commercial Agencies as amended.
3. Federal Law No. 5 of 1985 on Civil Transactions.
4. Federal Law No. 18 of 1993 on Commercial Transactions.
5. UAE intellectual property laws for trademarks, copyright and patents.

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

No, there are no franchise registration or disclosure laws, however, the Commercial Agencies laws in the UAE may allow the appointment of an exclusive agent who may in turn be considered a sole franchisee.

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

There are no registration requirements related to the franchise system.

1.5 Are there mandatory pre-sale disclosure obligations?

There are no specific mandatory disclosure obligations in connection with the sale of a franchise in the UAE.

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

No, pre-sale disclosure obligations do not apply to sales to sub-franchisees.

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

There are no such disclosures that are applicable in the UAE.

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

There are no requirements.

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

Membership is not mandatory in any case.

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

No, a membership with a national franchise association does not impose any additional obligations on franchisors.

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

Translation is not required, however, dealings with any government departments or the courts will require that documents are translated into the local language.

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

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

The UAE companies law, which applies to the UAE with the exception of the free zones, requires that all Limited Liability Companies must be 51% owned by nationals of the UAE. Most free zones do not carry that requirement and therefore foreigners may own a free zone entity entirely.

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

The most common entity that is used by franchisors are Limited Liability Companies established pursuant to the UAE Companies 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?

An entity practising any commercial activity in the UAE will require a licence to do so. When registering an entity, the authority registering the entity may require additional requirements for certain activities whilst some activities do not require additional or specific approvals. The approvals and requirements will be set by other government authorities and a person registering an entity will need to obtain a "No Objection" from the relevant authority in order to proceed to register the entity.

3 Competition Law

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

UAE Competition Law (Federal Law No. 4 of 2012) (the Law) and the Executive Regulations (Council of Ministers' Resolution No. 37 of 2014) prohibit certain anti-competitive practices and provides for the establishment of a "Competition Regulation Committee" (the Committee) under the authority of the UAE Ministry of Economy (the Ministry). The Regulations deal in detail with the procedures of applying to the Committee for exemptions, approvals and the examination of complaints. The Law has been in force since February 2013 and the Regulations since October 2014. However, the application and enforcement of the provisions has not been possible in practice due to the absence of certain key information. This has now been addressed by two Cabinet Resolutions (Resolution Nos. 13 and 22 of 2016). Both Resolutions take effect as from 1 August 2016.

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

There is no maximum permitted term.

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

There is no maximum permitted term.

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

The restrictive agreements which are considered prohibited are mentioned as a non-exclusive list of examples, which primarily focus on the collusion of persons in a market and against anti-competitive practices including and not limited to, price fixing, abuse of a dominant position in market, imposing terms or prices of resale, etc. What is important to note, is one of the tests that the law focuses on, which is any act anti-competitive in nature in the law which seeks to prejudice, limit or prevent competition.

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

There are no rules mentioned in respect of encroachment.

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

Yes, they are enforceable.

4 Protecting the Brand and other Intellectual Property

4.1 How are trade marks protected?

Federal Law No. (37) 1992 on trademarks, or trademark law, which was amended by Law No. (19) 2000 and Law No. (8) 2002, provides protection for registered trademarks in the UAE and aims to safeguard the interests of both businesses and consumers in the country. The law includes the definition of trademarks, signs that cannot be registered as trademarks, trademark registration and cancellation procedures, transfer of ownership and mortgage of trademarks, licensing others to use trademarks, penalties for trademark law infringement and general and transitory provisions.

Some of the main articles of the trademark law include:

Article (19): The period of protection provided by the registration of a trademark is 10 years which can be renewed for a successive period of 10 years by submitting an application within the last year of the protection period in accordance with the terms and conditions set by this law and its executive regulations.

Article (20): The Ministry can remove a registered trademark forthwith after notifying the concerned party about the reasons for removal, listening to their explanations and considering their defence. The affected parties can appeal the removal decision at the relevant civil court within 30 days from the date of notification about the removal.

Articles (37) and (38) details the penalties for violating the trademark law. The following acts will invite an imprisonment and/or a fine of at least AED 5,000:

- Forging or imitating a trademark registered according to the law in a way that misleads the public who use goods and services distinguished by the original trademark. The same applies to all who deliberately use a forged or imitated trademark.
- Using a registered trademark owned by a third party or placing it illegally and with bad intention on the products.
- Deliberate sale, display, promotion or possession (with the intent of selling) of products with a forged, imitated or illegally placed trademark.
- In addition, article (38) can lead to a jail term not exceeding one year and a fine of not less than AED 5,000 and not more than AED 10,000 or one of these penalties for anyone who uses a trademark that may not be registered as per the provision of this law, or illegally writes statements on trademarks or commercial documents giving a false impression that the person holds a registered trademark.

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

Yes, the new UAE companies law that came into force on 1 July 2015 contains a provision titled "Disclosure of company secrets" (article 369). The UAE already has a number of laws that penalise the disclosure of trade secrets or impose obligations of confidentiality and provide differing scopes of protection for trade secrets. For example: the Civil Transactions law imposes an obligation on employees to keep confidential the commercial and industrial secrets of their employers even after the end of their employment contract (articles 905 and 922); and the UAE Penal Code punishes anyone who holds a secret because of his profession or position and discloses it other than when legally permitted or uses it for his own or another's benefit without permission (article 379). Know-how is protected by the UAE Patent law of 2002 as information or facts of a technical nature resulting from experience obtained in the practice of a profession and capable of being practically applied.

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, it is protected under the provisions of the Federal Law No. (7) 2002 On Copyrights and Related Rights.

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?

Although there is no mandatory disclosure under the law, if contractually agreed, the franchisee may have the right to rescind the agreement and/or claim damages.

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

The UAE law focuses on the parties to a transaction (unless the misrepresentation is handled under the criminal articles of misrepresentation). Therefore, a sub-franchisee shall have a right against the franchisee unless the third-party rights are created by contract. An indemnity may be relied on from the master franchisor by the sub-franchisee if it is directed to his benefit. In most circumstances, such a misrepresentation when leading the sub-franchisee to court will prompt the sub-franchise to claim against both the franchisor and master franchisor.

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

A franchisor may successfully avoid liability for pre-contractual misrepresentation by the use of disclaimers, however, such disclaimers may not exclude a franchisor from any criminal liability for pre-contractual misrepresentation.

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

Class actions are not permitted in such claims.

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 an agreement to be governed by local law. There is nothing to prevent parties from choosing a particular law or court to be chosen for the Franchise Agreements. The general norm is to have the local courts, courts of the franchisor or arbitration.

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. The UAE laws may enforce foreign orders and awards. The UAE courts as well may entertain applications for interlocutory relief and enforce any order to desist from using names, products or services.

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

Yes, arbitration is recognised as a viable means of dispute resolution in the UAE. The UAE is a party to the New York Arbitration Convention. Parties, when agreeing to an arbitration clause, will typically elect the Dubai International Financial Centre London Court of International Arbitration (DIFC-LCIA), Dubai International Arbitration Centre (DIAC) or rarely, the International Chamber of Commerce (ICC).

7 Real Estate

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

Generally, commercial property leases last for three years or five years. There is a tendency nowadays to register one-year leases following the registration requirements of registering leases annually.

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 term such as a lease assignment must be agreed and signed by the assignee, assignor and landlord. The concept is not widely used and typically a landlord would prefer to have the right to determine whether they would want a lease to be assigned and deal directly with a tenant without a lease assignment clause.

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

Non-nationals may not own property outside certain allowable territories. There are no legal restrictions that prohibits a non-national to lease nor sub-lease because of his nationality.

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 in a particular location)?

A tenant can reasonably expect a rent-free period, which is referred to in the UAE as a grace period of three months. "Key money" is usually not demanded by the landlord, but rather by the existing tenant if there is a takeover of the lease.

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?

Agreements may impose a binding requirement for an order to be re-directed, and such breach of a clause may lead to the termination of the franchise or a cause for damages to be claimed.

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 and the franchisor may do so, however, it is advisable that such local domain names are mentioned in the agreement as owned by the franchisor.

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 override termination rights except if such franchise agreement was registered with the Ministry of Economy as an exclusive agency agreement following the Commercial Agencies Law. Regardless, even if a party terminated a contract the courts may decide not to terminate the contract (i.e. if it is unfair to do so) notwithstanding an agreed termination clause.

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

There are no local laws that impose minimum notice periods that must be given. The courts may, however, decide to find acts and terms unfair and may provide alternative remedies or decisions that protect the parties in a transaction.

10 Joint Employer Risk and Vicarious Liability

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

No such risk can be assumed unless agreed and stated in the 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?

Not directly, in regards to the performance of the employees' duties.

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 applicable in the UAE.

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

Entities in the UAE do not withhold tax and there are no withholding tax requirements in respect of royalties for franchisors.

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 applicable in the UAE.

12 Commercial Agency

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

Yes there is such a risk. Mentioning clearly in an agreement that the relationship is not an agency is important and ensuring that no instruments are signed or given which provides that the franchisee is acting as an agent would be highly advisable.

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 courts will take into consideration the issues of dealings in good faith and to act fairly is a general principle in UAE law. The courts will, though, consider fairness and reasonableness in 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?

There are no specific laws in respect of franchise dealings.

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 are specified by the law.

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, this is not applicable in the UAE.

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 refusal was conditional and such conditions were met, a franchisee will find it hard to convince a court that the franchisor acted unfairly by not renewing, therefore a franchisor not extending and acting within his rights and to what was agreed in the agreement may not be liable.

16 Franchise Migration

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

Yes, a franchisor is entitled to impose restrictions on a franchisee's freedom.

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

A step-in clause will be recognised and enforced, however, with certain aspects of the business like the lease there are certain relationships and rights that the franchisor may not be able to control. Structuring the correct step-in right is vital if the franchisor wishes that a step-in right can be properly enforced.

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?

The power of attorney will be recognised so long as it is an official document. An official document in the UAE requires either a foreign government authority to authenticate it and thereafter the ministry of foreign affairs of the UAE or otherwise if it is authenticated by the notary public in the UAE.

17 Electronic Signatures and Document Retention

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

There are no specific requirements for an electronic signature, however, the UAE has recognised electronic dealings and in evidence an email or an attached agreement that is electronically signed will be considered sufficient proof that the agreement was signed by the party sending that agreement.

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

No. Whilst an email is sufficient proof and evidence that the party sending the email confirms the agreement, an independent electronic file of the document stored will not achieve the same result nor be sufficient to convince the courts. The original document in such an instance would need to be presented.

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With nearly a decade of successful litigation experience across the United Arab Emirates, Mr. Al Shamsi has built one of Dubai's most reputable and respected law practices. He is widely regarded as a top litigator in the Dubai Courts, with extensive experience in corporate, banking and finance and insurance law. Mr. Al Shamsi advises both local and international companies and governmental entities in cases involving complex litigation. He appears regularly before the Appeals Court and the Court of Cassation, as well as UAE's Federal Supreme Court. Mr. Al Shamsi has been described as being "*…very thorough and highly efficient – Hamdan faced each challenge with strategy, professionalism and confidence which ultimately resulted in our successful outcome*". It is no surprise that he has been awarded as one of the most influential young leaders in the Middle East and the young achiever award, amongst many more.

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Hamdan AlShamsi Lawyers & Legal Consultants was established in 2011. It has since become a name synonymous with success and is well-known in the legal circuit. The success of the law firm is due to its specialisation in advising on commercial issues, insurance, due diligence, family law, intellectual property law, banking, companies law and other matters locally, and its dedication towards offering unparalleled, high-quality and culturally sensitive legal services, while adhering to the highest standards of integrity and excellence.

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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. On the federal level, franchising is regulated by the U.S. Federal Trade Commission ("FTC"), which promulgated 16 C.F.R. Part 436 (the "FTC Franchise Rule"). Under 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) satisfies 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 will make a required payment or commit to make a required payment to the franchisor or its affiliate. According to the FTC's Compliance Guide, the required payment must be a minimum of 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. 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 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 definitions 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, tradename, 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 a 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 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 federal FTC Franchise Rule imposes a pre-sale disclosure requirement that applies to all states, obligating franchisors to furnish prospective franchisees with the material terms of the franchise relationship prior to consummating the sale of a franchise. Franchisors disclose this material information in a prescribed format commonly referred to as a Franchise Disclosure Document ("FDD"). In addition, at the state level, 15 states have registration and/or disclosure requirements that must be met before a franchise can be offered and sold in that state. Only 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. Twenty-five 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 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 domestic consumer markets. However, 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/sub-franchisor is treated as a franchisee for the purposes of franchise disclosure and registration laws. Similar to the "typical" franchisee, the master franchisee/sub-franchisor 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, as noted in the response to question 1.2 above, there are 15 states that require a franchisor to register its FDD with that state's administrative or governmental agency. These states' laws require a franchisor to either: (i) register their FDD; or (ii) 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?

Any violation of the pre-sale disclosure requirement imposed by the FTC Franchise Rule is a violation of the U.S. Federal Trade Commission Act, and grants the FTC the right to sue franchisors in federal court and to seek any or all of the following remedies: (i) civil penalties of up to $11,000 per violation; (ii) injunctive relief with respect to violations of the FTC Franchise Rule, including barring franchise sales in the United States; and (iii) restitution, rescission, or damages on behalf of the affected franchisees. While the FTC can bring 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 sub-franchisees. While the FTC Franchise Rule does not directly address master franchising, the North American Securities Administrators Association, Inc. ("NASAA") has adopted a Multi-Unit Commentary 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 (from the FDD the franchisor uses) for offering and selling sub-franchise rights to prospective master franchisees/sub-franchisors. This pre-sale disclosure requirement is not only imposed on franchisors offering and selling sub-franchise rights to prospective franchisees and multi-unit developers, it is also imposed upon master franchisee/sub-franchisors who "step-into" the franchisor's shoes and engage in franchise sales activities and provide training and support to sub-franchisees. Therefore, under the NASAA guidelines, master franchisees/sub-franchisors are responsible for preparing and providing their own FDD in connection with their offer and sale of sub-franchises and, where applicable, complying with state registration requirements.

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

Under the FTC Franchise Rule, franchisors are obligated to furnish prospective franchisees and multi-unit developers with certain material information through the prescribed format of an FDD. The purpose of the FDD is to provide prospective franchisees and multi-unit developers with the information they need to make an informed decision about investing in the franchisor's franchise system. The FDDs, which are the most essential component of the pre-sale due diligence process, are uniform in structure and are comprised of 23 categories ("Items") of detailed information and accompanying exhibits regarding, among other things: (i) the

history of the franchisor (and any parent or affiliate), including any history of bankruptcy or litigation; (ii) the business experience of the franchisor's principals; (iii) the recurring or occasional fees associated with operating the franchised business; (iv) an estimate of the 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 financial performance information concerning existing franchised and company-owned units, such as past or projected revenues or sales, gross income, and net income or profits). Franchisors are not required by federal or state law to provide prospective franchisees with this information, but if they choose to do so, they may provide the information in Item 19 of the FDD; provided that there is a reasonable basis for the information and such information is properly disclosed. 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 the aforementioned franchise disclosure and registration laws, 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 highly 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.

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 highly regulated sectors and/or sensitive industries or businesses (e.g., communications and broadcasting), and especially those which may have a potential impact on national security (e.g., banking, technology, weapons manufacture, maritime, aircraft, energy, etc.). As franchise opportunities in the United States do not typically involve these industries or businesses, it is not likely that franchisors will be affected by such restrictions.

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

As is frequently the case with other businesses, franchisors operating in the United States will typically utilise a corporation or limited liability company ("LLC") as their preferred forms of business entity. While each of these entity types offers "limited liability" to its owners, choosing between the two will depend on the legal, financial and tax needs of the franchisor and its principals. If a franchisor chooses to use the corporate form of entity, typically a "C corporation" is used (as opposed to an "S corporation" which is most often used in connection with small, closely held businesses, such as those formed by franchisees. (It is important to note that foreign investors are prohibited from being owners of S corporations.) In a C corporation, income which is received by the company is taxed at the entity level. Then, the company's profits are taxed (again), to the company's shareholders when distributions are made. However, over the last 10–15 years many franchisors have chosen to use the LLC as its 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 (e.g., fewer "corporate" formalities in management structure and activities, fewer ownership restrictions), income allocation and the ability to transfer assets out of the entity. Since LLCs are usually treated as "pass through" entities for tax purposes, the entity's profits are not taxed at the business level. Rather, they flow through to the company's owners, proportionately to their ownership percentage. The owners 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 entities to conduct their U.S. operations. However, if a U.S. franchisor is a wholly-owned subsidiary of a foreign parent, then certain financial disclosures regarding the foreign parent 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 (typically, trademarks or service marks) associated with the franchise system; another might be the "franchisor entity" which would enter into the franchise agreement (and other agreements) with franchisees; another might be a management company which would 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 also formed in order to hold title to each parcel of real estate that is owned by the franchisor or its affiliates. Where the franchisor subleases the various premises to its franchisees, the franchisor may choose to form separate entities to enter into each "master-lease" with the landlord rather than have one real estate "leasing entity". This provides the franchisor (and its affiliates) with greater asset protection and additional flexibility in the event that it wanted to sell or transfer a particular parcel of real estate.

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 in international franchising in the United States is the master franchise method, where the master franchisee is granted the right to either develop the assigned territory itself or to sub-franchise the territory to other franchisees, with the master franchisee taking on "franchisor" obligations (e.g., providing initial training and ongoing support and guidance) and typically receiving a significant share of the initial franchise fees and ongoing royalty payments paid by the franchisees within the territory. Alternatively, some franchisors, who wish to retain more control over their franchise network and do not wish to share their initial franchise fees and ongoing royalty fees with a master franchisee, will grant territories to "area developers" who obligate themselves to develop their territory, but have no rights to offer sub-franchises to other franchisees. Since the U.S. is a large country with varying demographics and diverse cultures, franchisors 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 perhaps both. However, the "joint venture" approach has not been frequently utilised by franchisors (including foreign franchisors). Potential disadvantages of joint ventures include, among others: (i) the risk of ineffective management and/or disagreements with the partner; (ii) requiring a large investment; and (iii) the sharing of initial and ongoing fees, profits and other benefits.

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

In the United States, new business entities are formed under state law and their formation documents (e.g., for corporations: the Certificate of Incorporation; and for LLCs: the Articles of Organisation) are filed with the Secretary of State (or similar agency) in the state of formation. (In a small number of states, there are publication requirements for new business entities, most notably, in New York with respect to LLCs, limited liability partnerships ("LLPs") and limited partnerships ("LPs").) Any new business entity formed in the United States is required to obtain a federal taxpayer identification number by filing Form SS-4 with the Internal Revenue Service. 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 programmes). A handful of states require the filing of initial reports and tax forms rather than waiting to file an annual report. Finally, entities which are involved in certain specific industries or types of businesses (e.g., education/school based, childcare based businesses, or businesses selling alcohol to the public) may have to obtain one or more licences or permits in order to comply with state or local laws.

3 Competition Law

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

In the U.S., "competition law" is generally referred to as "antitrust law". In contrast to other jurisdictions, such as the E.U., "antitrust" laws do not directly regulate the offer and sale of franchises. Rather, the FTC Rule (16 C.F.R. 436 *et seq*.), and statutes in certain states (such as New York's Franchise Sales Act (N.Y. G.B.L. § 680 *et seq*.) or California's Franchise Investment Law (CA Corp. Code §31000 *et seq*.)), directly regulate the required disclosures and sales practices with respect to the offer and sale of franchises (discussed in detail in section 1, above). However, these are not generally considered "antitrust" or "competition" laws in the U.S.

Nonetheless, despite not directly regulating the sale of franchises, there are "antitrust" laws that do impact upon the franchise relationship that apply in the United States. On the federal level, the major antitrust statutes that may apply to franchising are the Sherman Act, (15 U.S.C. §1 *et seq*.) (generally prohibiting anti-competitive or monopolistic conduct), and the Clayton Antitrust Act (15 U.S.C. §§12 *et seq*.) and 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. In addition, almost every state in the U.S. has enacted its own antitrust laws, which are usually based upon, but may differ from, the federal antitrust statutes. Therefore, while these state statutes may be similar, and usually look to federal law for guidance, practitioners need to examine both the federal and state laws in the applicable jurisdiction in order to avoid any potential issues.

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 vendors or 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. Prudent franchisors are well-advised to comply with all applicable disclosure requirements, and properly detail any potentially anti-competitive aspects of the franchise relationship within the FDD (e.g. specific suppliers that must be used), so as to significantly lessen any potential liability for antitrust issues with their franchisees in the context of the offer or sale of the franchise.

Notably, there may be circumstances where an offer or sale of a franchise constitutes an "unfair" or "deceptive" act or practice, under either federal law or an analogous state law. The federal FTC is responsible for consumer protection enforcement for over 70 different laws, including the FTC Act, which contains a broad prohibition against "unfair and deceptive acts or practices". *See* e.g. §15 U.S.C. 45 ("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"), many of which provide for a private right of action.

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

No. There is no federal regulation of the maximum permitted term for a franchise agreement. However, there is wide 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 to automatic renewal agreements that continue in perpetuity (for example, an agreement that renews automatically every 10 years without any limit). On 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 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 violation of the implied covenant of 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)). The Robinson-Patman Act is another antitrust law that can impact a franchisor's ability to set pricing. A franchisor should be wary of differentiating between certain franchisees, or groups of franchisees, in its pricing of required goods or services, as favouritism to certain franchisees may constitute violations of the Robinson-Patman Act (15 U.S.C. §13) (anticompetitive price discrimination).

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 includes 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 will 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 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 antitrust statutes may also impose liability for anti-competitive conduct within a particular jurisdiction.

Although there is no specific federal minimum obligation with respect to the territorial rights of franchisees, encroachment or the unfair allocation of territories could lead to liability outside of antitrust law (*discussed infra*), 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 (and the disclosures in the FDD) that address and define the franchisor's right to sell franchises (or operate itself) in a franchisee's "protected territory", must be crafted with great care. Franchisors are well-advised to give thought not merely to geographical limits, but also to the applicable "market" of customers to which a franchisee will be selling its goods and services to. Healthy franchise systems should take steps to ensure that each franchised business has a sufficient "market" of customers to remain viable and profitable, as that not only minimises the potential for litigation, but also ultimately is in the best interests of both the franchisor, as well as its individual franchisees.

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

Under federal antitrust law, in-term and post-term non-compete and non-solicitation of customer provisions are generally enforceable, and there is no prohibition against them. However, that is not dispositive, as the enforceability of these contract terms depends largely on state law. 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, 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 to 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 among jurisdictions as to the enforceability of the non-compete and non-solicitation clauses typically provided for in franchise agreements.

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 (the "Office of Origin"), approved, and then submitted to the WIPO for international approval and registration (within 12 or 18 months). Once approved at the WIPO level, the mark may be submitted to the other member nations in which the mark holder seeks to obtain trademark protection. When an international mark holder seeks approval of an international trademark within United States (through the Madrid Protocol, often called a "Madrid application," or "Section 66(a) Application"), the application is submitted to the United States Patent and Trademark Office ("USPTO"). The application will then be examined by the USPTO, in the same manner, and subject to the same standards, as a mark seeking approval within the U.S. The international mark must be approved by the USPTO before it is allowed to be registered within the U.S.

In the United States, at the federal level, 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 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 any 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. Trademark infringement actions can also be brought to address online violations, including unauthorised usage of a trademark in a domain name (or "cybersquatting"), by initiating actions under the Lanham Act (as amended by the Anti-Cybersquatting Piracy Act), or initiating an arbitration proceeding to seize the offending domain under the Uniform Domain-Name Dispute-Resolution Policy's ("UDRPs") "ICANN" procedure.

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.

The Defend Trade Secrets Act of 2016, 18 U.S.C. §1831 *et seq*. (the "DTSA") now 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).

In addition, each state has its own common law trade secret protection, which operates in addition to protections at the federal level. There is variation between specific states, and some states additionally have statutory protection for confidential information or trade secrets. Typically, a party must have taken significant efforts to maintain the secrecy of its trade secrets in order to be afforded common law or statutory protection. 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. Franchisors should also mandate that their franchisees require that their own respective agents or employees agree to confidentiality prior to disseminating any of the franchisor's trade secrets. 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 provisions designed to facilitate the protection of confidential information in court. New or prospective franchisors should be extremely mindful of confidentiality issues before discussing their "new concept", their "secret sauce", or other intellectual property with anyone (including potential investors or prospective business partners). Non-disclosure agreements should be entered into prior to having discussions in which a prospective franchisor has disclosed a trade secret or idea that is unique and worth protecting.

Publications by the franchisor, including operations manuals and policy and procedure manuals, may also be protected by federal copyright law (discussed below). In addition, a franchisor might consider applying for a federal patent with the USPTO if a franchisor has a unique invention or product, process, or design. However, confidential trade secrets can be kept in perpetuity, while patents expire. Further, in applying for a patent, a company risks publication of its intellectual property, as patents are public, and worse, if a patent application is rejected, it is typically publically available within 18 months. Therefore, it may be better to protect certain IP as a "trade secret", depending upon the nature of the IP.

Finally, the reputation associated with a brand must be protected from all too-increasingly-common online assaults. In this current climate, online social media, third-party product or service reviews, or other online commentary or postings, can have a significant and wide-reaching negative impact on a trademark or brand. Franchisors must now therefore not only remain vigilant in protecting their trademark or intellectual property from being stolen or usurped, but also from unfairly disparaging commentary or defamatory material. However, prior to bringing any action, a franchisor should be mindful that the United States has particularly strong public policy rights associated with freedom of speech. The franchisor should consider whether the potentially offending content is protected opinion, or otherwise qualifies for protection as free speech. There are implications (such as "Anti-SLAPP" statutes) that may punish overly litigious franchisors who bring lawsuits that improperly infringe upon someone's freedom of speech. However, franchisors (and franchisees) are not helpless against unlawful reputational assaults on their branding or trademarks. Traditional common law defamation, based upon the relevant state law, may be utilised when false claims are made concerning a brand or service. In addition, the Lanham Act may also be utilised to protect a federal trademark from statements that might be misleading to consumers, even if such statements are not literally false (which may open the door to bringing claims under the Lanham Act to protect a mark from statements that might not be literally false, but which may be misleading). The FTC Act may allow a franchisor to seek assistance from the FTC due to a third party utilising "unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce…" 15 U.S.C. §45(a)(1). "Little FTC Acts" in particular states may also apply, including what are often called unfair and deceptive trade practices acts, and allow a franchisor to bring an action based upon these state statues to protect its branding from unfair online competition or commentary. Finally, most online service providers have terms of service that prohibit defamatory or unfairly disparaging speech. Often, it may be sufficient (and cost effective) to directly contact a service provider and attempt to have the offending material removed under the terms of service, at least in the first instance, rather than resort to litigation.

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 Property Organization ("WIPO"). Within the U.S., federal law protects both registered and unregistered copyrighted material. The Federal Digital Millennium Copyright Act ("DMCA"), also provides a mechanism whereby copyright holders can directly notify third-party online service providers that an infringement is occurring (e.g. through a user posting a confidential portion of an operations manual), and ask that the provider remove or disable any access to the infringing material. Most third-party internet service providers also have terms of service that prohibit infringement, and will remove offending material on that basis alone, once notified of unauthorised use of 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. Nonetheless, there are exceptions to copyright (such as "Fair Usage"), and a franchisor should carefully consider the pitfalls that it may encounter before it commences a lawsuit seeking to protect its copyright.

Franchisors should be mindful that a wide variety of publications and media, including operations manuals, advertisements, menus, or computer programs, may be protectable by copyright. Franchisors should be careful to draft clear agreements covering 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 the assessment of additional damages, including exemplary (sometimes treble) damages, and attorney fees, against those who violate the law in this regard.

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 sections of the franchise operating manual were copied practically verbatim, those portions were considered to be 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?

A franchisee does not have a right under the FTC Act to file suit against a franchisor for federal disclosure violations. However, while the Federal Trade Commission may itself commence a federal court action and seek to obtain injunctive relief as a result of a

franchisor's violative practices and/or to recover monetary equitable relief (such as restitution or rescission of a franchise agreement) for a franchisee harmed by a franchisor's past violations, this is not a typical occurrence.

It is only under state law, either by virtue of state unfair trade practice acts (frequently referred to as "Little FTC Acts"), state franchise statutes, or state business opportunity laws, that an aggrieved franchisee is empowered to commence a lawsuit against a franchisor and its control persons for disclosure violations. If a franchisee prevails in court (or in arbitration), 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 violation 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 franchised business in order to open it and to keep it operationally afloat. However, rescission 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 criminal penalties or obtain an injunction against a non-compliant franchisor. A harmed franchisee will have different rights and potential remedies depending on the applicable law and so, it is generally advisable for such a franchisee to retain counsel knowledgeable in the applicable state's franchise law.

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

A typical master franchisee ("master") "steps into the shoes of the franchisor" and has the authority to enter into unit or sub-franchise agreements with franchisees. As a result, the master is typically responsible for providing its franchisees with post-sale support. Such a master will be deemed a "sub-franchisor" under federal and state disclosure laws and should issue and register its own, separate, FDD. If the master and/or the franchisor fail to comply with their respective disclosure obligations, the FTC Act and most state franchise statutes will hold them jointly and severally liable for their failure(s).

As a result of these circumstances, a franchisor will often seek to shift full liability onto the master by including an indemnification provision in the Master Franchise Agreement. Such provisions are generally enforceable, except where state law may deem them to be against public policy (e.g., for intentional misconduct of the indemnitee).

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

It depends. The FTC's Franchise Rule deems it an unfair or deceptive practice for a franchisor to disclaim, or require a prospective franchisee to waive reliance on, representations made in the FDD itself. Any violation of this prohibition could give rise to claims brought by a franchisee under a state's Little FTC Act or under common law (e.g., for fraud or negligent misrepresentation). However, under the FTC Act, a franchisor may still disclaim liability for representations made outside of the FDD. Several states have enacted anti-waiver provisions which render unenforceable any provision in a franchise agreement that purports to waive a franchisee's legal rights to recover damages for a franchisor's pre-contractual misrepresentations. Other jurisdictions take the position that merger and integration clauses are generally unenforceable if a franchisee is fraudulently induced to execute a franchise agreement under the theory that the fraud is extraneous to the contract.

Courts are more likely to uphold a "no representations" 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. At a minimum, disclaimer clauses may still be useful to the franchisor as proof that the franchisee did not reasonably rely on the misrepresentation. However, to the extent a franchisor may have made misrepresentations by omitting material information in its pre-sale disclosures to a franchisee, disclaimer clauses will not insulate the franchisor from liability.

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

Yes, franchisees can sue as a plaintiff group and may even bring a class action lawsuit if the putative class of franchisees meets the federal or applicable state law requirements for class certification. However, franchisees are almost always required under the terms of their franchise agreements to sue the franchisor on an individual basis and relinquish any right to pursue a group or class action lawsuit. Typically, class action waiver clauses are incorporated in the arbitration provisions of a franchise agreement and bar class or group arbitrations.

While class action waiver provisions are generally enforceable, they may be deemed unenforceable under some state laws on grounds of unconscionability. It is settled law, however, that class action waivers included in arbitration provisions (which is invariably the case) are 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?

Many franchise agreements include choice-of-law provisions that designate the law of the franchisor's home state as the governing law for the contract and any related disputes. 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 some other reasonable basis for the parties' choice; and (2) the selection does not violate the public policy of the state with the predominant interest. The scope of the choice of law provision will determine the types of disputes and claims that must be decided in accordance with the chosen state's laws.

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. Other state laws specifically mandate that the local state's franchise

law protect franchisees within the state and override any choice of law provision.

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 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 only be granted 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 the recognition and enforcement of foreign judgments. While local courts typically recognise and enforce final and valid foreign judgments in accordance with recognised principles of international comity, the laws of each state may vary. Though most states have adopted some version of the Uniform Foreign Money-Judgments Recognition Act, such provisions only confer recognition upon foreign *money* judgments. While U.S. courts have enforced foreign court orders for permanent injunctive relief, they have been less inclined to enforce preliminary injunctions issued abroad.

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

As codified in the Federal Arbitration Act ("FAA"), U.S. federal law considers arbitration a favoured means of dispute resolution. The FAA applies in state and federal courts, and pre-empts any U.S. state law that purports to deny or limit the right of contracting parties to agree to arbitrate their disputes. The United States acceded to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention) in 1970, having agreed to apply it, on the basis of reciprocity, to the recognition and enforcement of foreign arbitral awards resolving commercial disputes. It also ratified the Inter-American Convention on International Commercial Arbitration (Panama Convention), which requires that the U.S. and most South American nations enforce arbitration agreements and awards in one another's countries. The New York Convention and Panama Convention have been incorporated into U.S. law in Chapters 2 and 3, respectively, of the FAA. The assurance that, under the New York Convention, an arbitral award will generally be recognised and enforced by the courts of signatory nations is a major reason why arbitration is generally the preferred method of dispute resolution in the international context.

The main international arbitration forums located in the United States are the American Arbitration Association's ("AAAs") international division known as the International Centre for Dispute Resolution ("ICDR") and the International Institute for Conflict Prevention & Resolution ("CPR"). The International Chamber of Commerce ("ICC") can also administer arbitrations from its New York City branch office. Other organisations such as the London Court of International Arbitration ("LCIA") can conduct U.S.-seated arbitrations from their foreign offices. *Ad hoc* (self-administered) arbitrations often proceed in accordance with the UNCITRAL Rules or the CPR's Non-Administered Arbitration Rules.

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 10 years or more. While, perhaps, this may not be as prevalent in smaller communities, even there, leases of 10 years (or more) can usually be negotiated for well-known franchise brands. (While there is no standard length of franchise agreement in the U.S., many franchise agreements have an initial term of 10 years.) Tenants often seek to incorporate one or more option terms into their leases. Some franchisors, and some franchisees (if they 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 right to "hold over" at the end of the lease's contractual term. In most instances, commercial leases contain provisions requiring the Tenant to pay anywhere between 125% and 200% of the base Rent and Additional Rent during any holdover period(s), although the amount of the overage, as is the case with most lease provisions, is usually subject to negotiation.

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

Yes, this 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 if either of two events occur: (i) the franchisee's lease is terminated by the landlord; or (ii) franchisee's franchise agreement is terminated by the franchisor. Some landlords will consent to such a requested lease term by so providing in a three-party rider or addendum to the lease, which is executed by the franchisor, franchisee/tenant and the landlord. Landlords will usually require that the franchisor (or other assignee) must cure any defaults (including the payment of any outstanding rent/additional rent, etc.) before the franchisor or another franchisee can take over the lease. Savvy franchisors or franchisees may negotiate a lease term providing that, under such circumstances, the landlord's consent

will be "deemed" to have been given and that the only requirement is that proper notice is provided to the landlord. Other landlords may resist agreeing to such a provision outright, while others may seek to obtain financial concessions from the franchisor in return for agreeing to such a provision. For example, where landlords have required the franchisor or franchisee to provide either a full or partial guaranty of the lease (e.g., a "good guy" guaranty where the guarantor is responsible for all of the obligations under the lease for such period of time that the tenant remains in possession of the premises), the landlord may require that a comparable guarantor be added (or substituted) as part of the transaction. Whether or not the franchisee/tenant, as well as any guarantor(s), will be released from liability under the lease upon such a sale, is also a key issue to be negotiated.

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

Typically, not in the franchise context. While U.S. federal law restricts foreign ownership of certain federal oil, gas and mineral leases, and authorises the blocking of certain foreign acquisitions of U.S. companies with respect to particular industries which potentially impact on national security, energy resources and critical infrastructure, such restrictions are generally inapplicable to franchising opportunities in the U.S. Under federal law, foreign owners or investors in U.S. real estate are subject to U.S. tax to the same extent as domestic owners are. In most instances, foreign investors would acquire U.S. real estate interests, including leases, by utilising single purpose U.S. entities which are created specifically in order to acquire or lease the real property.

7.4 Give a general overview of the commercial real estate market. 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 in a particular location)?

While the U.S. commercial real estate market is large and varied, it was in the process of recovering from the "great recession" of 2008 through 2012. In certain metropolitan areas, the real estate market had recovered fairly well and it was not uncommon for landlords to charge premium rents for "class A" and other desirable retail locations. Recent events however, have created a concerning negative impact in the retail section of the U.S. commercial real estate market, due, in significant part, to the impact that the purchase of products on the Internet has had on retail sales generally, and inevitably, on the sale of products from franchised (or franchisor owned) retail locations. According to a recent study by Aaron Smith and Monica Anderson, by 2015, approximately 10% of annual retail purchases, almost $350 billion, were purchased online. Further, almost 80% of Americans make purchases via the internet. This trend will likely continue and is likely to have an increasingly negative impact on "brick and mortar" retail purchases generally, and on franchised retail outlets, specifically. Until the last recession, malls and shopping centres in the U.S. had experienced explosive growth since the 1950s. However, based on the internet's continuing negative impact on retail locations (including franchised outlets), malls and shopping centres may well become smaller and rents may have to be reduced in order to induce retailers to make long term commitments that both landlords and lenders desire or require. It is unlikely that we will see, in the foreseeable future, the kind of explosive growth that malls and shopping centres had previously experienced.

Partly as a result of these factors, reasonable construction periods (which vary depending on the location and type of work to be done), landlord contributions to tenant "work letters" and some "free rent" periods, are usually available. In other areas of the country, including more suburban and rural areas, where the real estate market (and the local economies generally) have been, perhaps, more "hard hit," it is even more common for tenants to obtain a period of free rent and/or tenant improvement allowances.

The specific work that the landlord agrees to do in order to prepare the premises for the franchisee/tenant's occupancy is memorialised in a "work letter" which is almost always subject to negotiation. It will be influenced by such factors as the length of the lease term, the tenant's credit worthiness and overall "desirability" and, of course, the rent to be paid. The time needed to perform both landlord's and tenant's work will vary according to the nature of the work to be performed, but will typically range from 60 days to six months and sometimes, may be even longer where it is anticipated that particular zoning or "permitting" issues will apply. While no rent will be charged during the construction period, tenants frequently seek out an additional "free rent" period after the premises opens for business while still within the construction period and, in some cases, even after the construction period has ended. In certain areas, such as where a free standing building is being constructed for the franchised unit, or for larger construction projects, such as hotels, even longer construction periods, and "free rent" periods, may come into play.

In certain metropolitan areas where the real estate market had recovered well, landlords would sometimes charge commercial tenants so called "key money" as a premium for the tenant's right to secure the lease. The pressure from Internet sales has had a negative impact on this practice. In most cases, where key money is a factor, the deals usually involve transactions where an existing lease and infrastructure (e.g., built-in furniture, specialty plumbing or electrical work) are transferred to a new tenant and the landlord requests a one-time payment in recognition of the extra facilities and the convenience that the tenant is inheriting. Good examples of this situation include a restaurant having a recently upgraded infrastructure in place, or where a petrol station having substantial equipment improvements is being transferred to a new tenant (petrol distributor). Unlike the residential context where tenants are sometimes asked to pay key money to superintendents or building managers in order to secure a flat and such "off the books" practices are illegal, in the commercial real estate market context, requests for key money are legitimate so long as the money being requested by the landlord and being paid by the tenant is set forth in the lease.

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 define, in both the franchise agreement and the FDD (along with required state disclosure documents), 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.

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), there is no specific statutory restriction upon a franchisor's limiting access by its franchisees to the online market (as might be the case in other countries). However, a franchisor's failure to clearly define a franchisee's rights with respect to online sales, especially in its required disclosure documents and franchise agreements, may result in litigation, including claims by aggrieved franchisees for "disclosure" violations (including both federal and applicable state law), and common law claims for fraudulent or negligent omission, breach of contract, and/or breach of the implied covenant of good faith and fair dealing.

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

No. A franchisor may require (in its franchise agreement) that a franchisee utilise a specific domain name, and return usage of that domain to the franchisor after expiration of the franchise. It is advisable that a franchisor disclose domain name requirements within the FDD, and that the franchise agreement clearly set forth any post-termination requirements with respect to domain names. The 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) (the domain would properly stay with the franchisee, as the franchisor "acquiesced to the use of its mark in the Respondent's domain name for at least a period of several years")).

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. Common examples include: 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 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/registration 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 to 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. However, in instances where the default involves the franchisee's failure to pay monies owed to the franchisor, the permitted notice/cure period under relationship laws is often considerably shorter. Additionally, for certain defaults which are perceived to be egregious and/or which pose a threat to the well-being of the public or damaging to the franchisor's brand, 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, unauthorised use of the franchisor's registered trademarks), 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 lease has expired or has 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 (e.g., consents to their cancellation), in the event that a debtor in a Chapter 11 reorganisation wishes to "assume" its franchise agreement or lease (i.e., keep it/them "in place"), it is unlikely that the franchisor will be able to quickly terminate these agreements provided that the debtor 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).

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

Yes. As was discussed above in question 9.1, almost half of all states in the United States (and U.S. territories of Puerto Rico and the U.S. Virgin Islands) have so-called "relationship laws" which govern one or more substantive aspects of the franchisor-franchisee relationship, such as the franchisor's ability to terminate or fail to renew the franchise. In addition to typically requiring the franchisor to have "good cause" (or "reasonable cause") before it is permitted to either terminate or not renew a franchisee's franchise, most relationship laws require the franchisor to provide the franchisee with written notice (within which the franchisee may cure the alleged default and avoid termination), which may be significantly longer in duration (e.g., between 30 and 90 days) than the period provided for in the franchise agreement. The reason for such provisions is to protect franchisees from having their livelihood (and often a large financial investment) taken away from them on short notice. Where applicable, such relationship laws will apply irrespective of the express notice provisions (and/or governing law and jurisdiction provisions) which are provided in the franchise agreement, and any such inconsistent provisions will be deemed unenforceable. While U.S. courts generally cannot "revive" or reinstate a franchise after the franchisor has terminated the franchise agreement, a franchisee who successfully asserts a claim that the franchisor violated an applicable relationship law and improperly terminated the franchisee's franchise agreement, will be awarded appropriate damages, prejudgment and post-judgment interest as well as court (or arbitration) costs, including reasonable attorneys' fees which were incurred by the franchisee in connection with the litigation or arbitration. Franchisors, and their counsel, need to be aware of any applicable relationship law when evaluating how to handle a franchisee's default and/or potential termination.

10 Joint Employer Risk and Vicarious Liability

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

The "joint employer" doctrine is a concept in employment law. It expands the definition of "employer" to include additional persons or entities that exert sufficient influence or control over the "terms and conditions" of employment (directly, or 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 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 expanded the definition of "joint employer" for NLRA violations in a manner that expanded the joint employer test to include "indirect" control, which was troubling in the franchise context since franchisors typically control system standards. *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 exercising *indirect* control over franchisees' 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 if they did so, it would, in turn, significantly impact upon the viability of the franchise business model, generally. With the arrival of the Trump Administration, the NLRB indicated that it would be reversing the prior administration's course on application of the joint employer doctrine and the Browning-Ferris standard in the franchise context (*see* U.S. Dept. of Labor, 6/7/17 Press Release, 17-0807-NAD). In 2017, the NLRB adopted a more conservative standard in *Hy-Brand Industrial Contractors, Ltd. and Brandt Construction Co*., 365 NLRB No. 156 (2017), only to have that decision vacated due to a conflict of interest (*see* February 26, 2018 NLRB Press Release), returning the NLRB to the prior standard.

The NLRB has indicated it will be seeking to engage in rulemaking regarding the joint employer doctrine, and that it would "issue a proposed rule as soon as possible…" (NLRB May 9, 2018 Press Release; NLRB June 5, 2018 Press Release and Chairman Ring's Letter). Therefore, while the current administration has indicated that it will be moving to tighten the joint employer standard, the current law is arguably that of the prior administration's *Browning-Ferris* decision.

In addition, a much watched NLRB matter, *McDonald's USA LLC, et al. v. Fast Food Workers Committee, et al*., NLRB Case No. 02-CA-093893 had previously been settled in March of 2018 without reaching any findings regarding joint employer status on the part of the franchisor. Essentially, McDonalds was accused of being liable as a joint employer for, *inter alia*, the franchisee's acts in improperly disciplining workers for participating in minimum wage protests. However, on July 17, 2018, the ALJ presiding over the case refused to authorise the settlement, thereby re-opening the matter. *See Id*., July 17, 2018 Order (Denying Motions to Approve Settlement Agreements). The *McDonald*'s case could also have an impact upon the franchise bar and the NLRB's interpretation of joint employer status in the franchise context. As such, this area of law remains in flux, and franchisors should proceed with caution. While the NLRB's policy decisions are alarming to some, the application of the joint employer doctrine only really impacted those franchisors who directly – or indirectly (depending on the standard) – controlled the fundamental terms and conditions of their franchisees' employment relationships, or specifically became involved in opposition to unionisation or collective bargaining with respect to their franchisees' employees. Franchisors that do not seek to impose any significant control over the employees of their franchisees, especially in the labour relations arena, will significantly reduce their risk of being considered joint employers.

There has been a recent uptick in litigation regarding whether a franchisor may be considered a joint-employer in wage and hour, and discrimination matters. In FLSA wage and hour matters, franchisors should be wary of setting policies that impact upon worker classification or wages. In *Parrott v. Marriott International, Inc*., Case No. 17-10359 (E.D. Mich, September 6, 2017), Plaintiffs alleged that the ultimate franchisor, Marriott, exerted sufficient control over the "Terms and Conditions" of employment of the managers of their franchisees, so that they should be deemed joint-employers, along with the franchisees, for FLSA violations (here, misclassification of Food Managers as "executives" who were exempt from overtime pay protections). The Court agreed, and denied a motion to dismiss, despite Marriot's arguments that it had to exert sufficient control over its system. In discrimination matters, franchisors should avoid directly training a franchisee's employees on discrimination policy, or issuing a written discrimination policy. Those matters should generally be left to the individual franchisees, lest the franchisor be deemed to be exercising sufficient control over those terms and conditions of employment. In *Harris v. Midas*, 17-cv-0095 (W.D. Pa. Nov. 8, 2017), a franchisor was found to have exerted sufficient control over a franchisee's sex discrimination training and policies, to adequately allege a "joint employer" relationship in a sex discrimination and harassment lawsuit, surviving a motion to dismiss. The message is that franchisors who try to exert too much control over the direct relationship between a franchisee and the franchisee's employees, do so at their peril.

There is legislative activity on the federal level regarding joint employment. The "Save Local Business Act" (H.R. 3441) has now passed through the U.S. House of Representatives (as amended on 11/7/17). This proposed law tries to clarify who may be considered a joint employer under the NLRA and FLSA. It avoids the "indirect" standard, and instead finds joint employment where a person "directly, actually and immediately, and not in a limited and routine manner, exercises significant control over the essential terms and conditions of employment such as hiring employees, discharging employees, determining individual employee rates of pay and benefits, day-to-day supervision of employees, assigning individual work schedules, positions, and tasks, or administering employee discipline". This is legislation that may become enacted in the future, and the franchise bar is watching its development closely.

Nonetheless, the broader 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.

As of this writing, it is important to note that 18 states have now passed legislation on the local level, either through their labour laws or franchise laws, which in varying ways limit how franchisors could be "joint employers" of their franchisee's employees. More bills have been introduced, and it is likely that in the coming years, roughly half of the states in the U.S. could have local legislation finding franchisors exempt from joint employer status, at least in certain circumstances. However, as noted by many practitioners, these state statutes could do little to impact federal enforcement of federal law, and more than half of the states have no statutes limiting joint employer status for franchisors. These statues are untested, and in the fact-specific area of employment law and the joint employment standard, it may take time for any consistent authority to develop. Little uniformity has emerged between these state statutes, and franchisors should be mindful of the state laws that may apply to their circumstances.

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

Franchisors have been found to be vicariously liable for the acts or omissions of their franchisees (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 of 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 by 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?

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 unless the overseas franchisor or the franchisor's home country is subject to U.S. economic sanctions.

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

Royalty 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 are, like most types of U.S. source income, 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 a reduced withholding tax rate or a full exemption. There is no benefit to structuring the royalties as management service fees since such fees are also 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?

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 between franchisor and franchisee and that the franchisor will be held vicariously liable for harm caused by the actions (or failure to act) of 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 an innocent third party: (a) reasonably believed, based on a representation of the franchisor, that the subject franchisee was 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 franchisees hold themselves out to the public as independent owners on all of their signage and advertisements.

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, but not all, automatically incorporate by common law an implied covenant of good faith and fair dealing into every contract within their jurisdictions, including franchise agreements. A few do not, and a few only do so in limited non-franchise contexts, so it is important to analyse which state's law applies in a given circumstance. Where it exists, 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. Further, good faith and fair dealing is a fact-driven analysis, and even well-drawn contracts may not anticipate every contingency. Therefore, where a franchisor wishes to retain the unfettered ability to make an important decision that may be to the significant detriment of a franchisee, it is prudent for a franchisor to make clear that it has the absolute discretion to do so within the contract, and thereby avoid the inadvertent application of the implied covenant of good faith and fair dealing.

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.

There are other exceptions to contract law which may require good faith conduct. 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 actually override or void contractual language, and prohibit, amongst other things, unfair or inequitable conduct by a franchisor. Some even require "good" reasons for termination, 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). Many of these "relationship" statutes also contain "anti-waiver" provisions, which prohibit any attempt to waive or nullify their statutory protections through contractual language. *See* NJ Stat. §56:10-7(a) (anti-waiver provision). 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, there are significant economic factors that also decidedly tilt towards treating franchisees fairly. 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 FDDs) 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, or exercising a right in a way that may put a franchised unit out of business.

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 conduct of the franchisor once a franchise relationship has been established. Nineteen 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"). 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, including selective contract enforcement; (v) restrict or prohibit the franchisor from directly or indirectly (for example, through another franchisee) encroaching upon a franchisee's territory; and (vi) obligate the franchisor to repurchase inventory upon termination or non-renewal of the franchise. 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, who often are given a standard form franchise agreement on a take-it-or-leave-it basis.

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 with franchisees 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.

There are also 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.

Since relationship laws vary from state to state, it is essential to do an analysis to determine which state's relationship laws apply. Most states' relationship laws address jurisdiction, although a few states are silent on the topic. Out of the states that do address the jurisdictional application, there is variance relative to how narrowly or broadly jurisdiction is applied. For example, some states require the franchised unit to be located in its state for its relationship laws to apply. Other states apply a broader scope, allowing its relationship laws to apply if the franchised unit is located within the state or if the franchisee is a resident of or is domiciled in the state. Still others apply an even broader scope.

15 Franchise Renewal

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

Typically, a franchisee's right to renew its franchise agreement is conditioned on a number of factors, including, among other things, the franchisee being in compliance with its obligations during the initial term and 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. If the franchisee must sign a new franchise agreement upon renewal or

if there is an interruption or change to the franchisee's business, then the franchisor must comply with any applicable FDD registration and disclosure requirements.

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, since the scale of bargaining power is tipped in the franchisor's favour, the freedom to contract is not absolute. 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 90 days' (and in some cases, six 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. While the goal of these relationship laws is to protect franchisees from arbitrary termination or non-renewal of the franchise relationship, the unintended side effect is the possible creation of a perpetual franchise relationship which may go against either party's (or both parties') intent.

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?

Franchisees are generally 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. 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 or "conditions" in connection with a proposed transfer of the franchised business. Examples of such conditions typically include: (a) requirements imposed on the existing franchisee (e.g., being current on all of its financial obligations to the franchisor, not being in default of the franchise agreement, the payment of a transfer fee, and the delivery of a general release in favour of the franchisor); and (b) requirements imposed on the transferee franchisee (e.g., entering into the franchisor's "then current" franchise agreement, meeting certain financial criteria, 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. However, as many franchisors will not waive their right of first refusal "up front" (e.g., before a deal between the franchisee and prospective transferee is negotiated), the fact that the franchisor has the "right of first refusal", sometimes has a "chilling effect" on the franchisee's ability to sell, because the proposed purchaser must spend considerable time, effort and money negotiating the deal with the franchisee, entering into an agreement only to find that "its" deal has been "taken" by the franchisor pursuant to its "right of first refusal".

Several state relationship laws impact on a franchisor's ability to impose restrictions on the franchisee's ability to transfer its business. For example, some relationship laws provide that it is an unfair or deceptive act for a franchisor to refuse to permit a transfer without having "good cause". Others permit a franchisor to reject a proposed transfer if the transferee fails to satisfy the franchisor's then-current requirements, as long as the franchisor's refusal is not arbitrary 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 and opportunity 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 in the U.S. 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). Reasons for asserting such "step-in" rights include 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. Such "step-in" provisions, which are disclosed in the franchisor's offering prospectus given to prospective franchisees and are set forth in the franchise agreement, are generally enforceable. Where the franchisee is going to be leasing the franchised business premises (as in most cases), the franchisor should require that the franchisee enter into a "Collateral Assignment of Lease" agreement (typically, a three-party agreement between franchisor, franchisee and the landlord) which will provide for the various circumstances in which the franchisor will be permitted to assert its "step-in" rights. If such an agreement is entered into (or the landlord otherwise consents in writing, such as in a lease rider or lease amendment), the franchisor will likely be able to enforce its "step-in" rights.

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 (if no "step-in" rights have been provided for in a lease rider or amendment), may object to or seek to frustrate the franchisor's attempts to assert "step-in" rights. In such case, the franchisor would usually not be permitted to use any form of "self-help" (under governing state law) and it is likely that it would be forced to 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 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. Rather, as explained above in question 16.2, franchisors often use a "collateral lease assignment" agreement in order to protect their "step-in" rights. Similarly, franchisors commonly use agreements (with different names) which appoint the franchisor and perhaps "any officer or agent of franchisor" as attorney-in-fact (e.g., holder of a power of attorney), in terms of providing for the orderly (and peaceful) transfer of telephone numbers, fax numbers, and internet domain names, etc., used by the franchised business. These issues typically arise in the context of an involuntary transfer or termination of the franchised business. Such agreements authorising the franchisor to take such action as "attorney-in-fact" are generally enforced.

17 Electronic Signatures and Document Retention

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

The federal Electronic Signatures in Global and National Commerce Act (ESIGN), passed in 2000, confirmed that electronic signatures have the same legal standing as "wet ink" signatures. In order to be a valid electronic signature, it is essential that, among other things: (i) each party intends to sign the document; (ii) the signature must be associated with the applicable document; and (iii) that in certain consumer situations, the parties to the contract must consent to do business electronically. ESIGN pre-empts state laws regarding electronic signatures. ESIGN does not mandate the use of electronic signatures, but it does eliminate the barriers to doing so.

The rules regarding electronic signatures depends in large measure on the choice of law provisions in the franchise agreement, as different jurisdictions will have different rules. This is particularly the case when considering international franchising. Franchisors should do an analysis of the laws of the applicable country to determine whether electronic signatures are acceptable.

If the franchise agreement is a deed, further formalities are required, such as needing to be executed in front of a witness. The witness must be present to witness the signing of the document, and there is no current authority on whether the requirement that the witness be present to see the signature can be satisfied by virtual means. Best practices suggest the franchise agreement be signed in "wet ink" version, where the witnessing of the signature is less able to be challenged.

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

Under the FTC Franchise Rule, franchisors must keep a copy of each materially different version of their FDD and also a copy of the signed receipt, both for at least three years. Many states impose similar, if not stricter, requirements. Even after such time, it is prudent from a business standpoint to keep such documents for a longer period of time. While many states allow for such document retention to be digital rather than "wet ink", it is prudent to keep "wet ink" versions of these important documents. Whether from an evidentiary perspective or to satisfy one's burden of proof with regards to franchise rules, a "wet ink" version provides the best evidence in the event a dispute arises.

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Richard L. Rosen, the founding member of The Richard L. Rosen Law Firm, PLLC, has been actively engaged in the practice of franchise law in New York City for over 40 years, during which time he has represented countless franchisors and franchisees, both as counsel and as a business adviser. Mr. Rosen has been engaged in virtually all aspects of franchising during his career. He has counselled and represented franchisors in the setting up of franchising systems and programmes; formed franchising entities; drafted and negotiated franchise agreements, multi-unit area development agreements, master franchise agreements, registration statements, disclosure and other ancillary franchise documents; represented franchisees and franchisee associations; litigated in both state and federal courts; and mediated, arbitrated and litigated matters on behalf of both franchisors and franchisees. He has represented franchisors and franchisees in virtually every field.

Mr. Rosen is a founding member and immediate past chairman of the Franchise, Distribution and Licensing Law Section of the New York State Bar Association, a member of the Steering Committee of the National Franchise Mediation Program, The CPR Institute For Dispute Resolution, Distinguished Panel of Neutrals and a member of the Executive Committee of the Business Law Section of the New York State Bar Association.

He has been interviewed on both television and radio, *The American Bar Association Journal*, *The Franchise Times* and *Forbes* Magazine, regarding franchising. Mr. Rosen is a contributor to "Franchising 101, The Complete Guide to Evaluating, Buying and Growing Your Franchise Business" compiled by the *Association of Small Business Development Centers* and has written many articles on the legal and business aspects of franchising.

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 U.S.*; *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.

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John A. Karol joined the firm in 2010, and has been a partner since 2014. Mr. Karol practises predominately litigation, arbitration, mediation, franchise law, intellectual property law, and employment law. Mr. Karol has litigated and arbitrated a wide variety of franchise-related disputes, for both franchisees and franchisors. Mr. Karol has also worked with Mr. Rosen on a wide variety of franchise-related, commercial, trademark and intellectual property advisory matters. Mr. Karol also maintains a significant employment practice, representing employers and employees in a wide variety of matters. Mr. Karol has several significant reported decisions, including decisions concerning the NY Franchise Sales Act and its potential application against individual officers and directors, enforcement of arbitration provisions and arbitrability, and spoliation of evidence ("ESI").

Mr. Karol graduated from Fordham Univ. School of Law in 2002. Mr. Karol is admitted to practice in New York, New Jersey, the 9th Cir., and the United States District Courts for the SDNY, EDNY, DNJ, DMI, and associated bankruptcy courts. He is a member of the NYSBA (Business Law Section's franchise committee), and the NYC Bar Association.

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, healthcare, 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. In 2018, we were named Franchising Law Firm of the Year in the USA by *Lawyers Worldwide Awards Magazine*.

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