

PANORAMIC

FRANCHISE 2025

Contributing Editor

Mark Kirsch

Lathrop GPM



 LEXOLOGY

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Panoramic guide (formerly Getting the Deal Through) enabling side-by-side comparison of local insights, including franchise market overview; key considerations when forming and operating a franchise; offer and sale of franchises; franchise contracts and the franchisor/franchisee relationship; and recent trends.

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Ashtons Legal

USA

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Lathrop GPM

Global overview

Mark Kirsch

Lathrop GPM

The world changed in 2020 and has continued to change and evolve – in many ways. Individuals, businesses and entire economies around the world have reacted to these events and have also continued to evolve. While we like to think that the covid-19 pandemic is behind us (and hopefully is), its impact, both positive and negative is here to stay. Further, the last four years have seen local, regional and global changes – wars, global climate change, economic and financial disruptions and inflation, artificial intelligence (AI) increasingly becoming part of our mainstream business and personal lives. These events remind us of how interconnected the world is, and the impact of these events and evolutions on travel, hospitality, restaurants, healthcare, education and, of course, economies and industry.

Businesses, workers and consumers have emerged and many are thriving with a new sense of resilience. Companies accelerated investments in technology or developed new product and service offerings. AI is being used more extensively in various industries. The restaurant industry, which is home to many franchise brands, increased its investments in mobile technology and contactless payments, modified menu offerings, shifted to takeaway, and partnered with delivery companies to counteract the changes in consumption and travel habits. Education, tutoring and training businesses developed and implemented new virtual offerings. New businesses and services arose, such as ghost kitchens (professional cooking facilities set up to provide delivery only meals). Businesses found new consumers and new markets around the corner, across their home countries and around the globe. As we know, some companies see a crisis, recognise an opportunity, and act. Those companies come out on the other side stronger, and as a result, companies are rethinking their approaches to growth, development and expansion into new markets.

Businesses have embraced the new normal and are evaluating new opportunities. Many franchisors that were doing business in countries now involved in wars may have ceased or paused development, or are deploying resources elsewhere. Other companies may wish to explore opportunities outside their borders for the first time and are ready to dip their toe in international franchise waters; others who may have been franchising or distributing in a foreign country pre-pandemic are now considering alternatives to expansion, with multiple approaches in different countries, such as direct franchising, master franchising, non-franchised licensing or distribution, or direct investment in company owned outlets in a country. For all those companies, and for their in-house and outside counsel, Lexology PanoramicFranchise is a must-read for initial expansion diligence. Whether a company in Country A is looking to distribute its goods in Country B, or is looking to expand its outlets and services to Country C, D, E or F, understanding the commercial, financial, legal and regulatory landscape of target countries is critical. This edition should be the first resource used to evaluate franchising and distribution issues in a particular country and guide strategic decisions.

This edition of Lexology PanoramicFranchise is organised in the familiar style of a country-by-country analysis. Each chapter is written by a lawyer (or lawyers) with impeccable credentials and significant experience representing franchisors, master franchisees, sub-franchisors, franchisees, licensors and distributors in his or her country. Each chapter uses the same questionnaire that addresses the issues, business concerns and legal questions that most counsel and executives focus on as they embark on exporting their brand to a new country. Therefore, for the reader who wishes to dive into a particular country or several countries, each chapter discusses the relevant issues, moving from general to specific, much in the way counsel would prepare for a discussion with management. In general, each chapter guides the reader as follows.

- The chapter begins with a market overview, describing franchising in that country and its role in business and the economy.
- The chapter proceeds to discuss basic business issues, such as business formation, taxation, restrictions on foreign investors, labour and employment, real estate and intellectual property.
- Next, the chapter explores franchise issues, going from the general to the specific, including the definition of a franchise, the laws and regulations governing franchising, franchisor eligibility and franchisee selection.
- Digging deeper, the chapter explores franchise-specific laws or other intellectual property, trademark, licensing, agency or competition laws. Our authors guide the reader through various aspects of the franchise process, such as franchise disclosure rules, registration and filing requirements, and even applicable general legal principles and codes of conduct.
- The chapter also addresses the details and nuances of franchise agreements and the franchise relationship in each country, including restrictions on or arguments for terminations, renewals, transfers, fees, foreign exchange controls, confidentiality and non-competition covenants. As befitting any legal summary, the chapter discusses the court system, dispute resolution (including arbitration) and governing law requirements.
- Finally, the chapter wraps up with legal and other developments, and updates and trends.
- In addition, where applicable, the chapter provides links to the most critical and relevant laws and regulations accessible through the Lexology website.

However, business operations, including franchising and distribution into new markets and countries, are rarely implemented through a one-size-fits-all approach. This edition of Lexology PanoramicFranchise allows the reader to evaluate each potential country on its own or create strategies for groups of countries. Because each chapter is organised in the same manner, the reader can identify, evaluate and analyse particular issues across several markets. Counsel may wish to evaluate one or more specific issues across multiple countries, weed out potential targets that are problematic, or focus efforts on better targets, as set out in the following examples.

- Company X is using direct franchising in its home country but wishes to explore alternative forms of franchising in other countries, such as master franchising

or sub-franchising – this edition addresses each country’s regulations and requirements as applied to different franchise models.

- Maybe Company X is considering a non-franchise licensing or distribution model and wishes to avoid granting franchises or becoming liable as an accidental franchise. This edition will enable counsel to consider if the law in one or more countries could be a dead end because the current or proposed arrangement is a franchise. This permits a re-evaluation of the strategy for that country or a modification of the commercial arrangement.
- Will a country’s tax structure or restrictions on foreign investment make entry into that country a non-starter, or are there restrictions or controls on foreign exchange that make repatriation of currency a challenge?
- If protections of confidential information, know-how and trade secrets are critical, will a particular target country be protective?
- If a company employs specific franchise agreement provisions for the protection of its system or for generating revenue, are those contract provisions permitted or enforceable in certain target countries?
- If a company designates specific suppliers, or controls pricing or resale prices in its home country arrangements or in certain foreign markets, a review of those portions of multiple chapters will assist the company and its counsel in mapping out an expansion strategy.
- Recognising that disputes with franchisees or master franchisees are likely to be inevitable at some point in the life cycle of franchise relationships, which countries are most hospitable to the company’s desired dispute resolution procedures and which will enforce foreign judgments?
- Companies’ plans change over time and at some point, a company may wish to withdraw from a market or country. Are there restrictions on terminations of franchises that may be an impediment?

This edition of Lexology PanoramicFranchise is a valuable resource to evaluate franchising, whether in a neighbouring country to the reader’s region, or in one or more countries on the other side of the globe. It is not, nor is it intended to be, a fulsome treatise on all aspects of franchising and franchise laws in over 20 countries with the goal to make the reader an expert in franchise law in those countries. Rather, it identifies the most significant issues that counsel, management, and their clients and companies need to know. Lexology Panoramic Franchise provides guidance on these issues, as well as direction as to where additional evaluation is needed. The reader will recognise that many issues will require consultation with local counsel in the target country. Further analysis may be particularly necessary regarding non-franchise issues, such as entity formation, tax and labour. Additional research will be needed with respect to franchise-specific issues, such as disclosure and registration, permitted contract clauses or franchise terminations. An in-house lawyer, in-house executive or a company’s outside counsel may not be comfortable with turning over all the questions and issues to foreign counsel. This edition will arm the reader with information to ask intelligent questions of foreign counsel. When seeking out counsel in another country, what better source than the author who wrote the relevant chapter?

Let me take this opportunity to thank the group of authors who have contributed to this edition. They have spent years honing their skills and knowledge and have shared it with the readers in an extremely user-friendly manner.

Business opportunities and challenges are different from those pre-pandemic, and businesses and governments are navigating economic, supply chain, and technology changes – and evolutions. However, one thing has not changed: the need for lawyers and executives to intelligently analyse and evaluate business growth opportunities to provide their clients with the best advice in an efficient manner, so that both counsel and clients can make sound strategic decisions. The world has changed, and businesses and commercial relationships are continuing to evolve – are you poised to act?



[Mark Kirsch](#)

mark.kirsch@lathropgpm.com

[Lathrop GPM](#)

[Read more from this firm on Lexology](#)

Canada

[Bruno Floriani](#), [Marissa Carnevale](#), [Yasmine Shadman](#)

[Lapointe Rosenstein Marchand Melançon LLP](#)

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MARKET OVERVIEW

Franchising in the market

- 1 | How widespread is franchising in your jurisdiction? In which sectors is franchising common? Are there any economic or regulatory issues in the market that are more or less hospitable to franchising or make it economically viable in your jurisdiction?

Franchising is widespread across Canada in over 50 industries including automotive, travel, senior care, education and health and fitness, with the retail, hospitality and restaurant sectors being the most popular. In fact, Canada has one of the largest franchise industries in the world following the United States and franchising is often used by US companies to enter into the Canadian market.

As opposed to other jurisdictions, there are no registration requirements for establishing a franchise system in Canada or to obtain a licence to enter into contracts and grant franchise rights in such capacity, nor is there a requirement that disclosure documents or other materials be registered, thereby facilitating entry into franchising. Moreover, the Canadian provinces that have adopted franchise disclosure laws have rules in place governing pre-contractual disclosure only; the pre-contractual disclosure process itself is self-governed in that franchisors are solely responsible for the contents of the disclosure materials and their compliance, and there is no advance submission of the disclosure items to any regulatory authorities for verification or approval.

Law stated - 25 May 2024

Associations

- 2 | Are there any national or local franchise associations? What is their role in franchising, including any impact on laws or regulations? Are there any rules of conduct or membership requirements?

Canadian franchisors and franchisees have created a robust and effective [Canadian Franchise Association](#) (CFA) to build and support the franchise industry in Canada, which currently has thousands of members nationwide. Although there is no requirement to become a member of the CFA, membership typically lends credibility to a franchise, given that franchisors are required to meet the definition of a franchise to qualify as members, provide proper documentation in support of their membership application, and commit to abide by the CFA [Code of Ethics](#). Membership with the CFA also requires that franchisors use the CFA disclosure document guide and commit to giving potential franchisees all the information they need to make a viable business decision.

Law stated - 25 May 2024

BUSINESS OVERVIEW

Types of vehicle

1

3 | What forms of business entities are relevant to the typical franchisor?

There are several different vehicles available to foreign franchisors who wish to carry on business in Canada, each with varying tax and corporate consequences. The preferred choice of vehicle used for the expansion of a foreign franchise system into Canada is the incorporation of a Canadian subsidiary. By using a Canadian subsidiary, the franchisor has a local direct physical presence and indicates to the general public that it has made a commitment to Canada. Foreign franchisors may instead wish to enter the Canadian market by franchising directly from their country without the creation of a permanent establishment in Canada, thus avoiding being considered by Canadian tax authorities as carrying on business in Canada.

Law stated - 25 May 2024

Regulation of business formation

4 | What laws and agencies govern the formation of business entities?

The federal legislation under which a corporation may be incorporated is the [Canada Business Corporations Act](#) (CBCA). Provinces have also enacted similar statutes regulating the formation of corporate entities. The formation of partnerships and other non-corporate entities is governed solely by legislation that is specific to each province. Business entities must usually register with the relevant corporate or business registry of each province in which they wish to conduct business.

Law stated - 25 May 2024

Requirements for forming a business

5 | Provide an overview of the requirements for forming and maintaining a business entity.

Registration mechanisms for forming and maintaining business entities in Canada are generally straightforward, requiring little more than the payment of prescribed fees and the filing of specific corporate or business registry forms that describe, inter alia, the nature of the business, its structure, the scope of its undertakings and basic information regarding its shareholders and directors. Annual filings are also typically required in each of the provinces in which a business entity carries on business and, in the case of corporations incorporated under the CBCA, at the federal level.

Law stated - 25 May 2024

Restrictions on foreign investors

6 | What restrictions apply to foreign business entities and foreign investment?

Pursuant to the [Investment Canada Act](#), foreign business entities seeking to acquire or establish a Canadian business are required to notify [Innovation, Science and Economic Development Canada](#) no later than 30 days following such acquisition or establishment. An onerous and thorough review process applies to non-World Trade Organization investors where the asset value of the acquired Canadian business is at least C\$5 million for direct acquisitions or C\$50 million for indirect acquisitions. However, the C\$5 million threshold will apply to indirect acquisitions where the asset value of the acquired Canadian business represents greater than 50 per cent of the asset value of the global transaction. The review threshold for World Trade Organization investors was increased to an 'enterprise value' of C\$1.326 billion as of February 2024. This amount is indexed annually. Most franchisors do not meet this threshold.

Furthermore, certain corporate statutes, such as the CBCA, set out requirements as to the residency of directors pursuant to which at least one director (or 25 per cent of the directors if there are more than four) must be a Canadian resident. The Canadian province of Manitoba also maintains certain director residency requirements for corporations. Otherwise, the corporate governance regimes of the Canadian provinces of Quebec, Ontario, British Columbia, Alberta, Nova Scotia, New Brunswick, Newfoundland and Labrador, Prince Edward Island and recently Saskatchewan have no residency requirements for directors. The province of Saskatchewan maintains that if none of the directors reside in the province of Saskatchewan, the corporation must appoint an attorney in Saskatchewan.

Law stated - 25 May 2024

Taxation

7 | What aspects of the tax system are relevant to franchisors? How are foreign businesses and individuals taxed?

Generally, three business structures are available to a franchisor wishing to export its franchise system into Canada:

- A foreign franchisor may choose to contract directly with its Canadian franchisees without carrying on business in Canada directly or through a permanent establishment in Canada. In such an event, income earned in Canada by the franchisor through royalty payments and rent would be characterised as passive income and subject in Canada to a withholding tax only. The standard withholding tax rate of 25 per cent under Canadian income tax legislation is often reduced to 10 per cent by tax treaties entered into between Canada and other jurisdictions – these should be carefully reviewed and considered at the structural stage of planning any entry into the Canadian market.
- A franchisor may opt to carry on business in Canada using a Canadian branch or division. If the franchisor carries on business in Canada through a fixed place of business or permanent establishment, any income derived in respect thereof will generally qualify as 'business income' that is taxable in Canada on a net income basis. Furthermore, the income of a non-resident franchisor carrying on business through a Canadian branch will typically be subject to a 'branch tax' that is payable at

the time the earnings of the subsidiary are accrued (and not at the time the income is paid to the foreign franchisor). In light of the foregoing, few franchisors choose to establish a branch office or division for the purpose of expanding into the Canadian market.

- A franchisor may choose to carry on business in Canada through a federally or provincially incorporated subsidiary. This is the most frequently used vehicle by non-resident franchisors wishing to export a franchise system into Canada. The incorporation of a subsidiary presents certain advantages, including the avoidance of Canadian withholding tax on passive income. Nonetheless, the subsidiary's income would be taxable in Canada on a net income basis and dividends paid to its parent would be subject to a withholding tax of 25 per cent. This rate is often reduced to between 5 per cent and 15 per cent by tax treaties entered into between Canada and other jurisdictions. The franchisor may also charge a reasonable fee for providing assistance to its Canadian subsidiary in the operation of its business activities with the expectation that a reasonable portion of such fee may then be deducted from the subsidiary's income for tax purposes. Normally, a fee negotiated between arm's-length parties would meet the reasonability test.

In conclusion, significant business and tax consequences arise from each of the above-mentioned structures – a thorough review of all relevant Canadian legislation pertaining to each structure and a careful evaluation of the effect of tax treaties ratified by Canada is strongly advised.

Law stated - 25 May 2024

Labour and employment

8 | Are there any relevant labour and employment considerations for typical franchisors?

Each Canadian province has enacted its own health and safety, employment standards and labour relations legislation. Accordingly, provincial laws and regulations govern most matters relating to labour law (eg, minimum wages, hours of work, overtime, leave, termination of employment, union certification and collective bargaining rights).

Each franchisee must operate as a truly independent and distinct entity from its franchisor so as to be considered a separate employer for labour union certification and collective bargaining purposes. Additionally, even if the franchisee is separately incorporated and operates independently, it is imperative to ensure that there exists no common control or direction emanating from the franchisor that is greater than that which typically characterises the franchisor-franchisee relationship. To do otherwise would be to run the risk of having a union certification or collective agreement with respect to one franchisee being extended to other franchised or corporate outlets. Furthermore, most provincial jurisdictions recognise successor liability following a transfer or sale of a business, such that the new employer is bound by the union certification and, in certain circumstances, by the collective bargaining agreement concluded with the union representing the employees of the sold business.

While no provinces have enacted legislation recognising a joint employer status for franchisors per se, it is important to note that the [Ontario Fair Workplaces, Better Jobs Act 2017](#), does not require that businesses carrying on associated or related activities have the intent or effect of defeating employment standards legislation to be treated as one employer and held jointly and severally liable, thus creating a wider scope of application and increasing the possibility of associated businesses being deemed joint employers.

Law stated - 25 May 2024

Intellectual property

9 | How are trademarks and other intellectual property and know-how protected?

The [Trademarks Act](#) (Canada) defines a trademark as a 'sign or combination of signs that is used or proposed to be used by a person for the purpose of distinguishing or so as to distinguish their goods or services from those of others or a certification mark'. As such, distinctiveness is central to the definition and a trademark need not be registered to be valid, or even licensed, in Canada. Nonetheless, registration with the [Canadian Intellectual Property Office](#) has the advantage of providing nationwide protection of the registered trademark and, in the Province of Quebec, enables the use of any English-only terminology that is a registered trademark on catalogues, brochures, public signs and certain other commercial advertising (provided that no French version of the trademark has been registered) and, in the case of public signage, provided that a generic description of the goods and services, a slogan or another term or indication pertaining to the goods and services is included in French to ensure a 'sufficient presence' thereof. An application for registration may be filed without having to specify a basis for filing or including a declaration as to the use of the concerned trademark. Recent amendments to the Trademarks Act (Canada) have also allowed for the filing of certain non-traditional types of trademarks (such as sound, scent or taste).

Remedies available following the breach of exclusive use clauses or the use of a confusing trademark range from injunctive remedies to passing-off actions that may be instituted before either the Federal Court of Canada or the provincial superior court with territorial jurisdiction.

There is no statutory protection of know-how in Canada. Parties must rely on common law tort and contractual undertakings to protect know-how from unauthorised disclosure or use. Accordingly, the nature of the confidential information that a franchisor wishes to protect, as well as the legal consequences arising as a result of its dissemination, should be clearly identified by the contracting parties in their franchise agreement.

In 2019, Canada became a member country of the [Madrid Protocol](#) and therefore foreign franchisors seeking Canadian trademark registrations may apply for the same by way of the [Madrid International Trademark System](#).

Law stated - 25 May 2024

Real estate

10 | What are the relevant aspects of the real estate market and real estate law? What is the practice of real estate ownership versus leasing?

With the exception of the province of Quebec, all provincial property laws are based on the English common law system, pursuant to which real estate can either be held in fee simple or by way of a leasehold interest. Such interest is registered with the public land registry. Quebec's property laws are based on the French civil law system. They require the registration of ownership rights and permit the registration of lease rights in the public land registry.

No particular restrictions exist as to the nature of the arrangement to be concluded between the franchisor and the franchisee with regard to real (or, in civil law, immovable) property. For instance, a franchisor may wish to enter into a head lease and sublease the premises to a franchisee. In such circumstances, cross-default provisions as between the sublease and the franchise agreement are advisable so that a right to terminate for breach of one gives rise to a right to terminate the other. In the absence of such provisions, the franchise agreement and the sublease will be construed as two independent contracts and breach of one may not have any bearing on the other. Moreover, it is advisable to include automatic termination provisions in a sublease and a franchisor's right to terminate in a franchise agreement in circumstances where the head lease is terminated.

In Canada, it is more common for franchisors to lease (or require that their franchisees lease) rather than purchase real estate for franchise locations given the significant capital investment that is required and that property located in prime locations is often not available for purchase.

Generally, foreign ownership of, or the transfer to non-residents of, real estate situated in Canada is not restricted, save for the purchase of residential property or for those instances where such real estate benefits from statutory protection given its cultural or historical significance.

Law stated - 25 May 2024

Competition law

11 | What aspects of competition law are relevant to the typical franchisor in your jurisdiction? How is competition law enforced in the franchising sector?

The [Competition Act](#) (Canada) sets forth penal and civil recourses with respect to various practices, including those identified as conspiracies and collusion, abuse of dominance, price maintenance, promotional allowances and price discrimination, false or misleading advertising, deceptive marketing and pyramid selling, refusal to deal, exclusive dealing, tied selling, as well as certain other vertical market restrictions.

While the penal provisions of the Competition Act impose a higher burden of proof, their violation grants injured parties the right to sue for damages caused by such practices; those damages are restricted to actual loss and costs. Fines are also applicable for certain types of offences. On the other hand, reviewable practices are civil in nature and are subject to the exclusive jurisdiction of the [Competition Tribunal](#), upon the request of the commissioner

of competition or at the request of a private party with leave from the Competition Tribunal to that effect. In the latter case, private litigants may only seek redress of conduct that constitutes a breach of an order under the Competition Act, as monetary awards are not provided for. The Competition Tribunal may make orders for a reviewable trade practice to cease or compel a business to accept a given customer or order on reasonable trade terms.

The [Commissioner of Competition](#) heads the [Competition Bureau](#) and has broad powers of investigation and inquiry, such as search and seizure, examinations under oath, and ordering the production of physical evidence or records and wiretapping (in certain circumstances). Its enquiries are conducted under strict rules of confidentiality and its powers remain subject to the supervision of the courts. On the international level, the Competition Bureau has concluded numerous agreements of notification and mutual assistance with its international counterparts and is an active member of the [International Competition Network](#).

Law stated - 25 May 2024

OFFER AND SALE OF FRANCHISES

Legal definition

12 | What is the legal definition of a franchise?

The offer and sale of franchises in Canada are regulated by the provinces rather than by the federal government. Definitive franchise legislation is currently in force in six Canadian provinces: Alberta, Ontario, New Brunswick (NB), Prince Edward Island (PEI), Manitoba and British Columbia (BC). The [Civil Code of Quebec](#) also contains provisions applicable to all contracts governed by Quebec law, including franchise agreements.

The [Arthur Wishart Act \(Franchise Disclosure\)](#) in the Province of Ontario (the Ontario Act), the [Prince Edward Island Franchises Act](#) (PEI Act), the [New Brunswick Franchises Act](#) (the NB Act), the [Manitoba Franchises Act](#) (the Manitoba Act) and the [British Columbia Franchise Act](#) (the BC Act) each generally define a 'franchise' as a right to engage in a business where the franchisee is required to make one or several payments to the franchisor in the course of operating the business or as a condition of acquiring the franchise or commencing operations, and in which the franchisee is granted either:

- the right to sell goods or services substantially associated with the franchisor's trademarks in circumstances where the franchisor or any of its associates has significant control over, or offers significant assistance in, the franchisee's method of operation; or
- representational or distribution rights to sell goods or services supplied by the franchisor or its designated supplier, and the franchisor (or any person it designates) provides location assistance to the franchisee.

Under the Ontario Act, the definition of 'franchise' provides that the right to exercise control over the franchisee's method of operation, as opposed to the actual exercise of that control, may be sufficient for the purposes of characterising a business as a franchise. This

definition potentially increases the number of business relationships that may fall under the Ontario Act's application.

The Ontario Act, the PEI Act, the NB Act and the BC Act apply to franchise agreements entered into on or after 1 July 2000, 1 July 2006, 1 February 2011 and 1 February 2017, respectively, and to renewals or extensions of franchise agreements, regardless of whether such franchise agreements were entered into before or after such date, provided that the business operated pursuant to such franchise agreements is to be operated partly or entirely in Ontario, PEI, NB or BC, respectively. The Manitoba Act is conceptually similar and applies to franchise agreements entered into, renewed or extended on or after 1 October 2012. Furthermore, there is no residency requirement for franchisees to whom the Ontario Act, the PEI Act, the NB Act, the Manitoba Act or the BC Act apply.

In [Alberta's Franchises Act](#) (the Alberta Act), a 'franchise' is defined as a right to engage in a business:

- in which goods or services are sold, offered for sale or distributed under a marketing or business plan substantially prescribed by the franchisor or any of its associates and that is substantially associated with any of its trademarks, service marks, trade names, logotypes or advertising; and
- that involves a continuing financial obligation of the franchisee to the franchisor or any of its associates and significant continuing operational controls by the latter on the operation of the franchised business, or the payment of any franchise fee (the latter fee being defined as any direct or indirect payment to purchase or to operate a franchise), and includes a master franchise and sub-franchise.

The Alberta Act applies to the sale of a franchise made on or after 1 November 1995 if the franchised business is to be operated partly or entirely in Alberta and if the purchaser of the franchise is an Alberta resident or has a permanent establishment in Alberta for the purposes of the [Alberta Corporate Tax Act](#).

Given the breadth of these definitions, Canadian franchise legislation may cover a number of business agreements and traditional distribution or licensing networks that would not typically qualify as franchise agreements, as the term 'franchise agreement' may be understood in other jurisdictions.

Law stated - 25 May 2024

Laws and agencies

13 | What laws and government agencies regulate the offer and sale of franchises?

Currently, adopted franchise legislation is limited to the Alberta Act, the Ontario Act, the PEI Act, the NB Act, the Manitoba Act and the BC Act (collectively, the Canadian Franchise Acts). No other province or territory of Canada has regulated the offer and sale of franchises through franchise-specific legislation, although the province of Saskatchewan has recently introduced a [bill](#) governing franchise disclosure that is expected to be enacted in the coming months.

Exemptions exist in each of the Canadian Franchise Acts, other than the Alberta Act, as follows.

Full exemptions

The Canadian Franchise Acts, other than the Alberta Act, do not apply to the following commercial relationships:

- employer-employee relationships;
- partnerships;
- memberships in a cooperative association, as prescribed in the NB Act, the PEI Act, the BC Act or the regulations to the Ontario Act, as the case may be;
- arrangements for the use of a trademark, trade name or advertising to distinguish a paid-for evaluation, testing or certification service for goods, commodities or services;
- arrangements with a single licensee in respect of a specific trademark, trade name or advertising if it is the only one of its general nature and type to be granted in Canada;
- any lease, licence or similar agreement for space in the premises of another retailer where the lessee is not required or advised to buy the goods or services it sells from the retailer or any of its affiliates (Ontario Act only);
- oral relationships or arrangements without any writing evidencing any material term or aspect of the relationship or arrangement;
- a service contract or franchise-like arrangement with the Crown or an agent of the Crown (except the Manitoba Act and the BC Act); and
- an arrangement arising out of an agreement for the purchase and sale of a reasonable amount of goods at a reasonable wholesale price or for the purchase of a reasonable amount of services at a reasonable price (except the Ontario Act).

Partial exemptions – the obligation to disclose

All of the Canadian Franchise Acts, other than the Alberta Act, contain exemptions from disclosure requirements that include, for example, the sale of a franchise to a person to sell goods or services within a business in which that person has an interest, provided that the sales arising from those goods or services do not exceed 20 per cent of the total sales of the business during the first year of operation of the franchise.

Exemptions are also set out in the Canadian Franchise Acts, other than the Ontario Act and the BC Act, in connection with the granting of a franchise if the prospective franchisee is required to make a total annual investment to acquire and operate the franchise in an amount that does not exceed the amount prescribed under each of the Canadian Franchise Acts, currently C\$5,000. Under the Ontario Act, an exemption similar to the foregoing exists in connection with the granting of a franchise if the prospective franchisee is required to make a total initial investment (not a total annual investment), determined in the prescribed manner, of an amount that does not exceed a prescribed amount, currently C\$15,000.

Exemptions exist in the Ontario Act, the Alberta Act and the BC Act with respect to the obligation to provide a disclosure document as follows:

- sale of a franchise by a franchisee provided that:
 - the franchisee is not the franchisor or an associate, director, officer or employee of the franchisor;
 - the sale is for the franchisee's own account;
 - the sale is not effected by or through the franchisor; and
 - in the case of a master franchise, the entire franchise is sold;
- sale of a franchise to a person who has been an officer or director of the franchisor or its associate for at least six months for that person's own account (Alberta Act and BC Act only);
- sale of a franchise to a person for the person's own account or to a corporation that the person controls if the person:
 - has been an officer or director of the franchisor or of the franchisor's associate for at least six months and is currently such an officer or director; or
 - was an officer or director of the franchisor or of the franchisor's associate for at least six months and no more than four months have passed since the person was such an officer or director (Ontario Act only);
- sale of an additional franchise to an existing franchisee if the additional franchise is substantially the same as the franchise that the franchisee is operating;
- a renewal or extension of an existing franchise agreement;
- the grant of a franchise for one year or less and that does not involve payment of a non-refundable franchise fee (Ontario Act and BC Act only);
- sale of a franchise by an executor, administrator, sheriff, receiver, trustee, trustee in bankruptcy or guardian on behalf of a person other than the franchisor or the estate of the franchisor;
- the grant of a franchise if the franchisor is considered to be operating or participating in a multi-level marketing plan pursuant to the Competition Act (Canada) (Ontario Act and BC Act only);
- sale of a right to a person to sell goods or services within or adjacent to a retail establishment as a department or division of the establishment, if the person is not required to purchase goods or services from the operator or the retail establishment (Alberta Act only); and
- sale of a fractional franchise (Alberta Act only).

The exemptions set out in each of the Canadian Franchise Acts, while substantively similar, are not identical. Under the BC Act, the sale of a franchise to a franchisee who invests more than a prescribed amount (currently C\$5 million) in the acquisition and operation of the franchise is exempted from the application of the disclosure requirements. Under the Ontario Act, the sale of a franchise if the prospective franchisee is required to make a

total initial investment, determined in the prescribed manner, of an amount that is greater than a prescribed amount, currently C\$3 million, is exempted from the application of the disclosure requirements.

One does not have to comply with the disclosure requirements under the Alberta Act when granting a licence to a person to sell goods or services within or adjacent to a retail establishment as a department or division of said establishment without requiring that the person purchase goods or services from the operator of the retail establishment.

Under the Manitoba Act and the BC Act, a franchisor is not required to provide financial statements to a franchisee if the franchisor meets certain criteria, including:

- a net worth of at least C\$5 million or, alternatively, having a net worth of at least C\$1 million to the extent that the franchisor is controlled by a corporation whose net worth is at least C\$5 million; and
- the existence of at least 25 of its franchisees engaged in business in Canada at all times during the five-year period preceding the date of the disclosure document.

In addition, each of the Canadian Franchise Acts other than the Alberta Act and the BC Act affirms that a franchisor may apply for a ministerial exemption allowing it not to include its financial statements in a disclosure document.

Law stated - 25 May 2024

Principal requirements

14 | What are the principal requirements governing the offer and sale of franchises under the relevant laws?

There are no specific requirements governing the offer and sale of franchises under the Canadian Franchise Acts, other than the requirements of pre-contractual disclosure. In Quebec, article 1375 of the Civil Code of Quebec establishes a duty of the parties to conduct themselves in good faith, and this duty extends to pre-contractual negotiations. This obligation has generally been interpreted to require that franchisors inform franchisees during the offer and sale stage of franchises of any information that could affect their decision to enter into the franchise agreement and, correspondingly, that franchisees inform themselves through reasonable due diligence and investigation prior to entering into the franchise agreement.

Law stated - 25 May 2024

Franchisor eligibility

15 | Must franchisors satisfy any eligibility requirements in order to offer franchises? Are there any related practical issues or guidelines that franchisors should consider before offering franchises?

Except for compliance with applicable Canadian Franchise Acts and other legislation, there are no requirements that must be met before a franchisor offers franchises for sale – for example, that a franchisor be in business for a minimum period, that a franchisor has operated a minimum number of franchisor-owned operations, or that a franchisor has operated in Canada with franchisor-owned operations for a minimum period.

Law stated - 25 May 2024

Franchisee and supplier selection

- 16 | Are there any legal restrictions or requirements relating to the manner in which a franchisor recruits franchisees or selects its or its franchisees' suppliers? What practical considerations are relevant when selecting franchisees and suppliers?

There are no generally applicable restrictions governing the recruitment and selection of franchisees or franchisee's suppliers, the locations of franchised outlets or the distance between outlets. However, such restrictions do exist in certain industries whose products or services are specifically regulated, such as the tobacco industry, the alcohol industry and the cannabis industry. For practical purposes, it is generally advised to consider a potential franchisee's aptitudes, character traits, financial wherewithal and experience as an independent businessperson, and a supplier's experience in the relevant industry and its knowledge of the market and the territory, when evaluating whether to enter into a long-term relationship with any such potential franchisee or supplier.

Law stated - 25 May 2024

Pre-contractual disclosure – procedures and formalities

- 17 | What procedures and formalities for pre-contractual disclosure are required or advised in your jurisdiction? How often must the disclosures be updated?

A franchisor governed by any of the Canadian Franchise Acts must furnish a prospective franchisee with a disclosure document not less than 14 days before the earlier of the signing by the prospective franchisee of the franchise agreement or any other agreement relating to the franchise, or the payment of any consideration by or on behalf of the prospective franchisee to the franchisor or any of its associates relating thereto.

All of the Canadian Franchise Acts exclude confidentiality and site selection agreements from the definition of franchise agreements for the application of the disclosure requirements. In addition, the Alberta Act, the BC Act, the Manitoba Act and the Ontario Act exempt agreements that only contain terms and conditions relating to a fully refundable deposit (that is, a deposit that does not exceed 20 per cent of the initial franchise fee (capped at C\$100,000 under the Manitoba Act and the Ontario Act) and is refundable without any deductions or any binding undertaking of the prospective franchisee to enter into any franchise agreement).

A franchisor must also furnish a prospective franchisee under each of the Canadian Franchise Acts with a description of any 'material change' as soon as practicable after

the change has occurred and prior to the earlier of the signing of any agreement or the payment of any consideration by the prospective franchisee in relation to the franchise. A 'material change' is defined as a change (even if not yet implemented in certain cases) in the business, operations, capital or control of the franchisor or any of its associates, or in the franchise system, which change would reasonably be expected to have a significant adverse effect on the value or price of, or on the decision to acquire, the franchise.

Law stated - 25 May 2024

Pre-contractual disclosure – content

18 | What information is the disclosure document required or advised to contain?

The regulations under each of the Canadian Franchise Acts require that general information concerning the franchisor be included in the relevant disclosure document. This information includes the history of the franchisor, the business background of its directors, the general partners and the officers of the franchisor, and whether any of those persons have been subject to bankruptcy or insolvency proceedings or has been previously convicted of fraud or unfair or deceptive business practices. While substantively similar, the list of information that must be disclosed under each of the Canadian Franchise Acts is not identical.

Financial statements must be included in the disclosure document governed by the Canadian Franchise Acts, although the requirements set out in the regulations adopted under the Alberta Act (Alberta Regulations) differ substantially from those adopted under the other Canadian Franchise Acts. For instance, the latter regulations compel the inclusion in each disclosure document of statements regarding initial 'risk factors', whereas those are not required under the Alberta Regulations. The regulations adopted under the BC Act (BC Regulations) also differ from those adopted under the other Canadian Franchise Acts as they require franchisors that have operated for less than one fiscal year to disclose an opening balance sheet, prepared in the same manner as financial statements.

The disclosure document must also include all 'material facts'. This encompasses any information about the business, operations, capital or control of the franchisor, its associates or the franchise system that would reasonably be expected to have a significant effect on the decision to acquire, or the value of, the franchise. Unlike all the other Canadian Franchise Acts, the BC Act does not require franchisors to disclose how they select franchise locations, unless this information is considered a 'material fact' that would otherwise be subject to disclosure. The BC Act also provides that franchisors must provide potential franchisees with a list of all current franchises in Canada and not only those located in BC.

Law stated - 25 May 2024

Pre-sale disclosure to sub-franchisees

19 | In the case of a sub-franchising structure, who must make pre-sale disclosures to sub-franchisees? If the sub-franchisor must provide disclosure, what must be

disclosed concerning the franchisor and the contractual or other relationship between the franchisor and the sub-franchisor?

Each of the Canadian Franchise Acts imposes the obligation to disclose upon 'franchisors', the definition of which includes a sub-franchisor with regard to its relationship with a sub-franchisee. Accordingly, presale disclosures must be made to a sub-franchisee by the sub-franchisor in accordance with the same procedural and substantive requirements, and exemptions pertaining thereto, that apply to franchisors with regard to their relationships with their franchisees. Moreover, information regarding a sub-franchisor's relationship with the franchisor must be disclosed to a prospective sub-franchisee, but only to the extent that such information constitutes a material fact or is necessary for the sub-franchisor to properly acquit itself of its duty to furnish the information expressly prescribed by the relevant statutory and regulatory provisions governing disclosure.

Law stated - 25 May 2024

Due diligence

20 | What due diligence should both the franchisor and the franchisee undertake before entering a franchise relationship?

While the scope of proper due diligence efforts is too broad to be addressed in a short response, we would include at the core of such efforts:

- from a franchisee's perspective, conducting proper due diligence on the business opportunity being offered including evaluating its financial return, meeting with already established franchisees in the franchise system and building a business plan; and
- from a franchisor's perspective, evaluating the financial wherewithal of the prospective franchisee and whether its representatives have sufficient experience in the industry to successfully operate a franchise location and a fulsome grasp of the vision and philosophy of the franchised concept so as to be an effective operator and representative of the brand.

In addition, with respect to franchisees establishing the first Canadian franchise location of an existing foreign franchise system in Canada, it will be important for franchisees to evaluate whether the franchisor has adapted its franchise system to the Canadian market to comply with certain local requirements, for example, whether the franchisor has translated its materials and website to French for franchisees located in the province of Quebec.

Law stated - 25 May 2024

Failure to disclose – enforcement and remedies

21 | What actions may franchisees or any relevant government agencies take in response to a franchisor's failure to make required disclosures? What legal remedies are available? What penalties may apply?

Under each of the Canadian Franchise Acts, an action for damages or rescission may be instituted by the franchisee for non-compliance. The NB Act provides that a party to a franchise agreement may, in the event of a dispute with another party to such agreement, trigger a mandatory alternative dispute resolution mechanism (mediation). The foregoing does not, however, preclude any party to such franchise agreement from availing itself of other recourses available under contract or at law.

Rescission

Pursuant to all Canadian Franchise Acts, other than the Alberta Act, a franchisee may rescind the franchise agreement without penalty or obligation:

- 'for late disclosure', no later than 60 days after receiving the disclosure document if the franchisor failed to provide said document or a statement of material change within the prescribed time or if the contents of the disclosure document do not satisfy statutory requirements; or
- 'for absence of disclosure', no later than two years after entering into the franchise agreement.

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

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

Should a franchisor fail to provide the disclosure document as required under the Alberta Act, the prospective franchisee is entitled to rescind the franchise agreement by giving a cancellation notice to the franchisor or its associate, as the case may be, no later than the earlier of 60 days after receiving the disclosure document or two years after the grant of the franchise.

The franchisor does not have an obligation to purchase any of the franchisee's assets under the Alberta Act but must instead, within 30 days of receiving a cancellation notice, compensate the franchisee for any net losses incurred by the latter in acquiring, setting up and operating the franchised business.

Damages

Pursuant to all Canadian Franchise Acts, other than the Alberta Act, if a franchisee suffers a loss because of a misrepresentation contained in the disclosure document or in a statement of material change or as a result of the franchisor's failure to comply with any disclosure requirements, the franchisee has a right of action for damages against the franchisor,

the franchisor's broker (if any), the franchisor's associates, every person who signed the disclosure document or statement of material change and, under the Ontario Act, the franchisor's agent, all of whom are jointly and severally liable.

Under the Alberta Act, a franchisee who suffers a loss resulting from a misrepresentation contained in a disclosure document has a right of action for damages against the franchisor and every person who signed the disclosure document, on a joint and several basis.

Law stated - 25 May 2024

Failure to disclose – apportionment of liability

- 22 | In the case of sub-franchising, how is liability for disclosure violations shared between franchisor and sub-franchisor? Are individual officers, directors and employees of the franchisor or the sub-franchisor exposed to liability? If so, what liability?

Liability is imposed on franchisors and sub-franchisors for misrepresentations contained in a disclosure document, although the extent and scope of such liability is contingent upon the applicable franchise legislation. Where a franchisor and a sub-franchisor are found liable for misrepresentations contained in a disclosure document, their liability will be of a joint and several nature.

Generally, the officers, directors and employees of a company cannot be sued in their personal capacity for the debts and obligations of the company. Accordingly, a key advantage presented by the subsidiary structure is the creation of a generally effective shield for the foreign franchisor seeking to avoid exposure to liabilities arising in Canada. Nevertheless, liability will not be entirely absorbed by the corporate subsidiary in those cases where a separate entity furnished a guarantee under the franchise agreement or breached its legal or statutory obligations in respect of the same.

The Canadian Franchise Acts extend liability for misrepresentations contained in a disclosure document to a much broader class of persons than those who would otherwise be liable under Canadian common law. Under the Alberta Act, a franchisee has a right of action not only against the franchisor, but also against every person who signed the misrepresentative disclosure document. Similarly, each of the other Canadian Franchise Acts provide that a franchisee may claim damages for misrepresentation not only from the franchisor, but also from the broker and associate of the franchisor as well as every person who signed the relevant disclosure document or statement of material change. In light of the very broad statutory construction given to the term 'franchisor's associate', the principal owner or controlling shareholders of a franchisor who are personally involved in the granting or marketing of the franchise may qualify as franchisor's associates. Similarly, parent companies of Canadian subsidiaries incorporated for the purpose of conducting franchise operations in Canada may also qualify as franchisor's associates where such parent companies participate in the review or approval of the granting of a franchise.

Law stated - 25 May 2024

General legal principles and codes of conduct

- 23** | In addition to any laws or government agencies that specifically regulate offering and selling franchises, what general principles of law affect the offer and sale of franchises? What industry codes of conduct may affect the offer and sale of franchises?

General principles of law that may affect the offer and sale of franchises vary depending on the province in which a franchisor wishes to grant franchises.

In all provinces of Canada other than Quebec, general common law principles regarding contract formation govern the offer and sale of franchises. In Quebec, franchise agreements are governed by the general principles of contract formation found in the Civil Code of Quebec and are generally regarded as contracts of adhesion. The Civil Code of Quebec, in an effort to correct a presumed economic imbalance between the parties, provides more favourable interpretation principles and a significantly broader margin of redress for the adhering party to a contract of adhesion than that which would be available absent a contract of adhesion. Furthermore, an abusive clause in a contract of adhesion will be considered null, or the obligation arising from it may be reduced by a court.

In addition, courts in Quebec have established that franchisors must inform potential franchisees of any information in their possession that may have a decisive influence on the franchisee's will to contract. While franchising practitioners in Quebec have generally viewed this disclosure obligation as essentially similar to the obligation of franchisors under the Canadian Franchise Acts to disclose all 'material facts' to the franchisee, Quebec courts may give it a broader interpretation – courts have found a franchisor liable for failing to disclose to the potential franchisee internal reports and documents commissioned and produced upon the franchisor's request and at its expense, such as feasibility studies in respect of potential locations and aptitude tests with respect to the potential franchisee.

Law stated - 25 May 2024

Fraudulent sale

- 24** | What actions may franchisees take if a franchisor engages in fraudulent or deceptive practices in connection with the offer and sale of franchises?

The rights conferred by each of the Canadian Franchise Acts are in addition to, and do not derogate from, any other right, remedy or recourse that a franchisee may have in law.

Judicial decisions emanating from the common law provinces reflect a general and growing affirmation of the common law duty of good faith in franchising, the substantive requirements of which will be conditioned by the specific set of circumstances surrounding the formation of the franchise agreement and the conduct of both parties. Where the courts find that there has been a breach of such duty of good faith, the franchisor may be found liable to the franchisee for its damages. Not every breach of such duty will constitute a fundamental breach of the franchise agreement that would excuse the franchisee from future performance under the agreement.

In addition, pursuant to article 1401 of the Civil Code of Quebec, an error by a party induced by a fraud committed by the other party, or with its knowledge, will nullify consent whenever, but for the error, the misled party would not have contracted or would have contracted on different terms. It is important to note that in Quebec, silence may amount to a misrepresentation. Such a fraud could be sanctioned with damages and annulment of the contract or, should the franchisee prefer to maintain the contract, a reduction of its obligations set out in the franchise agreement equivalent to the damages to which it would otherwise be entitled.

Law stated - 25 May 2024

FRANCHISE CONTRACTS AND THE FRANCHISOR/FRANCHISEE RELATIONSHIP

Franchise relationship laws

25 | What laws regulate the ongoing relationship between franchisor and franchisee after the franchise contract comes into effect?

Other than the Canadian Franchise Acts, there are no specific statutes directly affecting the franchise relationship. With respect to matters not governed by the Canadian Franchise Acts, the ongoing franchise relationship is subject to generally applicable federal and provincial statutes and the principles of contractual law that emanate from the civil law in Quebec or the common law everywhere else in Canada.

Canadian courts have been pragmatic in their approach to ongoing relational matters as they relate to franchising. The clear and express terms of a franchise agreement will be determinative of the issues arising in connection with the same. If such agreements are ambiguous on a given point, courts will generally construct the litigious terms in a manner that provides for a 'sensible commercial result'. This has not, however, prevented courts from rendering judgments against franchisors that excessively and unlawfully interfere with the economic interest of their franchisees.

Law stated - 25 May 2024

Operational compliance

26 | What mechanisms are commonly incorporated in agreements to ensure operational consistency and adherence to brand standards?

Franchise agreements will often contain several controls and oversight mechanisms in favour of the franchisor to verify the accuracy of royalty payments made, supervise the use of its marks and ensure overall compliance of the franchised operations with the franchised concept and the brand. These may include an obligation for the franchisee to submit weekly, monthly or annual (or all three) reports of its sales, in addition to point of sale, inventory control and other software that report in real-time. The franchisor may also have a right to inspect and audit a franchisee's records in the event that a franchisee fails to submit these reports or these reports are suspected or determined to be inaccurate. Other controls

include requiring that franchisees submit all proposed store locations, store designers and contractors, product suppliers and marketing materials to the franchisor for prior approval, as well as a right to inspect the franchise location during operating hours to ensure that the franchisee is properly implementing the franchise system, which includes the right to assume management of the franchised location in extreme cases.

Law stated - 25 May 2024

Amendment of operational terms

27 | May the franchisor unilaterally change operational terms and standards during the franchise relationship?

To maintain competitiveness in the market, franchisors must continuously change and evolve their franchise systems to adapt to market realities. While franchisors may reserve the right to modify the franchise system throughout the term of the franchise agreement, the implementation of substantial operational standards may be difficult if not all franchisees are in agreement with the change or this change imposes a significant financial burden on franchisees. On the other hand, in the Province of Quebec, a franchisor may be liable if it fails to implement necessary changes to maintain the competitiveness and relevance of the franchise system, resulting in a significant erosion of the franchise network's market share. Franchisors should, therefore, be mindful of its franchisee's interests when implementing any operational changes to avoid potential objections, whether business or legal, from a large group of franchisees in the network.

Law stated - 25 May 2024

Policy affecting franchise relations

28 | Do other government or trade association policies affect the franchise relationship?

No other government policies or requirements directly affect the franchise relationship.

Law stated - 25 May 2024

Termination by franchisor

29 | In what circumstances may a franchisor terminate a franchise relationship? What are the specific legal restrictions on a franchisor's ability to terminate a franchise relationship?

There are no restrictions at law on the parties' rights to contractually establish termination rights and consequences arising upon termination. Nevertheless, courts may require that a material breach of the agreement be proven to permit its termination and will, from time to time, intervene to redress cases of abuse.

Law stated - 25 May 2024

Termination by franchisee

30 | In what circumstances may a franchisee terminate a franchise relationship?

There are no rights at law that would specifically allow a franchisee to terminate the franchise relationship other than those applicable to all contracts under general principles of law and those expressly granted by the Canadian Franchise Acts. Similarly, there is no restriction precluding the parties from granting specific termination rights to a franchisee, although this is not often seen in typical franchise agreements used in Canada.

Law stated - 25 May 2024

Renewal

31 | How are renewals of franchise agreements usually effected? Do formal or substantive requirements apply?

Except where disclosure is required under the Canadian Franchise Acts, the requirements to renew a franchise agreement are not prescribed by law. As such, the franchisor and franchisee will be free to determine the conditions incumbent upon the franchisee's exercise of a right to renew the franchise agreement. These conditions generally include requirements to provide written notice of the franchisee's intention to exercise the renewal right within a specific period of time, to make certain capital expenditures to modernise its franchise location to reflect the then current image of the brand, to be in compliance with the terms of the franchise agreement and to pay a franchise renewal fee. The right to renew may also be conditioned upon the execution of an updated version of the franchise agreement. While a franchise agreement may provide for automatic renewal, it is more common for renewal to be subject to substantive requirements similar to those described herein.

Law stated - 25 May 2024

Refusal to renew

32 | May a franchisor refuse to renew the franchise agreement with a franchisee? If yes, in what circumstances may a franchisor refuse to renew?

In Canada, a franchisor may refuse to renew a franchise agreement with its franchisee unless such renewal is contractually required. The franchisor may contractually subject such renewal to the signature by the franchisee of a new franchise agreement and other conditions, including performance goals that the franchisee is required to achieve.

Law stated - 25 May 2024

Transfer restrictions

- 33** | May a franchisor restrict a franchisee's ability to transfer its franchise or restrict transfers of ownership interests in a franchisee entity?

A franchisor may contractually restrict a franchisee's ability to transfer its rights and interests under the franchise agreement, most notably by subjecting such transfer to the prior consent of the franchisor.

Law stated - 25 May 2024

Fees

- 34** | Are there laws or regulations affecting the nature, amount or payment of fees?

No general restrictions apply to payment of initial fees. Where franchises are involved in the sale of specifically regulated products or services, including liquor, medical or pharmaceutical products and services, however, a franchisor's ability to collect royalties on such sales may be restricted.

Law stated - 25 May 2024

Usury

- 35** | Are there restrictions on the amount of interest that can be charged on overdue payments?

Franchise agreements frequently set out the rates of interest charged on overdue fees and royalty payments. Section 347 of the [Criminal Code](#) (Canada) provides that anyone who enters into an agreement to receive interest, or who receives a payment or partial payment of interest, at an effective annual rate of interest (broadly defined) in excess of 60 per cent on the credit advanced, commits an offence thereunder.

In addition, section 4 of the [Interest Act](#) (Canada) specifies that unless the contract expresses the applicable rate of interest on an annualised basis, interest will only be recoverable at a rate of 5 per cent per annum despite the terms of the contract.

Law stated - 25 May 2024

Foreign exchange controls

- 36** | Are there laws or regulations restricting a franchisee's ability to make payments to a foreign franchisor in the franchisor's domestic currency?

A franchisee may be required to make payments in a foreign franchisor's domestic currency. Nevertheless, the [Currency Act](#) (Canada) precludes a Canadian court from rendering a judgment in any currency other than Canadian currency.

Law stated - 25 May 2024

Confidentiality covenant enforceability

37 | Are confidentiality covenants in franchise agreements enforceable?

Confidentiality covenants in franchise agreements are not only enforceable but highly advisable in light of the fact that recourse is only otherwise available under common law tort, as opposed to under any specific Canadian statute governing trade secrets or other confidential information. Confidentiality clauses can be for a longer duration than noncompete clauses.

Law stated - 25 May 2024

Good-faith obligation

38 | Is there a general legal obligation on parties to deal with each other in good faith during the term of the franchise agreement? If so, how does it affect franchise relationships?

The Canadian Franchise Acts impose a general obligation of fair dealing upon the parties to a franchise relationship. It is established law in Canada that the relationship between a franchisor and a franchisee is generally not a fiduciary one.

The Supreme Court of Canada has found that there is an inherent duty for parties to honestly perform their contractual obligations, which precludes a contracting party from actively deceiving or knowingly misleading its contractual counterparty, including by way of lies, half-truths, omissions and even silence, depending on the circumstances.

Canadian courts (even in provinces without franchise legislation) have also generally begun to read into franchise agreements an implied duty of simple good faith (as opposed to 'utmost good faith'). A perhaps more fulsome obligation exists under the Civil Code of Quebec, which imposes a legal requirement for all parties in matters governed by Quebec civil law to conduct themselves in good faith during contractual and pre-contractual dealings. Accordingly, the courts have stated that where the franchisor retains sole discretion to authorise, prevent or proceed with a particular course of action, the franchisor will have to exercise its discretion reasonably. In addition, the duty to act in good faith requires a prompt response to another party's request and the making of a decision within a reasonable period of time thereafter. Moreover, parties under a duty of good faith must also pay any amounts that are clearly owed to another party in a timely manner.

The duty to act in good faith does not necessarily preclude a franchisor from competing with its franchisee (assuming, of course, the absence of contractual exclusivity in favour of the franchisee). A franchisor that opts to compete with its franchisee must ensure that

it continues to perform its legal obligations towards the latter and that it acts in such a way that the franchisee may continue to enjoy the benefits of its franchise. The common law principle of non-interference with the freedom of the parties to contract will often limit judicial interference in franchise agreements whose terms are found to accurately reflect the intent of the parties and are not patently inequitable. A determination as to whether a duty of good faith has been breached will be contingent upon all the surrounding circumstances.

Law stated - 25 May 2024

Franchisees as consumers

39 | Does any law treat franchisees as consumers for the purposes of consumer protection or other legislation?

Consumer protection legislation in Canada has been enacted at the provincial level. The applicability of such legislation is generally restricted to transactions entered into for personal, family or household purposes and the legislation generally excludes from its ambit transactions entered into for business purposes. In a 2004 case before the Superior Court of Quebec, a franchisee sought to avail itself of protection under the [Consumer Protection Act](#) (Quebec) but was unsuccessful, the Court concluding that the tenor of the correspondence between the franchisee and the franchisor, as well as the nature of the franchise agreement, both clearly implied a commercial relationship falling outside of the scope of the legislation.

Law stated - 25 May 2024

Language of the agreement

40 | Must disclosure documents and franchise agreements be in the language of your country?

The [Charter of the French Language](#) (Quebec) compels businesses to prepare franchise agreements and written disclosures, if any, in French for use in the Province of Quebec. As of 1 June 2023, a franchisee entering into an adhesion contract (namely, a franchise agreement where there is no ability to negotiate the essential terms) must first be given the opportunity to review a French version of the contract and all related documents before being legally entitled to expressly agree to be bound by the contract in English (or any other language). A franchisor can no longer prepare its franchise agreement solely in English and simply include a 'choice of language' provision if there is any risk that it may be characterised as an adhesion contract. Where the essential terms of the franchise agreement are in fact negotiable, and it is accordingly not an adhesion contract, another language may be used.

Law stated - 25 May 2024

Restrictions on franchisees

41 | What types of restrictions are commonly placed on the franchisees in franchise contracts?

Franchise agreements often provide for exclusive territories and exclusive dealings with designated suppliers. These are not illegal per se, but are subject to competition law concerns relating to substantial lessening of competition and market barriers, including the exclusive dealings and abuse of dominance provisions of the Competition Act (Canada). Restrictions on the customers that the franchisee is entitled to serve may not be acceptable as they may be viewed as violating the market division prohibitions of the Competition Act or providing strong evidence of collusion pursuant to the same. These business practices are only subject to review if they have a negative impact on competition in the concerned market, which would typically only arise if a franchisor or its network has a considerable market share.

Price maintenance is a reviewable trade practice under the Competition Act. The threshold for enforcement authorities to apply sanctions on the basis of price maintenance requires that the franchisor's conduct be likely to have an adverse effect on competition. Providing a minimum resale price may be considered evidence of undue influence by the franchisor and invite review by the Competition Bureau; however, franchisors may impose maximum prices as long as the latter are clearly referred to and defined in the franchise agreement and are not construed by courts as demonstrating an intent to establish a minimum resale price. Accordingly, it is always prudent for franchisors to include disclaimers, whether in advertising or on packaging, to the effect that franchisees are at liberty to establish their own resale prices. Furthermore, it is preferable to contractually provide that prices are only suggested and that the failure of the franchisee to adhere to the suggested prices will not result in termination of the franchise agreement or detrimentally affect the relations between the parties.

Franchisors who are deemed to control a market are also subject to review by the Competition Bureau under the abuse of dominance provisions in the Competition Act. As of 2009, the criminal pricing provisions addressing price discrimination, predatory pricing, geographical price discrimination and promotional allowances have been repealed with a view to promoting innovative pricing programmes and increasing certainty for Canadian businesses. Nonetheless, such pricing policies may be reviewed under civil provisions of the Competition Act where there is evidence of a likely substantial anticompetitive effect.

Non-competition and non-solicitation covenants are closely monitored by the courts. All restrictive covenants raise restraint of trade concerns and, accordingly, only reasonable restrictions as to scope of action (described with sufficient particulars), duration and geographical reach will be upheld by the courts. Canadian courts will generally not write down or reduce restrictive covenants determined to be unreasonable, but will uphold or strike down the covenant in its entirety.

As part of recent amendments made to the Competition Act, as of 23 June 2023, wage-fixing and no-poaching agreements between employers will be criminally prohibited. Such covenants will be prohibited under the new rule for unaffiliated employers, such as franchisors and their franchisees, even if they are not competitors in the same market.

Law stated - 25 May 2024

Courts and dispute resolution

42 | Describe the court system. What types of dispute resolution procedures are available relevant to franchising?

The [Constitution Act 1867](#) sets out the areas of law with respect to which the federal government has the power to legislate (eg, intellectual property, bankruptcy, trade and commerce) and the areas of law with respect to which each provincial government has the power to legislate within provincial borders (eg, property and civil rights). Canada also has a dual court system. The Federal Court of Canada has jurisdiction over matters in respect of which jurisdiction as to subject matter is specifically conferred to it by statute, whereas the provincial courts have residual jurisdiction over remaining matters.

Choice of forum clauses are generally enforced by Canadian courts, thus making it possible for the parties to choose that a non-Canadian court resolve any dispute or claim arising from any agreement. In addition, mediation and arbitration are viable and recognised mechanisms of dispute resolution across Canada. Furthermore, Canada is a signatory party to the [United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards](#). Both the federal and the provincial governments have also adopted substantially similar legislation to the [UNCITRAL Arbitration Model Law](#). To date, four provinces (Ontario, British Columbia, Alberta and Saskatchewan) have incorporated mandatory alternative dispute resolution processes into their respective procedural statutes, and most provinces have enacted arbitration legislation. In addition, the [Quebec Code of Civil Procedure](#) requires parties to consider private dispute prevention and resolution methods before referring their dispute to the courts.

Law stated - 25 May 2024

Governing law

43 | Are there any restrictions on designating a foreign governing law in franchise contracts in your jurisdiction? How does the governing law affect the contract's enforceability?

Under the Canadian Franchise Acts, a choice of law provision that attempts to contractually restrict the application of local franchise laws will be void. Where the Canadian Franchise Acts do not apply, Canadian courts will generally recognise and uphold a parties' choice of foreign governing law, provided that there is a sufficient nexus to the parties' relationship. However, a choice of foreign governing law made with the aim of avoiding the consequences of the applicable provincial laws of any Canadian jurisdiction will generally be considered invalid. Furthermore, where the applicable law is that of any province in Canada, the [United Nations Convention on the International Sale of Goods](#) will automatically apply in respect of sales of goods by foreign franchisors who are nationals of any other signatory nation, unless expressly set aside by the parties in the contract.

Enforcement of a contract in any province of Canada governed by the law of another province of Canada (or another country) may also prove to be cumbersome from a practical perspective as experts of the governing law in question must be retained to provide evidence of the relevant provisions of such foreign law in court.

Law stated - 25 May 2024

Arbitration – advantages for franchisors

- 44 | What are the principal advantages and disadvantages of arbitration for foreign franchisors considering doing business in your jurisdiction? Are any other alternative dispute resolution (ADR) procedures particularly favoured or disfavoured in your jurisdiction?

The principal advantages and disadvantages of arbitration for foreign franchisors in Canada are essentially the same as for local franchisors.

Arbitration has the main advantage of being confidential. Disputes between franchisors and franchisees do not become a matter of public record as would be the case with litigation in the judicial system. In addition, arbitration gives the parties a level of control that they may not otherwise have over some aspects of the dispute, such as choice of venue and forum and the selection of an arbitrator with expertise in franchise issues or the relevant technical or specialised fields. Arbitration agreements are final, reliable and not open to appeal; Canadian courts have generally refrained from intervening in such decisions. Finally, arbitration tends to be faster and cheaper than litigation, at least in theory.

As for its disadvantages, arbitration, like litigation, can become bogged down procedurally, diminishing the cost and time savings that often motivate its use. The lack of ability to appeal heightens risk for the parties that have no recourse against a bad decision. Some also argue that arbitration clauses that preclude access to the judicial system will prevent the use of proceedings such as injunctive or other equitable relief that can be obtained quickly to effectively end a breach of contract.

Another form of alternative dispute resolution favoured in Canada is mediation, which allows the parties to discuss between themselves, usually with the aid of an impartial and respected mediator, to arrive at a resolution of the dispute on mutually acceptable terms. Mediation is often provided in agreements as a dispute resolution procedure through which parties must first attempt to resolve their dispute, failing which they can resort to arbitration.

Law stated - 25 May 2024

National treatment

- 45 | In what respects, if at all, are foreign franchisors treated differently (legally, or as a practical matter) from domestic franchisors?

There is no legal discrimination or heightened level of legal requirements for foreign franchisors. Nevertheless, depending on the vehicle they choose through which to export

their franchises to Canada, foreign franchisors may find themselves subject to a different taxation regime from domestic franchisors, and subject to certain notice requirements under the Investment Canada Act. As a practical matter, franchisees may be more hesitant to enter into a franchise agreement, particularly one where the obligations of the franchisor (eg, training, advertising) are numerous, in circumstances where the franchisor has no domestic presence of note.

Law stated - 25 May 2024

UPDATE AND TRENDS

Legal and other current developments

46 | Are there any proposals for new legislation or regulation, or to revise existing legislation and regulation? Are there other current developments or trends to note?

The province of Saskatchewan has recently introduced a bill governing pre-contractual disclosure in franchise sales, the [Act respecting Franchises](#) (Bill 149), which underwent a second reading on March 4, 2024, and is set to become the seventh Canadian province to enact franchise-specific legislation. The key changes implemented by Bill 149 that may be of interest to foreign franchisors are summarised below.

In its current form, which is still under consideration in the context of the formal legislative process, Bill 149 requires franchisors operating in Saskatchewan to provide prospective franchisees with a disclosure document that meets certain requirements (namely, containing all material facts, financial statements, etc) at least 14 days before entering into any agreement with the franchisee or before the franchisee makes any payments relating to the franchise. Errors, defects in form or technical irregularities do not invalidate a disclosure document or a statement of material change as long as the substance thereof is not affected and the disclosure document or statement of material change remains substantially compliant.

The franchisee may rescind the franchise agreement within 60 days after receipt of the disclosure document if the latter had not been received in the prescribed time frame, or if its contents did not meet the prescribed requirements.

Bill 149 also imposes a duty of fair dealing and good faith on the parties to a franchise agreement, confirms franchisees' right to associate, provides for remedies for the breach or infringement thereof (as applicable) and includes other provisions akin to those found in other equivalent statutes in Canada.

However, compared to other Canadian Franchise Acts, Bill 149, as drafted, provides a narrower definition of 'franchise', whereby the franchisor (or the franchisor's associate) must actually exercise significant control over, or provide significant assistance in, the franchisee's method of operation, as opposed to merely having a right or offering to do any of the foregoing. The evidentiary burden would be higher than under the other Canadian Franchise Acts.

As they observe the legislative progression of this bill, both franchisees and franchisors in Saskatchewan should also keep abreast of the publication of any draft regulations, further detailing and refining the scope of the application of Bill 149.

Law stated - 25 May 2024



LAPOINTE ROSENSTEIN
MARCHAND MELANÇON
L.L.P. Attorneys

Bruno Floriani
Marissa Carnevale
Yasmine Shadman

bruno.floriani@lrmm.com
marissa.carnevale@lrmm.com
yasmine.shadman@lrmm.com

Lapointe Rosenstein Marchand Melançon LLP

[Read more from this firm on Lexology](#)

Chile

[Ignacio García](#)

[Porzio Ríos García](#)

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MARKET OVERVIEW

Franchising in the market

- 1 | How widespread is franchising in your jurisdiction? In which sectors is franchising common? Are there any economic or regulatory issues in the market that are more or less hospitable to franchising or make it economically viable in your jurisdiction?

Franchising is very widespread in Chile and most of the biggest international brands are already in the country due to its franchising development. The main sectors are clothing, food and beverages, convenience stores, drug stores, car rental, dry cleaning, language academies and real estate brokers, etc.

In general, Chile has a business-friendly environment, as it has been recognised in various rankings and studies, such as the business environment ranking developed by the Economic Intelligence Unit, which ranks Chile 30th worldwide and as the most prominent country in Latin America. In particular, for franchising development, it is useful that there are no specific regulatory barriers and the relation between franchisor and franchisee will be ruled mainly by what they have freely agreed. Another feature that may be noted is that Chile has entered into trade agreements with more than 65 countries, which accounts for approximately 88 per cent of global gross domestic product and 66 per cent of the world's population, creating value chains that are very useful for international brands.

Law stated - 7 June 2024

Associations

- 2 | Are there any national or local franchise associations? What is their role in franchising, including any impact on laws or regulations? Are there any rules of conduct or membership requirements?

No, there is no association. However, the Commerce Chamber of Santiago has a franchising committee, which is very active in gathering together different actors and promotes the development of new franchisees.

Law stated - 7 June 2024

BUSINESS OVERVIEW

Types of vehicle

- 3 | What forms of business entities are relevant to the typical franchisor?

A distinction must be made between franchisor and franchisee. A franchisor may or may not incorporate a company in Chile for the governance of its local operation. If a decision is made to incorporate a company, general rules applicable to Chilean companies will apply without any particular disadvantage or handicap arising from being a foreign franchisor

(shareholder of the company to be incorporated in Chile). In this respect, Chilean law does not discriminate against foreigners, who are treated as locals.

In addition, from a tax standpoint, the establishment of a local branch or subsidiary in Chile could be beneficial, not only for deducting any expenses paid in Chile, but also if the country of origin of the franchisor is a signatory to a double taxation treaty with Chile.

On the franchisee's side, practice indicates that most franchisees decide to use an existing legal structure or to incorporate a new legal entity for the purpose of developing franchising activity in Chile. In the case of brand new entities incorporated by the franchisee for the new operation, the franchisor will in most cases request from the franchisee, in addition to the execution of the agreement, a personal guarantee, considering that the new entity will not have assets or turnover to guarantee the operation.

Law stated - 7 June 2024

Regulation of business formation

4 | What laws and agencies govern the formation of business entities?

The Civil Code, the Commercial Code and special laws, such as the Law of Corporations and the Law of Limited Liability Companies, will govern the formation of business entities. The Tax Code and special tax laws will also apply.

As far as agencies are concerned, the Registry of Commerce and the Internal Revenue Service (SII) are to be cited.

Law stated - 7 June 2024

Requirements for forming a business

5 | Provide an overview of the requirements for forming and maintaining a business entity.

The main steps and requirements for the formation of a business entity are the following:

- drafting the by-laws or statutes of the company in the form of a public deed (stock corporations may be formed with a private document registered before a notary public) and execution of the document by the partners, associates or shareholders, before a notary public;
- drafting an abstract of the by-laws;
- publication of the above draft abstract in the Official Gazette;
- registration of the abstract with the Registry of Commerce;
- obtaining a fiscal number and initiate activities before the SII; and,
- obtaining the local municipality permit for the right to supply services and operate the company.

Regarding the first steps, as of 2013, Law No. 20.659 provided for a new system to create new business entities digitally and in a simplified and shorter manner. Entities may be formed in the following website: <https://www.registrodeempresasysociedades.cl/>

Maintaining a business entity

For the maintenance of a business entity, the following requirements will need to be complied with:

- payment of taxes to the local municipality every semester;
- payment of value added tax (VAT) on a monthly basis;
- payment of the annual taxes on profits;
- keeping accounting books and company books (depending on the type on entity, it will include shareholders meetings' minutes, board session's minutes, shareholder's registry); and
- complying with local laws, especially in relation to tax, employment and social security.

Law stated - 7 June 2024

Restrictions on foreign investors

6 | What restrictions apply to foreign business entities and foreign investment?

Foreign entities are allowed to operate in the Chilean market and, in general, there is no discrimination between foreign and domestic franchisors.

Before operating in Chile, foreign entities will be required to register with the SII to get a tax identification number, and to introduce and export the capital they shall operate in the formal exchange market and shall be bound by Law No. 20.848, which provides for a legal framework for foreign investments.

Law stated - 7 June 2024

Taxation

7 | What aspects of the tax system are relevant to franchisors? How are foreign businesses and individuals taxed?

In general terms, outbound payments made by a Chilean taxpayer to foreign companies or entities are subject to 35 per cent withholding tax (WHT). However, this rate is reduced depending on the legal nature of the payment (namely, royalties are subject to 30 per cent WHT). Payments by means of a franchising contract would be dealt as royalties for Chilean tax purposes.

Note that Chile has signed and approved several double taxation agreements (DTAs) with many countries such as Australia, Belgium, Canada, France, Ireland, Italy, Spain, Switzerland and the United Kingdom, among others. The majority of DTAs have established reduced tax rates applicable on interest, business profits, dividends, capital gain and royalties, etc.

As of 2020, Chilean taxpayers may choose from three different tax systems regarding income generated by domestic companies:

- the general regime (the corporate income tax rate is 27 per cent and final taxpayers can only use 65 per cent of the tax paid by the entity as a credit for its final taxes);
- the pro-small and medium enterprises regime (the corporate income tax rate is 25 per cent); and
- the transparent pro-small and medium enterprises regime (In this case, the company will not pay income tax and its owners will pay personal tax directly on the company's income).

Note that non-resident taxpayers who reside in a country with which Chile has a DTA in force will be entitled to use the full first-category income tax paid by the source entity as a credit against WHT. Therefore, in this case, the tax burden should not exceed 35 per cent.

Besides income tax, it is noteworthy that the VAT rate is 19 per cent.

Law stated - 7 June 2024

Labour and employment

8 | Are there any relevant labour and employment considerations for typical franchisors?

A labour relationship will be established once the following elements are put together:

- a labour contract;
- a link of 'subordination and dependence'; and
- the existence of rules on the place and time that the work will have to be executed.

Therefore, to avoid or at least reduce the risk of the franchisor being considered the employer of the employees of the franchisee, it will be necessary:

- to avoid participating in the business entity of the franchisee;
- to take care to include in the franchising contract a clause stating very clearly that the employees of the franchisee are not related to the franchisor;
- to include in the franchising contract a clause stating that the franchisee will have to comply on a periodical and regular basis with all the rules and duties regarding social security, the latter being an essential obligation of the franchisee;
- to manage very carefully the educational programmes given by the franchisor to the employees of the franchisee; and

- if the franchisor were to send one or more of its employees, especially at the beginning of the operations for 'a programme to teach the concept of the brand, management of same and management of the store and software', to take special care establishing such a programme in writing with the franchisee, implementing the programme with a representative of the franchisee and clearly limiting the duration of the programme.

Law stated - 7 June 2024

Intellectual property

9 | How are trademarks and other intellectual property and know-how protected?

The Chilean Constitution provides for the protection of the right to private property, the right to develop economic activity and for the protection of intellectual creations.

The Industrial Property Law (Law No. 19.039) provides for the protection of the different types of industrial property, including trademarks, industrial designs, drawings, patents, trade secrets, geographical indications, etc. In addition, Chile is a member of the Paris Convention.

To obtain trademark protection in Chile, it will be necessary to file a trademark application with the Chilean Patent and Trademark Office (INAPI) according to the procedure established in the Industrial Property Law, until registration is granted. A trademark registration will last for 10 years from the date of the grant and will be renewable for periods of 10 years.

Even if the registration of a trademark is not mandatory for using a trademark in Chilean territory, the franchisor will need to register its trademarks in Chile to avoid any risks of infringement by third parties and to manage the Chilean project amicably. It is also highly advisable to include in the franchising contract, in addition to a section on intellectual property, a licence agreement for the use of the franchisor's trademarks. This licence agreement will need to be registered with INAPI for the franchisee to be able to enforce the trademark rights in Chile, and to protect the brand.

Trademark registrations granted by INAPI are not vulnerable to cancellation on the grounds of non-use. This should change soon, in view of the pending bill under discussion in Congress.

Know-how will be typically protected by means of clauses regarding know-how and trade secrets included in the franchising agreement. In addition, this agreement should clearly state the levels of confidentiality the franchisee will have to request from its employees during the life of the labour contract and also following termination (the latter will be for a specific period). The franchisee's labour contract with its employees should clearly reflect this fact.

The Intellectual Property Law or Copyright Law (Law No. 19.336) provides for the protection of copyright. This is especially important in the case of franchising for software, architecture and manuals, etc. In addition, Chile is a member of the Berne Convention.

Law stated - 7 June 2024

Real estate

10 | What are the relevant aspects of the real estate market and real estate law? What is the practice of real estate ownership versus leasing?

Freedom of contract and market pricing applies. Therefore, there are no legal limitations on foreigners or foreign companies buying or renting a facility, except in border areas (which are normally non-urban) and for agricultural use.

Real estate operates on the basis of registered property and transfer of title must be made through a public deed and subsequent registration in the real estate registry of the city where the property is located.

Leases may be carried out through private documents, although for the purposes of certainty and validity, in the case of sale of the property or death of the lessor, a public deed and corresponding registration of the lease contract with the registry are strongly recommended. Lease agreements of urban properties are partially regulated by Law No. 18,101, but there is still ample scope for the parties' individual discretion.

Law stated - 7 June 2024

Competition law

11 | What aspects of competition law are relevant to the typical franchisor in your jurisdiction? How is competition law enforced in the franchising sector?

Franchise agreements are not subject to special treatment under Chile's competition law; therefore, general rules will apply. Noteworthy among these are the Antitrust Law (DL No. 211 of 1973) and the Unfair Competition Law (Law No. 20,169 of 2010). In contrast to the general Chilean legal system, the rules governing antitrust and unfair competition give special emphasis on case law, which is examined, studied and applied in court decisions.

As far as legal provisions are concerned, some parts are worth citing:

Any person that enters into or executes, individually or collectively, any action, act or convention that impedes, restricts or hinders competition, or sets out to produce said effects, will be sanctioned [. . .], notwithstanding preventive, corrective or prohibitive measures that may be applied to said actions, acts or conventions in each case.

The following will be considered as, among others, actions, acts or conventions that impede, restrict or hinder competition or that set out to produce said effects:

(a) Express or tacit agreements among competitors, or concerted practices between them, that confer on them market power and consist of fixing sale or

purchase prices or other marketing conditions, limit production, allow them to assign market zones or quotas, exclude competitors or affect the result of bidding processes.

(b) The abusive exploitation on the part of an economic agent, or a group thereof, of a dominant position in the market, fixing sale or purchase prices, imposing on a sale another product, assigning market zones or quotas or imposing other similar abuses.

(c) Predatory practices, or unfair competition, carried out with the purpose of reaching, maintaining or increasing a dominant position.

In general, an act of unfair competition is any act against good faith or good custom that, by illegitimate means, is carried out with the purpose of diverting the clientele of a market agent.

Other material that is useful in this regard is the guide issued in 2014 by the antitrust authority, [related to vertical restrictions that may affect competition](#).

The Unfair Competition Law contains a merely illustrative list of behaviour considered as 'acts of unfair competition', among others:

- any conduct that takes advantage of another's goodwill, or that aims to confuse a third party's goods, services, activities, distinctive signs or establishment with those of the infringer;
- the use of signs or spreading facts or assertions, incorrect or false, that lead to misinformation about the nature, provenance, components, characteristics, price, production process, brand, appropriateness in fulfilling objectives, quality or quantity, and in general about the advantages that are really provided by the offered goods or services; and
- any incorrect or false information or assertion about the goods, services, activities, distinctive signs, establishment or commercial relations of a third party that is capable of harming its goodwill or any expression directed to discredit or ridicule such person without any objective basis.

Law stated - 7 June 2024

OFFER AND SALE OF FRANCHISES

Legal definition

12 | What is the legal definition of a franchise?

Chilean legislation does not provide for a special law on franchising. Thus, Chilean law does not give a definition of franchising.

In spite of this, franchising agreements in force in Chile will be ruled by the Commercial Code, by the Civil Code and more particularly by the 'law of the contract'. In other words,

what the parties (namely, franchisor and franchisee) will have agreed in writing will be their 'law' for the duration of the contract. Thus, the main applicable law will be the contract executed by the parties, since the contract is to be considered as law for the parties. In fact, article 1545 of the Chilean Civil Code states: 'Any contract legally executed is law for the parties [. . .]'.

In addition, the Civil Code states in article 1546: 'Contracts must be executed in good faith, and therefore, in consequence, submit the parties not only to what is written in the contract, but also to what comes from the nature of the obligation [. . .]'. There is no doubt that such a provision refers to contracts that have been executed by the parties and that are in force.

Law stated - 7 June 2024

Laws and agencies

13 | What laws and government agencies regulate the offer and sale of franchises?

Chilean law does not provide for a Franchising Law, therefore, the general framework for business is applicable. The Civil Code, the Commercial Code and special laws, such as the Law of Corporations and the Law of Limited Liability Companies, will govern the offer and sale of franchises.

As far as entities are concerned, the Internal Revenue Service for tax issues and the Economic National Prosecutor and the Antitrust Court for competition issues, are to be cited.

Law stated - 7 June 2024

Principal requirements

14 | What are the principal requirements governing the offer and sale of franchises under the relevant laws?

There are no particular requirements, hence general rules will be applicable as for any business offer and sale.

Law stated - 7 June 2024

Franchisor eligibility

15 | Must franchisors satisfy any eligibility requirements in order to offer franchises? Are there any related practical issues or guidelines that franchisors should consider before offering franchises?

No, there are no eligibility requirements to offer franchises.

Law stated - 7 June 2024

Franchisee and supplier selection

- 16 | Are there any legal restrictions or requirements relating to the manner in which a franchisor recruits franchisees or selects its or its franchisees' suppliers? What practical considerations are relevant when selecting franchisees and suppliers?

No, there are no legal restrictions related to franchisees and suppliers' selection.

Regarding supplier selection note that recently criminal law was amended to incorporate the crime of corruption between private entities and individuals, whereby the employee or agent who requests or accepts to receive an economic benefit or of any other nature, for himself or a third party, to favour or for having favoured the contracting with one bidder over another, will be punished as a crime.

Law stated - 7 June 2024

Pre-contractual disclosure – procedures and formalities

- 17 | What procedures and formalities for pre-contractual disclosure are required or advised in your jurisdiction? How often must the disclosures be updated?

Considering that there is no franchising law in Chile, the form, terms and timing of pre-contractual disclosure will be determined and decided exclusively by the franchisor. In addition, once first contact is made with the potential franchisee, the parties agree on the pre-contractual disclosure agreement that could revoke any broader disclosure than the one initially in the franchisor's mind at the time of making the first approach.

In conclusion, the matter will have to be examined on a case-by-case basis, with the parties free to decide on how they will operate. The leverage of the franchisor on what to disclose will mainly depend on the strength of its brand and existing network. In addition, local practice indicates that even if the law does not provide for obligations or requirements, comprehensive disclosure will in most cases facilitate the understanding of the parties and will also facilitate the reaching of an agreement or, on the other hand, simply accelerate the termination of the negotiations. Finally, as all types of contracts have to be negotiated and entered into in good faith according to the provisions of the Civil Code, even if the type of disclosure is as indicated above, the franchisor will have to disclose in good faith, even pre-contractually.

Law stated - 7 June 2024

Pre-contractual disclosure – content

- 18 | What information is the disclosure document required or advised to contain?

Pre-contractual disclosure is not regulated; however, local practice indicates that disclosure documents used in Chile are standard and similar to the ones used overseas. In fact, since local law does not provide for any specific rules for franchising agreements or for

pre-contractual documents, the franchisor will be bound by good faith and in consequence do its best to give to the potential franchisee as much information as necessary to decide freely and become a franchisee.

With regards to the disclosure of economic figures and forecasts, it is advisable to explicitly declare that the economic results of the franchise are not a guarantee, unless it is agreed by the parties.

Law stated - 7 June 2024

Pre-sale disclosure to sub-franchisees

19 | In the case of a sub-franchising structure, who must make pre-sale disclosures to sub-franchisees? If the sub-franchisor must provide disclosure, what must be disclosed concerning the franchisor and the contractual or other relationship between the franchisor and the sub-franchisor?

There are no rules regarding disclosure, therefore the answer to 'Pre-contractual disclosure – content' is applicable.

Law stated - 7 June 2024

Due diligence

20 | What due diligence should both the franchisor and the franchisee undertake before entering a franchise relationship?

Local practice indicates that from a franchisor perspective, the following elements will be key, even before reviewing any document:

- choice of the correct franchisee;
- assurance that the candidate to franchisee does perfectly understand what is to be expected from the relationship; and
- an economic and basic legal review of the candidate individual or, in the case of companies, a review of the shareholders or controllers of the company.

Even if preliminary disclosure is not mandatory, local practice indicates that it will facilitate the communications between the parties and will put the franchisee on a degree of preparation regarding 'what the franchisor will expect from him'.

Thereafter, customary due diligence will be necessary.

Law stated - 7 June 2024

Failure to disclose – enforcement and remedies

21 |

What actions may franchisees or any relevant government agencies take in response to a franchisor's failure to make required disclosures? What legal remedies are available? What penalties may apply?

In view of the lack of law on franchising, there is no special rule on this matter, so the general rules of the Civil Code will apply. Among these rules, the most notable are provisions regarding the establishment of consent, good faith and the fulfilment of obligations, etc.

In the case of fraud, the Criminal Code will apply.

Law stated - 7 June 2024

Failure to disclose – apportionment of liability

22 | In the case of sub-franchising, how is liability for disclosure violations shared between franchisor and sub-franchisor? Are individual officers, directors and employees of the franchisor or the sub-franchisor exposed to liability? If so, what liability?

As there is no regulation regarding disclosure nor obligation to disclose, refer to answer 'Pre-contractual disclosure – content'. Nevertheless, if a crime is involved, criminal liability should be personal (or of the company).

Law stated - 7 June 2024

General legal principles and codes of conduct

23 | In addition to any laws or government agencies that specifically regulate offering and selling franchises, what general principles of law affect the offer and sale of franchises? What industry codes of conduct may affect the offer and sale of franchises?

Generally speaking, Chilean law will consider the parties that are to enter into a commercial agreement or contract as equals. Consequently, it does not impose more pre-contractual obligations than those that are the result of the application of the principle of good faith. In this respect, the Civil Code states that 'contracts must be executed in good faith'. Under this normal arrangement, the parties to a contract will only have to comply with the requirements of pre-contractual disclosure that are needed to ensure that both parties are acting in good faith (namely, to prove that the information granted to the other party was as necessary to execute the contract freely and under its usual meaning).

The obligations of the parties at the time of negotiating the agreement are not specifically established and therefore franchising contracts are to be treated like any other commercial contract. Thus, what was discussed at the time of the negotiations will in principle have little effect or value unless it is possible to prove that the discussion was not a simple discussion but an oral agreement that was taken before the execution of a final document and towards the execution of such final document.

In this respect, article 1554 of the Civil Code states:

The promise to enter into a contract does not produce any obligation, except if the following occurs:

- (a) that the promise is made in writing;
- (b) that the contract promised is not one of those that the laws declare ineffective;
- (c) that the promise contains a term or condition that sets the time of conclusion of the contract; and
- (d) that the promised contract is specified in such a manner that the only missing elements for its perfection are the handling of the good (object) or the solemnities prescribed by the laws.

In addition, articles 1560 to 1566 of the Civil Code contain rules for the interpretation of contracts. Some examples are:

if the intention of the parties is known, it should be considered more important than the literal words of the contract:

- the terms of the contract, even if they are general, will be applied only to the contract;
- the interpretation of a clause that produces effect will be preferred over an interpretation that does not;
- unless a clear intention of the parties against it, the contract should be interpreted in the way it better fits its nature;
- the clauses of common use are considered part of the contract even when they are expressly included; and
- the clauses of a contract should be interpreted in a way that favours the complete execution of the contract.

Therefore, at the time of offering and selling a franchise, the franchisor will need to be as transparent as possible. This does not mean that at the first contact, everything is to be disclosed. However, a memorandum of understanding (MOU) setting out the clear intentions of the parties and a clear timeline to be followed will be advisable. The MOU as such will not be easy to enforce (namely, it will hardly permit the franchisor to force the potential franchisee into a final franchising contract). However, clear and forceful clauses regarding the timeline to be followed, with milestones to be accomplished, confidentiality and non-competition, etc, are of the essence of an MOU and should be enforceable in the case of infringement. In addition, as far as the timeline is concerned, if the negotiations are fruitful and it is necessary to have more time for the execution of the final franchising contract, it would be advisable to execute a promise of a franchise, leaving to the execution of the final franchising agreement only the fulfilment of a condition or arrival of a fixed and expected deadline.

Law stated - 7 June 2024

Fraudulent sale

- 24 | What actions may franchisees take if a franchisor engages in fraudulent or deceptive practices in connection with the offer and sale of franchises?

The general legal rules will apply, mainly the Civil Code, the Commercial Code and the Criminal Code. Therefore, if there is a fraud, the franchisees may submit a criminal claim against the franchisor or submit the background information for the investigation of a prosecutor.

Law stated - 7 June 2024

FRANCHISE CONTRACTS AND THE FRANCHISOR/FRANCHISEE RELATIONSHIP

Franchise relationship laws

- 25 | What laws regulate the ongoing relationship between franchisor and franchisee after the franchise contract comes into effect?

The franchising agreement will be the law governing the parties. If a specific point is expressly covered by the text of the franchising agreement, a clause on the applicable law, if any, contained in the franchising agreement will apply. In this respect, the parties can decide to submit their contract to Chilean law or to foreign law.

Law stated - 7 June 2024

Operational compliance

- 26 | What mechanisms are commonly incorporated in agreements to ensure operational consistency and adherence to brand standards?

Most of the Chilean contracts or contracts executed with Chilean entities will contain clear provisions regarding operational compliance and standards. Therefore, most of the contracts will contain 'reporting requirements', 'procedure for audits' to be made by the franchisor and (or) by an independent third party, right for the franchisor to inspect (normally with a special consideration not to interfere with the day-to-day business), etc. In addition, it will be common to include in the educational programme to which the franchisee will be submitted during the year, special trainings regarding standards and operational compliance.

Law stated - 7 June 2024

Amendment of operational terms

27 | May the franchisor unilaterally change operational terms and standards during the franchise relationship?

Considering that the contract is a bilateral agreement, it can only be amended provided the will of the two parties is clear and providing the consent for the amendment is given by the franchisor and the franchisee. However, local practice indicates that many contracts include the right for the franchisor to upgrade some standards, and that the franchisee will incorporate those upgrades, for the sake of the business. Therefore, it is customary and as long as it does not imply a huge economic burden on the franchisee, it should be valid.

Law stated - 7 June 2024

Policy affecting franchise relations

28 | Do other government or trade association policies affect the franchise relationship?

No, on the understanding that Chilean laws will be applicable on matters related to employment, tax, competition, labelling and pollution rules, etc, and on the assumption that what is indicated in question 'Franchise relationship laws' applies.

Law stated - 7 June 2024

Termination by franchisor

29 | In what circumstances may a franchisor terminate a franchise relationship? What are the specific legal restrictions on a franchisor's ability to terminate a franchise relationship?

The law of the contract will apply. In addition, in view of the absence of franchising law in Chile, the clauses on termination are essential to the contract, and should be drafted very carefully. This applies not only to the timing for termination, to the formalities to be completed, and to the obligations that may survive for some time, but also to ruling how the relationship should develop between the notice of termination and the effective termination.

Law stated - 7 June 2024

Termination by franchisee

30 | In what circumstances may a franchisee terminate a franchise relationship?

The law of the contract will apply.

Law stated - 7 June 2024

Renewal

- 31 | How are renewals of franchise agreements usually effected? Do formal or substantive requirements apply?

The requirements and procedures to be followed will be the ones contained in the contract executed by the parties. As mentioned earlier, the franchising contract will be the law binding to the parties.

Law stated - 7 June 2024

Refusal to renew

- 32 | May a franchisor refuse to renew the franchise agreement with a franchisee? If yes, in what circumstances may a franchisor refuse to renew?

The law of the contract will apply. If no word is contained about renewal and the contract sets a specific term for the contract, the end of the term is not to be understood as an automatic obligation for the franchisor to renew the contract for an additional period.

Law stated - 7 June 2024

Transfer restrictions

- 33 | May a franchisor restrict a franchisee's ability to transfer its franchise or restrict transfers of ownership interests in a franchisee entity?

Yes. In fact, franchising agreements tend to be considered as *intuito personae* (namely, in consideration of the active participation of a particular natural person or persons) contracts and, therefore, if the contract does not provide for a right for the franchisee to transfer, a special agreement between the parties will be needed.

Law stated - 7 June 2024

Fees

- 34 | Are there laws or regulations affecting the nature, amount or payment of fees?

No, there are not.

Law stated - 7 June 2024

Usury

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35 | Are there restrictions on the amount of interest that can be charged on overdue payments?

Yes, Law No. 18.010, article 6 provides that the parties may not stipulate an interest rate that exceeds the product of the respective principal and the greater of:

- one-and-a-half times the current interest rate in effect at the time of the agreement, as determined by the Commission for the Exchange Market for each type of money lending operation; and
- the current interest rate in effect at the time of the agreement increased by 2 percentage points per annum, whether the rate is fixed or variable. Such concept is known as the conventional maximum interest rate.

Law stated - 7 June 2024

Foreign exchange controls

36 | Are there laws or regulations restricting a franchisee's ability to make payments to a foreign franchisor in the franchisor's domestic currency?

No. The foreign currency market is an open market that the franchisee can access freely through any bank operating in Chile.

In addition, at the time of sending money abroad, the franchisee will have to justify why the money is being sent. Depending on why a payment is being made, withholding tax may also apply.

Law stated - 7 June 2024

Confidentiality covenant enforceability

37 | Are confidentiality covenants in franchise agreements enforceable?

Yes, they are.

Law stated - 7 June 2024

Good-faith obligation

38 | Is there a general legal obligation on parties to deal with each other in good faith during the term of the franchise agreement? If so, how does it affect franchise relationships?

Yes. See the answer to 'Legal definition'.

Law stated - 7 June 2024

Franchisees as consumers

- 39 | Does any law treat franchisees as consumers for the purposes of consumer protection or other legislation?

No, because the law defines a consumer as a final beneficiary of the goods and services.

Law stated - 7 June 2024

Language of the agreement

- 40 | Must disclosure documents and franchise agreements be in the language of your country?

No. The contract is a private document and agreement between two parties. It can be written in Spanish or in a different language, provided the two parties understand the language in which the contract was written. In some practical cases, the parties may decide to use one specified language and have a sworn translation in a different language at the same time. In most cases of this nature, the contract will indicate that one of the languages will prevail in the case of discrepancy.

Note that if the forum chosen by the parties for dispute resolution were to be the Chilean courts, a contract in Spanish would be more than advisable.

Law stated - 7 June 2024

Restrictions on franchisees

- 41 | What types of restrictions are commonly placed on the franchisees in franchise contracts?

Possible restrictions in a franchise contract will be those written and agreed by the parties to the contract. If the two parties act in good faith and are older than 18, they will be allowed to execute any kind of franchising agreement, as long as it complies with Chilean legal order, public security and 'good habits'. Although Chile has a very open liberal market economy, there are some matters that are often discussed at the time of negotiating a franchising agreement in Chile.

Duration

The duration of franchising contracts usually varies in Chile depending mainly on the brand, type of goods or store, and investment to be made in Chile for the development of the business. However, what is quite common in practice is the stipulation of an automatic renewal clause if none of the parties were to inform the other of the intention not to renew, once the first term of three, five or seven years is close to expiry.

Territory

The territory of Chile is very large, the distances very important and the major cities would be the first point of interest for establishing a franchised business. Exceptions could be the business of convenience stores, of pharmacies, of private post offices, for which even very small towns in Chile might be of interest to a franchisor. Practice indicates that most franchising agreements give a franchisee the complete territory of Chile, including duty-free shops in ports and airports. In these cases, the right to sub-franchise is rather common.

Still, regarding territory, exclusivity or non-exclusivity will be a question of negotiation and agreement between the parties.

Restrictions on source of goods

In this respect, note that the Industrial Property Law contains a specific provision authorising the parallel import into Chile of legitimate goods. Therefore, a special clause will need to be carefully drafted in this respect in any franchising agreement.

Applicable law and courts

According to Chilean law, the parties to a contract can submit the contract to foreign law. The same can be said of the right of the parties to decide to submit their disputes to foreign courts. Practice indicates that there is no general rule in Chile in this respect. In the case of submission to Chilean courts, it is very common to see arbitration as a solution and especially the designation of the Santiago Arbitration and Mediation Centre of the Chamber of Commerce of the city of Santiago, which is prestigious and well-known in Chile and in Latin America.

Law stated - 7 June 2024

Courts and dispute resolution

42 | Describe the court system. What types of dispute resolution procedures are available relevant to franchising?

See the answers to 'Restrictions on franchisees' and 'Arbitration – advantages for franchisors'.

Law stated - 7 June 2024

Governing law

43 | Are there any restrictions on designating a foreign governing law in franchise contracts in your jurisdiction? How does the governing law affect the contract's enforceability?

See the answers to 'Restrictions on franchisees' and 'Arbitration – advantages for franchisors'.

Law stated - 7 June 2024

Arbitration – advantages for franchisors

- 44 | What are the principal advantages and disadvantages of arbitration for foreign franchisors considering doing business in your jurisdiction? Are any other alternative dispute resolution (ADR) procedures particularly favoured or disfavoured in your jurisdiction?

Arbitration is very often seen in franchising contracts in Chile. This applies to contracts where all the parties are Chilean and also to contracts where the franchisor is a foreign company.

Arbitration is expensive compared to an action before the ordinary courts. However, a procedure before an arbitrator should be faster than one in the ordinary courts. In addition, the arbitrator should have more experience than an ordinary civil judge in new contracts and in business matters where time is of the essence in solving disputes, and when collateral damage is to be minimised.

As far as local arbitration is concerned, see the answer to 'Restrictions on franchisees'.

Law stated - 7 June 2024

National treatment

- 45 | In what respects, if at all, are foreign franchisors treated differently (legally, or as a practical matter) from domestic franchisors?

There is no discrimination between foreign and domestic franchisors.

Law stated - 7 June 2024

UPDATE AND TRENDS

Legal and other current developments

- 46 | Are there any proposals for new legislation or regulation, or to revise existing legislation and regulation? Are there other current developments or trends to note?

There are no proposals of new legislation or regulations affecting franchising business directly, but there are several initiatives in discussion that should affect any business in general, including a tax reform (not to increase the tax rate but to reduce loopholes and eliminate exemptions) and data privacy reform (that somehow adopts some of the changes introduced by the EU General Data Protection Regulation), among others.

Law stated - 7 June 2024

PORZIO · RÍOS · GARCÍA
A B O G A D O S

Ignacio García

igarcia@porzio.cl

Porzio Ríos García

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UPDATE AND TRENDS

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MARKET OVERVIEW

Franchising in the market

- 1 | How widespread is franchising in your jurisdiction? In which sectors is franchising common? Are there any economic or regulatory issues in the market that are more or less hospitable to franchising or make it economically viable in your jurisdiction?

Franchising as a business model is developing rapidly in China. According to a report in January 2022 by the US International Trade Administration's global trade site, [Market Intelligence](#), China is one of the largest franchise markets in the world, with over 6,000 active franchises. The first pilot franchise regulations in the People's Republic of China were adopted in 1997. Since then, domestic franchises have taken off, particularly as Chinese consumers have gained more purchasing power. According to the statistical data published by the [China Chain Store & Franchise Association](#), at the end of 2021, the top 100 franchise systems in China operated more than 190,000 franchise units. The total gross revenues of the top franchise systems in 2021 reached 2,300 billion yuan (equivalent to about US\$330 billion).

Western brands are often viewed favourably by Chinese consumers, as they are associated with high quality and superior customer service. Before the covid-19 pandemic, the sectors in which international franchises were particularly successful in China included academic and personal development services such as adult education, early childhood education, language classes, fitness classes and skills development. Elderly care and hospitality services were also in demand.

While the pandemic initially brought significant disruption and economic restrictions, China's economy has been recovering since the beginning of 2023. During the pandemic, international franchises had difficulties in recruiting, vetting and training franchisees, particularly in the cases of multi-unit operators and master franchisees, due to travel restrictions. In March 2023, China resumed accepting applications for business visas. In April 2023, China lifted mask mandates for public transport, workplaces and schools.

Law stated - 16 May 2024

Associations

- 2 | Are there any national or local franchise associations? What is their role in franchising, including any impact on laws or regulations? Are there any rules of conduct or membership requirements?

The Chinese business association for the franchise industry, the China Chain Store & Franchise Association, has more than 1,000 members, including domestic and foreign franchisors, retailers and suppliers. It was formed in 1997 to promote education and training in the retail and distribution industries, and participates in policy-making related to the operation of chain retail stores and franchises.

Law stated - 16 May 2024

BUSINESS OVERVIEW

Types of vehicle

3 | What forms of business entities are relevant to the typical franchisor?

Under the [Commercial Franchise Administration Regulation](#) (the Franchise Regulation), individuals cannot offer franchises in the People's Republic of China (PRC). Generally, domestic franchisors prefer to incorporate as either a limited liability company or a company limited by shares.

International franchisors typically prefer to operate in China without establishing a local entity. It is not necessary to open a local subsidiary to grant franchises in China, unless the foreign franchisor wishes to engage in other commercial activities (including leasing or subleasing premises to franchisees), and particularly if the franchisor wishes to exercise the right to take over the franchisee's location in China. Franchisors who decide to incorporate in China no longer need to establish a wholly foreign-owned enterprise or a joint venture company with a Chinese partner, as these types of legal entities were abolished when the new [Foreign Investment Law](#) (FDI) came into force on 1 January 2020. Under the new law, legal entities incorporated in the PRC by foreigners are governed by the same rules as domestic entities, under the [Company Law of the PRC](#) (the Company Law).

Forming a joint venture company with a Chinese partner is possible, but generally should be avoided unless there is no other way to establish a franchise in China. Forming a joint venture in any jurisdiction is comparable to entering into a marriage, and dissolving a marriage is more complicated than winding down a contractual relationship. Additionally, in the PRC, the day-to-day control of the company's legal representative (similar to a general manager) and company chop (a common local phrase for a 'corporate seal' in China, and much of East Asia) is equally – if not more – important than having a majority share in the capital of the joint venture company. Such control may impede operational efficiency, which in turn may frustrate the purpose of establishing a joint venture with a local partner in the first place.

Law stated - 16 May 2024

Regulation of business formation

4 | What laws and agencies govern the formation of business entities?

The formation of limited liability companies and companies limited by shares is governed by the Company Law and its regulations. The State Administration for Market Regulation (SAMR) and local bureaus for market regulation are responsible for company registrations.

Foreign investors incorporating in China need to file a 'foreign investor information report' with the Ministry of Commerce (MOFCOM) through the corporate filing system maintained by SAMR. If the industry of the target business is on the Negative List, the foreign investor should also obtain approval from MOFCOM.

Law stated - 16 May 2024

Requirements for forming a business

5 | Provide an overview of the requirements for forming and maintaining a business entity.

Each business entity must meet certain requirements of the Company Law with respect to the number of shareholders, capital contributions, articles of association, name and domicile of the company.

For franchisors, the company's scope of business should include offering franchises and the business activities covered by the franchise model.

Upon completion of the registration, the company will obtain a business licence with a unique 'unified social credit code'. Within 30 days of obtaining the business licence, the company should register with the local state tax administration. The company may need to obtain additional licences issued by other government agencies depending on the industry of the business. For example, a restaurant must obtain a food operation licence from the China Food and Drug Administration.

To maintain a business entity, companies must submit an annual report to SAMR by 30 June of the next calendar year. The company must register certain changes (such as changes of name, domicile, place of business, scope of business, etc) with SAMR within 20 days of the change taking place.

On 29 December 2023, the Standing Committee of the National People's Congress of China promulgated the amended Company Law of the People's Republic of China (2023 Company Law), which represents a major overhaul following its initial major changes in 2005 and smaller amendments in 2013 and 2018. The 2023 version, which will come into force on 1 July 2024, significantly modifies over 200 articles, with substantial changes to more than 100 articles. These amendments address various aspects of corporate law, including capital contributions and reductions, equity or share transfers and repurchases, corporate governance, shareholder rights protection, and procedures for company establishment and dissolution or liquidation.

Law stated - 16 May 2024

Restrictions on foreign investors

6 | What restrictions apply to foreign business entities and foreign investment?

International franchisors who decide not to open a local subsidiary are restricted in certain activities, such as purchasing or leasing real estate for purposes other than self-use.

Most franchising activities are not restricted to foreign investment, but certain industries – including publishing, the wholesale and resale of tobacco, and compulsory school education – remain closed to foreign investment.

Foreign investors should consult the Special Administrative Measures for Access of Foreign Investments (Negative List), updated by the National Development and Reform Commission and MOFCOM, which came into effect on 1 January 2022. The catalogue categorises industries either as 'restricted' (foreign investment is subject to certain restrictions, such as restrictions on shareholding structures) or 'prohibited' (no foreign investment is allowed).

Foreign investors investing in industries that are not on the Negative List will enjoy national treatment.

Law stated - 16 May 2024

Taxation

7 | What aspects of the tax system are relevant to franchisors? How are foreign businesses and individuals taxed?

If the foreign franchisor sells franchises in the PRC without establishing a local entity, all remittances of royalties by a Chinese franchisee to the overseas franchisor will be subject to value added tax at a rate of 6 per cent and the withholding tax. The rate of withholding tax on royalties is 10 per cent, unless reduced by a treaty. Management fees and other active income sourced in China are also taxable.

Chinese tax authorities may consider service fees and other payments to be subject to withholding tax if they suspect that these payments are designed to reduce royalties. As Chinese franchisees are better suited to liaise with Chinese tax authorities, franchisors should consider gross-up clauses to shift the burden of dealing with tax authorities to the local franchisees.

If there is no gross-up clause, the franchisor may be able to credit withholding taxes paid in China against the income tax of the franchisor in its home country.

Franchisors selling franchises via a local subsidiary are charged an enterprise income tax at a rate of 25 per cent.

China has been adjusting its tax policies to support economic growth and respond to global trends. For example, there were reductions in value added tax (VAT) rates and corporate income tax exemptions for small-scale taxpayers to stimulate business activities.

Reductions in VAT rates

- In recent years, China reduced the VAT rates for certain sectors to alleviate financial pressures on businesses. For example, the VAT rate for some services and goods was decreased from 16 per cent to 13 per cent, and from 10 per cent to 9 per cent for other categories.
- These reductions aimed to lower the tax burden on businesses, especially in sectors like manufacturing, transportation and construction, which are heavily reliant on VAT mechanisms.

Corporate income tax exemptions for small-scale taxpayers

- To support small and micro enterprises, China implemented various tax relief measures. These included lowering the threshold for qualifying as a small-scale taxpayer, which allowed more businesses to benefit from reduced tax rates.
- Small-scale taxpayers could enjoy a lower corporate income tax rate, with some eligible for a rate as low as 20 per cent on a portion of their taxable income, significantly lower than the standard rate.
- Additionally, specific exemptions and deductions were introduced for small businesses in sectors like technology and innovation, aiming to encourage investment in these areas.

Law stated - 16 May 2024

Labour and employment

8 | Are there any relevant labour and employment considerations for typical franchisors?

Employment relationships are governed by the [Labour Law](#) (3rd 10) and the [Labour Contract Law](#) (3rd 10). If the relationship between the parties satisfies the definition of a 'franchise' under the Franchise Regulation, the risk of the franchisee being deemed an employee of the franchisor is very low.

There is currently no indication from the Chinese courts or the Ministry of Human Resources and Social Security that a franchisor may be considered a joint employer of the franchisee's employees, provided that the franchisee maintains a business operation separate from the franchisor.

Law stated - 16 May 2024

Intellectual property

9 | How are trademarks and other intellectual property and know-how protected?

China is a first-to-file jurisdiction and trademarks registered abroad are generally not protected. The China National Intellectual Property Administration has been working on expediting the examination process, and it now takes around six to nine months for the Trademark Office to finish all the procedures and issue the registration certificate if the application smoothly passes the examination without any amendment notification, official rejection or third-party opposition. The registration is valid for 10 years with an option to renew.

Franchisors should consider registering their trademarks in the PRC as soon as possible and before entering the Chinese market. In addition to any English or other non-Chinese language marks and logos, franchisors should create and register a trademark in Chinese

characters before a squatter can register it. Having a Chinese language trademark also mitigates the risk of a franchisee registering the mark in its own name and breaking away from the franchise system. Localising a foreign brand is important to increase the recognition and reputation of the brand among Chinese customers, as English is not widely spoken in mainland China.

Trade secrets are protected contractually as well as under the [Anti-Unfair Competition Law](#) (《反不正当竞争法》) and the [Criminal Law](#) (《刑法》).

Law stated - 16 May 2024

Real estate

10 | What are the relevant aspects of the real estate market and real estate law? What is the practice of real estate ownership versus leasing?

Land title and real estate leases are governed by the [Civil Code](#) (《民法典》).

The land in urban centres belongs to the state and can be leased only for a certain period. Businesses can own commercial units in buildings, but not the land on which the building is built.

To be able to purchase or lease real estate for purposes other than self-use, a foreign entity should incorporate a Chinese company and obtain approvals from the local MOFCOM. With respect to self-use real estate, the branch or representative office of the foreign entity may purchase properties according to its needs. As such, if sub-leasing or lease assignment is part of the franchise system, it is recommended that the foreign franchisor incorporates in China and obtains the government's approval, because such practice may be considered as operating a real estate business.

If the franchisee leases the premises directly from a landlord, the franchise agreement should address possible relocation where the franchisee's lease expires before the end of the franchise agreement term, as commercial leases in the PRC are relatively short (between three and five years).

Law stated - 16 May 2024

Competition law

11 | What aspects of competition law are relevant to the typical franchisor in your jurisdiction? How is competition law enforced in the franchising sector?

Article 17(4) of the [Anti-Monopoly Law](#) (《反垄断法》) prohibits the establishment of exclusive geographical areas without justifiable cause for players with a dominant market position. Franchisors in China rarely have a market share that is significant enough to constitute a dominant market position.

Price-fixing and minimum resale prices are prohibited in vertical agreements or horizontal monopoly agreements between competitors. However, the Anti-Monopoly Law provides

some exceptions for horizontal agreements. The practice of setting recommended prices may attract scrutiny from the anti-monopoly authorities if the franchisor enforces the recommendation. The Anti-Monopoly Bureau of the State Administration for Market Regulation (yǎnzhèng) is the primary anti-monopoly authority in the PRC.

Franchisors should observe the price-fixing restrictions under the Anti-Monopoly Law. The authorities actively enforce the law, including against certain industries such as car dealerships.

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

The Anti-Monopoly Law prohibits tie-in sales clauses imposed by parties with a dominant market position without justification.

The Supreme People's Court issued the Interpretation on Several Issues Concerning the Application of the Anti-Unfair Competition Law of the People's Republic of China has been in effect since 20 March 2022. The Interpretation has a total of 29 articles and makes detailed provisions on article 2 of the Anti-Unfair Competition Law, counterfeiting and confusion, false publicity and online unfair competition, etc.

Law stated - 16 May 2024

OFFER AND SALE OF FRANCHISES

Legal definition

12 | What is the legal definition of a franchise?

The Commercial Franchise Administration Regulation (the Franchise Regulation) defines a franchise as an arrangement in which:

- the franchisor through an agreement grants a franchisee the right to use the franchisor's business operating resources, including registered trademarks, logos, patents and proprietary technologies;
- the franchisee conducts business under a uniform mode of operation; and
- the franchisee pays franchise fees according to the agreement.

The Chinese definition of a franchise is quite broad. The Chinese term for franchising (yǎnzhèng) includes both business format franchises (as in the United States) and product distribution arrangements. Furthermore, licensing of non-trademark intellectual property rights – such as trade secrets or patented technology – can also fall under the definition of a franchise if a fee is paid and the licensee conducts business under a uniform mode of operation.

Law stated - 16 May 2024

Laws and agencies

13 | What laws and government agencies regulate the offer and sale of franchises?

The People's Republic of China (PRC) (excluding Hong Kong and Macao) is a civil law jurisdiction, heavily based on the German model. All contracts in the PRC must conform to the general principles set out in the Civil Code. Franchise relationships are governed by the following regulations and administrative measures:

- the Franchise Regulation;
- the [Commercial Franchise Registration Administrative Measures](#) (F ǎn% H; žÖ);
- the [Commercial Franchise Information Disclosure Administrative Measures](#) (F y%áo«2; žÖ) (Information Disclosure Measures).

The Ministry of Commerce (MOFCOM) is the government body that enforces franchise regulations.

Other laws that may affect franchisors include:

- the Labour Contract Law;
- the Anti-Unfair Competition Law;
- the Anti-Monopoly Law;
- the [Trademark Law](#) (F ǎ)ǎ);
- the [Copyright Law](#) (W\CÖ).

Law stated - 16 May 2024

Principal requirements

14 | What are the principal requirements governing the offer and sale of franchises under the relevant laws?

Under the Franchise Regulation, franchisors must meet certain eligibility requirements, offer pre-sale disclosure and comply with mandatory content requirements for franchise agreements. Franchise agreements must include, among other things:

- provisions regarding fees;
- the term of the agreement and the nature of the franchise business;
- the standards of operation;
- details of the assistance and training provided by the franchisor;
- the standards of quality of the products or services and quality guarantees;
- provisions for the protection of consumer rights;
-

the allocation of liability for consumer rights violations between the franchisor and franchisee;

- provisions relating to the promotion and advertising of the products or services; and
- provisions regarding amendment, cancellation and termination of the franchise agreement.

There is no requirement to register a franchise agreement or franchise disclosure document. However, franchisors are required by law to register with MOFCOM or a local MOFCOM department within 15 days of the first franchise agreement being signed. The list of documents required for registration with MOFCOM usually includes, but is not limited to:

- the franchisor's standard form of franchise agreement;
- the franchise agreement signed with the first franchisee in China;
- the corporate registration certificate;
- the market plan;
- registration certificates for trademarks or copyright (eg, logo) used in the franchise system; and
- evidence of compliance with article 7(2) of the Franchise Regulation (the 2+1 Rule).

All documents must be translated into Chinese. Documents that are prepared abroad must be notarised and either legalised at the Chinese embassy in the country of origin or certified according to the Hague Convention on Abolishing the Requirement of Legalisation for Foreign Public Documents.

International franchisors should register with MOFCOM's head office in Beijing, rather than with local MOFCOM departments. The franchisor should register any changes in the information submitted to MOFCOM within 30 days of that change taking place.

Law stated - 16 May 2024

Franchisor eligibility

- 15** | Must franchisors satisfy any eligibility requirements in order to offer franchises? Are there any related practical issues or guidelines that franchisors should consider before offering franchises?

All franchisors in China must have a mature business model and demonstrate compliance with the requirements of article 7 of the Franchise Regulation. The 2+1 Rule contained in this article requires that a franchisor must have owned and operated at least two outlets for at least one year. According to the practice developed by MOFCOM officials, the outlets may be owned and operated by the franchisor's subsidiaries or, in some cases, other affiliates; the outlets may also be located outside China if they are operated under the same franchise brand. If the outlets are located outside China, franchisors may use statements issued by trade organisations (eg, the International Franchise Association) to

show compliance with the 2+1 Rule. Chinese courts generally agree that it is possible to have a mature system without complying with the 2+1 Rule, which in practice means that the franchise agreement will be valid (assuming non-compliance with the 2+1 Rule is properly disclosed), but in such a case, registering with MOFCOM will be problematic.

Law stated - 16 May 2024

Franchisee and supplier selection

- 16** | Are there any legal restrictions or requirements relating to the manner in which a franchisor recruits franchisees or selects its or its franchisees' suppliers? What practical considerations are relevant when selecting franchisees and suppliers?

There are no such regulations specifically targeting franchising.

Law stated - 16 May 2024

Pre-contractual disclosure – procedures and formalities

- 17** | What procedures and formalities for pre-contractual disclosure are required or advised in your jurisdiction? How often must the disclosures be updated?

Franchisors should provide prospective franchisees with a franchise disclosure document at least 30 days before signing the franchise agreement. There is no prescribed format; franchisors may choose to follow the format of the disclosure documents prepared for other jurisdictions or follow the order set out in article 5 of the Information Disclosure Measures. There is no requirement to register a franchise agreement or franchise disclosure document; however, franchisors should register with MOFCOM within 15 days of the first franchise agreement being signed.

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

Law stated - 16 May 2024

Pre-contractual disclosure – content

- 18** | What information is the disclosure document required or advised to contain?

According to article 5 of the Information Disclosure Measures, information that must be disclosed to a potential franchisee includes:

- basic information about the franchisor and its management;
-

basic information regarding the operational resources of the franchisor, such as the franchisor's registered trademarks, logos, patents, proprietary technology and operational or business format model;

- basic information about franchise fees, such as the type, amount and payment method for franchise fees, any required security deposits, and the conditions and method of refund;
- the terms and conditions for supplying products, services and equipment by the franchisor;
- a description of the continuous services to be provided to the franchisee, including operating guidance, technical support and training;
- the components and method for the operational guidance and supervision provided to the franchisee;
- the investment budget for a franchise location;
- the list of existing franchise outlets within the PRC and an assessment of their business performance (an earnings claim);
- summaries of the financial statements and audit reports for the past two years;
- a description of the franchisor's franchise-related lawsuits and arbitrated matters in the past five years, and of any bankruptcies in the past two years;
- information regarding any record of material illegal operations with respect to the franchisor or its legal representative; and
- a copy of the franchise agreement.

Article 23 of the Franchise Regulation prohibits franchisors from concealing any relevant information, even if not specifically listed. Furthermore, article 500 of the Civil Code prohibits a party from intentionally concealing key facts relating to contract creation. These provisions can be interpreted as a requirement to disclose all material facts, even if this information is not listed in the regulations.

Law stated - 16 May 2024

Pre-sale disclosure to sub-franchisees

19 | In the case of a sub-franchising structure, who must make pre-sale disclosures to sub-franchisees? If the sub-franchisor must provide disclosure, what must be disclosed concerning the franchisor and the contractual or other relationship between the franchisor and the sub-franchisor?

The obligation to provide pre-sale disclosure to the sub-franchisee rests with the sub-franchisor.

Following the principle of good faith in negotiating and performing contracts, the sub-franchisor should disclose all material facts regarding the franchisor and the relationship between the franchisor and sub-franchisor, for example:

- the ownership of any intellectual property rights used in the franchise system;

- the term of the master franchise agreement;
- if the franchisor is the supplier of products, services or equipment, the terms and conditions of the supply arrangement;
- a description of services (eg, training, marketing, and operational support) provided by the franchisor, if any, and the franchisor's oversight rights; and
- a description of lawsuits and arbitral proceedings related to the franchise system.

Law stated - 16 May 2024

Due diligence

20 | What due diligence should both the franchisor and the franchisee undertake before entering a franchise relationship?

Conducting due diligence on a prospective franchisee is an essential step in a franchise transaction in China. In major urban centres, a lot of information about a corporation can be obtained online (in Chinese), including:

- credit records, if the franchisee is an individual;
- its shareholders;
- its registered capital;
- its management;
- its affiliates; and
- any past litigation.

At the very least, a franchisor should start by obtaining a copy of the individual's passport or identity card. If the prospective franchisee is a domestic company, the franchisor's lawyers should obtain a copy of the business licence (营业执照). Business licences disclose the Chinese character name of the corporation that must be used in the contract (even if the contract is in English) to ensure that the contract may be enforced against the franchisee. The business licence also discloses the name of the *Ösleñ* (translated as 'the legal representative'), who is the only person who can sign for the company unless he or she issues a power of attorney to another person to sign the agreement.

On the other hand, it is also advisable for the potential franchisee to conduct necessary due diligence checks on the franchisor and the franchise business. In addition to the franchise disclosure document provided by the franchisor to the potential franchisee, the potential franchisee shall consider checking the status of the franchisor company and its franchise business, past and ongoing litigations and administrative penalties, and the status of its operational resources, such as trademarks.

Law stated - 16 May 2024

Failure to disclose – enforcement and remedies

- 21 | What actions may franchisees or any relevant government agencies take in response to a franchisor's failure to make required disclosures? What legal remedies are available? What penalties may apply?

MOFCOM has the authority to charge an administrative penalty of up to 100,000 yuan for failure to comply with disclosure obligations, but rarely exercises this authority.

If a franchisor conceals relevant information, fails to provide disclosure or provides false information, the franchisee may rescind the franchise agreement.

Damages can be claimed under the Civil Code; however, damages awards are generally low in franchise cases.

Law stated - 16 May 2024

Failure to disclose – apportionment of liability

- 22 | In the case of sub-franchising, how is liability for disclosure violations shared between franchisor and sub-franchisor? Are individual officers, directors and employees of the franchisor or the sub-franchisor exposed to liability? If so, what liability?

There are no statutory rules or guidance from MOFCOM or the courts regarding the liability of the franchisor for non-disclosure or misrepresentation by the sub-franchisor.

General principles set out in the Civil Code, including the principle of good faith in negotiation and performance of contracts, apply to contractual indemnity for disclosure non-compliance or pre-contractual misrepresentation. Under domestic laws, limitation of liability for bodily injuries or death, or exclusion of liability on the grounds of negligence or gross negligence, are unenforceable.

Law stated - 16 May 2024

General legal principles and codes of conduct

- 23 | In addition to any laws or government agencies that specifically regulate offering and selling franchises, what general principles of law affect the offer and sale of franchises? What industry codes of conduct may affect the offer and sale of franchises?

The law in the PRC is based on the principle of good faith in negotiating and performing contracts (*culpa in contrahendo*), which is the opposite of the common law doctrine of *caveat emptor* (buyer beware). Furthermore, article 500 of the Civil Code prohibits a party from intentionally concealing key facts relating to contract creation. These provisions support the pre-sale disclosure obligation (including all material facts disclosure) and the obligation to perform a franchise agreement in good faith, which is part of PRC law.

Law stated - 16 May 2024

Fraudulent sale

- 24** | What actions may franchisees take if a franchisor engages in fraudulent or deceptive practices in connection with the offer and sale of franchises?

Franchisees can apply to court to revoke a franchise agreement that was concluded as a result of fraud or complain to the authorities of fraud. Article 224 of the Criminal Law provides a special charge for fraud in connection with contracts.

Law stated - 16 May 2024

FRANCHISE CONTRACTS AND THE FRANCHISOR/FRANCHISEE RELATIONSHIP

Franchise relationship laws

- 25** | What laws regulate the ongoing relationship between franchisor and franchisee after the franchise contract comes into effect?

After entering into the franchise agreement, the parties must perform their contractual obligations in good faith. The Commercial Franchise Administration Regulation (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.

Law stated - 16 May 2024

Operational compliance

- 26** | What mechanisms are commonly incorporated in agreements to ensure operational consistency and adherence to brand standards?

Franchisors typically reserve inspection and audit rights to monitor compliance with the franchise agreement. International franchisors should factor in the costs of site visits to the franchisee's location when determining royalty or other fees. In addition to the audit rights, franchisors should require franchisees to provide copies of tax returns. Monitoring franchisees' Chinese websites is also important.

While having access to the franchisee's computer systems and point-of-sale data is useful to monitor compliance with financial obligations, complete access to franchisees' computers and data is difficult to achieve in the People's Republic of China (PRC), including for privacy and cybersecurity law reasons.

Law stated - 16 May 2024

Amendment of operational terms

27 | May the franchisor unilaterally change operational terms and standards during the franchise relationship?

If the franchise agreement allows the franchisor to change operational terms and standards unilaterally, the franchisor may exercise such contractual rights in good faith.

Law stated - 16 May 2024

Policy affecting franchise relations

28 | Do other government or trade association policies affect the franchise relationship?

Members of the Chinese business association for the franchise industry, the China Chain Store & Franchise Association, must abide by its code of ethics.

Law stated - 16 May 2024

Termination by franchisor

29 | In what circumstances may a franchisor terminate a franchise relationship? What are the specific legal restrictions on a franchisor's ability to terminate a franchise relationship?

The grounds for terminating a franchise agreement must be set out in the franchise agreement. Except for the cooling-off period set out in article 12 of the Franchise Regulation, there are no prescribed grounds of termination.

Law stated - 16 May 2024

Termination by franchisee

30 | In what circumstances may a franchisee terminate a franchise relationship?

If a franchisor conceals relevant information, provides false information or fails to provide a disclosure document, the franchisee may rescind the franchise agreement. The franchisee must exercise its right of rescission within one year after they knew or ought to have known the cause for rescission, unless the franchise agreement provides for a longer rescission period (article 564 of the Civil Code). Some Chinese courts have recently denied rescission claims where there was no substantial negative impact on the franchisee caused by failure to disclose, or where the franchisee failed to prove that the failure to disclose had substantially affected its decision to join the franchise system.

Other grounds for terminating a franchise agreement must be set out in the franchise agreement. Except for the cooling-off period set out in article 12 of the Franchise Regulation, there are no prescribed grounds of termination.

Law stated - 16 May 2024

Renewal

- 31** | How are renewals of franchise agreements usually effected? Do formal or substantive requirements apply?

Renewal of the franchise agreement must be evidenced in writing. All formal or substantial requirements for the renewal must be set out in the franchise agreement. A new disclosure is not required if the franchise agreement is renewed on the same terms and conditions. Renewal of a trademark licence must be recorded with the National Intellectual Property Administration.

Law stated - 16 May 2024

Refusal to renew

- 32** | May a franchisor refuse to renew the franchise agreement with a franchisee? If yes, in what circumstances may a franchisor refuse to renew?

Subject to any contrary provisions in a franchise agreement, a franchisor is not obliged to comply with a request for renewal.

Law stated - 16 May 2024

Transfer restrictions

- 33** | May a franchisor restrict a franchisee's ability to transfer its franchise or restrict transfers of ownership interests in a franchisee entity?

Franchisees may transfer or sell their franchise only with the franchisor's consent (article 18 of the Franchise Regulation).

Law stated - 16 May 2024

Fees

- 34** | Are there laws or regulations affecting the nature, amount or payment of fees?

Fees charged by international franchisors in China typically include:

- royalties;
- initial franchise fees;
- development fees;

- advertising fund fees; and
- interest on late payments, or all of the above.

The type, amount and method of payment of franchise fees are not prescribed by the franchise regulations and must be negotiated between the parties. However, international franchisors should consider some practical aspects when negotiating franchise fees.

- Due to foreign currency exchange regulations, weekly or biweekly payments by a local franchisee to an overseas recipient are difficult to administer. For example, a domestic entity needs State Administration for Foreign Exchange approval to purchase foreign currency exceeding the US\$50,000 annual limit. Chinese payors transferring money overseas must submit certain paperwork to the bank, including a tax authority-issued tax recordal form. Therefore, royalty and other regular payments are usually charged on a monthly or quarterly basis.
- As English is not widely spoken in mainland China, advertising targeting Chinese consumers must be in Chinese and adapted to local customs and culture. If an international franchisor charges advertising fund fees, a separate fund for Chinese advertising should be considered.
- If the franchisor charges a pre-contractual deposit, the purpose of this payment and conditions of refund (if the deposit is refundable) must be evidenced in writing.
- Chinese parties are rarely comfortable providing personal guarantees. Instead, domestic franchisors charge a security deposit, which may be returned to the franchisee on the expiration of the franchise agreement if the franchisee has complied with the obligations under the agreement.

Law stated - 16 May 2024

Usury

35 | Are there restrictions on the amount of interest that can be charged on overdue payments?

Generally, interest charged on overdue payments is considered a penalty. Article 585 of the Civil Code provides that if the agreed-upon amount of liquidated damages is excessively higher than the actual loss incurred by the creditor, parties (generally, the debtor) may request the court to make an appropriate abatement.

The Judicial Interpretation of Private Lending (JIPL), issued by the Supreme People's Court in June 2015, provides that courts must accept and enforce claims of interest under 24 per cent, allow but not enforce claims of interest under 36 per cent, and void interest above 36 per cent. Although the JIPL only applies to private lending contracts, in practice courts apply it to other types of contracts.

Law stated - 16 May 2024

Foreign exchange controls

36 | Are there laws or regulations restricting a franchisee's ability to make payments to a foreign franchisor in the franchisor's domestic currency?

Yes. Chinese yuan is still not freely exchangeable, although controls have loosened over the past decade.

Chinese residents must obtain State Administration of Foreign Exchange approval to purchase foreign currency above the annual quota of US\$50,000. Foreign exchange controls are primarily enforced by the banks, which monitor all overseas payments made by customers. Chinese franchisees should submit documents evidencing their payment obligations (eg, a franchise agreement) to make the overseas payment. To facilitate payments, franchisors should ensure that all registration requirements (eg, registration with the Ministry of Commerce (MOFCOM) and recording of trademark licences with the National Intellectual Property Administration) are completed in good time.

Furthermore, banks require payors to submit a tax recordal form issued by the tax authorities. Many tax departments will not issue tax recordal forms until all withholding taxes are paid.

Law stated - 16 May 2024

Confidentiality covenant enforceability

37 | Are confidentiality covenants in franchise agreements enforceable?

Yes. Franchisors should ensure that their agreements with Chinese franchisees are properly initialled, signed and sealed, and reference the franchisee's legal name in Chinese. Franchisors should collect evidence of the information that has been disclosed and the time of disclosure. Identifying a clear scope of information that is subject to a confidentiality covenant enhances the chances of enforcement.

Law stated - 16 May 2024

Good-faith obligation

38 | Is there a general legal obligation on parties to deal with each other in good faith during the term of the franchise agreement? If so, how does it affect franchise relationships?

Yes, the law in the PRC is based on the principle of good faith in negotiating and performing contracts. Article 7 of the Civil Code and article 4 of the Franchise Regulations require the parties to act fairly, honestly and in good faith.

Law stated - 16 May 2024

Franchisees as consumers

- 39 | Does any law treat franchisees as consumers for the purposes of consumer protection or other legislation?

The authors are not aware of any such laws.

Law stated - 16 May 2024

Language of the agreement

- 40 | Must disclosure documents and franchise agreements be in the language of your country?

There is no such requirement. In practice, providing a Chinese language version is highly recommended to avoid a franchisee's claims that the English version was not understood. Chinese translation of the franchise agreement is also required for registration with MOFCOM and enforcement.

Law stated - 16 May 2024

Restrictions on franchisees

- 41 | What types of restrictions are commonly placed on the franchisees in franchise contracts?

Subject to the duty of good faith, which does not support overbroad restrictive clauses, employee non-compete and non-solicitation covenants are enforceable.

The franchisor may set recommended prices for franchisees, although this may attract scrutiny from the anti-monopoly authorities if the franchisor enforces the recommendation.

Law stated - 16 May 2024

Courts and dispute resolution

- 42 | Describe the court system. What types of dispute resolution procedures are available relevant to franchising?

Franchising disputes usually fall under the jurisdiction of either the basic or intermediate people's courts. Specialised intellectual property (IP) courts in some major cities also have jurisdiction over major franchise cases. The level of court that will hear a dispute is determined by the amount of the claim and the status of the party (namely, a domestic litigant or a foreigner). The monetary thresholds differ between provinces. Generally, foreign-related disputes have a lower monetary threshold to be heard by an intermediary people's court or specialised IP court. In other words, it is easier for a foreign party to obtain

more sophisticated judges at the trial level and get an appeal heard by higher people's courts.

Domestic franchise disputes are typically heard by local courts. There are few reported court decisions that involve international franchisors, even though international claimants have a good track record of prevailing in local courts.

Contrary to popular belief, Chinese courts are efficient and generally friendly to foreign parties.

Law stated - 16 May 2024

Governing law

- 43 | Are there any restrictions on designating a foreign governing law in franchise contracts in your jurisdiction? How does the governing law affect the contract's enforceability?

Subject to the provisions of the [Law of the Application of Law for Foreign-Related Civil Relations of the PRC](#)

[C \(2017\) No. 13](#), there are no restrictions on the parties to a foreign-related transaction to select foreign law to govern their franchise agreement. However, the choice of foreign governing law must be considered against the advantages and disadvantages of choosing a foreign dispute resolution forum. Chinese courts will consider the choice of law by the parties. However, it is strongly recommended that Chinese law is chosen as the governing law since practically it is cheaper and more convenient to enforce a decision made by the Chinese courts.

If the franchisee's or guarantor's assets are in the PRC, enforcing a foreign judgment may be either difficult or impossible, as China enforces foreign court decisions only on the basis of a treaty or reciprocity with the respective jurisdiction. There is currently no such treaty or reciprocity with the United States, Canada, Australia or the United Kingdom; in such cases, litigation in China is the preferred route. If litigating or arbitrating domestically, Chinese law should govern the agreement to avoid the costs and inconvenience of explaining foreign law to the judge or arbitrator.

Law stated - 16 May 2024

Arbitration – advantages for franchisors

- 44 | What are the principal advantages and disadvantages of arbitration for foreign franchisors considering doing business in your jurisdiction? Are any other alternative dispute resolution (ADR) procedures particularly favoured or disfavoured in your jurisdiction?

The PRC is a party to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958). While Western companies overwhelmingly prefer arbitration to litigation in Chinese courts, arbitral awards must still be approved by a local court for enforcement. This process is as expensive and time-consuming as a trial. Furthermore, certain issues (eg, ownership of a Chinese-registered trademark) are unlikely

to be eligible for arbitration. Arbitration tends to be more expensive and time-consuming than litigating directly in a Chinese court. However, arbitration may be an effective tool if the franchisee has assets outside China, as arbitral awards are more portable across borders than court judgments.

Law stated - 16 May 2024

National treatment

45 | In what respects, if at all, are foreign franchisors treated differently (legally, or as a practical matter) from domestic franchisors?

Subject to the real estate restrictions and restrictions on foreign investment in certain industries, foreign franchisors are not treated differently from domestic franchisors.

Law stated - 16 May 2024

UPDATE AND TRENDS

Legal and other current developments

46 | Are there any proposals for new legislation or regulation, or to revise existing legislation and regulation? Are there other current developments or trends to note?

At this time, no significant reforms of the franchise regulations have been announced by the government. However, judicial approaches to franchise disputes continue to evolve. One of the recent trends seen in court decisions is that courts expect the franchisee seeking termination of the franchise agreement for failure to provide a franchise disclosure document (FDD) to explain how the absence of the FDD or a particular piece of information affected the franchisee's decision to buy the franchise. This is different from the approach in some other jurisdictions, such as Canada, where failure to provide an FDD or certain information leads to the rescission regardless of the impact on the franchisee.

Law stated - 16 May 2024



Jones & Co.
Jones Law Professional
Corporation

钟保禄
律师事务所

Джонс и Ко.
Корпоративная фирма

Paul D Jones
Jennifer Zhang

pjones@jonesco-law.ca
zhang.jiahui@jonesco-law.ca

Jones & Co

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Germany

[Benedikt Rohrßen](#), [Giorgia Carandente](#)

[Taylor Wessing](#)

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MARKET OVERVIEW

Franchising in the market

- 1 | How widespread is franchising in your jurisdiction? In which sectors is franchising common? Are there any economic or regulatory issues in the market that are more or less hospitable to franchising or make it economically viable in your jurisdiction?

The latest statistics for 2023 of the German Franchise Association eV show ongoing positive developments in the franchise sector: approximately 1,000 franchise systems nationwide counted over 147,000 franchise partners, reaching an overall turnover of more than €147 billion, with an increase of 2.3 per cent compared to the previous year. The most franchised industry is services (48 per cent), followed by trade (19 per cent) on a par with gastronomy, tourism and leisure (19 per cent), and by crafts, construction and refurbishment (14 per cent).

Law stated - 11 June 2024

Associations

- 2 | Are there any national or local franchise associations? What is their role in franchising, including any impact on laws or regulations? Are there any rules of conduct or membership requirements?

The most important franchise association in Germany is the German Franchise Association eV, with approximately 450 member companies. It issues legal opinions on draft legislative acts, as well as guidelines and practical advice on newly introduced franchise-related laws or regulations. Those who wish to become members must comply with its code of ethics, stipulating practical guidelines for best practice and fair dealings between franchisors and franchisees and regulating issues such as pilot projects, rights of use regarding the corporate identity and training for the franchisees.

Law stated - 11 June 2024

BUSINESS OVERVIEW

Types of vehicle

- 3 | What forms of business entities are relevant to the typical franchisor?

The franchisors' choice depends especially on the obligations and liability risks to be undertaken, the seed capital and business assets and tax implications connected thereto. Most popular for medium or large businesses is the company with limited liability (GmbH), a flexible private limited liability company, which requires a minimum share capital of €25,000 and limits liability with regard to creditors to the company's assets. Bigger businesses might choose the corporation (AG), a public limited company that requires a minimum share capital of €50,000. As an alternative, the entrepreneurship (UG), also known as

'mini GmbH', also provides for limited liability, but with a share capital of €1. If the franchise system shall be set up in different states of the European Union, another option is the *Societas Europaea* (SE), a public limited company requiring a minimum share capital of €120,000. For tax reasons, such corporations are often combined with partnerships (eg, as GmbH & Co KG, or AG Co KG).

Law stated - 11 June 2024

Regulation of business formation

4 | What laws and agencies govern the formation of business entities?

The Civil Code ([BGB](#)) and the Commercial Code ([HGB](#)) regulate the incorporation of partnerships, while the Limited Liability Company Act ([GmbHG](#)) governs the formation of a GmbH or a UG, the Stock Corporation Act ([AktG](#)), the formation of the AG, and the Council Regulation (EC) No. 2157/2001 of the SE.

Law stated - 11 June 2024

Requirements for forming a business

5 | Provide an overview of the requirements for forming and maintaining a business entity.

Compared with an AG entity, the GmbH entities – and even more so the UG entities – are less formalised, easier and cheaper. One-person foundations are allowed and founders can be German or foreign natural and legal entities. The incorporation agreement requires, as minimum information, the full name and registered office of the company, the object of the enterprise, the amount of the share capital, as well as the shareholders' contributions. Once certified by a notary, it must be registered with the Commercial Register by the competent local court. The entries in the Commercial Register are published in the Electronic Federal Gazette.

Law stated - 11 June 2024

Restrictions on foreign investors

6 | What restrictions apply to foreign business entities and foreign investment?

In principle, foreign business entities are free to do business and invest in Germany. However, thorough reviews by the German Federal Ministry for Economic Affairs and Energy and notification obligations apply to acquisitions in specified industry sectors related to public order and security, such as defence, IT, telecoms and critical infrastructure, unless they are made by individuals or business entities based in the European Union, Iceland, Liechtenstein, Norway (the European Economic Area) or Switzerland (based on sections 55–62 of the [Foreign Trade and Payments Ordinance](#)). Moreover, the European

Union and its member states are cooperating on the screening of foreign direct investments into the Union: Regulation (EU) 2019/452 was implemented in Germany by the statutory amendments of the [Foreign Trade and Payments Act](#).

Law stated - 11 June 2024

Taxation

7 | What aspects of the tax system are relevant to franchisors? How are foreign businesses and individuals taxed?

Further to the entry in the Commercial Register, all German tax-resident business entities are automatically registered with the tax authorities. To avoid penalties, tax declarations must be submitted by 31 July or by tax accountants by 28 February thereafter. The income tax, which is usually the highest tax, is calculated based on the profits indicated in the last tax declaration: for AGs or GmbHs, a corporate income tax of 15 per cent of the taxable income is due, while individuals or partnerships are subject to a progressive income tax of up to 45 per cent. Most companies are also subject to a trade tax, whose amount usually varies between 7 per cent and 18 per cent and is determined on a local basis by the competent municipality.

If the franchisor employs workers, a wage tax is due with the monthly pay slip. If the object of the franchise is goods or services, a value added tax of 7 per cent (limited to the taxi, hotel or public transport industry) or 19 per cent, applicable to most sectors, is due on the net price.

Law stated - 11 June 2024

Labour and employment

8 | Are there any relevant labour and employment considerations for typical franchisors?

Yes. As specified both in the franchise agreement itself and in any additional regulations, especially the franchise manual, franchisors should not limit the franchisee's freedom too much, thus avoiding subjecting the franchisee to the highly protective employment and social security laws. To reduce said risk of qualification of employment, the franchisor shall draft and practically implement the franchise agreement in a way that leaves the franchisee with sufficient leeway to exercise a self-employed activity, avoiding any implications that the franchisee is personally and economically dependent on the franchisor. If there is a contradiction between the agreement and its actual implementation, the latter is decisive. In fact, the parties' conduct prevails over the wording of their contract (see German Federal Court, 11 October 2018, Case No. [VII ZR 298/17](#); Rohrßen, ZVertriebsR 2019, 323). Therefore, the franchisor must also make sure to live up to the contract.

Law stated - 11 June 2024

Intellectual property

9 | How are trademarks and other intellectual property and know-how protected?

Franchising, trademarks and know-how go hand in hand and therefore their protection is of utmost importance. Trademarks are protected by registration, by acquisition of market recognition or notoriety. The registration at national level is a quite speedy and inexpensive process and is filed, online or with a paper-based application, with the German Patent and Trade Mark Office (DPMA) in Munich. To obtain protection across all member states of the European Union, the filing shall be submitted to the European Union Intellectual Property Office in Alicante. For international protection, the application shall be filed with the World Intellectual Property Organization in Madrid. In all cases, the protection starts on the filing date and initially lasts 10 years. It can be renewed for further 10-year periods, upon payment of the renewal fee. Innovations can be patented, but the know-how contained, for example, in handbooks and best practice guidelines does not always meet the necessary technical requirements. Therefore, it can be best protected by non-disclosure agreements, subject to Directive (EU) 2016/943 on the protection of undisclosed know-how and business information (trade secrets) against their unlawful acquisition, use and disclosure, implemented in Germany by the Act on protection of business secrets ([GeschGehG](#)) published on 18 April 2019.

As to the enforcement, trademark owners can obtain a preliminary injunction even without an oral hearing and within a very short time, but any delay in issuing proceedings can mean that this right may fall away. Both parties must be represented before the court by a German qualified lawyer.

Law stated - 11 June 2024

Real estate

10 | What are the relevant aspects of the real estate market and real estate law? What is the practice of real estate ownership versus leasing?

Unless the franchise is set up as a pure online business, the franchisor should protect its interest in a strategic location of the franchise shop. If the franchisor owns or leases the shop, the termination scenarios of both the franchise and the lease or sublease contract should be synchronised. The downside of such scenario is that the franchisor bears the risk of non-payment of the lease. As an upside, the franchisor can clearly require the franchisee not to compete beyond the five-year limit of general EU competition law, as the limit does not apply if the franchisee leased or sub-leased the premises from the franchisor (article 5, paragraphs 1(a) and 2 of the Vertical Block Exemptions Regulation; for details, see Rohrßen, VBER 2022, EU Competition Law for Vertical Agreements (Springer, 2023), Chapter 5.2 on non-competes and Chapter 7 on franchising); in all other cases, the franchisee may nevertheless, according to case law, be subject to a non-compete obligation if it is necessary for the functioning of the franchise system. If, instead, the lease agreement is entered into by the franchisee with a third party, the franchisor usually requires to be granted a right of subrogation as lessee (to be contractually agreed upon

with the lessor in the lease contract) in the event of termination of the franchise contract. This way the franchisor can ensure the continuation of the franchise personally or through another franchisee.

Law stated - 11 June 2024

Competition law

11 | What aspects of competition law are relevant to the typical franchisor in your jurisdiction? How is competition law enforced in the franchising sector?

Competition law (also known as antitrust law) consists both of EU and German laws. The basic principle is that agreements or behaviours that have as their object or effect to appreciably restrict competition are prohibited (article 101 of the Treaty on the Functioning of the European Union; section 1 of the German Competition Act ([GWB](#))). Franchise agreements are privileged: 'provisions which are strictly necessary to ensure that the know-how and assistance provided by the franchisor do not benefit competitors do not constitute restrictions of competition' (Court of Justice of the European Union, 28 January 1986, Case No. 161/84, Pronuptia, paragraph 27). This typically includes post-contractual non-compete obligations. In practice, many franchise agreements simply adhere to the requirements of the Vertical Block Exemptions Regulation (as revised with effect from 1 June 2022) to be on the safe side (see Rohrßen, VBER 2022: EU Competition Law for Vertical Agreements (Springer, 2023), especially Chapter 7).

Law stated - 11 June 2024

OFFER AND SALE OF FRANCHISES

Legal definition

12 | What is the legal definition of a franchise?

German law does not provide a definition of franchise and neither does EU law (see the report issued in 2016 by the Directorate-General for Internal Policies of the European Union on Franchising, p185; Kieran McLoone, 'Germany: The Self-Regulated Franchising Haven', in Global Franchise, Issue 6.4 of 2021, p46). Nevertheless, there is a common understanding that the term defines the set of rights granted by a franchisor to a legally and financially independent and self-employed party, the franchisee, with the aim of a cooperative distribution system. A franchise entitles and obliges the franchisee, against a direct or indirect financial compensation, to undertake, under the franchisor's supervision, the marketing system of goods, services or technology conceived by the franchisor (namely, the franchise system), which includes the franchisor's confidential know-how and ongoing technical and economic support, as well as the specific business concept and the intellectual and industrial property rights related to it.

Law stated - 11 June 2024

Laws and agencies

13 | What laws and government agencies regulate the offer and sale of franchises?

There is no specific German franchise law. Instead, the offer and sale of franchises are regulated by:

- the general good faith requirement, requiring a pre-contractual disclosure (sections 242 and 311 of the Civil Code (BGB));
- the quite strict German rules on standard form contracts (sections 305–310 of the BGB), because franchise agreements are pre-drafted contractual rules provided by the franchisor for multiple franchisees; as a rule of thumb, the contractual rules need to be reasonable – and are void (not reduced to a valid minimum) if they unreasonably disadvantage the franchisee;
- the general requirements not to violate protective laws (section 134 of the BGB) or public policy (section 138 of the BGB);
- the statutory right of withdrawal if franchisees are natural persons to be qualified as founders of a business (section 491 et seq of the BGB; see German Federal Court, 14 December 1994, Case No. [VII ZR 46/94](#), Ceiling Doctor);
- the laws for commercial agents (section 84 et seq of the Commercial Code (HGB)) if the franchisees' interests are similar to those of a commercial agent (see German Federal Court, 12 November 1986, Case No. [I ZR 209/84](#), Beverage delivery service);
- the laws for commission agents (section 383 et seq of the HGB) may apply, especially if the franchisor aims to set the resale price;
- article 101 of the Treaty on the Functioning of the European Union (TFEU) and section 1 of the German Competition Act (GWB) as regards restrictions on competition;
- the Act Against Unfair Competition ([UWG](#)) as regards advertising (unfair commercial practices – eg, misleading advertising – are illegal, and subject to claims for cease-and-desist, damages, confiscation of profits); and
- government agencies that regulate franchise business, which exist only in the form of competition authorities.

Law stated - 11 June 2024

Principal requirements

14 | What are the principal requirements governing the offer and sale of franchises under the relevant laws?

There is no specific German franchise law. Instead, the offer and sale of franchises are regulated by:

- the general good faith requirement, requiring a pre-contractual disclosure (sections 242 and 311 of the BGB);
- the quite strict German rules on standard form contracts (sections 305–310 of the BGB), because franchise agreements are pre-drafted contractual rules provided by the franchisor for multiple franchisees; as a rule of thumb, the contractual rules need to be reasonable – and are void (not reduced to a valid minimum) if they unreasonably disadvantage the franchisee;
- the general requirements not to violate protective laws (section 134 of the BGB) or public policy (section 138 of the BGB);
- the statutory right of withdrawal if franchisees are natural persons to be qualified as founders of a business (section 491 et seq of the BGB; German Federal Court, 14 December 1994, Case No. VII ZR 46/94, Ceiling Doctor);
- the laws for commercial agents (section 84 et seq of the HGB) if the franchisees' interests are similar to those of a commercial agent (German Federal Court, 12 November 1986, Case No. I ZR 209/84, Beverage delivery service);
- the laws for commission agents (section 383 et seq of the HGB) may apply, especially if the franchisor aims to set the resale price;
- article 101 of the TFEU and section 1 of the GWB as regards restrictions on competition;
- the UWG as regards advertising (unfair commercial practices – eg, misleading advertising – are illegal, and subject to claims for cease-and-desist, damages, confiscation of profits); and
- government agencies that regulate franchise business, which exist only in the form of competition authorities.

Law stated - 11 June 2024

Franchisor eligibility

- 15** | Must franchisors satisfy any eligibility requirements in order to offer franchises?
Are there any related practical issues or guidelines that franchisors should consider before offering franchises?

German law does not provide eligibility requirements. However, self-regulatory rules exist, collected and laid down by the European Franchising Federation in its European Code of Ethics for Franchising and by its member German Franchise Association eV in their updated German version. Even if they only bind their members, these rules contain practical guidelines on best practice or fair dealings between franchisors and franchisees. Accordingly, the franchisor shall:

- have exercised the franchise concept already for a reasonable period with at least one pilot project;
- be the owner or lawfully authorised user of the franchise corporate identity (company name, trademark or other specific identification of its network); and

- provide both initial and follow-up training to the franchisees.

Law stated - 11 June 2024

Franchisee and supplier selection

- 16 | Are there any legal restrictions or requirements relating to the manner in which a franchisor recruits franchisees or selects its or its franchisees' suppliers? What practical considerations are relevant when selecting franchisees and suppliers?

No, there are no franchise-specific laws. In principle, franchisors are free to select their franchisees and their suppliers. Restrictions, however, may apply if the franchisor is a dominant undertaking or has relative or superior market power (which must not be abused, see article 102 of the TFEU and sections 19 and 20 of the GWB) or pursuant to anti-discrimination laws (franchisors must not, generally speaking, discriminate on grounds of race or ethnic origin, sex, religion, disability, age or sexual orientation, see sections 19–21 of the General Act on Equal Treatment ([AGG](#))).

Law stated - 11 June 2024

Pre-contractual disclosure – procedures and formalities

- 17 | What procedures and formalities for pre-contractual disclosure are required or advised in your jurisdiction? How often must the disclosures be updated?

In Germany, there is no standard procedure. Case law (starting with the Higher Regional Court of Munich, 16 September 1993, Case No. [6 U 5495/92](#)) requires the franchisor to disclose any circumstances that may affect the agreement's purpose within a reasonable period (two to four weeks may suffice) before concluding the franchise agreement (or any preliminary contract with binding effect, including area development franchise agreements or master franchises). For the sake of proof, franchisors should make a disclosure in writing – ideally also digitally, with special encryption and restricted access to protect business secrets.

Updating the disclosure may be necessary when the information provided becomes outdated before the conclusion of the franchise agreement. For example, the franchisor is obliged to give an update if the turnover and revenue information changes: 'The defendant should have informed the claimant that the turnover development of the pilot operation was below the forecast, even if there were plausible reasons for this' (see Higher Regional Court of Cologne, 24 April 2009, Case No. [6 U 70/08](#), juris-paragraph 23, 'refilling of printer cartridges and cartridges').

Law stated - 11 June 2024

Pre-contractual disclosure – content

- 18 | What information is the disclosure document required or advised to contain?

The necessary information depends on the general principle of good faith. However, according to the prevailing legal opinion, the franchisor only has to inform about issues known to the franchisor, meaning that the franchisor does not need to perform researches for the franchisee as the franchisor is not obliged to provide services as a start-up consultant. The obligation is, instead, limited by the franchisor's legitimate interest in protecting its trade secrets and essential know-how prior to the conclusion of the agreement.

As first aid may serve the guidelines published by the German Franchise Association eV on pre-contractual information and the – rather extensive – list in the UNIDROIT's Model Franchise Disclosure Law (not enacted in Germany, though). Circumstances to be disclosed include in particular the franchise system's:

- mode of operation (see Higher Regional Court of Munich, 11 July 1996, Case No. [24 U 63/95](#));
- profitability or achievable turnover on the basis of generally applicable facts (see Regional Court of Hamburg, 17 May 2018, Case No. [334 O 14/18](#));
- necessary labour and capital input (see Higher Regional Court of Düsseldorf, 30 June 2004, Case No. [U \(Kartell\) 40/02](#)); and
- advantages of the cooperation within the franchise network, if applicable (eg, purchasing benefits – see German Federal Court, 20 May 2003, Case No. [KZR 19/02](#), Apollo Optics).

The information given – and answers to questions asked by the franchisee – must accurately reflect the realities of the franchise system in question, as the necessary basis for any suitable profitability forecast (see also Higher Regional Court of Düsseldorf, 25 October 2013, Case No. [I-22 U 62/13](#)).

Law stated - 11 June 2024

Pre-sale disclosure to sub-franchisees

19 | In the case of a sub-franchising structure, who must make pre-sale disclosures to sub-franchisees? If the sub-franchisor must provide disclosure, what must be disclosed concerning the franchisor and the contractual or other relationship between the franchisor and the sub-franchisor?

Within a sub-franchising structure, the sub-franchisor, as a future contractual partner of the franchisee, must make pre-sale disclosure (see section 311 of the BGB). Its extent depends on what the franchisee needs to know to decide about joining the franchise system. The information to be disclosed, especially concerns:

- information about the franchise;
- how tasks are allocated among the franchisor (also known as the master franchisor), the sub-franchisor and the sub-franchisees; and
- the basic content of the master franchise agreement, especially the licence, which allows and limits sub-franchisors installing of sub-franchisees and implementing

of the franchise, including the consequences if the master franchise agreement is terminated.

Law stated - 11 June 2024

Due diligence

20 | What due diligence should both the franchisor and the franchisee undertake before entering a franchise relationship?

Franchisors should check whether the franchisee fits into the franchise system. To be more precise, this includes whether the franchisee is personally a good fit (characteristics, experience, abilities and ambition) and economically suitable (minimum capital requirements, territory available).

Franchisees should check the franchise system, its concept, the franchise agreement, the information disclosed pre-contractually, the competition situation, the territory and location.

Law stated - 11 June 2024

Failure to disclose – enforcement and remedies

21 | What actions may franchisees or any relevant government agencies take in response to a franchisor's failure to make required disclosures? What legal remedies are available? What penalties may apply?

Except in minor cases where they may simply ask for any missing or apparently inaccurate information, franchisees have the following options.

- Terminate the franchise agreement for cause (section 314 of the BGB) within a reasonable period after having learned about the material breach of contract, typically two months (see, for commercial agents and distributors, German Federal Court, 29 June 2011, Case No. [VIII ZR 212/08](#)). A prior warning is often not necessary, provided such event profoundly disrupts the trust between the parties.
- Void the agreement if entered into by a mistake willingly induced by the franchisor (section 123 of the BGB).
- Claim damages.

The franchisee can demand to be placed in the same position he or she would have been in if the franchisor had not breached the disclosure obligation (section 249 of the BGB). Damages can be calculated by comparing the operating costs (system costs and rent or lease paid, insurance contributions, wages and social security contributions, costs for service providers) and losses in value (eg, the equipment, the warehouse) with the revenues. Alternatively, the franchisee can choose to rescind the entire franchise agreement retroactively if the franchisee would not have concluded the franchise agreement if the franchisor had duly informed the franchisee (see German Federal Court,

27 July 2006, Case No. [23 U 5590/05](#), juris-paragraph 30). If the franchise contract is rescinded, all transactions will be reversed (namely, each party will return what it has received from the other). The worst-case scenario in practice is that such breach may induce further, not very successful, franchisees to terminate their franchise agreements.

Law stated - 11 June 2024

Failure to disclose – apportionment of liability

22 | In the case of sub-franchising, how is liability for disclosure violations shared between franchisor and sub-franchisor? Are individual officers, directors and employees of the franchisor or the sub-franchisor exposed to liability? If so, what liability?

In principle, liability for disclosure violations is not shared between franchisor and sub-franchisor, but the sub-franchisor alone will be liable towards the franchisee – because the disclosure requirement only exists within their relationship. By way of exception, the franchisor can be liable towards the sub-franchisee:

- directly in the case of tort or product liability (eg, for providing defective products); or
- indirectly, namely when the franchisor is liable in regard to the sub-franchisor for breach of contract (eg, if the franchisor negligently provided incorrect information) and thus bears all consequential damages, including those the sub-franchisor has to bear due to the franchisor's breach of contract.

Individual officers, directors and employees of the franchisor or sub-franchisor are, in principle, exempt from liability for disclosure violations. By way of exception, they can be exposed to liability, especially if they have claimed a particular position of trust and expertise for themselves and then provided wrong information, and more so where this occurred with wilful intent and with the intention of causing financial loss.

Law stated - 11 June 2024

General legal principles and codes of conduct

23 | In addition to any laws or government agencies that specifically regulate offering and selling franchises, what general principles of law affect the offer and sale of franchises? What industry codes of conduct may affect the offer and sale of franchises?

Offering and selling franchises must, like any other transaction, comply with the obligation of good faith, specifically with regard to negotiation (*culpa in contrahendo*). Accordingly, pre-sale disclosure is mandatory as it may, if omitted or incorrectly done, allow the franchisee to reverse the whole franchise agreement. A guideline on pre-contractual information is provided at the European level by the European Code of Ethics for Franchising and at the national level by the German Franchise Association eV. Moreover,

there is the rather extensive list in the UNIDROIT's Model Franchise Disclosure Law (not enacted in Germany, though). Circumstances regarding the franchise system to be disclosed include in particular:

- the mode of operation (see Higher Regional Court of Munich, 11 July 1996, Case No. 24 U 63/95);
- the profitability or achievable turnover on the basis of generally applicable facts (see Regional Court of Hamburg, 17 May 2018, Case No. 334 O 14/18);
- the necessary labour and capital input (see Higher Regional Court of Düsseldorf, 30 June 2004, Case No. U (Kartell) 40/02); and
- the advantages of cooperation within the franchise network if applicable (eg, purchasing benefits, German Federal Court, 20 May 2003, Case No. KZR 19/02, Apollo Optics).

Law stated - 11 June 2024

Fraudulent sale

24 | What actions may franchisees take if a franchisor engages in fraudulent or deceptive practices in connection with the offer and sale of franchises?

Beyond the general remedies under civil law against missing or inaccurate franchise sales disclosure provided by a damage claim or a rescission of the contract, the franchisee may in the case of fraudulent or deceptive practices revert to the 'tools' of criminal law and criminal procedure: the franchisee may file a criminal complaint, thus having the law enforcement investigate the case, gather proof and potentially resulting in a conviction – which may serve as proof in the damages claims before the civil courts (sections 415 and 286 of the Code of Civil Procedure ([ZPO](#))).

Law stated - 11 June 2024

FRANCHISE CONTRACTS AND THE FRANCHISOR/FRANCHISEE RELATIONSHIP

Franchise relationship laws

25 | What laws regulate the ongoing relationship between franchisor and franchisee after the franchise contract comes into effect?

There are no specific laws on the franchise relationship, and therefore it is best practice to regulate it in detail. When designing or developing the franchise system, the general rules of the German Civil Code (especially on standard form contracts: they need to be reasonable) and of the Commercial Code, the general good faith requirement and the competition (antitrust) rules must be observed.

Law stated - 11 June 2024

Operational compliance

26 | What mechanisms are commonly incorporated in agreements to ensure operational consistency and adherence to brand standards?

To ensure franchise compliance (namely, the franchisees operate a uniform network according to the corporate identity guidelines and deliver a consistent brand message and experience to the customers) franchisors use the following tools:

- clearly identify the standards;
- establish a contact person (franchise compliance officer or franchise compliance coordinator) dedicated to checking and clearing issues at the earliest convenience, and if not, enforcing the standards – and introduce that person to the franchisee;
- provide for regular reporting duties (eg, products sold or services rendered, monthly net turnover, etc), especially those items that are relevant for calculating the franchise fees;
- provide for inspection and audit rights, for the franchisor and third parties sworn to secrecy;
- underline the importance of compliance by stipulating contractual penalties or liquidated damages in the case of a breach; and
- reward the best examples among the franchisees ('franchisee of the year', etc).

Law stated - 11 June 2024

Amendment of operational terms

27 | May the franchisor unilaterally change operational terms and standards during the franchise relationship?

Yes, provided that the franchise agreement contains valid 'change of terms provisions', especially to modify the relationship to develop the franchise system, the contractual products or the services and adapt to technological, legal or other changes. Such clauses are permissible and reasonable for the franchisee if they are sufficiently precise, stipulate the respective circumstances for change, adequately safeguard the interests of the sales intermediary and provide reasonable time before the change comes into effect (sections 310, 307 and 308 No. 4 of the Civil Code (BGB); German Federal Court, 6 October 1999, Case No. [VIII ZR 125/98](#) Kawasaki; Higher Regional Court of Munich, 8 February 2023, Case No. [7 U 8606/21](#), paragraph 34 – see Rohrßen, ZVertriebsR 2023, Issue 4).

If, however, the franchise agreement does not provide a unilateral right to change the operational terms, the franchisor and franchisee remain, in principle, bound by the franchise agreement. By way of exception, the franchise agreement or its operational standards, or both, might be changed if the franchise agreement were otherwise frustrated (section 313 of the BGB).

Law stated - 11 June 2024

Policy affecting franchise relations

28 | Do other government or trade association policies affect the franchise relationship?

Those who wish to become members of the German Franchise Association eV, namely, the most important franchise association in Germany, representing around 450 member companies at the economic, political and social level, must comply with its code of ethics, stipulating practical guidelines of best practice and fair dealings between franchisors and franchisees, and regulating issues such as pilot projects, rights of use regarding the corporate identity, and training for the franchisees.

Law stated - 11 June 2024

Termination by franchisor

29 | In what circumstances may a franchisor terminate a franchise relationship? What are the specific legal restrictions on a franchisor's ability to terminate a franchise relationship?

If the franchise agreement is entered into for an unlimited period, it can be terminated with cause or without cause, namely ordinarily ('for convenience'), according to the terms stipulated in the agreement. In lack of such terms, the statutory provisions regarding commercial agents may apply by analogy (see German Federal Court, 23 July 1997, Case No. [VIII ZR 130/96](#), Benetton: likely, but not yet ruled out) as follows:

- one month's notice in the first year of contractual relationship;
- two months in the second year;
- three months in the third to fifth year; and
- six months as of the sixth year.

Fixed-term agreements, instead, can only be terminated for cause (namely, extraordinarily) with immediate effect, unless the parties specifically agreed on terms for ordinary termination. For the franchisor, such cause is typically, for example, the franchisee's non-payment of the franchise or advertisement fees, competitive practices, serious breaches of the franchise system directives or violation of the reporting and information obligations. Termination for cause, however, in principle requires sending the other party a warning first, since termination shall be the last resort (and hence default of payment alone does not necessarily suffice; see Higher Regional Court of Berlin, 21 November 1997, Case No. [5 U 5398/97](#), Burger King). Finally, the parties can always agree on an amicable termination of the agreement. In very rare cases, the franchisor can also just let the franchisee's business run dry. However, to protect the franchisor's brand image and corporate identity, this option can be convenient only where the territory or the market is no longer relevant for the franchisor; for example, if the franchisor gives up the whole franchise.

Law stated - 11 June 2024

Termination by franchisee

30 | In what circumstances may a franchisee terminate a franchise relationship?

If the franchise agreement is entered into for an unlimited period, it can be terminated with cause or without cause ('ordinarily', or 'for convenience'), according to the terms stipulated in the agreement. Without such terms, the statutory provisions on notice periods regarding the commercial agent may apply by analogy:

- one month in the first year of contractual relationship;
- two months in the second year;
- three months in the third to fifth year; and
- six months as of the sixth year.

Fixed-term agreements, instead, can only be terminated for cause (namely, extraordinarily), with immediate effect, unless the parties specifically agreed on terms for ordinary termination. For the franchisee, such cause is typically, among others, the franchisor's breach of territorial exclusivity, reduction of the assigned territory agreed upon or direct supply in said territory. The parties can, of course, always agree on an amicable termination of the agreement.

Law stated - 11 June 2024

Renewal

31 | How are renewals of franchise agreements usually effected? Do formal or substantive requirements apply?

Renewals are usually effected in writing; typically, because this is required by the franchise agreement and because written agreements serve as proof of what the parties have stipulated. However, the parties may also renew the agreement tacitly, by simply continuing to perform it after its expiration date. Therefore, to avoid undesired results (eg, if there are ongoing negotiations with a new franchisee), the parties should cease trading on the date of effective termination.

Law stated - 11 June 2024

Refusal to renew

32 | May a franchisor refuse to renew the franchise agreement with a franchisee? If yes, in what circumstances may a franchisor refuse to renew?

Yes, in principle. The franchisor is free to either extend the franchise agreement or refuse to renew it, without requiring specific circumstances or reasons for its refusal. Nevertheless, further to the investment made in the franchise, the franchisee is entitled to a reasonable

return and, at least, to recoup the resources invested. For this reason, if, shortly before the termination, the franchisor stated its intention to renew the franchise agreement, which led the franchisee to expend further resources in the franchise, the latter may be entitled to compensation for the damages suffered, in the event of a sudden refuse of the franchisor to renew the franchise agreement. Nevertheless, the franchisor's freedom to renew or not may be limited, especially when the franchisor has a dominant position on the market. If the franchisor has created trust in the franchisee that the franchise agreement will be renewed, a decision to the contrary may result in the obligation to pay damages or frustrated expenses for investments not returned.

Law stated - 11 June 2024

Transfer restrictions

33 | May a franchisor restrict a franchisee's ability to transfer its franchise or restrict transfers of ownership interests in a franchisee entity?

Yes. The transfer of the franchise and of the rights and obligations connected therewith to a third party requires the franchisor's consent by law (section 415 of the BGB), regardless if it occurs in the form of sale, lease, pledging or other. In lack of it, there is cause for extraordinary termination (see German Federal Court, 26 November 1984, Case No. [VIII ZR 214/83](#)). Further conditions for the transfer, including the franchisor's pre-emption right, are usually – and are best – stipulated in the franchise agreement. A transfer of the franchise can also be contractually excluded, to protect the franchisor's know-how and image, especially from competitors. Exceptions may apply to the transfer of single rights, which are not characterised by the personal features of the franchisee.

Law stated - 11 June 2024

Fees

34 | Are there laws or regulations affecting the nature, amount or payment of fees?

No. The nature, amount and payment modalities of the franchise fees are subject to the contractual freedom of the parties. Nevertheless, the franchise fees cannot violate the general principles of public policy (section 138 of the BGB; for details on the franchisee fees to be stipulated under German law and an overview on the fees required by different systems on the German franchise market, see Rohrßen, ZVertriebsR 2022, 139–151).

Law stated - 11 June 2024

Usury

35 | Are there restrictions on the amount of interest that can be charged on overdue payments?

Interest rates must not be usurious, but comply with the general principles of public policy (section 138 of the BGB). As a rule of thumb, standard late payment interest rates amount to 5 per cent over the bank rate; nevertheless, the legal late payment interest rate in business-to-business transactions amounts to 9 per cent over the bank rate (section 288, paragraph 2 of the BGB). Regardless of the rate outcome, the creditor is also entitled to claim a lump sum of €40 as compensation for the payment delay (section 288, paragraph 5 of the BGB).

Law stated - 11 June 2024

Foreign exchange controls

36 | Are there laws or regulations restricting a franchisee's ability to make payments to a foreign franchisor in the franchisor's domestic currency?

No, there are no such restrictions. Nevertheless, any cross-border outgoing payment over €12,500 or the corresponding amount in the foreign currency must be reported to the German Central Bank (section 11 of the German Foreign Trade and Payments Act (AWG) in connection with section 67 and following of the German Foreign Trade and Payments Ordinance (AWV)).

Law stated - 11 June 2024

Confidentiality covenant enforceability

37 | Are confidentiality covenants in franchise agreements enforceable?

Yes. Confidentiality covenants are a fundamental means of protection of the franchisor's know-how. A contractual penalty is generally agreed upon to determine and simplify the calculation of damages in the case of breach. Moreover, the breach of confidentiality can also amount to an infringement of competition law and be regulated by the German Act Against Unfair Competition. Finally, non-compliance with the confidentiality obligation can justify termination for cause.

Law stated - 11 June 2024

Good-faith obligation

38 | Is there a general legal obligation on parties to deal with each other in good faith during the term of the franchise agreement? If so, how does it affect franchise relationships?

Yes. The parties' obligation to live up to an agreement according to the requirements of good faith is expressly set forth by section 242 of the BGB and sections 86 and 86a of the Commercial Code (HGB) (for details, see Thume/Rohrßen, in Röhricht/Graf von Westfalen/Haas, HGB, 6th ed. 2023, sections 86 and 86a). The good faith obligation

typically requires franchisors to treat franchisees equally and to protect them, under very strict preconditions, from competition by other franchisees belonging to the same franchise system. The prerequisite for such an immanent obligation (and a corresponding contractual claim of the franchisee to injunctive relief) is that the economic existence of the franchisee is permanently endangered by the competing activity of the franchisor (Higher Regional Court of Düsseldorf, 10 February 2012, Case No. [16 W 62/11](#), juris, paragraph 39 Kentucky Fried Chicken; Higher Regional Court of Celle, decision of 28 August 2008, Case No. [13 U 178/08](#), juris, paragraph 15). If the franchise agreement qualifies as general terms and conditions (namely, if it was drafted unilaterally and offered to the counterparty on a take-it-or-leave-it basis), any provision contrary to the principle of good faith is void (section 307 of the BGB). Moreover, according to the case law, a breach of the obligation to act in good faith can be a cause for immediate termination of the franchise agreement (German Federal Court, 10 February 1993, Case No. [VIII ZR 48/92](#), section IV.2(b) Computer-Peripherie).

Law stated - 11 June 2024

Franchisees as consumers

39 | Does any law treat franchisees as consumers for the purposes of consumer protection or other legislation?

In principle, no – franchisees fall under the category of businesses (section 14 of the BGB) and, therefore, cannot claim consumer rights (German Federal Court, 24 February 2005, Case No. [III ZB 36/04](#)). Nevertheless, the franchisee may, if considered as a founder, be entitled to withdraw from the franchise agreement within the first 14 days regardless of any reason. To limit such term, the franchisor must instruct the franchisee accordingly (typically within the franchise agreement or its annexes).

Law stated - 11 June 2024

Language of the agreement

40 | Must disclosure documents and franchise agreements be in the language of your country?

No, not by law. However, all documents should be in a language the franchisee understands, both for practical and legal reasons, as this avoids misunderstandings and disputes between the parties. It is also a requirement of the European Code of Ethics for Franchising issued by the European Franchise Federation. Moreover, the contractual language should ideally accord with the competent jurisdiction or arbitration's official language and with the law applicable to the franchise agreement. If the agreement is drafted in multiple languages, usually in a dual-column form, it is important to identify which language prevails in the case of any discrepancy or dispute concerning meaning.

Law stated - 11 June 2024

Restrictions on franchisees

41 | What types of restrictions are commonly placed on the franchisees in franchise contracts?

Franchisors may limit the franchisees' economic freedom in several ways, typically by restricting the following elements.

- Territories, specifically by prohibiting active sales to exclusive territories (or customer groups), which the franchisor reserved for itself or allocated to another franchisee or other buyer. Limiting sales via the franchisee's website is, however, anticompetitive and such provision is void and subject to fines by the competition authorities (see 'On online sales bans and related internet resale restrictions', Rohrßen, ZVertriebsR2019, 341 et seq with further references; for example, clauses of online resale restrictions see Rohrßen, GRUR- Prax 2018, 39–41; on the new Vertical Block Exemption Regulation see Rohrßen, ZVertriebsR 2021, 293–298). Insofar, EU competition law forms one important block (if not the most important – see Flohr, ZVertriebsR 2022, 71, 74) for building franchise agreements.
- Sourcing: franchisors may require the franchisees to source the contractual products or services from the franchisor. This is not a non-compete obligation in the narrow understanding of the Vertical Block Exemptions Regulation (VBER).
- Resale pricing: limited to imposing a maximum price or recommending a sale price, without any incentives or pressure.
- Poaching of the franchisor's or other franchisee's employees, to protect the franchisor's business secrets, especially where the franchisee after termination joins a competitor.
- Competition, through non-compete obligations during and after the term of the franchise agreement.

For an overview on the need to adapt vertical agreements to the new EU competition law, and for specific, more detailed guidance for distribution and franchise agreements, see Rohrßen, VBER 2022: EU Competition Law for Vertical Agreements (Springer, 2023).

Law stated - 11 June 2024

Courts and dispute resolution

42 | Describe the court system. What types of dispute resolution procedures are available relevant to franchising?

Franchisors can turn to the German courts for mediation (see section 278, paragraph 5 and section 278a of the German Code of Civil Procedure) and litigation. Litigation allows starting with interim injunctions to reach temporal results at an early stage. Also, an expedited payment procedure is available for cases where the franchisor does not expect

the franchisee to reject a payment claim. Cases may also be dealt with in English, at the Chamber for International Commercial Disputes in Frankfurt am Main.

Law stated - 11 June 2024

Governing law

- 43 | Are there any restrictions on designating a foreign governing law in franchise contracts in your jurisdiction? How does the governing law affect the contract's enforceability?

The choice of the parties to apply a foreign law to their franchise contract is generally permitted, according to article 3 of the Rome I Regulation. However, German franchisors usually stipulate franchise agreements under domestic law because a different choice would be overridden by a large amount of national mandatory provisions (including the quite strict rules on standard form contracts). For an overview on the various levels of protection of franchisees in various countries worldwide, see Rothermel, Internationales Kauf-, Liefer- und Vertriebsrecht (2nd edition, 2021), Chapter H.

Law stated - 11 June 2024

Arbitration – advantages for franchisors

- 44 | What are the principal advantages and disadvantages of arbitration for foreign franchisors considering doing business in your jurisdiction? Are any other alternative dispute resolution (ADR) procedures particularly favoured or disfavoured in your jurisdiction?

Principal advantages over proceedings in court

Arbitration proceedings are conducted as follows:

- they are held in any language agreed (while judicial proceedings in Germany are generally held in German);
- they are confidential (while German court hearings are open to the public, even if rarely well-attended); and
- they are easily enforceable, compared to decisions of foreign courts outside the European Economic Area and Switzerland (see section 1029 et seq of the German Code of Civil Procedure; New York Convention of 1958 on the Recognition and Enforcement of Arbitral Awards).

Principal disadvantages over proceedings in court

Interim measures may not be as quick as before German courts. Therefore, franchise agreements should at least stipulate that the German courts have jurisdiction where the

franchisor's industrial property rights are infringed, thus enabling the franchisor to act quickly.

Costs are, as a rule of thumb until an amount in dispute of €5 million, higher than in German courts. The costs of arbitration may, however, be lowered by reducing the number of arbitrators from three to one; the arbitration clause may therefore provide for such reduction, especially with regard to smaller cases, where the amount in dispute is, for example, lower than €5 million (hence in the majority of disputes with single franchisees who do not also act as sub-franchisors).

Other ADR procedures available are through mediation or an ombudsman, which may be initiated through the German Franchise Association eV.

Law stated - 11 June 2024

National treatment

45 | In what respects, if at all, are foreign franchisors treated differently (legally, or as a practical matter) from domestic franchisors?

None – legally, they are to be treated the same. Practically, franchisees may prefer binding themselves to and cooperating with domestic franchisors, as this simply feels 'closer to home'. For the franchisor, in return, establishing a company in Germany brings the franchisor in closer contact to the market, the franchisees, and helps to minimise the liability risk for the franchisor's principal company. Generally, domestic franchisors stipulate franchise agreements under German law – because even if a choice of a foreign law generally is permitted (article 3 of Rome I Regulation), this choice would be overridden by a large amount of national mandatory provisions (including the quite strict rules on standard form contracts). For an overview on the various levels of protection of franchisees in various countries worldwide, see Rothermel, Internationales Kauf-, Liefer- und Vertriebsrecht (2nd edition, 2021), Chapter H.

Law stated - 11 June 2024

UPDATE AND TRENDS

Legal and other current developments

46 | Are there any proposals for new legislation or regulation, or to revise existing legislation and regulation? Are there other current developments or trends to note?

The main recent legal development occurred on 1 June 2022, when the revised Vertical Block Exemption Regulation (VBER) and accompanying guidelines (namely, the new EU Competition rules for all vertical agreements, including franchise agreements) entered into force. As the VBER provides a safe harbour for vertical agreements, both the VBER and the related Vertical Guidelines are to be taken into account when setting up franchise systems. Generally, franchising is a different kind of animal compared to other kinds of distribution systems in terms of uniformity (business name and business methods are

required for the functioning of franchising systems and thus, as far as necessary, fall outside the scope of article 101(1) of the Treaty; see Vertical Guidelines 2022, paragraph 166). Franchise agreements are exempt under the VBER as long as neither the franchisor's nor the franchisee's market share exceeds 30 per cent and the agreement is free from the hardcore restrictions set out in article 4 of the VBER. The basic rules that apply to franchise agreements under the new VBER insofar are very similar to the previous VBER of 2010. The new VBER, however, grants more leeway as regards protecting exclusive and selective distribution systems, while it provides more rules for online intermediation services. In the case of dual distribution (namely, where the franchisor competes with its franchisees on the retail level through the franchisor's own operated stores), the strict rules on information exchange under article 2(4) and (5) of the VBER need to be observed: the exchange of information shall be directly related to the implementation of the vertical agreement and necessary to improve the production or distribution of the contract goods or services to be exempt. The Commission in the Vertical Guidelines (paragraphs 99 and 100) provides non-exhaustive lists of examples that are either likely or unlikely to fulfil these criteria. For an overview, see Rohrßen, ZVertriebsR 2021, 293–298 and Rothermel/Rohrßen, IHR 2022, 221–230; for details see Rohrßen, VBER 2022: EU Competition Law for Vertical Agreements (Springer, 2023).

For the rest, no, there are currently no concrete proposals for regulating the franchising business in Germany. Instead, the most recent discussions, which reached the German parliament in 2011 via a petition, have petered out. This is also due to the results of a comparative study on franchise laws that concludes that the German courts have established a rather clear case law that reduced the typical information disparity between franchisors and franchisees. This, again, resulted in relatively few issues reaching the courts, compared to other countries where statutory rules apply (Gesmann-Nuissl, Internationales Franchiserecht, 2019, p18) – and also compared to distribution systems that rely on other intermediaries (eg, commercial agents or distributors).

Since 2020, German retail in general, and franchise businesses in particular, have suffered hefty downturns due to the covid-19 pandemic. Consequently, many franchisors have been forced to consider whether to permanently close down those shops where business is stagnant (especially those that were not thriving already before the pandemic). For others, however, it opened the door to reinvention and entrepreneurship. Both the latest survey of the German Franchise Association eV and the ongoing growth and rising sales figures of the franchise industry in 2023 show that, even in a period of multiple crises (including the uncertainties resulting from the war in Ukraine and conflict in the Middle East), the franchise industry in Germany has continued to develop at a positive level. Market trends indicate that there are particularly high chances for growth in the home services, education and training, skilled trades, and healthcare sectors – including, in particular, tech-related franchises like electronic device repair, business tech consulting and digital marketing services.

Law stated - 11 June 2024

TaylorWessing

Benedikt Rohrßen
Giorgia Carandente

b.rohrssen@taylorwessing.com
g.carandente@taylorwessing.com

Taylor Wessing

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MARKET OVERVIEW

Franchising in the market

- 1 | How widespread is franchising in your jurisdiction? In which sectors is franchising common? Are there any economic or regulatory issues in the market that are more or less hospitable to franchising or make it economically viable in your jurisdiction?

With a population of approximately 1.42 billion people, India has one of the biggest franchise markets in the world. Several studies estimate that the market has been growing at a rate of over 30 per cent over the past five years and is expected to maintain this rate of growth over the next two years, with estimates of the market value reaching US\$140 billion to US\$150 billion.

In India, franchising is common in the food and beverages, hotels, healthcare and wellness, and education sectors.

India does not have any franchise-specific laws or bodies to regulate franchise businesses and franchise agreements are mostly contractual in nature. Currently, there are no perceived regulatory or economic issues that are likely to impede the growth of franchises in India.

Law stated - 22 May 2024

Associations

- 2 | Are there any national or local franchise associations? What is their role in franchising, including any impact on laws or regulations? Are there any rules of conduct or membership requirements?

Yes, there are several privately run franchising associations in India, membership of which is voluntary. The Indian Franchise Association and the Franchising Association of India are two such associations.

These associations primarily provide a platform for stakeholders to network and discuss issues facing the industry. Certain associations also assist stakeholders with finance-raising, market insights and business solutions.

Generally, each association has its own code of conduct or by-laws for its members.

Law stated - 22 May 2024

BUSINESS OVERVIEW

Types of vehicle

- 3 | What forms of business entities are relevant to the typical franchisor?

The choice of business entity relevant to a franchisor depends on the residential status of the franchisor.

A company established under the [Companies Act 2013](#) (CA) or a limited liability partnership (LLP) established under the [Limited Liability Partnership Act 2008](#) (the LLP Act) are the two most common forms of business entities used by Indian franchisors. An Indian franchisor may also conduct business by setting up a partnership firm under the [Partnership Act 1932](#) or as a sole proprietorship firm. Several factors are considered when deciding the most suitable form of business entity, including the need for external investments, ease of regulatory compliance and taxation.

It is not mandatory for foreign franchisors to form a business entity in India to grant franchise rights to Indian parties. Foreign franchisors can enter into a direct franchise agreement with Indian franchisees. The government's [Foreign Direct Investment Policy](#) (the FDI Policy) prescribes the forms of business entity that foreign parties can establish in India. Under the FDI Policy, a foreign franchisor may set up a company under the CA or an LLP under the LLP Act.

Law stated - 22 May 2024

Regulation of business formation

4 | What laws and agencies govern the formation of business entities?

The CA and the LLP Act govern the formation of companies and limited liability partnerships, respectively. The Ministry of Corporate Affairs is the primary government agency responsible for administration of the CA and the LLP Act.

In addition to the CA and the LLP Act, the FDI Policy and the Foreign Exchange Management Act 1999 and its accompanying regulations are relevant as they prescribe the conditions for making foreign investments in India, including the forms of business entity that can be established.

Indian franchisors may also set up a partnership firm under the Partnership Act 1932, which governs partnership businesses in India.

Law stated - 22 May 2024

Requirements for forming a business

5 | Provide an overview of the requirements for forming and maintaining a business entity.

Each form of business entity is governed by separate legislation that prescribes the specific requirements for forming and maintaining such an entity. For the purposes of this section, we will briefly discuss the requirements for incorporating a private limited company in India, which is the most common form of business undertaking.

The CA regulates the incorporation of companies. There are different categories of companies, such as private limited, public limited companies and one-person companies. There could be further classifications within these categories depending on the liability of shareholders.

At least two shareholders are required to set up a private limited company. The shareholders can be an individual or a body corporate. Furthermore, the CA requires a private limited company to have at least two directors, one of which must be an Indian resident.

The process for incorporation of a private limited company involves several steps, which includes preparation of the by-laws (namely, the articles of association (AOA) and the memorandum of association (MOA)), submission of applications to the Ministry of Corporate Affairs for reservation of name of the proposed company, grant of director identification numbers to the proposed directors, and submission of by-laws with the jurisdictional Registrar of Companies. The AOA contain the by-laws of a company and the MOA provides for business objects, the authorised and paid-up share capital, and the number and value of shares subscribed by the initial shareholders of the company. The process for incorporation of a company is exhaustive and several declarations and undertakings must be provided by the directors and shareholders of the prospective company. The declarations primarily relate to the directors' interest in any other business outside the proposed company and any prior conviction of the proposed directors and shareholders in any offence in connection with the promotion, formation or management of any other company in India. It takes between 30 days and two months to form a company in India.

Once a company is established, it must comply with the CA, which, inter alia, requires a company to hold at least four meetings of directors and one annual meeting of shareholders in a fiscal year. All companies are required to maintain statutory registers, including registers of shareholders, directors, fixed assets, share transfers, directors' interests in other businesses, and the minutes of the directors' and shareholders' meetings. In addition to the CA, a company is subject to other legislation covering labour and employment, foreign exchange, indirect tax and income tax.

Law stated - 22 May 2024

Restrictions on foreign investors

6 | What restrictions apply to foreign business entities and foreign investment?

The FDI Policy set out by the Department for Promotion of Industry and Internal Trade dictates the sectors that are open for foreign investments and the conditions subject to which foreign investments can be made in India, including the nature of business entities that can be established by foreign residents in India. There are certain sectors that are prohibited from receiving foreign investments. These sectors include real estate, lottery and chit-fund businesses. Although the government has liberalised the foreign investment regime and most sectors are now open for foreign investment up to 100 per cent without any need for prior government approval, there are certain sectors where prior approval is required. For example, government approval is required for foreign investments in

a business operating in the defence sector when the overall foreign investment in the business exceeds 74 per cent. Similarly, any foreign investment in a multi-brand retail trading business requires prior government approval. There are certain sectors in which foreign investment is not permitted beyond a prescribed threshold, such as the print media sector and multi-brand retail trading, where foreign investment is capped at 26 per cent and 51 per cent, respectively. Additionally, the FDI Policy also imposes additional compliance conditions and requirements for FDI in some sectors where up to 100 per cent FDI without government approval is allowed. For example, an Indian company with foreign investment beyond 51 per cent engaged in single-brand retail trading must source 30 per cent of products locally in India.

The FDI Policy should be studied prior to making any foreign investments or setting up an entity to understand the restrictions that may be applicable to the proposed transaction.

Law stated - 22 May 2024

Taxation

7 | What aspects of the tax system are relevant to franchisors? How are foreign businesses and individuals taxed?

The Income-Tax Act 1961 (the IT Act) is the primary legislation on income taxes. The IT Act requires Indian franchisees to deduct the prescribed withholding tax on royalties, service fees and other payments made to franchisors.

The IT Act prescribes different withholding tax rates for different categories of services and these rates change from year to year.

India has signed double taxation avoidance agreements (DTAA) with various countries. The IT Act provides that withholding tax should be deducted at the rate prescribed in the IT Act or the relevant DTAA of the home country of the foreign resident, whichever is more beneficial to the foreign resident.

Goods and services tax (GST), which is the primary indirect tax, applies uniformly across India. GST is applicable on royalties and service fees. In an arrangement where both the franchisor and the franchisee are Indian, the franchisor charges GST from the franchisee along with royalty or service fees, and subsequently deposits the GST with the tax department. However, in a cross-border franchise agreement between an Indian franchisee and a foreign franchisor, the foreign party is not required to charge or collect GST, but the Indian franchisee is liable to pay GST directly to the Indian tax department under the reverse charge mechanism.

Law stated - 22 May 2024

Labour and employment

8 | Are there any relevant labour and employment considerations for typical franchisors?

No, unless the franchisor establishes an entity in India and employs people directly. Typically, employment and labour laws do not apply in a franchisor-franchisee relationship. It is unlikely that a franchisee would be deemed an employee of its franchisor.

Law stated - 22 May 2024

Intellectual property

9 | How are trademarks and other intellectual property and know-how protected?

There are various ways in which intellectual property (IP) can be safeguarded in India, with both common law and domestic legislation covering the protection and enforcement of IP rights. For instance, trademarks are protected under the [Trade Marks Act 1999](#), and copyrights, patents and industrial designs have their own dedicated statutes. The Trade Marks Act 1999 does not require franchisors to register or disclose their licences granted to their franchisees. That said, the Trade Marks Act 1999 does provide for the recordation of a registered user, which is a party other than the brand owner itself authorised to use a registered trademark in India. The Trade Marks Act 1999 lays out actions for the infringement of registered trademarks and for the passing-off of unregistered marks under common law. Remedies for infringement and passing off typically include injunctions, damages, account-of-profits and search-and-seizure in anti-counterfeiting cases. Interestingly, in India, trademark infringement can be subject to both civil and criminal action.

There is currently no dedicated legislation for the protection of know-how. Instead, know-how and trade secrets are generally protected and enforced through contractual arrangements. A typical franchise agreement with an Indian franchisee should contain robust confidentiality obligations, as well as provisions setting out what constitutes the franchisor's trade secrets and the consequences of their misuse. Separate non-disclosure agreements can also be considered during the process of vetting and negotiating with potential franchisees.

Law stated - 22 May 2024

Real estate

10 | What are the relevant aspects of the real estate market and real estate law? What is the practice of real estate ownership versus leasing?

Indian franchisors and franchisees are free to either own or lease business premises. The property price or lease rent for a business space varies from city to city depending on supply and demand.

The major legislation that regulates real estate transactions are the [Transfer of Property Act 1882](#), the [Registration Act 1908](#), the Indian Contract Act 1872, and state-specific stamp duty and rent control legislation. The law requires in most cases that real estate agreements

be made in writing and registered with the local authority after payment of the appropriate stamp duty or tax.

In many franchise agreements, franchisors retain the right to acquire the assets of the franchise business upon termination of the franchise agreement. The Foreign Exchange Management Act 1999 and the regulations framed therein prohibit a foreign entity from acquiring any immovable property in India without setting up a local entity in India. A foreign franchisor that wants to acquire an immovable property from its Indian franchisee must establish a business entity in India.

Law stated - 22 May 2024

Competition law

11 | What aspects of competition law are relevant to the typical franchisor in your jurisdiction? How is competition law enforced in the franchising sector?

The [Competition Act 2002](#) is the primary antitrust legislation in India. Although the Act does not have any express provisions in the context of franchisor-franchise relationships, it prohibits enterprises or persons at different stages of the production chain from entering into an arrangement for the production, supply, distribution, acquisition or control of goods, or provision of services that will cause an appreciable adverse effect on competition.

Exclusive supply and distribution supply agreements, agreements for refusal to deal, or resale price maintenance between enterprises at different stages or levels of the production chain can be declared void when such agreements cause an appreciable adverse effect on competition in India.

The restrictions commonly imposed under a franchise agreement are not deemed anticompetitive per se if they are reasonable and aim to enhance the standard, efficiency and uniformity of a franchise system. However, the Competition Commission of India, on receipt of complaints, may examine the reasonableness of the restrictions contained in a franchise agreement on a case-by-case basis.

Law stated - 22 May 2024

OFFER AND SALE OF FRANCHISES

Legal definition

12 | What is the legal definition of a franchise?

There is no legal definition of a franchise under Indian law.

Law stated - 22 May 2024

Laws and agencies

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13 | What laws and government agencies regulate the offer and sale of franchises?

There is no law or government agency that regulates the offer and sale of franchises in India.

Law stated - 22 May 2024

Principal requirements**14** | What are the principal requirements governing the offer and sale of franchises under the relevant laws?

There are no specific laws governing offer and sale of franchises in India. The Indian Contract Act 1872 has provisions regarding the offer and acceptance of a contract in general and these would apply in respect of franchise agreements as well.

Law stated - 22 May 2024

Franchisor eligibility**15** | Must franchisors satisfy any eligibility requirements in order to offer franchises? Are there any related practical issues or guidelines that franchisors should consider before offering franchises?

No, Indian law does not prescribe any specific eligibility requirements that a franchisor should meet before offering franchises in India. Franchisors should meet the general requirements regarding competency to contract. The Indian Contract Act 1872 requires a person to be of sound mind, and at least 18 years of age. The person should not be disqualified from entering into a contract under any other specific law of the land to which he or she is subject. Additionally, the contract should be made for a lawful consideration, lawful object, and with the free will of the involved parties.

Law stated - 22 May 2024

Franchisee and supplier selection**16** | Are there any legal restrictions or requirements relating to the manner in which a franchisor recruits franchisees or selects its or its franchisees' suppliers? What practical considerations are relevant when selecting franchisees and suppliers?

No, Indian law does not prescribe any requirements relating to the manner in which a franchisor should select or recruit franchisees or suppliers.

Law stated - 22 May 2024

Pre-contractual disclosure – procedures and formalities

- 17 | What procedures and formalities for pre-contractual disclosure are required or advised in your jurisdiction? How often must the disclosures be updated?

Franchisors are not required to make any pre-contractual disclosures to franchisees or government agencies prior to the sale of a franchise in India. However, franchisors must not make false representations regarding the franchised business.

Law stated - 22 May 2024

Pre-contractual disclosure – content

- 18 | What information is the disclosure document required or advised to contain?

Franchisors are not required to make any pre-contractual disclosures to franchisees or government agencies prior to the sale of a franchise in India.

Law stated - 22 May 2024

Pre-sale disclosure to sub-franchisees

- 19 | In the case of a sub-franchising structure, who must make pre-sale disclosures to sub-franchisees? If the sub-franchisor must provide disclosure, what must be disclosed concerning the franchisor and the contractual or other relationship between the franchisor and the sub-franchisor?

No such disclosures are required to be made to sub-franchisees.

Law stated - 22 May 2024

Due diligence

- 20 | What due diligence should both the franchisor and the franchisee undertake before entering a franchise relationship?

Although not mandatory, it is recommended that franchisors carry out proper due diligence on a prospective franchisee to ensure that it:

- meets the franchisor's eligibility conditions for the business in the relevant territory;
- has good standing and is legally compliant with applicable laws; and
- has adequate net worth to operate and scale the franchise business.

From the franchisee's perspective, it should be ensured that the franchisor is solvent and that there is no pending litigation or any adverse event that may affect business in the applicable territory.

Law stated - 22 May 2024

Failure to disclose – enforcement and remedies

- 21 | What actions may franchisees or any relevant government agencies take in response to a franchisor's failure to make required disclosures? What legal remedies are available? What penalties may apply?

Indian law does not require a franchisor to make any pre-sale disclosure to its franchisees or to any government agencies regarding the sale of a franchise business. However, if any false representations are made, the franchisee has the option of civil action and may claim damages.

Law stated - 22 May 2024

Failure to disclose – apportionment of liability

- 22 | In the case of sub-franchising, how is liability for disclosure violations shared between franchisor and sub-franchisor? Are individual officers, directors and employees of the franchisor or the sub-franchisor exposed to liability? If so, what liability?

Indian law does not require franchisors or sub-franchisors to make any disclosure to sub-franchisees regarding the sale of a franchise business.

Law stated - 22 May 2024

General legal principles and codes of conduct

- 23 | In addition to any laws or government agencies that specifically regulate offering and selling franchises, what general principles of law affect the offer and sale of franchises? What industry codes of conduct may affect the offer and sale of franchises?

There is no specific law in India that regulates the offer and sale of a franchise. The franchise arrangements are purely contractual. Under Indian law, a contractual arrangement must not be based on misrepresentation, fraud or undue influence.

Law stated - 22 May 2024

Fraudulent sale

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- 24** | What actions may franchisees take if a franchisor engages in fraudulent or deceptive practices in connection with the offer and sale of franchises?

Under the Indian Contract Act 1872, a franchisee who is subject to any misrepresentation, fraud, or undue influence may set aside the franchise agreement and make a claim for damages.

The franchisee may also file a complaint against the franchisor for an offence of cheating under the Indian Penal Code where there is adequate evidence to prove that the franchisor acted fraudulently or dishonestly with criminal intent.

Law stated - 22 May 2024

FRANCHISE CONTRACTS AND THE FRANCHISOR/FRANCHISEE RELATIONSHIP

Franchise relationship laws

- 25** | What laws regulate the ongoing relationship between franchisor and franchisee after the franchise contract comes into effect?

There is no franchise-specific law in India and franchisor-franchisee relationships are governed by the franchise agreement. In addition to the franchise agreement, involved parties are subject to a number of other laws, such as foreign exchange control regulations, antitrust laws, intellectual property laws, tax regulations, data privacy laws, and, anti-corruption legislation.

Law stated - 22 May 2024

Operational compliance

- 26** | What mechanisms are commonly incorporated in agreements to ensure operational consistency and adherence to brand standards?

Franchisors incorporate a number of provisions in the franchise contract to protect brand and quality standards and bring about uniformity in operational efficiencies. Such provisions include a franchisor's right to inspect the franchisee's business and premises, the right to audit the franchisee's books of accounts, conditions for the appointment of suppliers, and conditions that should be met prior to opening new stores.

Law stated - 22 May 2024

Amendment of operational terms

- 27** | May the franchisor unilaterally change operational terms and standards during the franchise relationship?

Under Indian law, a franchisor cannot unilaterally change operational terms and standards during the franchise relationship. Any change must be recorded in writing with mutual consent.

Law stated - 22 May 2024

Policy affecting franchise relations

28 | Do other government or trade association policies affect the franchise relationship?

The policies of trade associations do not affect the franchise relationship.

However, changes in government policy could have an impact on franchise relationships. For example, a change in tax policy or payment regulations may impact the franchise relationship.

Law stated - 22 May 2024

Termination by franchisor

29 | In what circumstances may a franchisor terminate a franchise relationship? What are the specific legal restrictions on a franchisor's ability to terminate a franchise relationship?

Franchisors can terminate a franchise agreement as per the terms and conditions agreed in the agreement. Any termination of a franchise agreement outside the framework of the agreed terms may be deemed a breach of the agreement.

Law stated - 22 May 2024

Termination by franchisee

30 | In what circumstances may a franchisee terminate a franchise relationship?

Since a franchisor-franchisee relationship is contractual, a franchisee can terminate the franchise agreement as per the terms agreed in the agreement. Any termination of a franchise agreement outside the framework of the agreed terms may be deemed as a breach of the agreement.

A franchisee that is subject to any misrepresentation, fraud or undue influence has the option to terminate the agreement and claim damages.

Law stated - 22 May 2024

Renewal

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- 31** | How are renewals of franchise agreements usually effected? Do formal or substantive requirements apply?

Because a franchisor-franchisee relationship is contractual, the conditions for renewal are usually provided in the agreement. In cases where a franchise agreement does not contain any provisions for renewal of the agreement, both parties must mutually agree to renew the agreement. Substantive law does not prescribe any conditions for renewal of franchise agreements.

Law stated - 22 May 2024

Refusal to renew

- 32** | May a franchisor refuse to renew the franchise agreement with a franchisee? If yes, in what circumstances may a franchisor refuse to renew?

Franchisors must renew franchise agreements if they contain legally binding renewal provisions and where the conditions for renewal are met. A franchisor can refuse to renew a franchise agreement when the agreement does not obligate the franchisor to do so, or in cases where the franchisee has failed to meet the eligibility criteria prescribed for renewal of the franchise agreement.

Law stated - 22 May 2024

Transfer restrictions

- 33** | May a franchisor restrict a franchisee's ability to transfer its franchise or restrict transfers of ownership interests in a franchisee entity?

Yes, a franchisor may contractually restrict its franchisee from transferring the business. A franchisor may also restrict the owners of its franchise entity from transferring their ownership interest in the franchise entity. Such restrictions should be unequivocally and expressly stated in the franchise agreement.

Law stated - 22 May 2024

Fees

- 34** | Are there laws or regulations affecting the nature, amount or payment of fees?

Currently, Indian law does not regulate the nature or amount of fees that could be paid by Indian franchisees to their franchisors.

Law stated - 22 May 2024

Usury

- 35** | Are there restrictions on the amount of interest that can be charged on overdue payments?

Although there is no restriction on the amount of interest that can be charged on overdue royalties, the Reserve Bank of India (RBI) prescribes the maximum amount of interest that can be charged by a foreign party in respect of overdue service fees. The maximum interest rate that can be charged on overdue payments for services is the benchmark rate plus 300 basis points spread. The benchmark rate is widely accepted interbank rates applicable to the currency of the transaction. The maximum permissible rate of interest is occasionally adjusted by the RBI and is therefore subject to change.

Law stated - 22 May 2024

Foreign exchange controls

- 36** | Are there laws or regulations restricting a franchisee's ability to make payments to a foreign franchisor in the franchisor's domestic currency?

The prevailing Foreign Exchange Management Act 1999 and its accompanying regulations and notifications do not restrict a franchisee from making payments to its foreign franchisor in the franchisor's domestic currency.

Law stated - 22 May 2024

Confidentiality covenant enforceability

- 37** | Are confidentiality covenants in franchise agreements enforceable?

Confidentiality covenants in franchise agreements are generally enforceable, provided such covenants are reasonable and have a well-defined scope.

Law stated - 22 May 2024

Good-faith obligation

- 38** | Is there a general legal obligation on parties to deal with each other in good faith during the term of the franchise agreement? If so, how does it affect franchise relationships?

The Indian Contract Act 1872 does not expressly incorporate the doctrine of good faith. However, some courts, for instance, the Gauhati High Court in the case of [The Food Corporation of India and others v M/s Anup Trade And Transport \(P\) Limited and others \(Case No. WA 36/2020\)](#), have opined that every contract inherently

includes the principle of good faith. Therefore, Franchisors and franchisees should generally deal in good faith.

Law stated - 22 May 2024

Franchisees as consumers

39 | Does any law treat franchisees as consumers for the purposes of consumer protection or other legislation?

The [Consumer Protection Act 2019](#) (CPA) is the primary consumer protection legislation in India. The term 'consumer' as defined in the CPA expressly excludes persons who purchase goods or services for commercial purposes. Therefore, it is improbable that franchisees could be treated as consumers.

Law stated - 22 May 2024

Language of the agreement

40 | Must disclosure documents and franchise agreements be in the language of your country?

There is no legal requirement for disclosure documents. Furthermore, the law does not require franchise agreements to be in a specific local language. The agreement can be drawn in any language mutually agreed on by the parties.

Law stated - 22 May 2024

Restrictions on franchisees

41 | What types of restrictions are commonly placed on the franchisees in franchise contracts?

The restrictions that are commonly imposed on franchisees are contractual in nature and includes:

- restrictions on business activities outside the applicable territory;
- non-compete restrictions;
- confidentiality obligations;
- restrictions on transfer of ownership interest in the franchise entity;
- restrictions on transfer of assets and franchise business to a third party without first offering to the franchisor; and
- restrictions on the franchisees to procure raw materials from unauthorised vendors.

Law stated - 22 May 2024

Courts and dispute resolution

42 | Describe the court system. What types of dispute resolution procedures are available relevant to franchising?

India has a unified judicial system, with the Supreme Court at the top of the hierarchy followed by the high courts of each state. The district court is positioned below the state's high court and is followed by various subordinate courts. In addition to the regular civil courts, various tribunals (including appellate tribunals) have been set up for specialised matters, such as income taxes, debt recovery, intellectual property and company law. Appeals from the orders of these tribunals lie with either the designated appellate tribunals, the state's high court or the Supreme Court, as the case may be.

Each court in India, except the Supreme Court, has a defined territorial limit over which it can exercise its jurisdiction. Furthermore, a pecuniary limit has been prescribed for all district and subordinate courts, and a court cannot exercise jurisdiction over a matter whose value exceeds the pecuniary limit set for that court. Generally, subject to the applicable pecuniary limit, a suit should be filed in the court that has jurisdiction over the place where the cause of the action arose, or where the defendant resides or carries on its business. Appeals from subordinate courts lie with the state's district court. Similarly, an appeal from a district court can be filed with the state's high court and then with the Supreme Court.

There is a huge pendency of cases in India. On average, it takes approximately five to seven years for the disposal of a suit by the original court and approximately three years in appeal cases.

Indian law does not prescribe a separate set of procedures for the resolution of franchise-specific disputes. If parties to a franchise agreement decide to resolve their dispute in Indian courts, then all such disputes will be resolved according to the [Code of Civil Procedure 1908](#), which applies to all contractual and other civil cases.

Law stated - 22 May 2024

Governing law

43 | Are there any restrictions on designating a foreign governing law in franchise contracts in your jurisdiction? How does the governing law affect the contract's enforceability?

Although Indian law does not expressly prohibit foreign franchisors from agreeing to a foreign governing law in contracts with Indian parties, Indian courts are not comfortable adjudicating disputes under such contracts due to their lack of familiarity with foreign law.

However, a foreign franchisor may opt for a foreign governing law should it decide to resolve disputes through arbitration seated in India or in a foreign country.

Law stated - 22 May 2024

Arbitration – advantages for franchisors

- 44** | What are the principal advantages and disadvantages of arbitration for foreign franchisors considering doing business in your jurisdiction? Are any other alternative dispute resolution (ADR) procedures particularly favoured or disfavoured in your jurisdiction?

Resolution of disputes in Indian courts is likely to result in a protracted litigation owing to a huge backlog of cases and slow disposal rates. Therefore, arbitration of disputes, as opposed to litigation in courts, is preferred.

The [Arbitration and Conciliation Act 1996](#) (the Arbitration Act) governs domestic arbitration, international commercial arbitration and the enforcement of foreign arbitral awards. The Arbitration Act defines an international commercial arbitration as an arbitration involving commercial disputes arising from a legal or contractual relationship between two or more parties, wherein one of the parties is a foreigner.

The parties to an international franchise agreement may opt to arbitrate either in India or outside India in any country that is:

- a signatory to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards or the Geneva Convention on the Execution of Foreign Arbitral Awards; and
- notified as such by the Indian government.

Other than arbitration, there are no effective or binding alternative dispute resolution mechanisms in India.

Law stated - 22 May 2024

National treatment

- 45** | In what respects, if at all, are foreign franchisors treated differently (legally, or as a practical matter) from domestic franchisors?

Indian law does not treat foreign franchisors any differently from domestic franchisors. However, in cross-border franchise agreements, foreign exchange laws may impose certain additional conditions and restrictions, such as those relating to remittances of payments and, acquisition of assets and business by the franchisors in India.

Law stated - 22 May 2024

UPDATE AND TRENDS

Legal and other current developments

- 46** | Are there any proposals for new legislation or regulation, or to revise existing legislation and regulation? Are there other current developments or trends to note?

There are no significant current developments or proposals for revising the existing legislation.

Law stated - 22 May 2024

G&W

LEGAL

Srijoy Das
Anup Kumar
Shivalik Chandan

srijoydas@gnwlegal.com
akumar@gnwlegal.com
shivalik@gnwlegal.com

G&W Legal

[Read more from this firm on Lexology](#)

Israel

Orit Gonen

Gilat Bareket & Co, Reinhold Cohn Group

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UPDATE AND TRENDS

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MARKET OVERVIEW

Franchising in the market

- 1 | How widespread is franchising in your jurisdiction? In which sectors is franchising common? Are there any economic or regulatory issues in the market that are more or less hospitable to franchising or make it economically viable in your jurisdiction?

Franchising is common in the Israeli market, especially in the food and beverage industry, and in merchandising, especially in the apparel and fashion industry. The Israeli market welcomes franchising, and there are no regulatory issues that have a negative effect on franchising relationships.

Law stated - 14 May 2024

Associations

- 2 | Are there any national or local franchise associations? What is their role in franchising, including any impact on laws or regulations? Are there any rules of conduct or membership requirements?

The Israel Franchise Promotion Centre, established in 2001, is a voluntary centre that promotes franchising in Israel. All members of the organisation are subject to an ethics code that aims to ensure the ethical management of franchise businesses. There is no membership requirement.

A few more institutes also promote franchising and provide services in respect of franchising.

Law stated - 14 May 2024

BUSINESS OVERVIEW

Types of vehicle

- 3 | What forms of business entities are relevant to the typical franchisor?

Most franchisors in Israel are incorporated companies (mostly private limited liability and domestic) or partnerships. Franchisors are rarely self-employed individuals.

Law stated - 14 May 2024

Regulation of business formation

- 4 | What laws and agencies govern the formation of business entities?

Business entities such as companies (including branches) or partnerships are formed under the [Companies Law 1999](#) or the Partnership Ordinance 1975, respectively, and are registered in the respective register. As for partnerships those have to be registered under the Partnership Ordinance (New Version) 1975 to do business in Israel. The registration of a partnership intending to do business is compulsive however lack of registration does not affect the existence of the partnership.

Law stated - 14 May 2024

Requirements for forming a business

- 5 | Provide an overview of the requirements for forming and maintaining a business entity.

Establishing a business entity in Israel requires establishing a company (or partnership). Any international company wishing to conduct business in Israel should be registered either as a branch or by way of establishing a subsidiary. In any case, a local address is required.

Upon commencement of its activity, the business should be registered with the relevant tax authorities. Maintaining a corporation is subject to annual fees and submission of annual reports approved by the company board of directors.

Under the Companies Law 1999, local Israeli companies and branches of foreign entities are under the obligation to appoint a certified public accountant (CPA) or an accounting firm serving as independent auditor. The CPA is appointed by the shareholders of the company in its annual general shareholder's meeting.

Law stated - 14 May 2024

Restrictions on foreign investors

- 6 | What restrictions apply to foreign business entities and foreign investment?

All foreign entities wishing to do business in Israel should establish a subsidiary or branch. Foreign entities are required to provide a local address. Foreign investments should comply with anti-money laundering regulations.

Unless dealing with defence or banking, there are no restrictions on foreign ownership of a business entity. Any foreign business entity or person starting to conduct business in Israel must appoint a local value added tax (VAT) representative whose permanent place of residence is in Israel and who assumes full responsibility for handling all VAT matters, if applicable.

Law stated - 14 May 2024

Taxation

- 7 |

What aspects of the tax system are relevant to franchisors? How are foreign businesses and individuals taxed?

Incorporated businesses are subject to regular income tax (corporate tax) imposed on taxable transactions. Certain transactions trigger payment of VAT.

As of 2018, Israel is party to over 50 double tax treaties, essentially following the Organisation for Economic Co-operation and Development model. A foreign resident entity may be exempt from corporate tax to the extent that its activities do not constitute a permanent establishment under an applicable tax treaty. There is no detailed legislation or Israeli court decision that provides a clear test under which it is possible to determine whether a non-resident has a taxable presence under Israeli tax law; thus, where there is no tax treaty protection, a non-resident is subject to tax on income accrued or derived in Israel.

Tax is calculated based on the actual income of the business entity or person from its activity in Israel. Income tax is paid on an annual basis and may be subject to payments on account. VAT, when applicable, is paid on a monthly or bimonthly basis, depending on the scope of the transactions.

A branch of a non-Israeli entity is taxed in Israel on the profits the branch derives from its Israeli activities, while a local subsidiary is generally taxed on its worldwide income. The rate of income tax imposed on corporations in Israel is currently 23 per cent, and the Israeli profits of a branch are subject to that rate.

Social security payments are relevant to a business entity doing business in Israel and hiring personnel.

The Supreme Court has held that payment of royalties or management fees by the franchisee to the franchisor will be considered as part of the purchase price of the goods and taken into account in calculating the custom fees due by the franchisee when those payments are a precondition to the purchase of the goods by the franchisee from the franchisor. This decision may affect the financial negotiations between franchisors and franchisees.

Law stated - 14 May 2024

Labour and employment

8 | Are there any relevant labour and employment considerations for typical franchisors?

Generally, a franchisor's employment relationship with its employees working in Israel is subject to Israeli law. Parties to an employment agreement may determine a different governing law; however, Israeli labour courts seldom apply foreign law when the law is less favourable to employees working in Israel than Israeli law.

As long as a clear separation between the franchisee and the franchisor is kept under the franchise agreement and is de facto, the risk that the franchisee's employees will be considered as the franchisor's employees is low. A franchise agreement should include

a specific indemnification clause to reduce the franchisor's risk of being liable for any payments to the franchisee's employees.

Law stated - 14 May 2024

Intellectual property

9 | How are trademarks and other intellectual property and know-how protected?

Any domestic or foreign franchisor may apply to register its trademarks for goods and services with the Israeli trademark office to ensure its exclusive right to use it. The trademark registration is valid as long as it is used in Israel and at least three years thereafter unless it is obvious there is no intention to use it in Israel any more.

The licence granted to the franchisee to use the franchisor's trademarks should be recorded with the Trademark Register for validation and to ensure that use of the trademark by the franchisee is attributed to its registered owner.

The [Trademarks Ordinance](#) also provides for the enforcement of non-registered trademarks. Know-how is protected as either a patent (provided it is patentable and registrable) or a trade secret under the [Commercial Torts Law 1999](#). For the sake of enforcing the protection, the know-how should be kept a secret. Once it reaches the public domain, the know-how is no longer protectable. It is advisable to address the matter of domain name (.il) allocation as part of the franchise agreement.

Law stated - 14 May 2024

Real estate

10 | What are the relevant aspects of the real estate market and real estate law? What is the practice of real estate ownership versus leasing?

There are no legal restrictions relating to foreign or domestic franchisors in respect of purchasing or leasing real estate.

Law stated - 14 May 2024

Competition law

11 | What aspects of competition law are relevant to the typical franchisor in your jurisdiction? How is competition law enforced in the franchising sector?

Competition in the Israeli market is regulated under the Commercial Competition Law 1988 (formerly known as the Restrictive Trade Practice Law). Franchise agreements are exempted from the prohibitions under the Law in accordance with a specific block exemption unless:

- the parties to the agreement are actual competitors;
- a party has monopoly power in the relevant product market or in an adjacent market;
or
- the agreement's duration is 10 years or longer.

Franchise contracts, which are covered unless the franchisee's market share exceeds 30 per cent, can control resale prices without restriction and may also restrict the franchisee from engaging in active sales promotion outside the assigned franchise territory.

The block exemption on franchise agreements protects ancillary restrictions included in a franchise agreement, provided that the restrictions are required for the realisation of its objective and do not cause substantial harm to competition.

The block exemption on franchise agreements further disqualifies certain terms barring the franchisee.

The Israel Competition Authority oversees enforcement of the law when it is violated. The enforcement proceedings begin with an investigation, which may lead to financial sanctions or criminal charges.

The franchise agreement should be carefully drafted to comply with the exemption for franchise agreements.

In September 2023, the Economic Competition Law was amended for the sake of regulating the issue of parallel imports in the aspect of economic competition. The main purpose of the amendment is to prevent harm to competition by way of thwarting or reducing competition from parallel imports by an authorised or licensed importer of goods. This amendment to the law applies to franchise agreements as well once the franchisee is the exclusive or authorised importer of the goods in question. It is thus important to take this amendment into consideration once a franchise agreement is drafted.

Law stated - 14 May 2024

OFFER AND SALE OF FRANCHISES

Legal definition

12 | What is the legal definition of a franchise?

There is no specific legislation regulating franchises in Israel. The only definition of 'franchise agreement' in Israeli legislation can be found in regulations enacted under the Commercial Competition Law 1988, which provide a block exemption to franchise agreements under certain circumstances. The definition of 'franchise agreement' in the regulations is as follows:

[a] contract under which a franchisor grants the franchisee the right to use the franchise for the purposes of marketing certain goods or types of goods, including each of the following:

- (1) use of a uniform trade name or trademark or service mark, and uniform characteristics of the goods being sold or of the sale and execution, which are material to the marketing and sale of the goods;
- (2) transfer of knowledge from the franchisor to the franchisee, which is material to the marketing and sale of the goods;
- (3) commercial or technical assistance from the franchisor to the franchisee, during the term of the agreement.

Law stated - 14 May 2024

Laws and agencies

13 | What laws and government agencies regulate the offer and sale of franchises?

Israel has no specific laws or regulations for franchises. Franchises in Israel are regulated under contract laws, intellectual property laws and commercial competition law, as well as case law. No government agency regulates franchises in Israel.

Franchise agreements may be exempted from the Commercial Competition Law 1988 under a block exemption and are, thus, not considered restrictive arrangements banned under the Law, provided that the agreements comply with the requirements in the rules for franchise agreements.

The exemption under those rules will not apply where:

- the parties to the agreement are actual competitors;
- a party has monopoly power in the relevant product market or in an adjacent market;
- the agreement's duration is 10 years or longer; or
- the agreement includes restrictive stipulations, such as:
 - restriction of the franchisor from using licensed know-how after the term of the agreement, even when the know-how is in the public domain;
 - prevention of the franchisee from initiating judicial review of the validity of the rights in know-how transferred from the franchisor to the franchisee or other intellectual property rights;
 - prevention of the franchisee from selling or supplying goods to consumers outside the territory defined in the agreement; and
 - other restrictions that are only meant to reduce competition or are not necessary to fulfil its principal.

The Commercial Competition Law 1988 deems arrangements whose restrictions involve the right to use a patent, trademark, copyright or proprietary right as not restrictive, provided that the arrangement is made between the owner of the right and the party who receives

authorisation to use the right and where the right is subject to registration by law and is registered accordingly.

Law stated - 14 May 2024

Principal requirements

- 14** | What are the principal requirements governing the offer and sale of franchises under the relevant laws?

The offer and sale of franchise agreements are regulated under the general contract laws.

Law stated - 14 May 2024

Franchisor eligibility

- 15** | Must franchisors satisfy any eligibility requirements in order to offer franchises? Are there any related practical issues or guidelines that franchisors should consider before offering franchises?

There are no such requirements or guidelines.

Law stated - 14 May 2024

Franchisee and supplier selection

- 16** | Are there any legal restrictions or requirements relating to the manner in which a franchisor recruits franchisees or selects its or its franchisees' suppliers? What practical considerations are relevant when selecting franchisees and suppliers?

There are no specific rules or laws for franchisee selection unless the franchisor is a local government or public body subject to the Mandatory Tender Act 1992.

Law stated - 14 May 2024

Pre-contractual disclosure – procedures and formalities

- 17** | What procedures and formalities for pre-contractual disclosure are required or advised in your jurisdiction? How often must the disclosures be updated?

There are no requirements in respect of pre-contractual disclosure except under the general contract law, which requires that the parties negotiate in good faith. There is no specific requirement for updating the disclosure, except if the requirement derives from the duty of the parties to act in good faith for the duration of the agreement.

Law stated - 14 May 2024

Pre-contractual disclosure – content

18 | What information is the disclosure document required or advised to contain?

Under general contract law, each party is under the duty to disclose information, the non-disclosure of which might be considered as bad faith or might mislead the other party. When a due diligence process is initiated, all questions posed should be responded to in full transparency.

Law stated - 14 May 2024

Pre-sale disclosure to sub-franchisees

19 | In the case of a sub-franchising structure, who must make pre-sale disclosures to sub-franchisees? If the sub-franchisor must provide disclosure, what must be disclosed concerning the franchisor and the contractual or other relationship between the franchisor and the sub-franchisor?

There is no specific rule except the requirement to negotiate in good faith. It is advisable to include in the franchise agreement terms and conditions that should be included in a sub-franchising contract.

Law stated - 14 May 2024

Due diligence

20 | What due diligence should both the franchisor and the franchisee undertake before entering a franchise relationship?

Customary due diligence should, as in any other transaction, be undertaken.

Before starting to use a new brand in the Israeli market, parties should clear their right to do so, given that under Israeli law, a person may accrue rights in a trademark through use and be entitled to protection, even if the trademark is not registered. Thorough research of the market should be performed before establishing franchises in the market; a search in the database of the Trademark Register alone is not sufficient.

Law stated - 14 May 2024

Failure to disclose – enforcement and remedies

21 | What actions may franchisees or any relevant government agencies take in response to a franchisor's failure to make required disclosures? What legal remedies are available? What penalties may apply?

Breach of the duty to disclose under the general duty to act in good faith during the pre-contractual period and negotiations entitles the franchisee to damages. The damages are usually punitive, calculated based on the actual loss incurred by the franchisee owing to the negotiations (including full reimbursement of costs); however, in extreme circumstances, such as gross bad faith or intentional deceit, the courts may consider awarding reliance damages calculated on the basis of the expected gain of the franchisee had the agreement been executed.

Law stated - 14 May 2024

Failure to disclose – apportionment of liability

- 22 | In the case of sub-franchising, how is liability for disclosure violations shared between franchisor and sub-franchisor? Are individual officers, directors and employees of the franchisor or the sub-franchisor exposed to liability? If so, what liability?

The response to this question depends on the parties involved in the negotiations of a sub-franchise agreement. If both the franchisor and the franchisee participate in the negotiations, both are under the duty of good faith; thus, if that duty is breached, each of the parties will bear responsibility.

If the share of each of the parties may not be determined, the liability will be borne by both in equal share. Where the franchisor and the franchisee are legal entities, their representative will bear liability in respect of fraud or wilfully misleading acts.

Law stated - 14 May 2024

General legal principles and codes of conduct

- 23 | In addition to any laws or government agencies that specifically regulate offering and selling franchises, what general principles of law affect the offer and sale of franchises? What industry codes of conduct may affect the offer and sale of franchises?

The duty of good faith during negotiations, the culpa in contrahendo principle, is applied under the Contract (General Part) Law 1973. The Law does not prescribe the extent of disclosure and requires each negotiating party to act in a 'customary manner' and in good faith, thus leaving it to the courts to decide.

The Standard Contract Law 1982 applies when franchisors act under standard agreements. Pursuant to this law, the court may find certain terms to be unreasonable practice, unfair or oppressive. The Law further allows franchisors to seek advance approval of its standard agreement. The approval serves as a declaration that the standard terms are not oppressive.

Law stated - 14 May 2024

Fraudulent sale

- 24 | What actions may franchisees take if a franchisor engages in fraudulent or deceptive practices in connection with the offer and sale of franchises?

Given the lack of specific legislation in respect of franchise agreements, a franchisee is considered in the same way as any other party to a contract facing fraudulent or deceptive practices in the framework of negotiations. The law provides for reliance damages; however, in some extreme cases, the Israeli courts have granted performance damages.

Law stated - 14 May 2024

FRANCHISE CONTRACTS AND THE FRANCHISOR/FRANCHISEE RELATIONSHIP

Franchise relationship laws

- 25 | What laws regulate the ongoing relationship between franchisor and franchisee after the franchise contract comes into effect?

There are no specific laws; however, the Israeli courts regard the franchisor-franchisee relationship to be a trust-based relationship and, therefore, rarely enforce the relationship where a loss of trust transpires between them.

Law stated - 14 May 2024

Operational compliance

- 26 | What mechanisms are commonly incorporated in agreements to ensure operational consistency and adherence to brand standards?

Where the franchise agreement provides for royalty payments (rather than the case where the franchisee is reselling the franchisor's goods), it is common to require periodic reports and to allow the franchisor to audit the franchisee's business and inspect its books, especially if the royalties are calculated based on the income of the franchise or any other measurable volume of activity. The franchisor is further entitled to inspect the way its intellectual property is used by the franchisee and compliance with its code and standards.

Law stated - 14 May 2024

Amendment of operational terms

- 27 | May the franchisor unilaterally change operational terms and standards during the franchise relationship?

It depends on the agreement between the parties. Unilateral changes in the agreement terms without a proper mechanism that has been agreed is usually not recognised under Israeli law unless the change is for the benefit of the franchisee.

Law stated - 14 May 2024

Policy affecting franchise relations

28 | Do other government or trade association policies affect the franchise relationship?

No.

Law stated - 14 May 2024

Termination by franchisor

29 | In what circumstances may a franchisor terminate a franchise relationship? What are the specific legal restrictions on a franchisor's ability to terminate a franchise relationship?

Termination of a franchise agreement is subject to specific stipulations agreed to by the parties. Under Israeli contract law, any party may terminate an agreement in the event of material breach of the agreement subject to certain conditions. An agreement may be terminated if the franchisor was misled by the franchisee in negotiations, and the franchisor may prove that but for the misleading information it would not have entered into the agreement.

Where the agreement is unlimited in duration, any party may terminate subject to reasonable prior notice or any other condition deriving from the agreement between the parties, such as reimbursement of investment and repurchase of stock.

Law stated - 14 May 2024

Termination by franchisee

30 | In what circumstances may a franchisee terminate a franchise relationship?

In the same circumstances as applicable to the franchisor.

Law stated - 14 May 2024

Renewal

31 | How are renewals of franchise agreements usually effected? Do formal or substantive requirements apply?

No formal requirements apply. It is advisable to renew agreements in writing for evidential and certainty purposes.

Law stated - 14 May 2024

Refusal to renew

32 | May a franchisor refuse to renew the franchise agreement with a franchisee? If yes, in what circumstances may a franchisor refuse to renew?

The response depends on the franchise agreement. If the agreement does not provide for renewal, any party may refuse to renew.

Law stated - 14 May 2024

Transfer restrictions

33 | May a franchisor restrict a franchisee's ability to transfer its franchise or restrict transfers of ownership interests in a franchisee entity?

Such restriction is allowed (and customary), especially given the fact that Israeli courts consider the franchisor-franchisee relationship to be based on party trust.

Law stated - 14 May 2024

Fees

34 | Are there laws or regulations affecting the nature, amount or payment of fees?

No. It is advisable to consult a local certified public accountant for that matter.

Law stated - 14 May 2024

Usury

35 | Are there restrictions on the amount of interest that can be charged on overdue payments?

No, except that the courts have the discretion to lower unreasonable charges, even if the charges were agreed by the parties.

Law stated - 14 May 2024

Foreign exchange controls

- 36** | Are there laws or regulations restricting a franchisee's ability to make payments to a foreign franchisor in the franchisor's domestic currency?

No; however, all payments should comply with the anti-money laundering regulations applicable to banks in Israel.

Law stated - 14 May 2024

Confidentiality covenant enforceability

- 37** | Are confidentiality covenants in franchise agreements enforceable?

Yes, as long as the information covered may be regarded as a trade secret as defined in the Civil Torts Law 1999.

Law stated - 14 May 2024

Good-faith obligation

- 38** | Is there a general legal obligation on parties to deal with each other in good faith during the term of the franchise agreement? If so, how does it affect franchise relationships?

Yes. Bad faith may be regarded as breach of the franchise agreement, thus allowing its cancellation under certain conditions.

Law stated - 14 May 2024

Franchisees as consumers

- 39** | Does any law treat franchisees as consumers for the purposes of consumer protection or other legislation?

No. Under the Defective Products Law 1980, a strict liability standard is imposed on the manufacturer, importer, seller and distributor in respect of personal injury resulting from a defective product. The liability should be covered in the franchise agreement, as should the product liability insurance and its costs.

Law stated - 14 May 2024

Language of the agreement

- 40** | Must disclosure documents and franchise agreements be in the language of your country?

There is no such demand; however, the language of the agreement should be understood by both parties to stop any argument based on misunderstanding of the stipulations of the agreement.

Law stated - 14 May 2024

Restrictions on franchisees

41 | What types of restrictions are commonly placed on the franchisees in franchise contracts?

It is customary to include in franchise agreements restrictions such as:

- exclusive territories;
- restrictions on sources from whom a franchisee may purchase or lease goods or services (restrictions on the purchase of goods and services from other franchisees of the same franchisor or restrictions on the source of goods, even if those in line with the franchisee's business are forbidden under the block exemption of franchise agreements);
- restrictions on the customers to whom the franchisee is entitled to sell the franchisor's products or services;
- restrictions on advertising the goods or services;
- prohibition on franchisees soliciting the franchisor's or other franchisees' employees;
- non-competition;
- confidentiality;
- governing law;
- dispute resolution;
- audit rights;
- insurance;
- indemnification obligations;
- allocation of the goodwill accrued through the use of the brand by the franchisee to the franchisor;
- restriction on the use of intellectual property assets other than in accordance with the licence granted under the agreement (eg, restriction to apply for the registration of the trademarks owned and used by the franchisor or any confusing similar trademark restriction on allocation of domain name using the brand or any part thereof);
- assumption of full liability to the franchisee's employees by the franchisee; and
- post agreement restrictions relating to the use of the franchisor's intellectual property.

Law stated - 14 May 2024

Courts and dispute resolution

42 | Describe the court system. What types of dispute resolution procedures are available relevant to franchising?

Israeli courts were established under the Basic Law: the Judiciary, under which a single system of courts of law exists. The courts of law include the Supreme Court, five district courts and magistrates' courts (acting as first instance for most cases in Israel).

The courts are independent and constitute a separate unit under the Ministry of Justice.

Law stated - 14 May 2024

Governing law

43 | Are there any restrictions on designating a foreign governing law in franchise contracts in your jurisdiction? How does the governing law affect the contract's enforceability?

There is no restriction on applying foreign law in an Israeli court; however, the foreign law should be proved as any other fact (by way of expert opinion). The Israeli courts usually respect foreign governance of law agreed by the parties unless there are reasons not to respect such choice on the ground of public policy. Where foreign governing law is agreed between the parties, the substantive foreign law will be applied rather than the procedural law.

Law stated - 14 May 2024

Arbitration – advantages for franchisors

44 | What are the principal advantages and disadvantages of arbitration for foreign franchisors considering doing business in your jurisdiction? Are any other alternative dispute resolution (ADR) procedures particularly favoured or disfavoured in your jurisdiction?

Arbitration is common in franchise transactions in the Israeli market. The advantages of arbitration are:

- the freedom of the parties to choose their arbitrator;
- the possible efficiency of the process; the freedom of the parties to agree that the arbitrator will not be bound by procedural regulations or local evidence law;
- the freedom of the parties to agree that the decision is final and may not be appealed; and
- the freedom of the parties to set in advance the venue and the language of the process.

The disadvantages are:

- the cost of the proceedings, given that the parties should bear the fees of the arbitrator (subject to its final decision);
- the limited enforceability of orders issued by the arbitrator granting interim relief (although the district court is authorised to provide such relief under specific circumstances); and
- the fact that the decision may not be appealed unless the parties agree otherwise (even then, the grounds of appeal are rather limited).

It is advisable to consider business mediation before turning to arbitration or court proceedings.

Law stated - 14 May 2024

National treatment

45 | In what respects, if at all, are foreign franchisors treated differently (legally, or as a practical matter) from domestic franchisors?

Domestic and foreign franchisors are treated equally by the Israeli legal system.

Law stated - 14 May 2024

UPDATE AND TRENDS

Legal and other current developments

46 | Are there any proposals for new legislation or regulation, or to revise existing legislation and regulation? Are there other current developments or trends to note?

During the past two years, there have been no major developments in the field of franchising except for the earlier-mentioned amendment of the Commercial Competition law.

Law stated - 14 May 2024



Orit Gonen

orgonen@gilatadv.co.il

Gilat Bareket & Co, Reinhold Cohn Group

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Japan

[Etsuko Hara](#)

[Anderson Mōri & Tomotsune](#)

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MARKET OVERVIEW

Franchising in the market

- 1 | How widespread is franchising in your jurisdiction? In which sectors is franchising common? Are there any economic or regulatory issues in the market that are more or less hospitable to franchising or make it economically viable in your jurisdiction?

Franchising is very widespread in Japan. According to [the data published by the Japan Franchise Association](#), for the period from April 2022 to March 2022, the number of chains operating in Japan stood at 1,282 with 249,316 stores and a total turnover of approximately ¥27 trillion. Among other sectors, convenience stores are particularly common in Japan, with a total of 57,451 outlets as at 2022.

Law stated - 16 May 2024

Associations

- 2 | Are there any national or local franchise associations? What is their role in franchising, including any impact on laws or regulations? Are there any rules of conduct or membership requirements?

The Japan Franchise Association (JFA) was established in 1972 for the purposes of planning and promoting the healthy development of the franchise system. It has implemented voluntary rules, such as the JFA's Code of Ethics and the Voluntary Standard Regarding Disclosure and Explanation of Information to Prospective Franchisees. In addition to maintaining these voluntary rules, it also conducts research and educational training, and provides consultations.

Law stated - 16 May 2024

BUSINESS OVERVIEW

Types of vehicle

- 3 | What forms of business entities are relevant to the typical franchisor?

Most typical franchisors are organised in the form of a joint-stock company.

Law stated - 16 May 2024

Regulation of business formation

- 4 | What laws and agencies govern the formation of business entities?

The formation of joint-stock companies in Japan is governed by the [Companies Act \(Act No. 86 of 2005\)](#), under the supervision of the Ministry of Justice.

Law stated - 16 May 2024

Requirements for forming a business

- 5 | Provide an overview of the requirements for forming and maintaining a business entity.

The formation of a joint-stock company requires articles of incorporation and other incorporation documents to be prepared and registered at a competent legal affairs bureau. After incorporation, it is necessary to prepare financial statements and to hold a shareholders' meeting each year.

Law stated - 16 May 2024

Restrictions on foreign investors

- 6 | What restrictions apply to foreign business entities and foreign investment?

Foreign business entities must register their representatives in Japan to conduct business continuously in the country. Once registered, they can carry out business in the same way as domestic entities. In addition, foreign investment is regulated by the [Foreign Exchange and Foreign Trade Act \(Act No. 228 of 1949\)](#). Industry specific laws may also apply, depending on the business sector of the foreign entities.

Law stated - 16 May 2024

Taxation

- 7 | What aspects of the tax system are relevant to franchisors? How are foreign businesses and individuals taxed?

Franchisors in the form of joint-stock companies need to pay corporate tax, corporate enterprise tax, corporate inhabitant tax and consumption tax. Depending on the nature of the assets held by a franchisor, property tax and automobile tax may also be payable. Foreign businesses' and individuals' income sourced in Japan is generally subject to Japanese taxation.

Law stated - 16 May 2024

Labour and employment

- 8 | Are there any relevant labour and employment considerations for typical franchisors?

Labour regulations generally apply to franchisors with regard to the relationship between franchisors and their respective employees. In a typical franchise arrangement, a franchisee or the employees of a franchisee are not considered to be employees of the franchisor. To avoid the risk that a franchisee could be deemed employees of the franchisor, a franchisor must structure the franchise relationship so that the franchisee is an independent entity and must clearly explain the independent nature of the franchise relationship with the franchisee. In addition, to avoid the risk that employees of a franchisee could be deemed employees of a franchisor, it is advisable that a franchisor is not involved in the hiring process of employees of a franchisee and that it is clearly explained to the candidates that the employer will be the franchisee, not the franchisor. Breach of labour regulations may result in criminal penalties including imprisonment.

Law stated - 16 May 2024

Intellectual property

9 | How are trademarks and other intellectual property and know-how protected?

Franchisors can register trademarks to protect such marks from infringing use. Nevertheless, there is no registration system per se for know-how. Know-how that falls within the scope of registrable types of intellectual property – such as patents or designs – may be registered accordingly. In addition, if the know-how falls within the definition of a ‘trade secret’ under the [Unfair Competition Prevention Act \(Act No. 47 of 1993\)](#), it will be protected against any acts constituting unfair competition.

Law stated - 16 May 2024

Real estate

10 | What are the relevant aspects of the real estate market and real estate law? What is the practice of real estate ownership versus leasing?

In general, a franchisee leases real estate for its operations directly from a property owner. Disputes may arise when the lessor tries to increase the rent or terminate or refuse to renew the lease agreement. In such situations, protection is available to the franchisee under the [Land Lease and Building Lease Act \(Act No. 90 of 1991\)](#) and the doctrine of the destruction of a relationship of mutual trust, which limits a lessor’s ability to terminate a lease agreement to the case that the mutual trust relationship is destroyed because of the lessee’s violation of the agreement (Supreme Court, 28 July 1964, Minshu 18-6, p. 1220; 21 April 1966, Minshu 20-4, p. 720).

Law stated - 16 May 2024

Competition law

11 |

What aspects of competition law are relevant to the typical franchisor in your jurisdiction? How is competition law enforced in the franchising sector?

[The Act on Prohibition of Private Monopolisation and Maintenance of Fair Trade \(Act No. 54 of 1947\)](#) (the Antimonopoly Act) and its relevant regulations and guidelines such as [Guidelines Concerning the Franchise System](#) (the Franchise Guidelines) and [Distribution Guidelines](#). The guidelines describe what kind of activities or restrictions are problematic under the Antimonopoly Act. In particular, the franchisor must ensure that none of its activities fall under a category of unfair trade practices specified in the Antimonopoly Act or described by the Japan Fair Trade Commission in its [Designation of Unfair Trade Practices](#).

First, the Franchise Guidelines require franchisors to disclose sufficient and accurate information when they are soliciting prospective franchisees or their actions can be deemed to be deceptive customer inducement, which is one of the categories of conduct restricted as unfair trade practice (Designation of Unfair Trade Practices, item 8).

Second, the Franchise Guidelines regulate transactions between franchisors and franchisees. The Franchise Guidelines state that it could be an abuse of a superior bargaining position to limit parties with whom franchisees can make transactions, to compel franchisees to buy a designated amount of goods, to restrict the ability of the franchisees to offer discounts to their customers or to restrict competitive activities after the termination of a franchise agreement. It also states what kind of items should be considered in connection with tie-in sales (Designation of Unfair Trade Practices, item 10), dealing on restrictive terms (Designation of Unfair Trade Practices, item 12), and resale price restriction.

If a party's activity is considered to be unfair trade practice under the Antimonopoly Act, the Fair Trade Commission may impose administrative sanctions, such as a cease and desist order that orders the breaching party to stop the illegal activities, delete the clauses concerned from the agreement, and take any other measures necessary to eliminate such activities. Some categories, such as abuse of a superior bargaining position and resale price restrictions, could be subject to surcharges under the Antimonopoly Act.

Law stated - 16 May 2024

OFFER AND SALE OF FRANCHISES

Legal definition

12 | What is the legal definition of a franchise?

There is no uniform definition of a franchise in Japan. Nevertheless, there are three relevant definitions with regard to franchise businesses.

First, the Medium and Small Retail Commerce Promotion Act (Law No. 110 of 1973) (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 for sales of products and provides guidance regarding management, and primarily targets medium and small retailers. In addition, a 'specified chain business' is defined as:

any chain business the agreement for which includes clauses that permit its members to use certain trademarks, trade names or any other signs, and collects joining fees, deposits or any other money from the member when becoming a member[.]

If a franchise business falls under this definition, the disclosure obligation, etc under the MSRPCA applies.

Second, the Guidelines Concerning the Franchise System (the Franchise Guidelines) under the Act on Prohibition of Private Monopolisation and Maintenance of Fair Trade (Act No. 54 of 1947) (the Antimonopoly Act) provides the following:

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 the selling of commodities and the provision of services. In return, the member pays the head office.

Third, the Japan Franchise Association (JFA) defines a franchise as:

A continuing relationship between one business operator (called a Franchisor) and another business operator (called a Franchisee) where a Franchisor and a Franchisee enter into a contractual agreement, the Franchisor granting the Franchisee the right to conduct the product sales and other businesses under the same image, by using the Franchisor's trademark, service mark, trade name or other signs representing the Franchisor's business, as well as the Franchisor's management know-how; the Franchisee paying the consideration to the Franchisor in return, investing the fund necessary for the business, and operating the business under the Franchisor's guidance and assistance.

Law stated - 16 May 2024

Laws and agencies

13 | What laws and government agencies regulate the offer and sale of franchises?

If the franchise business falls within the scope of a specified chain business, the disclosure obligations under the MSRPCA are applicable in relation to the offer and sale of franchises. The Ministry of Economy, Trade and Industry, as well as other ministries depending on the franchise business, have overall responsibility in this regard.

From the perspective of competition law, the Franchise Guidelines regulate the offer and sale of franchises from the viewpoint of the Antimonopoly Act, and the Fair Trade Commission has overall responsibility in this regard.

The JFA has also 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.

Law stated - 16 May 2024

Principal requirements

- 14 | What are the principal requirements governing the offer and sale of franchises under the relevant laws?

Under the MSRCPA, franchisors whose businesses fall under the definition of a specified chain business are required to provide a written document that describes prescribed items and to explain the contents of the written documents prior to executing a franchise agreement with prospective franchisees.

The Franchise Guidelines require franchisors to disclose sufficient and accurate information to prospective franchisees and also regulate the ongoing relationship between franchisors and franchisees.

Law stated - 16 May 2024

Franchisor eligibility

- 15 | Must franchisors satisfy any eligibility requirements in order to offer franchises? Are there any related practical issues or guidelines that franchisors should consider before offering franchises?

There is no such requirement in general, except for the disclosure requirements provided in the MSRCPA and the Franchise Guidelines. If the industry in which the franchise operates is regulated by industry-specific laws, it is necessary to check those regulations.

Law stated - 16 May 2024

Franchisee and supplier selection

- 16 | Are there any legal restrictions or requirements relating to the manner in which a franchisor recruits franchisees or selects its or its franchisees' suppliers? What practical considerations are relevant when selecting franchisees and suppliers?

In addition to the MSRCPA, which stipulates the disclosure requirements, the Franchise Guidelines regulate the manner in which a franchisor recruits franchisees or selects its or its franchisees' suppliers. It is recommended that a franchisor, when recruiting a franchisee,

discloses sufficient information to the franchisee to avoid any misunderstandings about the business on the part of the franchisor. This disclosure includes but is not limited to matters relating to the terms and conditions of supply of products, such as a system for recommending suppliers, and matters relating to any restrictions applying to the franchisor or other franchisees in setting up similar or identical outlets close to the outlet planned by the franchisee. The Franchise Guidelines also mention that if the franchisor forces the franchisee to trade only with the franchisor or companies appointed by the franchisor regarding the supply of items such as products and raw materials without proper justification, it could be considered abuse of a superior bargaining position.

Law stated - 16 May 2024

Pre-contractual disclosure – procedures and formalities

17 | What procedures and formalities for pre-contractual disclosure are required or advised in your jurisdiction? How often must the disclosures be updated?

Under the MSRCPA, when a franchisor intends to negotiate a franchise agreement with a prospective franchisee, the franchisor must provide written documents describing the prescribed items and explain the contents of the written documents to prospective franchisees. There are no regulations regarding the frequency of updating disclosures after execution of a franchise agreement.

Law stated - 16 May 2024

Pre-contractual disclosure – content

18 | What information is the disclosure document required or advised to contain?

A franchisor whose business falls within the definition of a specified chain business under the MSRCPA is subject to the MSRCPA disclosure obligations.

Information about the following matters, which must include at least the items specified for each matter, must be disclosed to the franchisee:

- matters regarding the initial fee, deposit or any other money that the franchisor will collect at the time when the prospective franchisee becomes a franchisee:
 - the amount of money to be paid or the method of calculating the amount;
 - the nature of the money to be collected, such as whether it is an initial fee, deposit, equipment fee, etc;
 - the timing of payment;
 - the method of collection; and
 - whether the money will be refunded, and the conditions applicable to such refund;
- matters regarding terms and conditions of sales of products sold to franchisees:

- the type of products that are sold or arranged to be sold to the franchisees;
and
- the method of payment for such products;
- matters regarding management instruction:
 - whether there will be training or a seminar when joining;
 - the content of a training or a seminar, if provided; and
 - the method of continuous management instruction to franchisees and how many times such instruction will be conducted;
- matters regarding the trademark, trade name and any other indication that will be permitted to be used:
 - trademark, tradename and other indication that will be permitted to be used;
and
 - if there are any terms and conditions regarding the use of the indication, the content thereof;
- matters regarding the duration of the agreement and renewal and termination of the agreement:
 - the duration of the agreement;
 - the conditions and procedure to renew the agreement;
 - the requirements and procedures to terminate the agreement; and
 - the amount of compensatory damages that will accrue on termination of the agreement or the methods to calculate the amount or the content of any other obligation;
- matters regarding changes in the number of franchisees' stores during the most recent three business years:
 - the number of franchisees' stores as at the last day of each business year;
 - the number of franchisees' stores that began operations during each business year;
 - the number of franchisees' stores whose franchise agreements have been terminated during each business year; and
 - the number of franchisees' stores whose franchise agreements were renewed during each business year and the number of franchisees' stores whose franchise agreements were not renewed during each year;
- matters regarding income and expenditure of franchisees with similar local conditions – such as the population of the surrounding area and the volume of traffic, among others – during the most recent three business years:
 - the following amount of the franchisee recognised by the franchisor:
 - the sales amount;

- the sales cost;
 - the amount of money to be paid periodically by franchisees, such as royalties for the use of the business name, consulting fees, etc;
 - the employment costs;
 - any service and general administration expenses; and
 - any other factors and figures that form the basis of the calculation of income and expenditure; and
- reasons why the location conditions of the franchisees are considered similar;
- matters regarding any periodic payments:
 - the amount of money to be paid periodically or the method of calculating the amount of money to be paid periodically;
 - the nature of the payment, such as whether it is a royalty for the use of the business name, a consulting fee, etc;
 - the timing of payment; and
 - the method of collection of the payment; and
- other matters:
 - the name and address of the franchisor, the number of full-time employees and, if the franchisor is a company, the title and names of officers;
 - the amount of capital, names of the principal shareholders (those holding more than 10 per cent of the shares directly or indirectly) and, if the franchisor is conducting another business, the type of business;
 - the name of any entity in which the franchisor holds a majority of the voting shares;
 - the balance sheet and profit and loss statement, or other documents equivalent to these for the past three business years of the franchisor's business;
 - the date on which the franchisor began its specified chain business;
 - the number of litigation cases in which the franchisor is the plaintiff and a franchisee or ex-franchisee is the defendant with regard to the franchise agreement and vice versa during the past five business years;
 - business hours, business days and regular or irregular closing days of franchisees' units;
 - whether there is a provision stipulating whether the franchisor will engage in or allow other franchisees to engage in business operations conducting the same or similar retail business near the shops of the franchisee and the contents of the provision, if applicable;
 - whether there is a provision that prohibits or restricts the ability of franchisees to conduct businesses, such as prohibiting them from joining other specified chain businesses or from being employed with similar businesses (either

during or after termination or expiration of the agreement) and the contents of the provision, if applicable;

- whether there is a provision that prohibits or restricts disclosure of information that the franchisee may know regarding the specified chain business during or after termination or expiration of the agreement and the contents of the provision, if applicable;
- whether the franchisees need to remit all or part of the sale proceeds periodically, and the timing and method thereof;
- whether the franchisor lends or arranges to lend money to franchisees, the interest rate or the method of calculating the rate and any other conditions of the lending or arranging of lending;
- whether the franchisor adds interest to all or part of the remaining amount after setting off the rights and obligations that accrue in connection with a transaction with the franchisor during a certain period, the interest rate or the method of calculating the rate and any other conditions;
- whether the franchisor imposes on franchisees a special obligation regarding the structure, or interior or exterior of stores of franchisees, the contents of the obligation; and
- the amount of money or the method of calculating the amount of money that accrues when the franchisor or a franchisee violates the agreement.

Law stated - 16 May 2024

Pre-sale disclosure to sub-franchisees

- 19** | In the case of a sub-franchising structure, who must make pre-sale disclosures to sub-franchisees? If the sub-franchisor must provide disclosure, what must be disclosed concerning the franchisor and the contractual or other relationship between the franchisor and the sub-franchisor?

In the case of a sub-franchise, the relationship between the sub-franchisor and the sub-franchisee needs to be analysed; if it falls within the definition of a specified chain business under the MSRCPA, the sub-franchisor owes a disclosure obligation. In such a case, the information relating to the sub-franchisor must be disclosed. 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 has a disclosure obligation as well.

Law stated - 16 May 2024

Due diligence

- 20** | What due diligence should both the franchisor and the franchisee undertake before entering a franchise relationship?

It depends on the particular policy of the franchisor or the franchisee, but a general background check to ensure, among other things, that the counterparty is not an antisocial force and not associated with antisocial forces, is usually conducted.

Law stated - 16 May 2024

Failure to disclose – enforcement and remedies

- 21 | What actions may franchisees or any relevant government agencies take in response to a franchisor's failure to make required disclosures? What legal remedies are available? What penalties may apply?

A franchisor or a sub-franchisor whose business falls within the definition of a specified chain business under the MSRCPA owes disclosure obligations and any party who owes such obligations is responsible for any breach thereof. Generally, individual officers, directors and employees of the franchisor or the sub-franchisor are not exposed to a personal liability with regard to the failure of disclosure by the franchisor or the sub-franchisor. Nevertheless, if there are breaches of the duty of care or fault on the part of these individuals, they may face liability accordingly. In addition, there is a risk that a franchisee will name these individuals as defendants in a suit against the franchisor or the sub-franchisor to seek recovery of damages from them.

A franchisor or a sub-franchisor who failed to disclose sufficient and accurate information as required by the Franchise Guidelines could be deemed to have conducted a deceptive customer inducement, in which case, the Japan Fair Trade Commission may investigate and impose administrative sanctions.

Law stated - 16 May 2024

Failure to disclose – apportionment of liability

- 22 | In the case of sub-franchising, how is liability for disclosure violations shared between franchisor and sub-franchisor? Are individual officers, directors and employees of the franchisor or the sub-franchisor exposed to liability? If so, what liability?

A franchisor or a sub-franchisor whose business falls within the definition of a specified chain business under the MSRCPA owes disclosure obligations and any party who owes such obligations is responsible for any breach thereof. Generally, individual officers, directors and employees of the franchisor or the sub-franchisor are not exposed to a personal liability with regard to the failure of disclosure by the franchisor or the sub-franchisor. Nevertheless, if there are breaches of the duty of care or fault on the part of these individuals, they may face liability accordingly. In addition, there is a risk that a franchisee will name these individuals as defendants in a suit against the franchisor or the sub-franchisor to seek recovery of damages from them.

Law stated - 16 May 2024

General legal principles and codes of conduct

- 23 | In addition to any laws or government agencies that specifically regulate offering and selling franchises, what general principles of law affect the offer and sale of franchises? What industry codes of conduct may affect the offer and sale of franchises?

Apart from the MSRPCA, the Franchise Guidelines and the JFA's voluntary rules, the general principles of the [Civil Code](#) (Act No. 89 of 1896) affect the offer and sale of franchises. For example, franchisees can rescind the franchise agreement in the event of fraudulent disclosure of information or if there is a material misunderstanding about the franchise agreement. If damage has been caused by the violation of the disclosure requirement, franchisees may bring a claim for damages based on contract theory or tort theory.

Law stated - 16 May 2024

Fraudulent sale

- 24 | What actions may franchisees take if a franchisor engages in fraudulent or deceptive practices in connection with the offer and sale of franchises?

No special remedy exists for franchisees under the MSRPCA regarding violations of disclosure requirements. Therefore, in the case of fraudulent or deceptive practices of franchisors, franchisees need to base any claims to cancel or rescind on the general principles of contract under the Civil Code. For example, franchisees can rescind the franchise agreement in the event of fraudulent disclosure of information or if there is a material misunderstanding about the franchise agreement. If damage has been caused by the violation of the disclosure requirement, franchisees may bring a claim for damages based on contract theory or tort theory. In addition, franchisees may claim that a franchisor is violating the Franchise Guidelines, thus violating the Antimonopoly Act.

Law stated - 16 May 2024

FRANCHISE CONTRACTS AND THE FRANCHISOR/FRANCHISEE RELATIONSHIP

Franchise relationship laws

- 25 | What laws regulate the ongoing relationship between franchisor and franchisee after the franchise contract comes into effect?

The Guidelines Concerning the Franchise System (the Franchise Guidelines) under the Act on Prohibition of Private Monopolisation and Maintenance of Fair Trade (Act No. 54 of 1947) (the Antimonopoly Act) regulate the ongoing relationship between franchisors and franchisees, such as the matters relating to restriction on suppliers, forced purchase quota, restriction on bargain sales and amendments to the franchise agreement.

Law stated - 16 May 2024

Operational compliance

- 26 | What mechanisms are commonly incorporated in agreements to ensure operational consistency and adherence to brand standards?

Generally, franchise agreements oblige franchisees to comply with the Franchisor's operation manuals and other rules that set forth its brand standards in detail. In addition, various reporting requirements, which must be satisfied on a regular basis, are provided for in the franchise agreement. Franchisors also have inspection rights (also provided for in the franchise agreement) to check the records, etc, of franchisees whenever franchisors deem such inspections necessary.

Law stated - 16 May 2024

Amendment of operational terms

- 27 | May the franchisor unilaterally change operational terms and standards during the franchise relationship?

It depends on to what extent the franchise agreement and other ancillary agreements give the franchisor the discretion to change operational terms and standards unilaterally. In general, the franchisor reserves the right to change the operational manual unilaterally. Even if such right is reserved, the franchisors must carefully check if such unilateral change is beneficial for franchisees or is limited to a reasonable extent considering the surrounding circumstances.

Law stated - 16 May 2024

Policy affecting franchise relations

- 28 | Do other government or trade association policies affect the franchise relationship?

There are voluntary rules, such as the Code of Ethics and the Voluntary Standard Regarding Disclosure and Explanation of Information to Prospective Franchisees, prepared by the Japan Franchise Association (JFA). If a franchisor is a member of the JFA, its voluntary rules are an important consideration in the franchise relationship.

Law stated - 16 May 2024

Termination by franchisor

- 29 |

| In what circumstances may a franchisor terminate a franchise relationship? What are the specific legal restrictions on a franchisor's ability to terminate a franchise relationship?

Usually, the franchise agreement lists the circumstances in which the franchisor may terminate a franchise relationship. In addition, the franchisor may also terminate a franchise relationship based on mutual agreement.

If the franchisor violates the franchise agreement, the franchisor may terminate the franchise agreement prior to the expiration of the term of the agreement, based on the franchise agreement or on the Civil Code (Act No. 89 of 1896). Nevertheless, because franchise agreements are usually continuous long-term agreements, there is a possibility that courts will be more reluctant to terminate these agreements compared to normal agreements.

On this point, it may be useful to refer to the doctrine of the destruction of a mutual trust relationship, which has been established in the area of lease agreements that are also generally considered continuous agreements. With regard to lease agreements, a lessor's ability to terminate a lease agreement is limited to the case that the mutual trust relationship is destroyed because of the lessee's violation of the agreement (Supreme Court, 28 July 1964, Minshu 18-6, p. 1220; 21 April 1966, Minshu 20-4, p. 720). This means that a lessor may not terminate a lease agreement even if the lessee is violating it, provided that the violation is not sufficiently material to destroy the mutual trust relationship.

In the case of termination of a franchise agreement, a similar consideration could be made by the court to restrict a franchisor's ability to terminate a franchise relationship, depending on the circumstances.

Law stated - 16 May 2024

Termination by franchisee

30 | In what circumstances may a franchisee terminate a franchise relationship?

Usually, the franchise agreement regulates the circumstances in which a franchisee may terminate a franchise relationship. In addition, the franchisee may terminate a franchise relationship due to mutual agreement with the franchisor. In cases where there is no clause in the franchise agreement, the same considerations apply as those relating to termination by the franchisor. However, in general, the necessity of protecting a franchisor from termination by a franchisee is not strong, as compared to the necessity of protecting a franchisee from termination by a franchisor, and, therefore, it would be generally easier for franchisees than a franchisor to terminate the franchise agreement.

Law stated - 16 May 2024

Renewal

31 |

How are renewals of franchise agreements usually effected? Do formal or substantive requirements apply?

If the franchise agreement provides for an automatic renewal clause, there is no need to enter into a new agreement. If the franchise agreement requires the parties to renew the term, it is then necessary to enter into either a new agreement or an extension agreement.

Law stated - 16 May 2024

Refusal to renew

32 | May a franchisor refuse to renew the franchise agreement with a franchisee? If yes, in what circumstances may a franchisor refuse to renew?

Provisions in the franchise agreement generally determine whether a franchisor may refuse to renew the franchise agreement with the franchisee. In cases where the franchise agreement states that it will not be renewed unless otherwise agreed to between the parties, the franchisor may generally refuse to enter into a new agreement. On the other hand, in cases where the franchise agreement states that it will be renewed automatically unless either party notifies otherwise, it is unclear in which circumstances the franchisor may refuse to renew, especially after being renewed for many times. On this point, there is a case in which a court required 'compelling circumstances' that make it difficult to continue the agreement for a franchisor to be able to refuse to renew a continuous agreement (-Hokka Hokka Tei case, Nagoya District Court, 31 August 1998).

Law stated - 16 May 2024

Transfer restrictions

33 | May a franchisor restrict a franchisee's ability to transfer its franchise or restrict transfers of ownership interests in a franchisee entity?

As to the transfer of a franchise, it is possible to include a provision in a franchise agreement that requires the franchisor's consent for the franchisee to transfer its franchise under the agreement. Furthermore, under the Civil Code, when a party to an agreement is going to transfer its status or obligations under the agreement, the other party's consent must be obtained. Therefore, even if there is no clause in the franchise agreement requiring consent for transfer, the franchisor's consent is still necessary.

As to the transfer of an ownership interest in a franchisee entity, the owner of an ownership interest in a franchisee entity is generally free to transfer its ownership interest. Any covenant in a franchise agreement that prohibits the owner to transfer an ownership interest in a franchisee is not enforceable against the owner unless the owner is also a party to the franchise agreement. However, the franchise agreement may indirectly restrict the transfer of an ownership interest in a franchisee entity by making it an obligation of the franchisee to obtain the franchisor's consent or by making the transfer of an ownership interest a termination event.

Law stated - 16 May 2024

Fees

34 | Are there laws or regulations affecting the nature, amount or payment of fees?

There is no specific limitation on the amount or payment of fees. However, if fees are unreasonably high, the obligation to pay the fees may be deemed void because it may be construed to be against good public order and customs as laid out in the Civil Code. It is also possible that, depending on circumstances, imposition of a high fee is considered an abuse of superior bargaining position as laid out in the Antimonopoly Act.

Law stated - 16 May 2024

Usury

35 | Are there restrictions on the amount of interest that can be charged on overdue payments?

For interest on loans from a franchisor to a franchisee, the restriction on interest under the Interest Rate Limitation Act (Act No. 100 of 1954) applies; however, if the overdue payment is not in connection with a loan, there is no specific restriction on the amount of interest. If the interest charged is unreasonably high, however, the obligation to pay the interest may be deemed void because it is against good public order and customs as laid out in the Civil Code.

Law stated - 16 May 2024

Foreign exchange controls

36 | Are there laws or regulations restricting a franchisee's ability to make payments to a foreign franchisor in the franchisor's domestic currency?

In general, there are no restrictions on a franchisee's ability to make payments in a foreign currency. International transfer of funds exceeding a certain amount is subject to a reporting requirement under the [Foreign Exchange and Foreign Trade Act \(Act No. 228 of 1949\)](#), and depending on the destination country and purpose of the transfer of funds, stricter restrictions could be applicable.

Law stated - 16 May 2024

Confidentiality covenant enforceability

37 | Are confidentiality covenants in franchise agreements enforceable?

Confidentiality covenants are generally enforceable. If a franchisee breaches confidentiality covenants, a franchisor may seek compensation for the damages caused by such violation or seek a preliminary injunction to avoid any damages in advance.

Law stated - 16 May 2024

Good-faith obligation

38 | Is there a general legal obligation on parties to deal with each other in good faith during the term of the franchise agreement? If so, how does it affect franchise relationships?

Under article 1 of the Civil Code, there is a general duty to act in good faith. In addition, if an agreement is unreasonably advantageous to one party, it can be deemed void because it is against good public policy under article 90 of the Civil Code. 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. A court has construed that a franchisor has 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).

In addition, courts use article 90 of the Civil Code to limit liquidated damages. For example, in the Honke Kamadoya case (Kobe District Court, 20 July 1992), a court stated that liquidated damages of an amount equal to 60 months' loyalty payment were significantly out of balance with the expected amount of damages; consequently, the liquidated damages were void to the extent that they went beyond a reasonable amount of damages because such amount was against good public policy.

Law stated - 16 May 2024

Franchisees as consumers

39 | Does any law treat franchisees as consumers for the purposes of consumer protection or other legislation?

In principle, a franchisee would not be protected as a consumer for the purpose of consumer protection laws because the franchisee is doing business and is therefore a business operator. For example, the Consumer Contract Act (Act No. 61 of 2000) defines a 'consumer' as any natural person excluding a natural person who becomes a party to a commercial contract to engage in commercial endeavours. Nevertheless, as demonstrated by the courts' inclination to protect franchisees (eg, the doctrine of the destruction of a relationship of mutual trust), depending on the case, franchisees could be protected by interpretations of the Civil Code or other laws.

Law stated - 16 May 2024

Language of the agreement

- 40 | Must disclosure documents and franchise agreements be in the language of your country?

There is no clear requirement that disclosure documents need to be in Japanese, but since the disclosure obligation is imposed so that prospective franchisees have sufficient information and understand the franchise well, it is prudent to prepare these documents in Japanese. There is no requirement that franchise agreements should be in Japanese.

Law stated - 16 May 2024

Restrictions on franchisees

- 41 | What types of restrictions are commonly placed on the franchisees in franchise contracts?

Clauses related to territories, payment of fees, procurement of goods or services, non-compete obligation, governing law and dispute resolution are usually included in franchise contracts. For further details, it would be useful to refer to the matters that are subject to the disclosure obligation under the Medium and Small Retail Commerce Promotion Act (Act No. 110 of 1973).

Law stated - 16 May 2024

Courts and dispute resolution

- 42 | Describe the court system. What types of dispute resolution procedures are available relevant to franchising?

Assuming that both parties to the dispute are doing business in Japan, unless otherwise provided in an agreement, a dispute regarding a franchise relationship may be brought to a district court that has jurisdiction over the dispute under the [Code of Civil Procedure \(Act No. 109 of 1996\)](#). In every prefecture, one or more district courts exist. Decisions by district courts may be appealed to a competent high court, and then to the Supreme Court. In addition to litigation in a courtroom, arbitration is possible if the parties so agree.

Law stated - 16 May 2024

Governing law

- 43 | Are there any restrictions on designating a foreign governing law in franchise contracts in your jurisdiction? How does the governing law affect the contract's enforceability?

If the parties agree, it is possible to designate a foreign governing law in franchise contracts. In these cases, the enforceability of the contract is assessed under the specified foreign law. Nonetheless, compulsory regulations such as the disclosure obligations under the Medium and Small Retail Commerce Promotion Act (Act No. 110 of 1973) and the requirements under the Antimonopoly Act must be complied with by all parties to the contract.

Law stated - 16 May 2024

Arbitration – advantages for franchisors

- 44 | What are the principal advantages and disadvantages of arbitration for foreign franchisors considering doing business in your jurisdiction? Are any other alternative dispute resolution (ADR) procedures particularly favoured or disfavoured in your jurisdiction?

Foreign franchisors' principal advantage in choosing arbitration is that the proceedings can be conducted in English or any other language as agreed in the franchise agreement. In the case of litigation in Japanese courts, the language must be Japanese. In addition, arbitrators may be more familiar with franchise business than Japanese judges. The principal disadvantage of arbitration is the generally higher costs due to fees for the arbitrators and the fact that the number of arbitrators familiar with the franchise business in Japan as well as in the jurisdiction where the foreign franchisor mainly operates may be limited.

Law stated - 16 May 2024

National treatment

- 45 | In what respects, if at all, are foreign franchisors treated differently (legally, or as a practical matter) from domestic franchisors?

Because of certain restrictions on foreign business entities and foreign investment (eg, the Foreign Exchange and Foreign Trade Act (Act No. 228 of 1949) (FEFTA) and industry-specific laws), foreign franchisors could face different regulations. For example, certain technical licences could be subject to regulatory filing under the FEFTA, depending on the contents of the licence. In addition, if the industry of the franchise is regulated by specific laws, such laws may treat foreign franchisors differently.

Law stated - 16 May 2024

UPDATE AND TRENDS

Legal and other current developments

- 46 | Are there any proposals for new legislation or regulation, or to revise existing legislation and regulation? Are there other current developments or trends to note?

The Japan Fair Trade Commission conducted an industry survey about trade practices between franchisors and franchisees of convenience stores. Based on that research, the results of which were released in September 2020, its Guidelines Concerning the Franchise System (the Franchise Guidelines) were amended. For example, regarding 24/7 operations, the amended Franchise Guidelines recommend disclosing information about shortages of manpower, rising labour costs or other information that may have adverse effects on the management of the franchisee. The Franchise Guidelines also clarify that it could constitute a breach of the Act on Prohibition of Private Monopolisation and Maintenance of Fair Trade (Act No. 54 of 1947) if the franchisor refuses to discuss the shortening of operational hours with the franchisee, although it is contractually permissible by mutual consent.

In addition, the amendment to the Enforcement Regulation of the Medium and Small Retail Commerce Promotion Act (Act No. 110 of 1973) came into force on 1 April 2022. This amendment requires the disclosure of income and expenditure of franchisees with similar local conditions. The Japan Franchise Association updated its guidelines about disclosure documents to give examples of information to be disclosed in relation to the additional disclosure requirements.

Law stated - 16 May 2024

ANDERSON MŌRI & TOMOTSUNE

Etsuko Hara

etsuko.hara@amt-law.com

Anderson MMri & Tomotsune

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MARKET OVERVIEW

Franchising in the market

- 1 | How widespread is franchising in your jurisdiction? In which sectors is franchising common? Are there any economic or regulatory issues in the market that are more or less hospitable to franchising or make it economically viable in your jurisdiction?

There are approximately 870 franchise formulas operating in the Netherlands, with over 34,200 franchise outlets. Franchise businesses employ over 375,000 people and annual sales are well over €55 billion. This makes the franchise sector considerably important to the Dutch economy. Franchising is found in many industries, with focal points in retail (both food and non-food), services (for instance, medical services) and care, and comes in many forms. These vary from soft franchising, where the franchisee has a lot of freedom within the franchise to structure its activities (eg, by making its own selection from a wide range of products available to the franchise), to hard franchising, where the business operations are prescribed by the franchisor down to the smallest detail. In hard franchising, the franchisee is largely unburdened and in exchange, he or she relinquishes some of the freedom of movement in his or her entrepreneurship, as outlined in the explanatory note to the Dutch [Franchise Act](#), effective from 1 January 2021.

Law stated - 31 May 2024

Associations

- 2 | Are there any national or local franchise associations? What is their role in franchising, including any impact on laws or regulations? Are there any rules of conduct or membership requirements?

The Dutch Franchise Association (NFV) represents the interests of its affiliated members (namely, franchise organisations). Its main objective is to promote the healthy and balanced development of franchising in the Netherlands. The NFV is a member of the European Franchise Federation, as are franchise associations in almost all European countries. The NFV is also a member of the World Franchise Council, which is a forum where supranational issues can be discussed.

Law stated - 31 May 2024

BUSINESS OVERVIEW

Types of vehicle

- 3 | What forms of business entities are relevant to the typical franchisor?

Franchises may come in the form of any business entity existing under Dutch law, in particular:

- private limited liability companies (BVs);
- public companies (NVs);
- sole proprietorships;
- general partnerships; and
- limited partnerships.

BVs and NVs are legal entities. General partnerships, limited partnerships and sole proprietorships are non-legal entities. The question of whether a business entity is a legal entity or not affects the franchisor's personal liability.

Law stated - 31 May 2024

Regulation of business formation

4 | What laws and agencies govern the formation of business entities?

The formation of business entities is governed by Book 2 of the Dutch Civil Code for legal entities and Book 7A of the Dutch Civil Code. There are also several specific relevant laws for business entities, for example, the Works Councils Act. All business entities must be duly registered in the Commercial Register of the Dutch [Chamber of Commerce](#).

Law stated - 31 May 2024

Requirements for forming a business

5 | Provide an overview of the requirements for forming and maintaining a business entity.

The requirements for forming and maintaining a business entity depend on what form of business entity is incorporated. When a private limited liability is used by the franchisor, the following are required:

- a statement of no objection from the Dutch Ministry of Justice; and
- a notarial deed of incorporation, including the articles of association.

On 1 October 2012, an act for the simplification of private company law entered into force, making important changes to Dutch law applicable to BVs. From this date, the laws with respect to BVs became simpler and more flexible. As a result, it is now possible to deviate more from the statutory rules in the articles of association of the company and a minimum capital of €18,000 is no longer necessary. Furthermore, the mandatory bank and accountants' statements with a contribution in kind have been abolished. A notarial deed of incorporation is still required. The act entered into force with immediate effect and is applicable to all BVs. The act introduced several possibilities to deviate from the provisions

of the law in the articles of association, which offered foreign investors more freedom to incorporate or structure their BV as they deem appropriate.

Law stated - 31 May 2024

Restrictions on foreign investors

6 | What restrictions apply to foreign business entities and foreign investment?

Business entities that are incorporated under foreign law but are active on the Dutch market rather than within their own country are subject to the Companies Formally Registered Abroad Act (CFRA Act). The CFRA Act does not apply to members of the European Union or to countries that are members of the European Economic Area Agreement. All other entities must comply with certain requirements, which also apply to Dutch entities (such as registration in the Commercial Register, statutory minimum capital and the filing of annual accounts with the Commercial Register where the business entity is registered).

Law stated - 31 May 2024

Taxation

7 | What aspects of the tax system are relevant to franchisors? How are foreign businesses and individuals taxed?

In principle, taxable profits realised by corporate entities that are for tax purposes resident in the Netherlands – for example, BVs and NVs – are subject to the Dutch corporate income tax rate. Dividends received and capital gains derived from a shareholding to which the Dutch participation exemption applies are exempt from Dutch corporate income tax. Dividends distributed by a Dutch tax-resident company are generally subject to Dutch dividend withholding tax. A reduced rate or an exemption from Dutch dividend withholding tax may be available; for example, as a result of the application of a tax treaty or if the Dutch participation exemption applies. In principle, dividends distributed to an EU shareholder holding more than 5 per cent are also exempt from Dutch dividend withholding tax. In general, Dutch corporate taxpayers can credit dividend tax withheld against corporate income tax due.

Individual shareholders holding more than 5 per cent in the nominal share capital of a company (substantial interest) are generally subject to Dutch individual income tax in respect of dividends received and capital gains derived from such substantial interest. Individual shareholders holding less than 5 per cent in the nominal share capital of a company are generally subject to Dutch individual income tax.

Individuals performing franchise activities in the Netherlands, either in the form of tax-transparent partnerships or as sole entrepreneurs, are generally subject to income tax at progressive rates. Dutch individual entrepreneurs may apply a number of beneficial tax facilities.

No taxes are levied upon establishing a business in the Netherlands. Dutch capital tax, which was due on the incorporation of a company with capital divided into shares, was abolished on 1 January 2006. The acquisition of Dutch houses is currently subject to real estate transfer tax. For real estate business premises, a Dutch real estate transfer tax applies. In certain circumstances, the acquisition of more than 33.33 per cent of a Dutch real estate company is also subject to Dutch real estate transfer tax.

Wages paid by a Dutch employer are subject to Dutch wage withholding tax and Dutch social security premiums. Dutch wage withholding tax is creditable against the Dutch individual income tax liability in full. Attractive tax benefits are available for foreign employees if these employees have certain specific skills that are scarce in the Netherlands.

Dutch value-added tax (VAT) currently amounts to 21 per cent. Reduced VAT rates of 6 per cent and zero per cent apply for certain supplies, such as the supply of agricultural products. Imports performed by Dutch entrepreneurs are generally subject to Dutch VAT. In principle, the importing entrepreneur may credit or refund the VAT paid on the imported supplies. Exports from the Netherlands are generally exempt from Dutch VAT.

Law stated - 31 May 2024

Labour and employment

8 | Are there any relevant labour and employment considerations for typical franchisors?

In principle, franchisees are deemed independent entrepreneurs. Hence, no labour and employment considerations apply. However, franchisees may qualify as employees on the basis that the relationship between the franchisor and franchisee does not correspond with the franchise agreement as it is in fact an employment relationship. If the agreement is considered an employment agreement, the franchisee is, inter alia, entitled to holiday allowance and payment during illness. Also, laws regarding termination of the employment agreement apply.

According to tax law, the franchisor is required to withhold income tax and social security benefits if the tax authorities deem the relationship between parties a (fictitious) employment relationship. Each cooperation agreement, such as a franchise agreement, is considered on its own merits. The name and wording of the contract between the parties are not decisive. The courts look at the intention of the parties when entering into the franchise contract, as well as the way in which the parties have given substance to their relationship. An employment relationship can be assumed if the following can be established:

- the franchisee is obliged to perform the agreed duties in person;
- the franchisor pays the franchisee (directly or indirectly) for these duties; and
- a relationship of authority can be established that manifests itself in the right of the franchisor to give instructions that the franchisee must follow.

Particularly in franchise relationships, the following criteria prove to be decisive:

- the equivalence of the contracting parties;

- the ability of the franchisee to let someone else perform the duties (eg, third parties or employees of the franchisee);
- the franchisee bearing the business risk; and
- the economic independence of the franchisee.

Provided that the franchisee is truly a franchisee, pursuant not only to the contract but also to its day-to-day activities, no employment relationship should be deemed to exist. Particularly if the franchisee is contracted via his or her Dutch limited liability company, the risk of an employment relationship is limited, at least from a civil law perspective. The tax authorities have a different view on this.

Law stated - 31 May 2024

Intellectual property

9 | How are trademarks and other intellectual property and know-how protected?

Registered trademarks are protected by the Benelux Treaty for Intellectual Property and (or) the European Trademark Regulation. The registrant of a Benelux trademark has exclusive rights for specific classes of goods or services in Belgium, the Netherlands and Luxembourg if a trademark is registered in the public trademark registry of the [Benelux Office for Intellectual Property](#). In addition, the registrant has exclusive rights for specific classes of goods or services in the European Union if a trademark is registered as a community trademark in the public trademark registry of the Office for Harmonization of the Internal Market of the European Union.

In principle, know-how is not protected by any intellectual property right. However, trade secrets can be protected by the Act on the Protection of Trade Secrets since 2018. Know-how may also be protected under the general provisions of Dutch unfair competition law (including civil tort). Know-how could be contractually protected by including confidentiality (non-disclosure) obligations in an agreement (eg, a franchise agreement).

Law stated - 31 May 2024

Real estate

10 | What are the relevant aspects of the real estate market and real estate law? What is the practice of real estate ownership versus leasing?

In the Netherlands, there are no restrictions on the acquisition of real estate by foreigners. Therefore, foreign franchisors would not face difficulties should they wish to purchase real estate to lease to franchisees. However, franchisors must take the protection of lessees under the semi-mandatory Dutch lease law into account, even if the properties have been made available to the franchisees in the franchise agreement and no specific lease agreement has been drawn up.

There are two different tenancy regimes for the lease of commercial premises: the lease of retail space (including shops, restaurants and takeaways) and the lease of the other commercial premises (including travel agencies, cinemas, the ticket offices of lotteries and bank branches). Under the retail space regime, lessees are protected by various conditions of semi-mandatory lease law, including but not limited to:

- the minimum lease term is two to five years and there are limited grounds for termination by the lessor;
- termination or rescission can in principle only be effectuated judicially (also in the event of breach of contract); and
- the turnover rent may be affected by market rent review.

Under the regime of other commercial premises, the lessees only get protection of vacation. The lessees are entitled (within two months of the date of vacation) to request the court to extend the term of vacation. The court can be requested to approve a deviation from semi-mandatory law.

Law stated - 31 May 2024

Competition law

11 | What aspects of competition law are relevant to the typical franchisor in your jurisdiction? How is competition law enforced in the franchising sector?

Franchising agreements that do not meet the criteria set forth in European Commission Regulation (EU) 2022/270 (the Vertical Block Exemption Regulation (VBER)) and to which no de minimis thresholds apply will be prohibited on the basis of article 6.1 of the Dutch Competition Act (DCA) or article 10 of the Treaty on the Functioning of the European Union (TFEU), unless the four criteria detailing the legal exception of article 6.3 of the DCA or article 101(3) of the TFEU apply.

Competition laws in the Netherlands are enforced both administratively and by means of civil litigation (private enforcement). The Dutch Competition Authority can impose fines if a franchising agreement disregards what is set forth in the VBER, particularly if the agreement contains any hardcore restrictions (eg, resale price maintenance). The maximum statutory fine is 10 per cent of the undertaking's worldwide turnover. A party to a franchising agreement claiming that the agreement infringes article 6.1 of the DCA or article 101(1) of the TFEU can invoke the nullity of the agreement (in whole or in part) before a Dutch court. The court must then decide on the applicability of the VBER or the legal exception of article 6.1 of the DCA or article 101(1) of the TFEU. If it decides in the affirmative, it must subsequently determine whether this leads to nullity of only the infringing clauses or nullity of the agreement in its entirety. The latter will be the case if the court determines that without the infringing clause, the agreement would not (or would not on similar terms) have been concluded. In a few instances, the court has nullified a franchising agreement in its entirety, notably because the franchisor engaged in resale price maintenance.

The Authority for Consumers and the Market (ACM) supervises whether franchise and distribution agreements are disadvantageous to competition and consumers in the Netherlands, in which case such agreements may be prohibited. On 26 February 2019, the ACM published [new guidelines](#) for agreements between suppliers and buyers. Around this time, the ACM announced that, in future, it would be more vigilant regarding prohibited price agreements. This also seems to match the new line of the European Commission, which, until recently, did not prioritise this subject either.

Law stated - 31 May 2024

OFFER AND SALE OF FRANCHISES

Legal definition

12 | What is the legal definition of a franchise?

In the Franchise Act, effective from 1 January 2021, the term 'franchise' has not been explicitly defined, but both 'franchise agreement' and 'franchise formula' are defined terms.

A franchise agreement is defined as follows in article 911(1) of the Franchise Act:

an agreement pursuant to which the franchisor grants a franchisee, in return for a fee, the right and the obligation to operate a franchise formula, in the manner indicated by the franchisor, for the production or sale of goods or the provision of services.

A franchise formula is defined as follows in article 911(2) of the Franchise Act:

- an operational, commercial, and organizational formula for the production or sale of goods or the provision of services that is decisive for a uniform identity and image of the franchise enterprises within the chain where this formula is applied, and that in any case comprises:
- a trademark, model or trade name, house style or design; and
- know-how: i.e. an entirety of practical information not protected by intellectual property rights, derived from franchisor's experience and from the investigations it has carried out, which information is secret, substantial, and identified[.]

Law stated - 31 May 2024

Laws and agencies

13 | What laws and government agencies regulate the offer and sale of franchises?

There were numerous discussions about the need for a franchise law or franchise code in the Netherlands. At the beginning of 2015, the Ministry of Economic Affairs appointed a committee to prepare the Dutch Franchise Code, which was finalised in February 2016. The intention of the Ministry was that franchisors and franchisees in the Netherlands could voluntarily follow this code. However, a large majority of the franchisors opposed and rejected the Franchise Code, refusing to apply it to their franchise contracts.

At the end of 2016, the Ministry proposed a draft franchise bill that would declare the Franchise Code mandatory law. This draft franchise bill was rejected by many stakeholders during the consultation phase. The newly installed Dutch government indicated, in October 2017, that it wanted to introduce new legislation in the field of franchising to enforce the position of franchisees in the pre-competitive phase. On 12 December 2018, Mona Keijzer, the Under-Secretary of Economic Affairs and Climate, presented a new draft bill on franchises to the franchise sector for consultation. It has become an independent act that does not relate any more to the widely criticised Franchise Code. This Franchise Act was adopted by the Dutch parliament and senate in mid-2020 and came into force on 1 January 2021.

Law stated - 31 May 2024

Principal requirements

14 | What are the principal requirements governing the offer and sale of franchises under the relevant laws?

The Netherlands has moved from a country where franchising was not regulated to one of the most highly regulated countries in the world. Of all the requirements under the Franchise Act, seeking consent from the majority of the franchisees to innovate and change the franchise formula but also to start with a derived formula may become the greatest challenge for franchise formulas. According to article 911(2) of the Franchise Act, a derived formula is an operational, commercial and organisational formula that:

1. is decisive for a uniform identity and image of the enterprises in which this formula is applied;
2. corresponds to a franchise formula in one or more distinctive features that are recognisable to the public; and
3. is used directly or through third parties by a franchisor for the production or sale of goods, or the provision of services that are wholly or largely the same as the goods or services covered by the franchise formula within the meaning mentioned in (2).

A consequence of a derived formula could be that it competes with a franchisee's business operation.

Regarding the maintenance of the franchise relationship between franchisor and franchisee, the general obligation for them to behave 'as a good franchisor and a good franchisee' toward each other is stipulated in the Franchise Act. Furthermore, the provision

of assistance and commercial and technical support by the franchisor to the franchisee is one of the core elements of a franchise relationship.

Other principal requirements are:

- providing prospective franchisees with financial information, either historically if available for the franchisee's location or for similar locations, wherein the franchisor must explain why it has decided that the locations are similar and where it may deviate (this could lead to prognosis claims later on when results at the franchisee's location are lower than projected);
- sharing financial information with franchisees during the co-operation, including how the fees contributed by the franchisees are being spent and arguably also kick-backs or bonuses provided by suppliers, but guidelines on this are not currently explicit;
- agreeing on a goodwill calculation in the franchise agreement; and
- complying with non-compete restrictions.

Law stated - 31 May 2024

Franchisor eligibility

- 15** | Must franchisors satisfy any eligibility requirements in order to offer franchises? Are there any related practical issues or guidelines that franchisors should consider before offering franchises?

There are no specific requirements that must be met before a franchisor may offer franchises.

Law stated - 31 May 2024

Franchisee and supplier selection

- 16** | Are there any legal restrictions or requirements relating to the manner in which a franchisor recruits franchisees or selects its or its franchisees' suppliers? What practical considerations are relevant when selecting franchisees and suppliers?

Good franchising practice suggests that the franchisor should employ a careful process for recruiting and selecting franchisees, as the franchisor and its other franchisees may be negatively impacted by the improper operation of that franchise formula by an incompetent franchisee. This can damage the image and strength of the franchise chain and is therefore not compatible with good franchising practice.

Law stated - 31 May 2024

Pre-contractual disclosure – procedures and formalities

- 17** |

What procedures and formalities for pre-contractual disclosure are required or advised in your jurisdiction? How often must the disclosures be updated?

The Franchise Act puts far-reaching disclosure obligations on a franchisor in the pre-contractual phase towards the prospective franchisee. This includes any information that is or could reasonably be relevant and this information should enable the franchisee to make a well-considered decision to enter into a franchise agreement. The franchisee provides the franchisor with timely information about its financial position, insofar as it is reasonably relevant to enter into the franchise agreement. According to the explanatory memorandum accompanying the Franchise Act, the information should be clear, comprehensible, unambiguously formulated and tailored to the average franchisee. As an example, the explanatory memorandum suggests the addition of an explanatory note in the franchise agreement that explains the most important rights and obligations in the franchise agreement and their impact. This information should be provided at least four weeks prior to entering into the franchise agreement. During this standstill period, it is not allowed to amend the draft franchise agreement, unless such amendment is to the benefit of the prospective franchisee. It is also not possible for the franchisor to request investments or other payments from the franchisee in view of the upcoming franchise relationship. The standstill period enables the prospective franchisee to fulfil its duty of investigation, to assess all the documents, to engage an expert, and to come to further questions or obtain further consultation about the content and the implementation of the franchise agreement. Since the franchise disclosure document contains the franchisor's confidential information, the prospective franchisee can be obliged to sign a non-disclosure agreement before receiving the franchise disclosure document.

Law stated - 31 May 2024

Pre-contractual disclosure – content

18 | What information is the disclosure document required or advised to contain?

The prospective franchisee must provide the franchisor with timely information about his or her financial position if it is reasonably relevant to enter into the franchise agreement. Furthermore, the franchisor must provide the prospective franchisee, in a timely manner, with:

- the draft of the franchise agreement, including its appendices;
- a statement of the content and scope of rules regarding fees, surcharges, or other financial contributions to be paid by the franchisee or regarding the investments required from the franchisee; and
- information about:
 - the manner and frequency of any consultation between the franchisor and the franchisees and, if available, the contact details of the body representing the franchisees;
 -

the extent to and the manner in which the franchisor can enter into competition with the franchisee, including whether this may be by means of a derived formula; and

- the extent to, the frequency with and the manner in which the franchisee will have access to turnover-related data relating to the franchisee or relevant to the franchisee's business operations.

In addition, the franchisor must provide the prospective franchisee with the following information (if available to the franchisor, to a subsidiary or to a group company affiliated with the franchisor) in a timely manner if it is reasonably relevant to the conclusion of the franchise agreement:

- information about the franchisor's financial position; and
- financial data regarding the intended location of the franchise enterprise or, if such information is not available, financial data of one or more enterprises considered by the franchisor to be comparable, along with information from the franchisor making it clear the reasons why he or she considers them to be comparable.

Furthermore, the franchisor must provide the prospective franchisee with all other information that he or she knows, or can reasonably assume, to be relevant for the conclusion of the franchise agreement.

Law stated - 31 May 2024

Pre-sale disclosure to sub-franchisees

- 19** | In the case of a sub-franchising structure, who must make pre-sale disclosures to sub-franchisees? If the sub-franchisor must provide disclosure, what must be disclosed concerning the franchisor and the contractual or other relationship between the franchisor and the sub-franchisor?

In the Franchise Act and its explanatory memorandum, the situation of sub-franchising and the rights and obligations of the involved parties are not mentioned. Also, as there is currently no case law available on this subject, it is unclear how courts will address sub-franchising. However, it seems to be most logical that the party who concludes the franchise agreement with the sub-franchisees will be the party obliged to fulfil all disclosure requirements. This will generally be the sub-franchisor.

Law stated - 31 May 2024

Due diligence

- 20** | What due diligence should both the franchisor and the franchisee undertake before entering a franchise relationship?

Good franchising practice suggests that the franchisor must employ a careful process for recruiting and selecting franchisees. After all, the franchisor and other franchisees operating the franchise formula in question may be negatively impacted by improper operation of that franchise formula by an incompetent franchisee. This can damage the image and strength of the franchise chain and is therefore not compatible with good franchising practice.

Incidentally, the provision of information is not a one-way street. The prospective franchisee has an obligation to provide the franchisor with timely information about its financial position 'to the extent reasonably relevant to the conclusion of the franchise agreement', as stipulated in article 913(3) of the Franchise Act. The franchisee also has a special duty of investigation. The franchisee is obliged, within the limits of reasonableness and fairness, to take necessary measures to avoid entering into a franchise agreement under the influence of incorrect assumptions. This is intended to prevent the franchisee from relying solely on communications from the franchisor. In doing so, the franchisee may be expected to maintain a critical attitude. In certain circumstances, this may involve the franchisee seeking external advice from trade associations or other experts.

Law stated - 31 May 2024

Failure to disclose – enforcement and remedies

- 21 | What actions may franchisees or any relevant government agencies take in response to a franchisor's failure to make required disclosures? What legal remedies are available? What penalties may apply?

The Franchise Act is mandatory law. Deviating from the main provisions in a franchise agreement to the disadvantage of a franchisee operating in the Netherlands is not permitted. Such deviating clauses are invalid. If the franchise agreement contains deviating clauses, they cannot be invoked. When the franchisor does not provide the franchisee with the required information, either before the conclusion of the franchise agreement or thereafter, this could render the franchisor liable for any decisions that the franchisee makes without knowledge of such information when afterwards the franchisee claims that, with the required information, it would have decided otherwise or maybe would not even have concluded the franchise agreement. Consequently, the franchise agreement itself could be annulled and the franchisor may be compelled to compensate the franchisee for all fees paid, investments and costs made in the execution of the franchise agreement. The franchisee usually has three years to nullify all or part of the franchise agreement, which would require undoing the services rendered back and forth (including all payments, investments and costs made).

Another risk arises when a franchisor does not request the consent of its franchisees for certain changes (for instance, changes to the franchise formula, required investments, additional costs, or changes that may impact the revenue of the franchisees or the development and implementation of a derived formula) and the franchisees are of the opinion that those changes will have a negative financial impact. In these cases, the franchisees (either individually or with other franchisees) may claim damages or costs as a result of the decision made by the franchisor. The franchisees may also try to stop the franchisor from implementing new elements, decisions or a derived formula by

requesting court intervention, for example, a preliminary injunction, with the argument that the franchisees had not given their consent for these changes. The court could rule that the franchisor is not at liberty to implement certain changes and could be subject to penalties.

Law stated - 31 May 2024

Failure to disclose – apportionment of liability

- 22 | In the case of sub-franchising, how is liability for disclosure violations shared between franchisor and sub-franchisor? Are individual officers, directors and employees of the franchisor or the sub-franchisor exposed to liability? If so, what liability?

In the Franchise Act and its explanatory memorandum, the situation of sub-franchising and the rights and obligations of the involved parties are not mentioned. Also, as there is currently no case law available on this subject, it is unclear how courts will address sub-franchising. However, it seems logical that the party who concludes the franchise agreement with the sub-franchisees will be the party obliged to fulfil all disclosure requirements. This will generally be the sub-franchisor.

Under Dutch law, private companies with limited liability and public companies limited by shares both have legal personality. In principle, therefore, liability rests with the business and not with individual officers, directors or employees. Individual officers or directors are only exposed to liability in the event of improper management on their part that amounts to personal culpability of the directors. The burden of proof rests on the franchisee.

Law stated - 31 May 2024

General legal principles and codes of conduct

- 23 | In addition to any laws or government agencies that specifically regulate offering and selling franchises, what general principles of law affect the offer and sale of franchises? What industry codes of conduct may affect the offer and sale of franchises?

General civil law principles

In addition to the Franchise Act, the general laws of contract apply as well as Dutch court decisions. Book 6 of the Dutch Civil Code sets out the requirements relating to the formation of contracts. These provisions must be read in conjunction with the more general rules regarding juridical acts; that is, acts intended to invoke legal consequences provided in Book 3 of the Dutch Civil Code. In the legal literature and jurisprudence, certain rules of law in relation to franchises have been developed. It is important to be aware that all contracts concluded under Dutch law are subject to the general requirements of reasonableness and fairness.

EU and Dutch competition laws

Besides the Franchise Act and general civil law aspects, European and Dutch competition laws play an important role. The new Vertical Block Exemption Regulation is very important in this respect, as well as the Guidelines thereto. The Dutch Competition Authority ensures compliance with European and Dutch competition laws and recently announced it will intensify its efforts to enforce those vertical rules.

European code of ethics

Franchisors who are members of the Dutch Franchise Association are bound by the rules in the European Code of Ethics for Franchising drawn up by the [European Franchise Federation](#).

Law stated - 31 May 2024

Fraudulent sale

24 | What actions may franchisees take if a franchisor engages in fraudulent or deceptive practices in connection with the offer and sale of franchises?

Besides the options under the Franchise Act and general civil law, a franchisee could benefit from the Acquisition Fraud Act and its possible consequences for the franchise practice. This act provides that a person acting in the course of a profession or business is acting unlawfully towards another professional party if he or she makes statements to the other party that are misleading in one or more respects. Incidentally, it is not only misleading if untruths are told, but also if essential information is omitted, such as information that the other party needed precisely to make an informed decision about the transaction in question. This act dictates that the party that made the announcements must state and prove that the announcements were correct and complete. In contrast to the 'normal' law of evidence, the other party is not obliged to prove that these communications were incorrect or incomplete. This results in a significant easing of the burden of proof for the injured party.

If a franchisor engages in fraudulent or deceptive practices, the franchisee may base a claim for annulment of the contract against the franchisor due to deceit, error or misrepresentation. If the actions or omissions of the franchisor also qualify as a civil tort, which is always accepted in cases of deceit, the franchisor has an obligation to compensate all of the franchisee's damages.

Law stated - 31 May 2024

FRANCHISE CONTRACTS AND THE FRANCHISOR/FRANCHISEE RELATIONSHIP

Franchise relationship laws

25 | What laws regulate the ongoing relationship between franchisor and franchisee after the franchise contract comes into effect?

The Franchise Act, which came into effect on 1 January 2021, also regulates how the parties should act towards each other during the course of the franchise agreement. Namely, the franchisor should provide the franchisee with information during the relationship and both parties need to act as a 'good franchisor' and a 'good franchisee' respectively. This last concept is very comparable with a principle that already existed in Dutch civil law that parties need to act reasonably and fairly towards each other, and take into account the other parties' interests.

Law stated - 31 May 2024

Operational compliance

26 | What mechanisms are commonly incorporated in agreements to ensure operational consistency and adherence to brand standards?

It is common in franchise relationships to incorporate operational procedures and brand standards in manuals with the obligation in the franchise agreement on franchisees to comply with these manuals. In addition, often franchise agreements contain reporting and information obligations on the franchisee. Inspection and audit rights are less common, but can also be part of the franchise agreement.

Law stated - 31 May 2024

Amendment of operational terms

27 | May the franchisor unilaterally change operational terms and standards during the franchise relationship?

If the franchisor intends to alter the franchise formula using a provision contained in the franchise agreement or intends to have a derived formula (operated directly or through third parties) without amending the franchise agreement, and the franchisor requires from the franchisee an investment, fee, surcharge or other financial contribution or can reasonably foresee that the implementation will lead to costs or loss of turnover, the following applies.

If the required monetary contribution exceeds a certain financial threshold set out in the franchise agreement, the franchisor requires prior consent to implement the plan in question from:

- a majority of the franchisees established in the Netherlands with whom the franchisor has concluded a franchise agreement concerning the franchise formula; or
- each of the franchisees established in the Netherlands that are affected by the intended plan.

Examples of an alteration of the franchise formula are the introduction of new product groups or new services (or disposal thereof), focusing the franchise formula on new target

groups and exploring new marketing channels. Loss of turnover will likely occur if the franchisor intends to exploit a derived formula within the exclusive territory of the franchisee. In that event, the franchisor competes with its franchisees by using a derived formula directly operated by the franchisor or through third parties. It is advisable to add a financial threshold to the franchise agreement to determine the discretion of the franchisor regarding the alteration of the franchise formula or the use of a derived formula. This amount can be tailored to the type of franchise, the relevant sector and supply chain, and the size of the franchise enterprise. However, the proposed financial threshold requires the consent of the franchisee. If the financial threshold is not specified in the franchise agreement, prior consent will always be required from franchisees, regardless of the extent of the required investment, financial contribution, or costs or loss of turnover. The franchisor can benefit from the presence of a representative body of franchisees to obtain the necessary consent from the majority (that is, at least 50 per cent) of the franchisees. This could be less time-consuming than obtaining consent from the individual franchisees concerned.

Law stated - 31 May 2024

Policy affecting franchise relations

28 | Do other government or trade association policies affect the franchise relationship?

The European Franchise Code (EFC) implemented by the Dutch Franchise Association (NFV) may affect the franchise relationship when the franchisor is a member of the NFV. For example, the EFC stipulates that the franchisor must provide the franchisee with initial training and continuing commercial and technical assistance during the entire term of the agreement.

Law stated - 31 May 2024

Termination by franchisor

29 | In what circumstances may a franchisor terminate a franchise relationship? What are the specific legal restrictions on a franchisor's ability to terminate a franchise relationship?

Either party may have cause to terminate the franchise agreement in the case of a serious breach of obligations by the other party. The criteria for what constitutes a serious breach should be carefully considered before actually terminating, because Dutch courts have the discretion to decide that a certain circumstance does not qualify as a sufficiently serious breach, notwithstanding the fact that this may have been agreed by the parties in the franchise agreement.

In the case of termination of the franchise agreement by the franchisee without cause, a legal distinction should be made between contracts concluded for a definite and an indefinite duration. Contracts of definite duration can generally not be terminated before the end of the contract term unless the possibility to terminate early – without cause – has been specifically agreed upon. Early termination, in most situations, results in liability of

the terminating party. If a franchisee terminates a contract for a definite term prematurely without cause, the franchisor can claim continued performance or damages. The damages could consist of lost royalties of the franchisor, calculated over the remaining term of the contract, and costs and investments that the franchisor was not able to redeem owing to the premature termination.

In the case of a contract for an indefinite duration, the leading view recently affirmed by the Dutch High Court is that the contract may in principle be terminated by either party. However, the franchisee must respect a reasonable notice period, the length of which depends on the circumstances of the matter. If the franchisee terminates a contract without cause or does not respect a reasonable notice period, the franchisor could claim continued performance during the period that should have been respected by the franchisee, or instead claim financial compensation for damages.

Law stated - 31 May 2024

Termination by franchisee

30 | In what circumstances may a franchisee terminate a franchise relationship?

Either party may have cause to terminate the franchise agreement in the case of a serious breach of obligations by the other party. The criteria for what constitutes a serious breach should be carefully considered before actually terminating, because Dutch courts have the discretion to decide that a certain circumstance does not qualify as a sufficiently serious breach, notwithstanding the fact that this may have been agreed by the parties in the franchise agreement.

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Law stated - 31 May 2024

Renewal

- 31** | How are renewals of franchise agreements usually effected? Do formal or substantive requirements apply?

In practice, franchise agreements are often continued without the conclusion of a new formal agreement, dependent on the arrangements in the pending franchise agreement. Under Dutch law, no formal or substantive requirements apply.

Law stated - 31 May 2024

Refusal to renew

- 32** | May a franchisor refuse to renew the franchise agreement with a franchisee? If yes, in what circumstances may a franchisor refuse to renew?

Whether a franchisor may refuse to renew the franchise agreement with a franchisee depends primarily on the content of the agreement. Often, the possibilities and conditions for renewal are specified in the agreement. When there is no contractually agreed renewal mechanism, a franchisor may be able to terminate the relationship by not renewing the franchise agreement if it complies with a reasonable notice term. The franchisor may sometimes be required to compensate costs and investments of the franchisee and, in exceptional circumstances, a 'good reason' will be required. Furthermore, where the franchisor can prove that the franchisee is in breach of its material obligations, the franchisor may refuse to renew the agreement on the basis of breach of contract. In certain circumstances, the franchisor will be obliged to compensate the franchisee upon termination; for example, if the franchisor or a new franchisee takes over the franchise business, based on the Franchise Act the franchisor would be required to pay the franchisee a goodwill compensation. The calculation of the goodwill compensation should be specified in the franchise agreement.

Law stated - 31 May 2024

Transfer restrictions

- 33** | May a franchisor restrict a franchisee's ability to transfer its franchise or restrict transfers of ownership interests in a franchisee entity?

A general provision regarding contract transfers is set out in the Dutch Civil Code. A contracting party may, only with the consent of the other party, transfer its rights and obligations under the contract to a third party. Therefore, a franchisee may only transfer the franchise with the franchisor's consent. Often the franchise agreement contains a right for franchisor to refuse a transfer on objective grounds such as certain capabilities or its financial position. A franchisor will not normally refuse such a transfer where the third party meets the selection criteria. It can be contractually arranged that the franchisee should first offer the business to the franchisor on the same terms as those that the franchisee would

offer to the third party. Based on the Franchise Act, the franchisor must pay the franchisee a goodwill compensation in the event that it takes over the franchise business.

Law stated - 31 May 2024

Fees

34 | Are there laws or regulations affecting the nature, amount or payment of fees?

Franchising fees are not regulated by law. In practice, however, different types of franchise fees can be distinguished, for example:

- an entrance fee, which is a one-off payment that the franchisee pays to the franchisor and that represents a contribution towards the costs that the franchisor has incurred in the expansion of its chain and establishment of goodwill;
- a continuing franchising fee, which is a regular fee for the use of the franchise system, usually based on a percentage of profits that the franchisee has realised within a given term;
- a marketing fee, to cover marketing and promotion expenses; and
- IT fees for the use of certain technology or hardware.

When specific costs are being charged, according to the Franchise Act the franchisor is obliged to show and substantiate that those costs have actually been made.

Law stated - 31 May 2024

Usury

35 | Are there restrictions on the amount of interest that can be charged on overdue payments?

Under freedom of contract between professional parties, in principle, the parties are free to agree on the interest rates to be applied. If the parties did not agree on any interest rate, Dutch statutory trade interest applies automatically in the event of late payment. If no payment term has been agreed, then it is set automatically at 30 days after having received the invoice. On 16 March 2013, a new act entered into force, implementing Directive 2011/7/EU to prevent payment delays in commercial agreements. This act gives creditors more opportunities to recover their claims. Even though professional parties can agree upon payment terms, the act dictates that only in exceptional circumstances can a payment term longer than 60 days be agreed upon. When acting with governmental agencies, the maximum payment term should be 30 days and only in exceptional circumstances can it be longer than this, but it may never exceed 60 days. Based on this act, a creditor can claim a minimum compensation of €40 for the costs of recovery. Under this act, the statutory trade interest is increased by 1 per cent. This act does not apply to transactions with private consumers.

The Dutch statutory interest rate in commercial matters as of 1 January 2024 amounts to an annual percentage of 12.5 per cent. For transactions with consumers, a lower annual interest rate of 7 per cent applies.

Law stated - 31 May 2024

Foreign exchange controls

36 | Are there laws or regulations restricting a franchisee's ability to make payments to a foreign franchisor in the franchisor's domestic currency?

In principle, there are no laws or regulations restricting this ability, unless there are sanctions in place regarding certain states or the inhabitants thereof.

Law stated - 31 May 2024

Confidentiality covenant enforceability

37 | Are confidentiality covenants in franchise agreements enforceable?

Confidentiality covenants in franchise agreements are, in principle, enforceable. The franchisee typically commits itself for the duration of the contract (and following its termination) to keeping all details of the franchisor's business operations confidential. This typically extends to non-patented know-how materials. The franchisee is legally obliged to treat certain information received from the franchisor as confidential, according to the law on the protection of business secrets that has been in force since 17 October 2018. This law is based on the Directive 2016/943/EU on the protection of undisclosed know-how and business information (trade secrets) against their unlawful acquisition, use and disclosure. Although there may be a legal obligation to keep certain information confidential, it is still recommended to include a clear confidentiality clause in the franchise agreement, including a penalty clause in the event of confidentiality breaches. The courts have the right to mitigate such penalties and this right cannot be contractually excluded.

Law stated - 31 May 2024

Good-faith obligation

38 | Is there a general legal obligation on parties to deal with each other in good faith during the term of the franchise agreement? If so, how does it affect franchise relationships?

In the Netherlands, general civil law is governed by the principles of reasonableness and fairness. In the Franchise Act, this is made specific with the introduction of the obligation that the franchisor must act as a 'good franchisor' and the franchisee must act as a 'good franchisee'. Those principles may not only supplement the existing contract and relationship, but may also derogate from the contract that the parties agreed upon at an

earlier stage, in the event that such provision is, in the given circumstances according to the principle of reasonableness and fairness, unacceptable. The standard required to derogate from an agreed provision is high. Franchisors in particular should be aware that a provision in an existing contract that is very one-sided (eg, a provision that the franchise relationship may be terminated by the franchisor at any given moment, respecting a notice term of only 30 days), could be set aside by the principle of reasonableness and fairness, if such provision is unacceptable in the given circumstances.

It is not possible to predict what kind of provisions may be set aside, if any, as the court considers all relevant circumstances, including:

- the economic power of each party;
- the dependency of the parties from each other;
- the duration of the contract;
- the investments made by either party;
- what each party could reasonably expect from the other party; and
- all other relevant circumstances.

As a general rule, Dutch courts generally tend to protect weaker or smaller parties at the expense of economically stronger or larger parties. However, this certainly does not mean that, simply by being a weaker party, certain clauses will be set aside. This depends on all the circumstances of the matter.

Law stated - 31 May 2024

Franchisees as consumers

39 | Does any law treat franchisees as consumers for the purposes of consumer protection or other legislation?

When dealing with a very small franchisee, there is a possibility that general conditions – even potentially including a standard franchise agreement, or a part thereof – may be annulled because of reflex action of articles 6:236–238 of the Dutch Civil Code. Those articles deal with the ‘black’ and ‘grey’ lists, which set out prohibited clauses in general conditions for consumers.

Law stated - 31 May 2024

Language of the agreement

40 | Must disclosure documents and franchise agreements be in the language of your country?

The parties may agree to draw up contracts in whichever language they choose. However, based on the Franchise Act, it is arguable that disclosure documents, the franchised

agreement and any related documentation should be made available in a language that the franchisee understands.

Law stated - 31 May 2024

Restrictions on franchisees

41 | What types of restrictions are commonly placed on the franchisees in franchise contracts?

Some provisions (such as exclusive territories, restrictions on sources from whom a franchisee may purchase or lease goods or services, prohibitions on franchisees soliciting the franchisor's or other franchisees' employees, non-competition, governing law, dispute resolution, etc, are commonly placed on the franchisees in a franchise agreement. However, based on EU and Dutch competition laws, certain provisions would be void, for example, restrictions on the group of customers or price fixing.

Law stated - 31 May 2024

Courts and dispute resolution

42 | Describe the court system. What types of dispute resolution procedures are available relevant to franchising?

Franchise agreements generally contain a dispute resolution clause, in which a competent court or a form of arbitration is explicitly chosen. Arbitration through the [Netherlands Arbitration Institute](#) (NAI) is well regarded and is generally less expensive than the more internationally well-known International Chamber of Commerce (ICC) arbitration.

In cases where there is no valid arbitration provision, the sub-district court is competent in smaller claims (namely, for amounts less than €25,000) and for particular issues, such as employment and rent-related disputes. Larger claims may be brought before the civil judge of the district court.

Qualified registered mediators can assist with mediation for parties seeking out-of-court remedies.

The Netherlands Commercial Court (NCC) was created on 1 January 2019. It is a chamber in the Amsterdam District Court, where parties may litigate before the Dutch court in the English language. A matter may be submitted to the NCC where:

- the Amsterdam District Court or Amsterdam Court of Appeal has jurisdiction;
- the parties have expressly agreed in writing that proceedings will be in English before the NCC;
- the action is a civil or commercial matter within the parties' autonomy; or
- the matter concerns an international dispute.

Law stated - 31 May 2024

Governing law

- 43** | Are there any restrictions on designating a foreign governing law in franchise contracts in your jurisdiction? How does the governing law affect the contract's enforceability?

Franchisors cannot derogate from the Franchise Act in a franchise agreement, even if foreign law has been agreed upon, when franchisees are operating in the Netherlands. If Dutch law is applicable but a franchisee is located outside the Netherlands, the franchisor may deviate from the franchise agreement to the detriment of a franchisee.

Law stated - 31 May 2024

Arbitration – advantages for franchisors

- 44** | What are the principal advantages and disadvantages of arbitration for foreign franchisors considering doing business in your jurisdiction? Are any other alternative dispute resolution (ADR) procedures particularly favoured or disfavoured in your jurisdiction?

The principal advantages of arbitration are as follows.

- arbitration offers a choice regarding the language of proceeding; the regular courts in the Netherlands only accept the Dutch language (with the exception of the Netherlands Commercial Court);
- it is possible to agree on the country and area where the proceedings will be conducted;
- it is possible to choose the number of arbitrators and the time limitations;
- arbitration is, generally speaking, finalised more quickly than regular court procedures;
- arbitration may be dealt with by appointed experts instead of or in addition to lawyers; and
- involved parties can agree to observe secrecy in arbitration, whereas regular court proceedings are public.

The principal disadvantages of arbitration are that, in general, arbitration is much more expensive than regular court proceedings, regular court proceedings offer the possibility of appeal whereas arbitration does not, and the quality of arbitration may not always be ensured. This depends on the arbitration forum, although NAI and ICC arbitration in general is of good quality.

Law stated - 31 May 2024

National treatment

45 | In what respects, if at all, are foreign franchisors treated differently (legally, or as a practical matter) from domestic franchisors?

In principle, there is no difference in the treatment of foreign and domestic franchisors. However, the Franchise Act states that franchisors with franchisees operating outside the Netherlands should be able to deviate from the binding provisions in the Franchise Act, even when Dutch law is applicable to the franchise agreement. Franchisors with franchisees operating in the Netherlands are not allowed to deviate from the binding provisions in the Franchise Act, even when another (foreign) law system is applicable to the franchise agreement.

Law stated - 31 May 2024

UPDATE AND TRENDS

Legal and other current developments

46 | Are there any proposals for new legislation or regulation, or to revise existing legislation and regulation? Are there other current developments or trends to note?

The Franchise Act has been in effect since 1 January 2021 and needed to be respected from that date onwards for all new franchise agreements as well as for renewals. The transitional period of two years has expired and since 1 January 2023, all franchise agreements, including already existing franchise agreements, must fully comply with the Franchise Act.

Law stated - 31 May 2024



Tessa de Mönnink
Annelies van Zoest

monnink@parkeradvocaten.nl
zoest@scopeadvocaten.nl

Parker Advocaten

[Read more from this firm on Lexology](#)

New Zealand

Stewart Germann

Stewart Germann Law Office

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MARKET OVERVIEW

Franchising in the market

- 1 | How widespread is franchising in your jurisdiction? In which sectors is franchising common? Are there any economic or regulatory issues in the market that are more or less hospitable to franchising or make it economically viable in your jurisdiction?

Franchising is very active in New Zealand. The last survey carried out in 2021 by Massey University and Griffith University confirmed that there are 590 business-format franchise systems operating. The sectors in which franchising operates include administration and support services (34 per cent), other services (14 per cent), retail trade (non-food) (11 per cent), accommodation and food retail (11 per cent), and transport, postal and warehousing (9 per cent).

Law stated - 12 June 2024

Associations

- 2 | Are there any national or local franchise associations? What is their role in franchising, including any impact on laws or regulations? Are there any rules of conduct or membership requirements?

The [Franchise Association of New Zealand Incorporated](#) (FANZ) was formed in July 1996 and all members must comply with the FANZ Code of Practice and the Code of Ethics.

Law stated - 12 June 2024

BUSINESS OVERVIEW

Types of vehicle

- 3 | What forms of business entities are relevant to the typical franchisor?

Most franchisors conduct business in New Zealand as an incorporated company. Sole traders and partnerships are used and occasionally a franchisor may be a trading trust. Joint ventures are uncommon in New Zealand.

Law stated - 12 June 2024

Regulation of business formation

- 4 | What laws and agencies govern the formation of business entities?

The [Companies Act 1993](#) applies to all companies incorporated in New Zealand and to companies with an overseas shareholding. It does not apply to companies incorporated in

another country, unless such a company has been registered as an overseas company on the New Zealand Register of Companies. If a trading trust is used, then the [Trusts Act 2019](#) applies. The relevant agency is the [Ministry of Business, Innovation and Employment](#).

Law stated - 12 June 2024

Requirements for forming a business

- 5 | Provide an overview of the requirements for forming and maintaining a business entity.

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 give written consent 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 fee is NZ\$136.55. 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, please note the following:

- 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.

In relation to maintaining records with the Companies Office, company authority will be granted to directors and also to certain authorised persons (such as the person who incorporates the company online) allowing them to maintain up-to-date company information on the Register of Companies (such as resignation or appointment of directors, change of addresses, and filing annual returns).

Law stated - 12 June 2024

Restrictions on foreign investors

- 6 | What restrictions apply to foreign business entities and foreign investment?

Pursuant to the [Financial Reporting Act 2013](#), a company must be audited and must file financial statements if a large foreign business entity holds 25 per cent or more of the shareholding in a company and, at the balance date for the two preceding account periods:

- the total assets for the company and its subsidiaries were more than NZ\$20 million; or
- the total revenue was more than NZ\$10 million.

In relation to foreign investment, there are no barriers to 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 (eg, 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.

Law stated - 12 June 2024

Taxation

7 | What aspects of the tax system are relevant to franchisors? How are foreign businesses and individuals taxed?

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 5 per cent for royalties. In relation to the United Kingdom, Taiwan 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.

Law stated - 12 June 2024

Labour and employment

8 | Are there any relevant labour and employment considerations for typical franchisors?

The [Employment Relations Act 2000](#) applies in New Zealand. Union membership is voluntary, but there must be a written employment contract in relation to every employee of a franchisee. Strict procedures must be followed before employment can be terminated and any breach of these procedures could give rise to a personal grievance action that may cost the employer many thousands of dollars. Any properly drafted franchise agreement should contain a clause stating that a franchisor and a franchisee are not in a relationship of employer or employee, but that any franchisee must comply with New Zealand employment law.

Law stated - 12 June 2024

Intellectual property

9 | How are trademarks and other intellectual property and know-how protected?

The [Trade Marks Act 2002](#) is the relevant statute and all trademarks must be registered in New Zealand. The relevant body to deal with this is the [Intellectual Property Office of New Zealand](#). Trademark registrations last for 10 years and must then be renewed. Know-how is protected by normal intellectual property laws and would be deemed to be included in the definition of trade secrets; any properly drafted franchise agreement will include know-how in the definition of intellectual property and should contain a robust intellectual property clause.

Law stated - 12 June 2024

Real estate

10 | What are the relevant aspects of the real estate market and real estate law? What is the practice of real estate ownership versus leasing?

All real estate in New Zealand is recorded by [Land Information New Zealand](#), which provides a registered title for each piece of land. Titles can be freehold, leasehold, strata, cross-lease or some combination. If the property being purchased is on a unit title (which would mean that there would be a stratum estate of freehold under the [Unit Titles Act 2010](#)), an overseas franchisor can own land. However, if the land is greater than five hectares in area or will result in overseas investment in other 'sensitive' land (eg, 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.

Franchisors can lease commercial buildings without restriction. If real estate agents are engaged, they must comply with the [Real Estate Agents Act 2008](#). Franchisors who request real estate agents to find premises for them will have to pay an agreed commission to the relevant agents. The [Property Law Act 2007](#) is also relevant in relation to real estate and must be consulted.

Law stated - 12 June 2024

Competition law

11 | What aspects of competition law are relevant to the typical franchisor in your jurisdiction? How is competition law enforced in the franchising sector?

The [Commerce Act 1986](#) provides the regulatory framework relating to anticompetitive conduct and the Commerce Commission is charged with policing that framework. The [Commerce \(Cartels and Other Matters\) Amendment Act 2017](#) made significant changes and replaced the previous prohibition on price-fixing between competitors with an

expanded prohibition on cartel provisions, which extends to market allocations and output restrictions as well as to price-fixing by competitors.

The New Zealand cartel prohibition is very wide and will have a strong impact on franchise networks. Some additional clauses must be inserted into franchise agreements and there should be explanations as to why certain clauses are necessary. Consideration must be given to cartel clauses in franchise agreements. For example, clauses that set or influence prices, restrict output, or allocate markets will be impacted. The possibility that alternative arrangements might achieve the same or a similar commercial outcome as a cartel clause should also be considered. Another consideration is whether the collaborative activity exemption or the vertical activity exemption would apply. Expert legal advice should be obtained in relation to this 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 directly to the end consumer, yet at the same time has franchisees who sell to those consumers, the franchisor may be in competition with its franchisees. There may also be instances where 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 cognisant that there may be provisions in its franchise agreements that amount to cartel provisions.

The Commerce Act 1986 provides a number of statutory exceptions that would not constitute a cartel arrangement and may be pro-competitive. These exceptions relate to collaborative activities (eg, joint ventures or franchise arrangements), joint buying, vertical supply contracts and specified liner shipping arrangements. There are no defences for mistakes of fact relating to the elements of joint buying or of promotion and vertical supply contracts.

The [Commerce \(Criminalisation of Cartels\) Amendment Act 2019](#) has introduced a new criminal offence for cartel conduct and the criminal sanctions reflect the covert nature of cartels and the harm they cause to consumers and the economy. For an individual who commits an offence, the penalty on conviction could be imprisonment for a term not exceeding seven years or a fine not exceeding NZ\$500,000, or both. For a company that commits an offence, the penalty could be up to NZ\$10 million.

Law stated - 12 June 2024

OFFER AND SALE OF FRANCHISES

Legal definition

12 | What is the legal definition of a franchise?

There is no franchise-specific legislation in New Zealand, so there is no legal definition of a franchise. However, the Franchise Association of New Zealand (FANZ) was formed in July 1996 and all members must comply with the FANZ Code of Practice. The Code of Practice,

in section 2.1, defines 'franchise' as a business operated as a franchise, and that term is further defined in the rules as follows:

'Franchise' means the 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 the use of 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; and
- the requirement that the Franchisee conducts the business, or that part of the business subject to the Franchise Agreement, in accordance with the marketing, business or technical plan or system specified by the Franchisor; and
- the provision by the Franchisor of ongoing marketing, business or technical assistance during the term of the Franchise Agreement.

Law stated - 12 June 2024

Laws and agencies

13 | What laws and government agencies regulate the offer and sale of franchises?

No government agencies regulate the offer and sale of franchises. However, there are a number of laws that must be complied with, including the Commerce Act 1986, the [Fair Trading Act 1986](#) and the Real Estate Agents Act 2008. If a broker is used by a franchisor to assist with the sale of franchises, then the following procedures will be relevant.

All real estate in New Zealand is recorded by Land Information New Zealand, which provides a registered title for each piece of land. Titles can be freehold, leasehold, strata, cross-lease or some combination. If the property being purchased is on a unit title (which would mean that there is a stratum estate of freehold under the Unit Titles Act 2010), an overseas franchisor can own land. However, if the land is greater than five hectares in area or will result in overseas investment in other 'sensitive' land (eg, 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.

Franchisors can lease commercial buildings without restriction. If real estate agents are engaged, they must comply with the Real Estate Agents Act 2008. Franchisors that request real estate agents to find premises for them must pay an agreed commission to the relevant

agents. The Property Law Act 2007 is also relevant in relation to real estate and must be consulted.

Law stated - 12 June 2024

Principal requirements

- 14 | What are the principal requirements governing the offer and sale of franchises under the relevant laws?

A franchisor can offer a new franchise territory (a greenfield franchise) directly to a franchisee without having to comply with the Real Estate Agents Act 2008 so long as it is selling the franchises on its own behalf and not acting on behalf of someone else. If the franchisor appoints a real estate agent, then the real estate agent would need to be licensed under the Real Estates Agents Act 2008.

If a franchisee or business broker wishes to sell an existing franchise to a third party (who would be the incoming franchisee), then the business broker must be a licensed real estate agent under the Real Estate Agents Act 2008.

Law stated - 12 June 2024

Franchisor eligibility

- 15 | Must franchisors satisfy any eligibility requirements in order to offer franchises? Are there any related practical issues or guidelines that franchisors should consider before offering franchises?

There is no law in New Zealand that would create such a requirement. To become a member of FANZ, the Association's rules require a franchisor member to have a written franchise agreement and disclosure document, be financially sound and have the appropriate authorities to franchise, and provide the board with such documentary verification as it requires to support membership.

Law stated - 12 June 2024

Franchisee and supplier selection

- 16 | Are there any legal restrictions or requirements relating to the manner in which a franchisor recruits franchisees or selects its or its franchisees' suppliers? What practical considerations are relevant when selecting franchisees and suppliers?

There are no laws, regulations or government policies that provide any restrictions in terms of this question. If a franchisor is a member of FANZ it must provide any franchisee with its disclosure document, and the FANZ Code of Practice and Code of Ethics. The Code of Practice states that 'All members shall act in an ethical, honest and lawful manner and

endeavour to pursue best franchise practice'. It also provides a cooling-off period for the franchisee and sets out a dispute resolution process to be followed.

Law stated - 12 June 2024

Pre-contractual disclosure – procedures and formalities

17 | What procedures and formalities for pre-contractual disclosure are required or advised in your jurisdiction? How often must the disclosures be updated?

There are no franchising laws requiring 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. A member of FANZ must provide a potential franchisee with its disclosure document at least 14 days before the franchise agreement is executed and the disclosure document must be updated at least annually by the franchisor.

Law stated - 12 June 2024

Pre-contractual disclosure – content

18 | What information is the disclosure document required or advised to contain?

The disclosure document must provide:

- the name, registered office and physical business address of the franchisor;
- the names, job descriptions and qualifications (if any) of the franchisor's directors, executive officers or principals;
- a detailed curriculum vitae of the business experience of the franchisor and any related entities, and those of its directors, secretary, executive officers or principals;
- a viability statement with key financial information of the franchisor;
- details of any bankruptcies, receiverships, liquidations, placements in administration or appointment of a statutory manager, or materially relevant debt recovery;
- details of any criminal, civil or administrative proceedings within the past five years;
- a summary of the main particulars and features of the franchise;
- a list of the components of the franchise purchase;
- details of any financial requirements by the franchisor of the franchisee;
- details of existing franchises, number of outlets and franchisor-owned outlets, franchises terminated over the past two years, and any unresolved litigation; and
- other information listed in the FANZ Code of Practice.

Law stated - 12 June 2024

Pre-sale disclosure to sub-franchisees

- 19 | In the case of a sub-franchising structure, who must make pre-sale disclosures to sub-franchisees? If the sub-franchisor must provide disclosure, what must be disclosed concerning the franchisor and the contractual or other relationship between the franchisor and the sub-franchisor?

Legally, none is required. However, if a franchisor belongs to FANZ, it must comply with the Code of Practice and publish a disclosure document. A sub-franchisor would have to provide a disclosure document to a potential sub-franchisee if that sub-franchisor were a member of FANZ.

Law stated - 12 June 2024

Due diligence

- 20 | What due diligence should both the franchisor and the franchisee undertake before entering a franchise relationship?

A representative of the franchisor will need to meet a potential franchisee a number of times. It is important for the potential franchisee to meet the directors of the franchisor company as the parties will be entering into a franchise relationship. The franchisee must obtain independent legal and accounting advice and the franchisor's disclosure document will contain a lot of useful and essential information about the franchisor. The franchisee must ask relevant questions and obtain answers to any statements contained in the disclosure document. The franchisee should speak to at least six existing franchisees in the system and ask them how they find the franchisor, the training, the support and other relevant information.

Law stated - 12 June 2024

Failure to disclose – enforcement and remedies

- 21 | What actions may franchisees or any relevant government agencies take in response to a franchisor's failure to make required disclosures? What legal remedies are available? What penalties may apply?

If a sub-franchisor misrepresented the position without recourse to a franchisor, the franchisor should not be liable in any way. If a representation is made by a director or employee of the franchisor or the sub-franchisor, the protection of a limited liability company may not protect that individual, who may be personally liable pursuant to the Fair Trading Act 1986. There is a specific provision in that act in relation to employees being liable for personal misstatements while in their employment. There may also be liability pursuant to the [Contract and Commercial Law Act 2017](#).

Law stated - 12 June 2024

Failure to disclose – apportionment of liability

- 22 | In the case of sub-franchising, how is liability for disclosure violations shared between franchisor and sub-franchisor? Are individual officers, directors and employees of the franchisor or the sub-franchisor exposed to liability? If so, what liability?

If a franchisee is permitted to enter into a sub-franchise agreement with a sub-franchisee, then the franchisee would be liable for any violations or breaches of the disclosure document. The franchisor would not be liable in any way unless it has shared misleading information to the franchisee that is proven to be incorrect.

Law stated - 12 June 2024

General legal principles and codes of conduct

- 23 | In addition to any laws or government agencies that specifically regulate offering and selling franchises, what general principles of law affect the offer and sale of franchises? What industry codes of conduct may affect the offer and sale of franchises?

Contractual principles under the law of contract would apply to the first question. The second question is not applicable where a franchisor is a member of FANZ, in which case both the Code of Practice and the Code of Ethics would apply.

Law stated - 12 June 2024

Fraudulent sale

- 24 | What actions may franchisees take if a franchisor engages in fraudulent or deceptive practices in connection with the offer and sale of franchises?

Franchisees could make a complaint to the Commerce Commission and request an investigation in relation to such activity. Such protection differs due to the fact that fraudulent or deceptive conduct should not occur in relation to franchise sales. Also, such franchisees could bring a civil action against the franchisor and it may be possible for the directors of the franchisor company to be called as separate defendants as they could be personally liable for damages if the franchisor company has no assets. This protection does not differ from the protection provided pursuant to existing civil laws in New Zealand.

Law stated - 12 June 2024

FRANCHISE CONTRACTS AND THE FRANCHISOR/FRANCHISEE RELATIONSHIP

Franchise relationship laws

- 25 | What laws regulate the ongoing relationship between franchisor and franchisee after the franchise contract comes into effect?

No specific laws regulate the ongoing relationship between franchisor and franchisee after the franchise contract comes into effect.

Law stated - 12 June 2024

Operational compliance

- 26 | What mechanisms are commonly incorporated in agreements to ensure operational consistency and adherence to brand standards?

The franchisee must allow the franchisor (or its representative) to visit the premises at any reasonable time during business hours. The franchisee must also keep and maintain books of account and financial records, and complete financial accounts as may be prescribed by the franchisor. The franchisee shall permit the franchisor to inspect or obtain copies of any written records during normal business hours. If the franchisor considers that there is any irregularity in the books of account, then it may nominate an independent auditor to carry out an audit. It is also important to check whether there is a separate marketing bank account and how this will be controlled.

Law stated - 12 June 2024

Amendment of operational terms

- 27 | May the franchisor unilaterally change operational terms and standards during the franchise relationship?

Yes. The operating manuals can be updated and changed by the franchisor from time to time. All changes should be reasonable and in the best interests of the system and all updates to the manuals are mandatory for all franchisees.

Law stated - 12 June 2024

Policy affecting franchise relations

- 28 | Do other government or trade association policies affect the franchise relationship?

No government or trade association policies affect the franchise relationship.

Law stated - 12 June 2024

Termination by franchisor

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- 29** | In what circumstances may a franchisor terminate a franchise relationship? What are the specific legal restrictions on a franchisor's ability to terminate a franchise relationship?

Events that could lead to termination must be specified in the franchise agreement. There must be some default on the part of the franchisee for a valid termination to be confirmed. Also, it is usual and prudent for a notice of breach of franchise agreement to be issued by a franchisor to a specific franchisee and for the time limit for remedying the breach to have expired before the termination takes place. If a termination is unlawful, a franchisee would be able to seek redress from a court, with the remedies being either damages or an order from the court that the franchise be reinstated to the franchisee, which may then continue to conduct business pursuant to the franchise agreement.

Law stated - 12 June 2024

Termination by franchisee

- 30** | In what circumstances may a franchisee terminate a franchise relationship?

A franchisee may terminate a franchise relationship only if the franchisor has engaged in misrepresentations or fraudulent conduct as an inducement for the franchisee to enter the franchise agreement in the first place. Termination would be pursuant to specific sections as set out in the Contract and Commercial Law Act 2017. Furthermore, if a franchise agreement specifically allows the franchisee the right to terminate on, for example, six months' notice, the franchisee would be able to give such notice if required to exit the franchise but would lose the right to sell its business and recoup the upfront franchise fee together with any goodwill paid to the franchisor.

Law stated - 12 June 2024

Renewal

- 31** | How are renewals of franchise agreements usually effected? Do formal or substantive requirements apply?

All rights of renewal must be contained in the franchise agreement, which would normally set out the procedure for the franchisee to activate a renewal of term. Normally the franchisee must not have breached the agreement during the current term and the renewal option is normally exercisable by a franchisee giving the franchisor notice in writing not less than three months and not more than six months prior to the end of the current term. It is usual for a renewal fee to be paid by the franchisee to the franchisor and the amount of the renewal fee should be stated in the franchise agreement.

Law stated - 12 June 2024

Refusal to renew

32 | May a franchisor refuse to renew the franchise agreement with a franchisee? If yes, in what circumstances may a franchisor refuse to renew?

A franchisor may refuse to renew its franchise agreement with a franchisee if some provisions in the franchise agreement allow it to do so. If a franchisee has breached the franchise agreement in a material way during the term, or if two or more breach notices have been issued within a 12-month period, the franchisor may be able to block any renewal, provided the franchise agreement contains such a relevant clause. Furthermore, if a franchisee is in default at the time of purporting to renew a franchise agreement, the franchisor could prevent such renewal.

Law stated - 12 June 2024

Transfer restrictions

33 | May a franchisor restrict a franchisee's ability to transfer its franchise or restrict transfers of ownership interests in a franchisee entity?

A franchisor may restrict a franchisee's ability to transfer its franchise or restrict transfers of ownership interests in a franchisee entity provided the franchise agreement contains a right of first refusal clause in favour of the franchisor. Furthermore, 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.

Law stated - 12 June 2024

Fees

34 | Are there laws or regulations affecting the nature, amount or payment of fees?

There are no laws or regulations affecting the nature, amount or payment of fees, but should an unfair interest rate be imposed, such as 30 per cent, then the equitable doctrine of unjust enrichment may be available to assist a disgruntled and unfairly treated franchisee.

The Supreme Court in New Zealand has ruled that a penalty clause will be enforceable unless it is 'out of proportion' with the innocent party's legitimate interests in having the contract performed. The relevant case is *127 Hobson Street Ltd v Honey Bees Preschool Ltd* [2020] NZSC 53 (Honey Bees).

Law stated - 12 June 2024

Usury

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35 | Are there restrictions on the amount of interest that can be charged on overdue payments?

There are no restrictions on the amount of interest that can be charged on overdue payments. However, any ridiculous or oppressive amount is likely to be challenged by a franchisee or a franchisee's lawyer. If a franchisor wants to charge such a high rate of interest that it would be in the nature of an unjust penalty, then that rate of interest may be unenforceable by the court. The details in Honey Bees may be useful for reference.

Law stated - 12 June 2024

Foreign exchange controls**36** | Are there laws or regulations restricting a franchisee's ability to make payments to a foreign franchisor in the franchisor's domestic currency?

Laws and regulations exist restricting a franchisee's ability to make payments to a foreign franchisor in the franchisor's domestic country. In all cases, non-resident withholding tax would have to be deducted. New Zealand has double taxation treaties in relation to many countries, so any tax paid in New Zealand by an overseas franchisor in relation to the repatriation of income should be able to be claimed as a tax credit in the franchisor's foreign country.

Law stated - 12 June 2024

Confidentiality covenant enforceability**37** | Are confidentiality covenants in franchise agreements enforceable?

Confidentiality covenants in franchise agreements are important and they are enforceable as it is essential for a franchisor to be able to protect the integrity of all proprietary information.

Law stated - 12 June 2024

Good-faith obligation**38** | Is there a general legal obligation on parties to deal with each other in good faith during the term of the franchise agreement? If so, how does it affect franchise relationships?

There is no legal obligation for parties to act in good faith enshrined in New Zealand legislation. However, it is common and to be encouraged for good faith clauses to be inserted in all franchise agreements that apply to both franchisor and franchisee. The courts in New Zealand are moving towards implying a duty of good faith, 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.

Law stated - 12 June 2024

Franchisees as consumers

39 | Does any law treat franchisees as consumers for the purposes of consumer protection or other legislation?

New Zealand's current consumer law may cover business-to-business relationships and accordingly franchisors must contract out of consumer protection legislation such as the Consumer Guarantees Act 1993 and the Fair Trading Act 1986 to the fullest extent possible.

Consumer Guarantees Act

The [Consumer Guarantees Act 1993](#) (CGA), which was amended by the [Consumer Guarantees Amendment Act 2013](#), includes new guarantees relating to delivery and the supply of electricity and gas. It also has new obligations and restrictions relating to:

- contracting out of the CGA;
- collateral credit agreements; and
- indemnification of gas and electricity retailers.

Unfair contract terms

The [Fair Trading Act 1986](#), which has been amended has new obligations and restrictions relating to unfair contract terms, unsubstantiated representations, extended warranties, shill bidding, unsolicited goods and services, uninvited direct sales and lay-by sales, consumer information standards, product safety and product recalls, internet sales and auctions and auctioneers.

The existing prohibition on unfair contract terms has been extended in consumer contracts to small trade contracts worth under NZ\$250,000, so this will affect franchising.

A contract is a standard form small trade contract if each party is engaged in trade (namely, two businesses), it is not a contract between a business and a consumer, and the relationship between the two parties in trade in relation to the goods, services or interest in land provided does not exceed the annual threshold.

The Commerce Commission can apply to a court for a declaration that a term in a contract is unfair. If it is found to be unfair by a court then that business must not include the term or attempt to enforce or rely on the term. A business may also face:

- in the case of an individual, a fine not exceeding NZ\$200,000, and for a company, a fine not exceeding NZ\$600,000; and
-

a court order stopping that business from applying or enforcing that term, an order directing a refund or payment of damages, or both.

Unconscionable conduct

The same Amendment Act introduced unconscionable conduct in trade provisions, which are much broader and apply to all conduct and not just contractual terms.

The term 'unconscionable conduct' is not defined, but the Amendment Act states that a court can take the following into consideration:

- the relative bargaining power of the parties;
- the extent to which the parties acted in good faith;
- whether the affected person was reasonably able to protect their interests; and
- whether unfair pressure or tactics were used.

The Commerce Commission can seek penalties and fines as above. The Commerce Commission could also bring civil proceedings, for example, seeking a declaration from the court in relation to unfair contract terms. The remedies include damages, injunctions and other court orders.

Whether the new amendments apply to any contract will depend on whether the contract falls within the definition of a standard form small trade contract. When looking at the annual value threshold this is assessed when the relationship first arises.

No definition is provided in the Act. However, the prohibition is intended to address similar conduct as in Australia, where the courts have found conduct unconscionable that is 'against conscience by reference to the norms of society'. The intention is that New Zealand courts will be able to draw on existing Australian case law.

Law stated - 12 June 2024

Language of the agreement

40 | Must disclosure documents and franchise agreements be in the language of your country?

There is no legal requirement for disclosure documents and franchise agreements to be written in English, but since the major language of New Zealand is English, all parties would insist that English is used.

Law stated - 12 June 2024

Restrictions on franchisees

41 | What types of restrictions are commonly placed on the franchisees in franchise contracts?

A franchise agreement imposes certain restrictions on the franchisee, and some examples include the following:

- there may be a defined exclusive territory with a map attached or a non-exclusive territory;
- there is normally an obligation on the franchisee to use the approved suppliers as stipulated by the franchisor;
- the agreement will normally contain a restraint on competition for a certain area and duration;
- the agreement should contain a robust dispute resolution clause to be activated if there is a dispute between the parties. Normally, mediation is recommended but some agreements require arbitration. This is a matter of contract; or
- the agreement will contain a governing law clause and it will be subject to the exclusive jurisdiction of the courts in a stated country.

Regarding duration, exclusivity and grant-back provisions, there are no legal restrictions. However, if any agreement is deemed to be in perpetuity (in relation to duration) then that can have some inherent problems as the courts have ruled that nothing lasts forever and, in relation to one party wishing to terminate the arrangement or contract, the courts may allow a reasonable period of notice (six or 12 months) to be given, after which the agreement could be legally terminated.

Regarding non-competition restrictions, if such restrictions are unreasonable or unfair, then the courts will not enforce them, so great care is required when drafting. Australia commonly has 'sprinkler clauses' under which one party will try to restrict the other party for different periods regarding different geographical restrictions. The New Zealand courts are unimpressed by such clauses and will normally strike them out, with the result that there may be no restriction on competition. It is always essential to obtain a local counsel's advice regarding this area.

Law stated - 12 June 2024

Courts and dispute resolution

42 | Describe the court system. What types of dispute resolution procedures are available relevant to franchising?

The lowest level court in New Zealand is the district court, which can determine claims involving up to NZ\$350,000. For claims exceeding NZ\$350,000, the High Court of New Zealand is the relevant body. Appeals from the High Court of New Zealand go to the Court of Appeal of New Zealand, which sits in Wellington. Appeals from the Court of Appeal go to the Supreme Court of New Zealand, which also sits in Wellington.

If a franchisor belongs to the Franchise Association of New Zealand Incorporated (FANZ), the franchise agreement must contain a dispute resolution clause. The Code of Practice prescribes that mediation is mandatory, and it has a high chance of success. There is also the [Arbitration Act 1996](#). A domestic franchisor who is not a member of FANZ can

resort to court action, but the courts usually require an attempt to resolve the dispute by way of mediation. A foreign franchisor could issue proceedings in New Zealand and sue a particular franchisee, but again, the courts may require an attempt to settle any dispute by way of mediation. The governing law in any franchise agreement is important and most foreign franchisors require the governing law to be that of their home country. At the same time, it is recommended that foreign franchisors should stipulate that the governing law should be the law of New Zealand, as it is far easier to take swift action in relation to a defaulting master franchisee or franchisee through the New Zealand courts and to apply New Zealand law.

There is also the Disputes Tribunal whereby disputes between parties can go to a hearing before a referee with no lawyer representation allowed. The maximum amount of any claim is NZ\$30,000.

Law stated - 12 June 2024

Governing law

- 43 | Are there any restrictions on designating a foreign governing law in franchise contracts in your jurisdiction? How does the governing law affect the contract's enforceability?

There are no such restrictions. The choice of governing law is very important. If New Zealand is chosen as the jurisdiction where the contract is to be enforced and a judgment is obtained then the [Reciprocal Enforcement of Judgments Act 1934](#) applies.

Law stated - 12 June 2024

Arbitration – advantages for franchisors

- 44 | What are the principal advantages and disadvantages of arbitration for foreign franchisors considering doing business in your jurisdiction? Are any other alternative dispute resolution (ADR) procedures particularly favoured or disfavoured in your jurisdiction?

The principal advantages of arbitration include the fact that a hearing date would usually be much earlier than a court hearing date, the costs should be lower than the costs of litigation, any arbitration is confidential between parties so the result will not appear in the press or elsewhere, and it should be more informal than litigation in the High Court. Disadvantages include the fact that one party may want publicity but will not get it and enforcement of the arbitral award that may have to go down the path of litigation. Mediation is strongly favoured.

Law stated - 12 June 2024

National treatment

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45 | In what respects, if at all, are foreign franchisors treated differently (legally, or as a practical matter) from domestic franchisors?

Foreign franchisors must still comply with the laws of New Zealand insofar as they affect them. The only way they would be treated differently from domestic franchisors may be in the area of taxation, where income of any sort that is to be repatriated from New Zealand to an overseas jurisdiction will be subject to non-resident withholding tax.

Law stated - 12 June 2024

UPDATE AND TRENDS

Legal and other current developments

46 | Are there any proposals for new legislation or regulation, or to revise existing legislation and regulation? Are there other current developments or trends to note?

The Franchise Association of New Zealand is currently reviewing its Code of Practice and, as part of that review, it will be looking into marketing funds. It is highly likely that there will be a new separate section in the Code relating to marketing funds and requiring all franchisors to have the marketing funds in a separate bank account and to provide annual accounts and explanations to all franchisees in relation to that marketing account.

Law stated - 12 June 2024



Stewart Germann

stewart@germann.co.nz

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MARKET OVERVIEW

Franchising in the market

- 1 | How widespread is franchising in your jurisdiction? In which sectors is franchising common? Are there any economic or regulatory issues in the market that are more or less hospitable to franchising or make it economically viable in your jurisdiction?

Franchising is widespread in South Korea and is growing every year. According to statistical data provided by the Korea Fair Trade Commission (KFTC), in 2023 there were about 12,429 registered brands owned by 8,759 franchisors and operated at 352,866 franchised units. Statistical data strongly demonstrates the continuous growth of franchising in South Korea with a 4.9 per cent increase in the number of brands, a 7 per cent increase in franchisors and a 5.2 per cent increase in the number of franchised units compared to 2022. Meanwhile, the industries with the highest growth rate of franchising were the food services industry followed by the services (eg, transportation, hair salons) and retail industries (eg, convenience stores).

Law stated - 22 May 2024

Associations

- 2 | Are there any national or local franchise associations? What is their role in franchising, including any impact on laws or regulations? Are there any rules of conduct or membership requirements?

The Korea Franchise Association (KFA) is a non-profit organisation licensed by the Ministry of Trade, Industry and Energy. Its role is to promote the sound development of the franchise industry, enable mutual growth between franchisors and franchisees, and assist with the globalisation of national brands. A franchisor that has registered its disclosure document with the KFTC can join as a member of the KFA and must comply with the KFA's rules of ethical conduct.

Law stated - 22 May 2024

BUSINESS OVERVIEW

Types of vehicle

- 3 | What forms of business entities are relevant to the typical franchisor?

In South Korea, the stock company, the limited liability company, and the limited company are the business forms that would be relevant to a typical franchisor. While the most common type of business entity in South Korea is a stock company, some foreign investors opt for limited liability companies or limited companies from time to time.

Law stated - 22 May 2024

Regulation of business formation

4 | What laws and agencies govern the formation of business entities?

The Korean Civil Act and Commercial Act primarily govern the formation of business entities. In addition, the Foreign Investment Promotion Act relates to the formation of business entities from foreign investment.

The Korean Court Registry Office, the National Tax Service, and the Ministry of Trade, Industry and Energy are the main agencies that are related to the formation of business entities in South Korea.

Law stated - 22 May 2024

Requirements for forming a business

5 | Provide an overview of the requirements for forming and maintaining a business entity.

A business entity is established on registration at the Korea Court Registry Office and National Tax Service by submitting the required documents. There is no minimum paid-up capital for a stock company, a limited liability company, or a limited company. To enjoy benefits as a foreign-invested company under the Foreign Investment Promotion Act, the amount of invested capital must be at least 100 million won, and the foreign investment must be reported to the Ministry of Trade, Industry and Energy. In practice, the reports are received by designated foreign exchange banks or the Korea Trade-Investment Promotion Agency.

Law stated - 22 May 2024

Restrictions on foreign investors

6 | What restrictions apply to foreign business entities and foreign investment?

A foreigner may freely carry on foreign investment activities in South Korea without being subject to any restrictions unless otherwise specifically restricted by the Foreign Investment Promotion Act or other laws or regulations.

Although general foreign investment is not prohibited or restricted, a foreigner cannot make an investment in South Korea in the following circumstances:

- where it interferes with national security or disrupts public order;
- where it causes harm to the health and safety of nationals or is markedly contrary to public morals and decency; or
- when it violates South Korean laws and regulations.

Law stated - 22 May 2024

Taxation

7 | What aspects of the tax system are relevant to franchisors? How are foreign businesses and individuals taxed?

The principal taxes affecting business enterprises in South Korea include the corporate income tax, individual income tax, value added tax, customs duties, and the local income tax levied on corporate income tax. Specifically, non-resident corporations with a permanent establishment in South Korea are taxed only to the extent of their South Korea-sourced income, while non-resident corporations without a permanent establishment in South Korea are generally taxed through a withholding tax on each separate item of income that is subject to withholding tax. Thus, a non-resident franchisor without a local presence is only subject to the withholding tax, and the relevant tax rates are limited to the rates stipulated in the tax treaty between South Korea and the state in which the franchisor resides.

Law stated - 22 May 2024

Labour and employment

8 | Are there any relevant labour and employment considerations for typical franchisors?

Under the Korean Civil Act, an employer is vicariously liable to third parties for damages caused by the acts or omissions of employees committed during the performance of work that is directed or supervised by the employer. Therefore, if a franchisee or its employee is deemed to be an employee of the franchisor, the franchisor may be held liable for damages to a third party caused by the franchisee or the franchisee's employee during the performance of his or her work.

To reduce the risk of such liability, it is advisable for the franchisor not to be involved with the specifics of the franchisee's management and to specify in the franchise agreement that the franchise will be operated by the franchisee as an independent entity from the franchisor. Given that a franchisor and a franchisee are generally independent entities, and therefore the franchisee is not subject to the direction or supervision of the franchisor, it is unlikely that the above liability will be imposed on the franchisor.

Law stated - 22 May 2024

Intellectual property

9 | How are trademarks and other intellectual property and know-how protected?

South Korea is a first-to-file jurisdiction. In principle, the Trademark Act does not protect unregistered marks. Therefore it is advisable for franchisors to register their trademarks

with the Korean Intellectual Property Office (KIPO) pursuant to the Trademark Act when seeking to enter into franchise arrangements in South Korea. For registration, a trademark must have a distinctive feature that enables traders and consumers to distinguish the goods or services from another party's goods or services. In addition, when filing a trademark application, the trademark applicant is required to designate goods or services according to the Nice Classification (34 classes of goods and 11 classes of services under the 11th edition of the Nice Classification). Once the registration is granted, the trademark owner may seek to enforce the trademark rights against third-party infringements by seeking injunctive relief against further infringement, damages, or an order for the destruction of the infringing goods.

It is not mandatory for the trademark licence to be registered (namely, recorded) with the KIPO. However, if recorded, the trademark licence becomes effective against any third party who subsequently acquires the trademark right or an exclusive licence.

In addition to the Trademark Act, the Unfair Competition Prevention and Trade Secret Protection Act is available to protect well-known but unregistered trademarks, trade secrets and know-how.

Law stated - 22 May 2024

Real estate

- 10** | What are the relevant aspects of the real estate market and real estate law? What is the practice of real estate ownership versus leasing?

Foreign nationals can acquire real property located in South Korea with a simple report of the acquisition to the relevant local government office under the Act on Report on Real Estate Transactions. If a foreign national is a non-resident as stipulated in the Foreign Exchange Transactions Act, he or she would also need to make a report on real estate acquisition to a foreign exchange bank, with a few exceptions where a report must be submitted to the Bank of Korea.

In practice, most franchisees lease, rather than own, the real estate in which they operate their franchised units.

Law stated - 22 May 2024

Competition law

- 11** | What aspects of competition law are relevant to the typical franchisor in your jurisdiction? How is competition law enforced in the franchising sector?

The Monopoly Regulation and Fair Trade Act is the primary competition statute in South Korea, and it applies to franchise relationships (eg, establishing resale price maintenance, prohibiting product tying and imposing minimum sales targets).

Law stated - 22 May 2024

OFFER AND SALE OF FRANCHISES

Legal definition

12 | What is the legal definition of a franchise?

Under the Fair Transactions in Franchise Business Act (the Franchise Act), a franchise is defined as:

a continuous business relationship in which a franchisor allows the franchisee to use its own trademarks, service marks, trade names, signs, or any other trademarks (collectively, 'Business Marks') in selling goods (including raw materials and auxiliary materials; hereinafter the same shall apply) or services in compliance with certain quality standards or business methods, and supports, trains, and controls its franchisees in regards to relevant management and business activities, and in which franchisees pay required payments to their franchisor in return for the use of the Business Marks and the support and training provided for their management and business activities.

Law stated - 22 May 2024

Laws and agencies

13 | What laws and government agencies regulate the offer and sale of franchises?

The Franchise Act, which was enacted on 1 November 2002 and most recently amended on 2 January 2024, and which came into effect on 3 July 2024, and its Presidential Decree are the primary statutes applicable to the franchisor-franchisee relationship. Additionally, the Monopoly Regulation and Fair Trade Act (MRFTA) and regulations promulgated by the Korea Fair Trade Commission (KFTC) are generally applicable. Recently, KFTC also issued a new set of Guidelines for Assessing Unfair Business Practices in the Franchise Industry (the Franchise Guideline), effective from 24 March 2024. The Franchise Guideline provides an overview of unfair trade practices in the franchise industry through specific examples of each type of unfair trade practice in violation of the Franchise Act.

The KFTC regulates franchises in South Korea. The KFTC maintains a franchise-specific department, the Korea Fair Trade Mediation Agency, and has the authority to impose administrative measures against franchisors that engage in unfair activities. In this regard, the KFTC has the discretion to determine the unfairness or reasonableness of the activities of the franchisor, to levy penalties and to issue corrective orders against those violators depending on the nature and degree of the unfair activity. However, the violator may seek a district court's judicial review of the KFTC's findings.

Law stated - 22 May 2024

Principal requirements

- 14** | What are the principal requirements governing the offer and sale of franchises under the relevant laws?

The Franchise Act is a pre-sale disclosure and registration law and is the primary law governing the franchisor-franchisee relationship in South Korea. It seeks to provide a framework for building a fair and equal business relationship between the parties involved in franchising.

Law stated - 22 May 2024

Franchisor eligibility

- 15** | Must franchisors satisfy any eligibility requirements in order to offer franchises? Are there any related practical issues or guidelines that franchisors should consider before offering franchises?

Pursuant to the Franchise Act, only franchisors with experience operating at least one directly managed store (either inside or outside of South Korea) may offer a franchised business to others. This threshold requirement must be satisfied for a franchisor to prepare and register a franchise disclosure document to engage in the sale of franchises in South Korea.

However, this amendment provides exceptions for the following cases:

- franchisors who operate franchised businesses with permission or licence under other laws and regulations;
- franchisors who have at least one year of experience in operating a business in the same industry as the franchised business inside or outside of South Korea; and
- franchisors whose businesses have been verified by KFTC even if they have no experience in operating directly managed stores.

Law stated - 22 May 2024

Franchisee and supplier selection

- 16** | Are there any legal restrictions or requirements relating to the manner in which a franchisor recruits franchisees or selects its or its franchisees' suppliers? What practical considerations are relevant when selecting franchisees and suppliers?

The Franchise Act requires a franchisor to expressly grant a franchisee an exclusive business territory in the franchise agreement. Specifically, the franchisor must define the business territory for the franchised unit pursuant to an agreed-upon criterion (eg, geographic scope) and stipulate the business territory in the franchise agreement. During the term of the franchise agreement, the franchisor cannot establish a company owned,

affiliate-owned or franchised unit of the same type of business within the protected business territory of the franchisee.

The 'same type of business' means a business that would be considered the same as the franchise business in light of various factors, including the target class, territorial boundary, population boundary, types of products and services sold, and business manner and method, and is determined on a case-by-case basis.

The Franchise Act does not provide particular restrictions on the franchisor's selection of suppliers. However, the Presidential Decree requires the franchisors to disclose information on any items that must be purchased either from the franchisor or its designated suppliers, including any price obtained by the franchisor that exceeds the reasonable wholesale price. Furthermore, the recent amendment, effective from 3 July 2024, requires for franchise agreements to specify the type of mandatory items and their supply price.

Law stated - 22 May 2024

Pre-contractual disclosure – procedures and formalities

17 | What procedures and formalities for pre-contractual disclosure are required or advised in your jurisdiction? How often must the disclosures be updated?

The Franchise Act requires a franchisor to register a disclosure document and provide it to its prospective franchisees, master franchisees, and area developers before entering a franchise relationship. The disclosure procedure is as follows:

- a franchisor must provide a disclosure document even if the franchisee does not specifically request it in writing;
- in providing the disclosure document to a prospective franchisee, a franchisor must register the disclosure document with the KFTC and, thereafter, provide the registered disclosure document to the prospective franchisee; and
- the acceptance of franchise fees or execution of a franchise agreement is prohibited unless the franchisor has provided the registered disclosure document and 14 days (seven days if the prospective franchisee has been advised by counsel or a franchise broker) have elapsed from the date of providing the registered disclosure document.

The disclosure document may be delivered to a prospective franchisee by:

- providing the disclosure document (hard copy) directly or sending it by content-certified mail to the prospective franchisee;
- providing the disclosure document via access to the internet; or
- emailing the disclosure document in an electronic file to the prospective franchisee that is capable of a 'read-receipt' confirmation.

Regarding the update of the disclosures, a franchisor must register (or report) any changes in the disclosure document with the KFTC. Depending on the type of information that has been changed, deadlines for filing the report thereto range from within 30 days of the

occurrence of the cause of the change to within 30 days of the expiration of the quarter in which the cause of the change has occurred. Furthermore, the franchisor has an obligation to update the disclosure document on an annual basis within 120 days of the expiry of each fiscal year.

Law stated - 22 May 2024

Pre-contractual disclosure – content

18 | What information is the disclosure document required or advised to contain?

The disclosure document must disclose the following broad categories of information:

- information regarding the franchisor's general status;
- information regarding the current status of the franchisor's franchise (eg, the total number of company owned and franchised units in operation as of the most recent fiscal year's end);
- information regarding any legal violations of the franchisor and its executives;
- information regarding the franchisee's obligations;
- information regarding the conditions of, and restrictions on, the franchised business operations;
- detailed information regarding the procedure and period required to commence the franchised business;
- information regarding the franchisor's support regarding the management and operation of the franchised business;
- information regarding the franchisor's education and training; and
- information regarding the franchisor's directly managed stores.

In addition to delivering the disclosure document, the franchisor must prepare two additional documents to satisfy its pre-contractual disclosure obligations under the Franchise Act, respectively:

- a document containing information regarding the projected minimum and maximum sales revenue of the franchised unit for a period of one year after commencing operations, including the distance between the franchised units that served as the basis for calculating the sales projection and the prospective franchisee's contemplated franchised unit; and
- a document containing information regarding the 10 closest franchised units (eg, contact information, business name and location of the franchised units).

Law stated - 22 May 2024

Pre-sale disclosure to sub-franchisees

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- 19 | In the case of a sub-franchising structure, who must make pre-sale disclosures to sub-franchisees? If the sub-franchisor must provide disclosure, what must be disclosed concerning the franchisor and the contractual or other relationship between the franchisor and the sub-franchisor?

In a sub-franchising structure, the sub-franchisor must make pre-sale disclosures to sub-franchisees. The master franchisor need not provide a disclosure document to a sub-franchisee if the master franchisor is not in a contractual relationship with the sub-franchisee. In other words, a master franchisor has no obligation to provide a disclosure document if it is not a party to the franchise agreement or any other agreements with a sub-franchisee.

While a disclosure on the general status of the franchisor must be included in a disclosure document, neither the Franchise Act nor its Presidential Decree specifically requires that the information concerning the master franchisor be included in the disclosure document. However, given that the information on the contractual or other relationship between the master franchisor and the sub-franchisor may relate to the 'description of general status of the franchisor', depending on the circumstances it could be appropriate to include a brief summary of such information on the sub-franchising structure in the disclosure document.

Law stated - 22 May 2024

Due diligence

- 20 | What due diligence should both the franchisor and the franchisee undertake before entering a franchise relationship?

For franchisors seeking to offer their concepts in South Korea, it is advisable to carry out due diligence on the relevant market, business considerations, legal and regulatory materials (eg, registration and pre-contractual disclosure, and the franchisee's permits, licences or approvals for carrying out the franchise business) and the prospective franchisee (eg, full registered name and address, organisational structure, financial capability, involvement in past civil, criminal or administrative proceedings).

Law stated - 22 May 2024

Failure to disclose – enforcement and remedies

- 21 | What actions may franchisees or any relevant government agencies take in response to a franchisor's failure to make required disclosures? What legal remedies are available? What penalties may apply?

If there is a violation of any disclosure requirements, the franchisee may report such violation to the KFTC, and a franchisor that fails to register the disclosure document may face liability under the Franchise Act. First, the franchisor must refund any franchise fees collected if the franchisee makes a request for a refund within four months of the date of executing the franchise agreement. If a refund is due, the franchisor must make

the refund within one month of the date of the franchisee's request. Second, the KFTC may order a corrective measure, which would include ordering the franchisor to register or carry out the disclosure of the disclosure document. The four possible corrective measures include administrative warning, recommendation to correct, corrective order and administrative fine. The administrative warning is the least severe corrective measure, and the administrative fine is the most severe. With respect to the administrative fine, the KFTC may impose a fine of up to 2 per cent of the total sales of the franchisor to the specific franchisee in South Korea for the duration in which the franchisor was not in compliance. In determining the amount of the administrative fine, the Franchise Act stipulates that the KFTC should consider the nature, severity, duration, and frequency of the infraction, as well as the profits that the franchisor derived as a result of its non-compliance. Where the franchisor's total sales during the period of non-compliance are difficult to calculate, the Franchise Act provides that an administrative fine of up to 500 million won may be imposed.

Failure to comply with the requirement does not lead to automatic rescission or cancellation of the franchise agreement. However, the franchisee may bring a lawsuit for damages and cancel or rescind the franchise agreement under general principles of tort or contract law in accordance with the Korean Civil Act. If the franchisee is not adequately compensated through cancelling or rescinding the franchise agreement, the franchisee may be entitled to additional damages.

In connection with criminal penalties, the most severe penalty is reserved for fraud. The provision of false or exaggerated information or the omission of important items in a disclosure document required under the Franchise Act carries a penalty of up to five years' imprisonment or a fine of not more than 300 million won. Refusal to comply with the KFTC's orders to provide disclosure, if such orders are given, is also potentially subject to a serious penalty. Where disclosure is not provided, or where the disclosure is later reviewed by the KFTC upon the franchisee's request and found to be insufficient (but not fraudulent), the KFTC may demand that the franchisor provide proper disclosure materials. Failure to do so following the KFTC's corrective order may be punished with up to three years' imprisonment or a fine of up to 100 million won. Execution of a franchise agreement or acceptance of franchise fees within 14 days (seven days if the prospective franchisee has been advised by counsel or a franchise broker) of the delivery of the disclosure document is subject to a possible term of imprisonment of up to two years or a fine of up to 50 million won.

Law stated - 22 May 2024

Failure to disclose – apportionment of liability

- 22** | In the case of sub-franchising, how is liability for disclosure violations shared between franchisor and sub-franchisor? Are individual officers, directors and employees of the franchisor or the sub-franchisor exposed to liability? If so, what liability?

A master franchisor has no duty to provide a disclosure document if it is not a party to the franchise agreement or any other agreement with a sub-franchisee. In this case, the sub-franchisor is solely liable for violations of any disclosure requirements.

The sub-franchisor's individual officers, directors and employees in principle have no responsibility for disclosure requirements. Having stated that, if they wilfully or negligently engage in a disclosure violation, they would be jointly liable with the sub-franchisor for civil damages, and if directly engaging in fraudulent or deceptive practices regarding disclosure, such individuals may face criminal penalties.

Law stated - 22 May 2024

General legal principles and codes of conduct

23 | In addition to any laws or government agencies that specifically regulate offering and selling franchises, what general principles of law affect the offer and sale of franchises? What industry codes of conduct may affect the offer and sale of franchises?

The general fair trade principles under the MRFTA may affect the offer and sale of franchises. Also, the franchise agreement should not be contrary to the Act on the Regulation of Terms and Conditions. No rules, regulations, government agency codes or industry codes other than those of the KFTC may affect the offer and sale of franchises in South Korea.

Law stated - 22 May 2024

Fraudulent sale

24 | What actions may franchisees take if a franchisor engages in fraudulent or deceptive practices in connection with the offer and sale of franchises?

In the case of a disclosure violation, the franchisee can only report such violation to the KFTC. However, fraudulent or deceptive practices by a franchisor may constitute fraud as stipulated under the Korean Criminal Code, and the franchisee may directly file a criminal complaint with the prosecutors.

The franchisee's remedies against the franchisor for deceptive or fraudulent business practices include:

- filing a civil suit for damages against the franchisor, with or without cancelling or rescinding the franchise agreement itself;
- reporting it to the KFTC so that the KFTC determines whether to initiate criminal proceedings;
- requesting the KFTC to issue a corrective order or a fine against the franchisor; and
- directly filing a criminal complaint to the Prosecutor's Office.

Law stated - 22 May 2024

FRANCHISE CONTRACTS AND THE FRANCHISOR/FRANCHISEE RELATIONSHIP

Franchise relationship laws

- 25 | What laws regulate the ongoing relationship between franchisor and franchisee after the franchise contract comes into effect?

The Franchise Act regulates the ongoing relationship between a franchisor and its franchisee after the franchise agreement comes into effect. Moreover, the general provisions of the Monopoly Regulation and Fair Trade Act apply in regulating the franchise relationship (eg, establishing resale price maintenance, prohibiting product tying and imposing minimum sales targets). Also, the newly introduced Guidelines for Assessing Unfair Business Practices in the Franchise Industry gives an overview of unfair trade practices in the franchise industry.

Additionally, all business relationships are governed by the general principles set out in the Korean Civil Act and the Korean Commercial Act.

Law stated - 22 May 2024

Operational compliance

- 26 | What mechanisms are commonly incorporated in agreements to ensure operational consistency and adherence to brand standards?

Generally, the franchisor includes inspection rights (eg, access to the premises of franchised units) and audit rights (eg, review of the accounts, books and records of the franchisee) in the franchise agreements as the primary mechanisms for ensuring operational consistency and adherence to brand standards.

Law stated - 22 May 2024

Amendment of operational terms

- 27 | May the franchisor unilaterally change operational terms and standards during the franchise relationship?

A franchisor may not unilaterally change operational terms and standards in a way that may be considered disadvantageous to the franchisee, as such conduct could be seen as an unfair trade practice under the Franchise Act.

Law stated - 22 May 2024

Policy affecting franchise relations

- 28 | Do other government or trade association policies affect the franchise relationship?

Primarily, the Korea Fair Trade Commission's (KFTC) guidelines affect the franchise relationship.

Law stated - 22 May 2024

Termination by franchisor

29 | In what circumstances may a franchisor terminate a franchise relationship? What are the specific legal restrictions on a franchisor's ability to terminate a franchise relationship?

The Franchise Act does not provide specific grounds for terminating a franchise agreement. However, it stipulates the procedure that must be complied with to terminate a franchise relationship.

To terminate a franchise agreement in accordance with the Franchise Act, a franchisor is required to provide a first notice of breach (which states the grounds for the breach, requests a cure for such breach, and states that failure to cure will result in termination) to the franchisee. Once this first notice is given, a two-month cure period begins to run (and the franchisee's obligation to cure arises at this point). During the cure period, the franchisor must send another notice of the same breach to the franchisee. If the franchisee fails to cure the breach, the franchisor may terminate the franchise agreement at the end of the cure period.

Meanwhile, the Presidential Decree provides for nine exceptions to the above termination procedure and thereby allows for immediate termination of the franchise agreement by the franchisor. No other grounds for immediate termination are permitted under the Franchise Act. The nine exceptions are:

- a petition for bankruptcy is filed with respect to the franchisee (either by the franchisee or by a third party), the franchisee is adjudicated bankrupt, or rehabilitation or foreclosure proceedings commence against the franchisee;
- there occurs a suspension of payment of notes and cheques issued by franchisee, due to insolvency, etc.;
- the franchisee cannot continue with the operation of any franchised unit in the territory due to an event of force majeure;
- the franchisee clearly damages the franchisor's reputation or credit, and causes significant harm to the franchise business, by receiving an administrative disposition for violating the applicable laws relating to the operation of franchised units, including:
 - an administrative order requiring the franchisee to remedy the violation;
 - an administrative order imposing a penalty surcharge or fine on the franchisee for the violation; or
 - an administrative order mandating the suspension of operation of the franchise business;

the franchisee violates laws or regulations relating to the operation of any franchised unit and receives a cancellation order of qualifications, licence or approval, a business suspension order exceeding 15 days, or another administrative order that in nature cannot be corrected; provided that this shall not apply where an administrative fine, etc, has been imposed on the franchisee in lieu of such administrative order pursuant to any laws or regulations;

- the franchisee, after having cured the breach of the franchise agreement pursuant to the request from the franchisor, subsequently repeats the same breach within a period of one year, despite the franchisor having notified the franchisee in the notice of request to cure the first breach that, in the case of the same breach occurring after the cure, the franchise agreement could be terminated without providing the opportunity to cure;
- the franchisee has been subjected to criminal punishment for an act related to the operation of a franchise unit;
- the franchisee operates a franchised unit in a manner or form that clearly poses an imminent threat to public safety or health, and it is difficult to await corrective orders from the relevant authority; or
- the franchisee suspends business operations of any franchised unit for seven or more consecutive days without justifiable cause (as determined by the franchisor acting in good faith).

In addition, article 168-10 of the Commercial Act allows each party to terminate the franchise agreement under unavoidable circumstances by providing a prior notice to the other party within a set reasonable period, regardless of the duration of such franchise agreement. Therefore, the franchisor may terminate the franchise agreement based on the grounds that the purpose of the franchise agreement has been frustrated as a result of unforeseeable circumstances.

Law stated - 22 May 2024

Termination by franchisee

30 | In what circumstances may a franchisee terminate a franchise relationship?

Under the Franchise Act, there are no restrictions with respect to franchisees terminating their franchise relationships. However, the franchisee may terminate a franchise agreement under the circumstances stipulated therein or in the case of default by the franchisor. Also, article 168-10 of the Commercial Act provides that a party to a franchise agreement may terminate the agreement under unavoidable circumstances by providing a prior notice to the other party within a set reasonable period, regardless of the duration stipulated in the franchise agreement. Therefore, the franchisee may terminate the franchise agreement based on the grounds that the purpose of the franchise agreement has been frustrated due to unforeseeable circumstances.

Law stated - 22 May 2024

Renewal

- 31 | How are renewals of franchise agreements usually effected? Do formal or substantive requirements apply?

There are no formal (eg, stamp duty, notarisation or witnesses) or substantive requirements for renewals of franchise agreements.

Law stated - 22 May 2024

Refusal to renew

- 32 | May a franchisor refuse to renew the franchise agreement with a franchisee? If yes, in what circumstances may a franchisor refuse to renew?

Under the Franchise Act, if a franchisee requests to renew a franchise agreement during the 90 to 180-day period prior to the expiration of such agreement, a franchisor may not deny such request without just cause. As exceptions, the franchisor can refuse renewal of the franchise agreement in the following cases:

- the franchisee has been in breach of a payment obligation;
- the franchisee rejects common obligations and duties that are generally accepted by other franchisees; or
- the franchisee has failed to observe important business policies of the franchisor that are deemed necessary for maintaining the franchise business, such as matters pertaining to the procurement of a store or necessary facility, or matters pertaining to the observance of production methods or service methods.

If the franchisee requests a renewal, the notice of refusal stating the reasons for non-renewal must be provided within 15 days of receipt of the renewal request. If the notice of refusal is not provided to the franchisee, or a written notice of non-renewal or change in terms and conditions for the renewal is not provided to the franchisee between 90 and 180 days prior to the expiration of the franchise agreement, the franchise agreement will be deemed to have been renewed under the same terms and conditions.

However, the franchisor's obligation to grant the renewal only applies if the term of the applicable franchise agreement, including the initial term and any subsequent renewal terms, does not exceed 10 years. If 10 years have elapsed, the franchisor may refuse to renew the franchise agreement regardless of its reasons.

Law stated - 22 May 2024

Transfer restrictions

- 33 | May a franchisor restrict a franchisee's ability to transfer its franchise or restrict transfers of ownership interests in a franchisee entity?

The Franchise Act provides that the franchisee must first obtain prior written consent from the franchisor to assign the franchised business. The Commercial Act further states that, except for special circumstances, the franchisor must consent to the proposed transfer.

However, unless the parties have specifically agreed not to allow for the transfer of ownership interests in a franchisee, there are no restrictions on the franchisee's right to transfer ownership interests.

Law stated - 22 May 2024

Fees

34 | Are there laws or regulations affecting the nature, amount or payment of fees?

The payment and receipt of certain types of fees are strictly regulated under the Franchise Act. Specifically, the Franchise Act proscribes the franchisor from receiving 'direct' payment of the following fees from the franchisee, which are referred to as 'initial franchise fees':

- consideration that the franchisee pays to the franchisor for management rights such as the permission to use the business marks or support and education for its operating activities, such as application fee, membership fee, franchise fee, education and training fee or down payment; and
- consideration that the franchisee pays to the franchisor to secure payment for goods supplied by the franchisor or compensation for damages.

The Franchise Act stipulates that the franchisor must require the franchisee to deposit – in escrow – the initial franchise fees to a financial institution prescribed by the Presidential Decree. Thereafter, the franchisor may request payment of the initial franchise fee from the financial institution either when the franchisee has commenced operations (eg, opened its franchised restaurant) or when two months have passed from the execution date of the franchise agreement, whichever is earlier.

Notwithstanding the foregoing, the franchisor may receive the above fees directly from the franchisee without depositing the initial franchise fee to a financial institution if:

- the franchisor subscribes to a compensatory insurance policy for loss to the franchisee; or
- the franchisor and the franchisee agree that the franchisor will receive the initial franchise fee after two months from the date of executing the franchise agreement, or after the franchisee commences operation (eg, opens its franchise unit), whichever is earlier.

In practice, it is difficult, if not impossible, to find a financial institution that will open an escrow account for the benefit of a foreign franchisor. Furthermore, with regard to compensatory insurance, there is only one insurance provider in South Korea – Seoul Guarantee Insurance Company – that will issue an insurance policy. To subscribe, the foreign franchisor must have a guarantor located in South Korea (an individual or a

business entity) that would guarantee the amount of the insurance policy being purchased, but in practice, it is almost impossible for a foreign franchisor to get the insurance policy from Seoul Guarantee Insurance Company.

Given the difficulties in finding a South Korean financial institution and subscribing to compensatory insurance in South Korea, foreign franchisors seeking to receive the above fees directly from the franchisees often choose to defer the payment of those fees until two months have elapsed from the date of executing the franchise agreement or the franchisee commences operation of its franchised unit, whichever occurs earlier.

Law stated - 22 May 2024

Usury

35 | Are there restrictions on the amount of interest that can be charged on overdue payments?

No specific restrictions exist on the amount of interest that can be charged on overdue payments. However, if the interest is deemed excessive, it can be reduced by the South Korean courts if challenged.

Law stated - 22 May 2024

Foreign exchange controls

36 | Are there laws or regulations restricting a franchisee's ability to make payments to a foreign franchisor in the franchisor's domestic currency?

There are no laws or regulations restricting the ability of a franchisee to make payments to a foreign franchisor in the franchisor's domestic currency.

Law stated - 22 May 2024

Confidentiality covenant enforceability

37 | Are confidentiality covenants in franchise agreements enforceable?

In principle, confidentiality covenants in franchise agreements are enforceable.

Law stated - 22 May 2024

Good-faith obligation

38 | Is there a general legal obligation on parties to deal with each other in good faith during the term of the franchise agreement? If so, how does it affect franchise relationships?

The parties to a franchise agreement have a general obligation to act in good faith. More specifically, the franchisee's duties are stipulated as follows under the Franchise Act:

- make sincere efforts to maintain the integrity of the franchise business and the reputation of the franchisor;
- maintain proper inventory levels and display goods in an appropriate manner in accordance with the franchisor's supply plan and consumer demand;
- meet appropriate quality standards of goods or services, as required by the franchisor;
- use commodities provided by the franchisor, if alternatives of the same quality do not exist;
- meet appropriate equipment of business facilities, exterior and transportation requirements imposed by the franchisor;
- consult in advance with the franchisor when it is considering a change of goods, services or business activities;
- maintain and provide data necessary for unified business management and sales strategy formulation by the franchisor to assist the franchisee;
- allow the entry of the franchisor's officers and employees or its designees to the franchisee's business premises to inspect books and records, among other things;
- refrain from relocating its place of business or transferring the franchise to a third party without the consent of the franchisor;
- refrain from engaging in a competitive business as the franchisor during the term of the franchise agreement;
- notify the franchisor of any infringements of business technology or trade secrets; and
- notify the franchisor of any business marks that may have been revealed to a third party and cooperate with the franchisor in protecting its business marks.

The franchisor's duties defined under the Franchise Act are as follows:

- devise business plans;
- make efforts to continue to develop the quality, products and sale management functions of the franchise;
- provide franchisees with equipment for franchised units, goods, or services at reasonable prices;
- provide training and education to franchisees and their employees;
- provide ongoing advice to franchisees on the management and operation activities;
- refrain from establishing directly managed stores in competition with the franchisee within the business territory; and
- make sincere efforts to resolve disputes arising with the franchisee.

Law stated - 22 May 2024

Franchisees as consumers

- 39 | Does any law treat franchisees as consumers for the purposes of consumer protection or other legislation?

Franchisees are in general deemed to be independent entities from franchisors, and therefore there are no laws that specifically treat franchisees as consumers for the purposes of consumer protection.

Law stated - 22 May 2024

Language of the agreement

- 40 | Must disclosure documents and franchise agreements be in the language of your country?

While no express provision in the Franchise Act requires the franchisor to draft the disclosure document in a certain language, the general practice of the KFTC is to only accept Korean-language versions of the disclosure document for registration. Thus, the franchisor must prepare the disclosure document in Korean.

Likewise, the Franchise Act does not require that the franchise agreement be written in Korean. However, it is advisable for foreign franchisors to offer Korean translations of franchise agreements to make it easier for South Korean franchisees to understand. In addition, as the KFTC requires a Korean translation in the case of a template franchise agreement being written in a foreign language, it is necessary to translate the template franchise agreement and all ancillary documents into Korean when filing for registration.

Law stated - 22 May 2024

Restrictions on franchisees

- 41 | What types of restrictions are commonly placed on the franchisees in franchise contracts?

In general, franchise agreements often contain restrictions that regulate the protected business territories of each franchised unit, non-competition, governing law, and dispute resolution. However, there are no notable restrictions imposed by the Franchise Act on the franchisees on the provisions in franchise agreements.

Law stated - 22 May 2024

Courts and dispute resolution

- 42 | Describe the court system. What types of dispute resolution procedures are available relevant to franchising?

Most franchising disputes in South Korea are resolved in the courts. The South Korean judiciary system is three-tiered and consists of the Supreme Court, the high courts (the appellate courts) and the regional district courts (the courts of first instance).

As an alternative method of dispute resolution, the parties may choose mediation or arbitration. Under the Franchise Act, a franchise transaction dispute mediation committee was set up. The committee may mediate matters related to disputes over franchise transactions if requested by the KFTC or by the parties in dispute.

The Korean Commercial Arbitration Board (KCAB) is the principal arbitration forum for arbitrating disputes. Arbitration before the KCAB is an alternative way of producing impartial and fair resolutions to commercial disputes.

Law stated - 22 May 2024

Governing law

- 43** | Are there any restrictions on designating a foreign governing law in franchise contracts in your jurisdiction? How does the governing law affect the contract's enforceability?

There is no requirement for franchise documents to be governed by local laws. In fact, South Korean courts readily enforce foreign governing laws. However, some compulsory provisions of South Korean law might apply irrespective of the governing law as agreed by the parties in their contract.

Law stated - 22 May 2024

Arbitration – advantages for franchisors

- 44** | What are the principal advantages and disadvantages of arbitration for foreign franchisors considering doing business in your jurisdiction? Are any other alternative dispute resolution (ADR) procedures particularly favoured or disfavoured in your jurisdiction?

Unlike litigation before the South Korean courts, arbitration awards are not appealable as arbitration resolves a dispute through a single proceeding. In addition, as arbitration procedures are not public, important information regarding the franchise transaction may be kept confidential.

Foreign companies contracting with South Korean companies tend to choose arbitration over court litigation for its perceived advantage as a neutral dispute resolution forum. In litigation, a party who is resident in or a national of the jurisdiction of the court is likely to be more familiar with its court system than a foreign party. In addition, as the judicial system in South Korea is based on a three-tier system, arbitration is usually regarded as more efficient in terms of time and money.

On the other hand, in some cases, arbitration proceedings can incur higher costs than court litigation. For example, when an arbitration related to a highly specialised area is being

conducted, the cost of inviting expert witnesses and extensions of the arbitration period are the main causes of rising arbitration costs.

Law stated - 22 May 2024

National treatment

45 | In what respects, if at all, are foreign franchisors treated differently (legally, or as a practical matter) from domestic franchisors?

Aside from minor differences in connection with the obligation to report real estate acquisitions under the Act on Report on Real Estate Transactions and the relevant requirements under the Foreign Investment Promotion Act, foreign franchisors are not treated any differently from domestic franchisors.

Law stated - 22 May 2024

UPDATE AND TRENDS

Legal and other current developments

46 | Are there any proposals for new legislation or regulation, or to revise existing legislation and regulation? Are there other current developments or trends to note?

Mandatory items and their supply price calculation methods

Effective from 3 July 2024, the amended Franchise Act introduces a new requirement for franchise agreements to specify the type of mandatory items and their supply price calculation methods. The existing franchise agreements must comply with the new requirement within six months from the effective date. The Guidelines for Assessing Unfair Business Practices in the Franchise Industry outlines what may constitute mandatory items. For instance, fixtures or equipment such as patio chairs, smoking room chairs, air conditioners, cash registers and computer equipment in a food services franchise business that are not directly related to the uniformity and quality of the main food product, are not mandatory items, since these items do not affect their use or function, even if the franchisor sets quality standards and allows the franchisee to purchase them freely according to those standards.

Law stated - 22 May 2024



Sun Chang

sun.chang@leeko.com

Lee & Ko

[Read more from this firm on Lexology](#)

Switzerland

[Christophe Rapin](#), [Vincent Jäggi](#), [David Ginolin](#)

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MARKET OVERVIEW

Franchising in the market

- 1 | How widespread is franchising in your jurisdiction? In which sectors is franchising common? Are there any economic or regulatory issues in the market that are more or less hospitable to franchising or make it economically viable in your jurisdiction?

No official statistics are available on the extent of franchising in Switzerland. According to the Syndicate Unia, there were estimated to be approximately 20 franchisors with 400 franchisees in the early 1970s and 150 franchisors, mainly foreign, in 2000. The market continued to increase significantly to reach 250 to 300 franchisors (with up to five franchisees each) in 2015, the vast majority of which is expected to grow in the future according to a study conducted by the Swiss Franchise Association, which has recently been rebranded to become [Swiss Distribution](#).

However, the difficulty for franchisees to obtain a bank loan to finance their market entry does not facilitate market access.

According to Swiss Distribution, franchising is primarily present in retail, health and wellness, followed by gastronomy and fashion. The consulting and real estate sectors also count franchises, though to a lesser extent.

Law stated - 21 June 2024

Associations

- 2 | Are there any national or local franchise associations? What is their role in franchising, including any impact on laws or regulations? Are there any rules of conduct or membership requirements?

Swiss Distribution is the leading association in the Swiss franchise industry. Franchise associations have a limited impact on the development of statutory laws and regulations. During the consultation procedure on preliminary drafts of new legislation affecting franchising activities, franchise associations and various stakeholders from civil society (political parties, interest groups, non-governmental organisations, etc) may express their opinions on the proposed bill.

Swiss Distribution has developed its [Code of Conduct](#), which is binding for its members only (soft law). The Code of Conduct provides specific pre-contractual disclosure obligations and the specific duties of the parties to a franchise agreement. Indeed, a franchisor must demonstrate that it has successfully operated its franchising concept for a reasonable period of time (proof of concept) and must provide adequate initial training as well as commercial and technical support throughout the term of the franchise agreement.

Law stated - 21 June 2024

BUSINESS OVERVIEW

Types of vehicle

3 | What forms of business entities are relevant to the typical franchisor?

When it comes to setting up business in Switzerland, franchisors have a variety of legal forms from which to choose. However, the prevailing form of corporate vehicle established by a typical franchisor is the company limited by shares (AG), followed by the limited liability company (GmbH). Both AG and GmbH limit the personal liability of their holders for the debts of the company to their share of the corporate stock. However, only the AG may list on the Swiss stock exchange (the SIX Swiss Exchange or the BX Swiss).

Law stated - 21 June 2024

Regulation of business formation

4 | What laws and agencies govern the formation of business entities?

In Switzerland, no regulations apply specifically to franchises and franchise relationships. The relevant legislation is, therefore, to be identified on a case-by-case basis.

In terms of the formation of business entities, the [Swiss Civil Code](#) (CC) and the [Swiss Code of Obligations](#) (CO) are relevant. The technical aspects of registration required for the formation of an AG or a GmbH are governed by the [Commercial Register Ordinance](#).

Law stated - 21 June 2024

Requirements for forming a business

5 | Provide an overview of the requirements for forming and maintaining a business entity.

The forming and maintaining of a business entity depend on the legal corporate form chosen. Nevertheless, the process follows the same steps for an AG and a GmbH. The business entity may be formed by one or more natural or legal persons (regardless of domicile or nationality) during an assembly, known as a constitutive assembly, in a notarial deed.

The articles of association must contain in particular the company name, registered office and objects, the form of the company's external communications, the total amount of the capital, the extent to which it is paid up and the nominal value of shares. Irrespective of the size of the company, the minimum capital value of an AG is 100,000 Swiss francs, divided into shares with a nominal value that must be greater than zero Swiss cents, while that of a GmbH is 20,000 Swiss francs, divided into shares with a nominal value that must be greater than zero Swiss cents as well.

The franchisee is then registered in the public commercial register of the canton of its registered office. The commercial register indicates, in particular, a list of the members

authorised to act on behalf of the company. In the case of a GmbH, all listed individuals have management powers. The franchisee as a legal entity is liable for the actions of publicly registered members authorised to act on its behalf.

Function and residency requirements apply to those registered people. At least one member of the board of directors of the AG, respectively a managing director of the GmbH or a member of the top management entitled to represent the company with sole signing power, must reside in Switzerland. If the signature power is joint, two members with joint signing power must reside in Switzerland.

Law stated - 21 June 2024

Restrictions on foreign investors

6 | What restrictions apply to foreign business entities and foreign investment?

The franchise company must be represented by a person with sole signing power (namely, a member of the board of directors or a managing director) who is domiciled in Switzerland. In the case of joint signing power by two, the franchise company must be represented by two persons with joint signing power who are domiciled in Switzerland.

Foreign franchisors must also be aware that, according to the [Federal Act on the Acquisition of Real Estate by Persons Abroad](#), natural and legal persons with their registered office or domicile abroad as well as persons acting on their behalf may only acquire real estate in Switzerland after an authorisation procedure. However, the purchase of real estate for commercial use (eg, hotels, shops, offices and production halls) does not require authorisation.

As at the time of writing, no other restrictions apply to foreign business entities or foreign investment.

Law stated - 21 June 2024

Taxation

7 | What aspects of the tax system are relevant to franchisors? How are foreign businesses and individuals taxed?

In terms of taxation, the Swiss federal system implies that tax powers and revenues are shared between the Swiss Confederation, the cantons and the municipalities. Businesses and individuals are therefore taxed on all three levels. While the Swiss Confederation is competent exclusively in areas that the [Swiss Constitution](#) provides for, the cantons are sovereign in tax matters, which means in particular that they have a general competence to collect taxes, determine tax-exempt amounts, and set tax scales and rates. Thus, the level of taxation and the tax burden varies between cantons and each canton has the power to influence its tax competitiveness directly. This system has developed a domestic tax competition, which has led to relatively low tax rates in Switzerland in comparison with other jurisdictions.

Natural persons residing or staying for a certain period of time in Switzerland are subject to income and wealth tax. Foreign persons not benefiting from a permanent residency permit (the C permit) are, in principle, taxed on their income from Swiss sources by means of a withholding tax. However, admission fees and royalties paid to foreign franchisors are generally not taxed by withholding.

Legal entities, such as franchisees formed in AGs or GmbHs, residing in Switzerland are subject to tax as soon as they are entered into the commercial register or if they have their effective place of management in Switzerland. Income tax is levied at the federal, cantonal and municipality levels (namely, by the Swiss Confederation, the relevant canton and the relevant municipality). Relative tax rates are, for the majority of the cantons, flat tax rates applying on the taxable profit of a legal entity (progressive tax rates are the exception).

Depending on the location, it is not unusual to expect a rate between 14 and 17 per cent for income tax. Taxable income is determined through the statutory accounts or, in the case of a foreign company, the subsidiary accounts. The assessment for income tax is made on net profit after tax (tax expenses being deductible in Switzerland) as shown in the statutory financial statements that must be made according to the CO accounting standards. Companies that are not registered per se in Switzerland but are active in the country through a permanent establishment or a subsidiary are only taxed on profits generated by the Swiss activity or on real estate assets located in Switzerland. According to a judgment of the Federal Supreme Court ([BGer 134 I 303](#)), the activity of a franchisee does not, however, constitute a permanent establishment of the franchisor, even if the premises belonging to the franchisor in Switzerland are leased to the franchisee. Except for the taxation of an eventual rental income, no tax obligations arise for franchisors in the cantons where their franchisees are domiciled with regard to the franchise agreement as such.

After the rejection of earlier reform packages, the Swiss electorate agreed in May 2019 on a major tax reform, which had been debated at length. The reform aimed to align the Swiss tax system with international standards regarding corporate taxation. In general, the reform has increased the tax burden of large companies while reducing that of small and medium-sized enterprises. It implied the suppression, as of 1 January 2020, of special privileges granted to internationally active companies. To maintain Switzerland as a tax-efficient business location, the fiscal reform offered, among other things, the possibility to introduce a deduction of up to 50 per cent of research and development costs on the cantonal level and a 'patent box' system allowing profits from inventions to be taxed at a reduced rate at the cantonal level.

Swiss value added tax (VAT) is only collected at the federal level.

Since January 2019, foreign persons with a turnover of at least 100,000 Swiss francs through physical deliveries of products to Swiss-based customers have been subject to domestic tax.

Taxable persons are required to register and are responsible for declaring the tax due. As of 1 January 2024, the standard VAT rate is 8.1 per cent. Reduced rates are applied to some services and products, namely accommodation (at a rate of 3.8 per cent) and essential goods and services such as non-alcoholic beverages, food, medicines and books (at a rate of 2.6 per cent). In this framework, services related to franchise relations are subject to ordinary VAT.

Law stated - 21 June 2024

Labour and employment

8 | Are there any relevant labour and employment considerations for typical franchisors?

In Switzerland, franchisees are considered independent entrepreneurs rather than employees of the franchisor. However, the franchise contract is not regulated as such by Swiss law but is an 'innominate' or 'mixed' contract, which means that it consists of elements of several contracts regulated by the CO. It is, therefore, necessary for each matter in dispute to identify the predominant elements of the contractual relationship to determine the regime specifically applicable to the given case. On the basis of these principles, the Federal Supreme Court confirmed, in its judgment [BGer 118 II 157](#), the application by analogy of labour law provisions providing for compensation of the employee in the event of wrongful termination in a case where the franchisor held a particularly dominant position in relation to the franchisee, which was limited in its entrepreneurial freedom. This risk can be limited by ensuring that the franchisee enjoys genuine and broad entrepreneurial freedom. However, the risk of equating the franchise relationship with a relationship of subordination remains in two respects.

On one hand, in the case [BGer 134 III 497](#) concerning a distribution contract, the Federal Supreme Court ruled that the agent's protective provisions provided for in the provisions governing the commercial agency contract were applicable by retaining a relationship of subordination between the licensor and the distributor. This judgment may suggest that a franchisee might, in the same way, be protected as an agent even in the case of tenuous subordination to the franchisor. On the other hand, if a non-competition agreement has been concluded, part of Swiss legal literature states that the franchisee may be entitled to special remuneration when the franchise agreement is terminated. The Federal Supreme Court has neither decided on nor outlined the answer to either of the latter two points.

Law stated - 21 June 2024

Intellectual property

9 | How are trademarks and other intellectual property and know-how protected?

The [Swiss Trade Mark Protection Act](#) (TmPA) provides that any sign (such as words, letters, numbers and graphics) distinguishing the goods or services of one company from those of another may be registered as a trademark. Registration grants the holder an exclusive right to use the mark on the registered goods and services and the protection of their right for a 10-year period, which may be renewed an unlimited number of times. However, well-known trademarks within the meaning of article 6-bis of the [Paris Convention](#) benefit from protection not only for registered goods and services, but also for any non-registered ones. The Swiss Federal Institute for Intellectual Property is in charge of processing applications for registration. The application may be filed by more than one person intended to be a holder of the right to use the trademark, without any requirement as

to residence, headquarters or nationality being applicable. Since Switzerland is a party to the Madrid International Trademark System, the national registration can be supplemented by an international registration handled by the World Intellectual Property Organization in Geneva.

No proof of use of the trademark is required for registration. However, to avoid trademarks being registered as a reserve, the trademark must be used for its protection to take effect. If the owner does not use the trademark during the five years following registration, their right shall be forfeited if non-use is not justified and action may then be brought to cancel the registration.

Unauthorised use of a trademark identical or confusingly similar to a registered trademark shall be deemed to be an infringement. In such a case, Swiss law provides injunctive or prohibitive civil actions as well as other protective measures. The owner of the trademark may also demand financial compensation by means of a request for royalties, compensation of damages or the repayment of profits made by the infringer. Furthermore, the TmPA provides for criminal sanctions, upon complaint, of any unlawful use of another's trademark by a sentence of up to one year's imprisonment. In addition to civil and criminal remedies, the TmPA enables the owner of a trademark to oppose the entry in the register of an infringement of their trademark within three months following the publication of said infringement's registration.

In Switzerland, know-how is neither protected by specific legislation nor by Swiss regulations protecting intellectual property. However, in the case of unfair competition through the use of know-how developed by the franchisor with respect to its franchising concept, the [Federal Act against Unfair Competition](#) allows the franchisor to file a complaint. The case of unfair competition is then punishable by a pecuniary penalty or a sentence of up to three years' imprisonment. Know-how may also be protected by a clause in the franchise contract qualifying it as confidential information. The disclosure of the know-how could then be pursued through the legal means available in the case of breach of contract. In addition, the [Swiss Criminal Code](#) punishes, upon complaint, the breach of manufacturing or trade secrecy with a pecuniary penalty or imprisonment of up to three years.

Law stated - 21 June 2024

Real estate

10 | What are the relevant aspects of the real estate market and real estate law? What is the practice of real estate ownership versus leasing?

Franchisees do not usually own their own premises and usually lease them in the main cities of Switzerland. The franchisor may sometimes be the owner of the premises where the franchising activities are to be operated by the franchisee. In this specific set-up, the franchise contract also deals with the lease of the premises, and the franchisor-franchisee relationship may become a hybrid one combining franchising and commercial lease aspects.

Swiss law does not provide for specific legislation on commercial leases, but rather for one-off changes to the regime applicable to any lease contract. Local franchisors, as well as foreign franchisors, are free to enter into and arrange their lease relationships provided that mandatory tenants' protection provisions are complied with. As any lessee, franchisors are thus protected against abusive rent rates as well as by provisions requiring compliance with specific formalities upon the termination of the lease. Given the depreciation period of investments made and the inconveniences associated with moving a business, commercial leases are often longer than residential leases and must be terminated with at least six months' notice. If the landlord terminates the lease, the tenant may request an extension of the lease for a period of up to six years provided the circumstances justify it. It should also be noted that the installation and alteration of premises by lessees must be authorised by the owner or lessor and may give rise, at the end of the lease, to compensation for the lessee who financed them. It is, nevertheless, recommended that this matter be addressed more closely in the lease contract.

The CO requires the notarisation of the 'promise to sell' and the 'purchase of real estate'. When purchasing a building plot or changing the use to which the purchased property is to be put, land planning regulations and authorisation processes must also be taken into account.

In addition to these regulations, foreign franchisors must observe the restrictions imposed by the Federal Act on the Acquisition of Real Estate by Persons Abroad (BewG). According to the BewG, 'persons abroad', which are physical or legal persons domiciled or having their registered office abroad, as well as persons acting on their behalf, may acquire real estate in Switzerland under conditions verified in an authorisation procedure.

However, according to the BewG, the purchase of real estate for commercial use is not subject to authorisation. Hotels, retail premises, offices and manufacturing halls, for instance, are considered properties for commercial use.

Law stated - 21 June 2024

Competition law

11 | What aspects of competition law are relevant to the typical franchisor in your jurisdiction? How is competition law enforced in the franchising sector?

Franchising activities are governed by Swiss competition law, namely the [Federal Cartel Act](#), the [Federal Act on Price Supervision](#) and the Federal Act against Unfair Competition. Indeed, a franchise agreement qualifies as a vertical restraint between two entities and is subject to the same legal assessment as a traditional distribution contract. Swiss competition law tends to be compatible with Commission Regulation (EU) No. 2022/720 of 10 May 2022 (replacing Commission Regulation (EU) No. 330/2010 of 20 April 2010) and general European practice. However, in the Gaba case ([BGer 143 II 297](#)), the Federal Supreme Court refused to apply an EU regulation on technology transfer agreements under Swiss law, so as to take into account the specific legal and economic conditions of Switzerland.

On 12 December 2022, the Swiss Competition Commission (ComCo) published a notice concerning the assessment of vertical agreements ([CommVert](#); thus replacing the previous version of the CommVert that was into force as of 22 May 2017) and related guidelines containing detailed rules that may also apply in franchise relationships (eg, cross-supplies, non-compete obligations, know-how and resale prices).

A franchise agreement is deemed to contain illegal price restrictions if it provides for a minimum or fixed price for a product, or for the allocation of territory between different franchisees by preventing passive sales by other franchisees into those territories. A general prohibition of online sales in franchise agreements qualifies as an illicit hardcore restriction, as internet sales are considered passive sales pursuant to the CommVert (which may not be subject to an absolute prohibition) unless the website specifically targets customers in an individual territory (active sale).

Other restrictions may also qualify as hardcore restrictions, such as technical geoblocking measures, rerouting customers or restricting sales to customers located outside the contractual territory based on the information provided (eg, foreign credit cards) as those restrictions achieve the same goal of restricting passive sales to customers located outside a contractual territory.

In the latest development in the Pfizer case ([BGer 147 II 72](#)), the Federal Supreme Court held that recommended resale prices issued by Pfizer and made available to pharmacies through a third-party database that was directly connected to the cash registers of the pharmacies qualified as unlawful resale price maintenance. Notably, 89.3 per cent of the pharmacies supplied by Pfizer had fully or partly applied the recommended resale prices. The compliance of 50 per cent of the retailers appears to be sufficient for there to be a concerted practice. The fact that Pfizer has never exerted pressure on or offered special incentives to the pharmacies was not relevant. Pursuant to this judgment, non-binding price recommendations may be seen as problematic in Switzerland, especially when those recommendations are repeatedly and automatically communicated in the retailers' cash register systems. This ruling is stricter than the corresponding rules under European competition law.

The exposure of the parties to a franchise agreement that breaches Swiss competition law may be important. If a franchise agreement is found to contain illegal clauses, the parties may be fined up to 10 per cent of the turnover achieved in Switzerland in the preceding three years, without prejudice to potential civil claims.

Finally, a revision of the Federal Cartel Act and the Federal Act against Unfair Competition came into force on 1 January 2022. This revision implements the Fair Price Initiative, which aims to enable the purchase of products outside of Switzerland in potentially more favourable purchasing conditions. The revision establishes various new behavioural obligations for companies that are powerful relative to their market, prohibits discrimination while procuring goods and services abroad, and prohibits practices of geoblocking. The revised provisions may have a material impact on franchising activities in Switzerland.

As of 1 July 2023, a new revision of the Federal Cartel Act has extended the limitation periods to prosecute violations of amicable settlements and administrative orders (now seven years instead of five years), as well as violations of the obligation to provide information and violations relating to concentrations of undertakings (now four years instead of two years).

Law stated - 21 June 2024

OFFER AND SALE OF FRANCHISES

Legal definition

12 | What is the legal definition of a franchise?

As Swiss law does not specifically define franchising, the concept has been developed by case law and legal literature. According to a leading decision of the Federal Supreme Court ([BGer 118 II 157](#)), in concert with the legal literature and the Swiss franchising association Swiss Distribution, a franchise agreement consists of the distribution of goods or services by independent entrepreneurs (the franchisees) according to a uniform concept of sale and advertising provided by the franchisor. For this purpose, the franchisee receives the right to use the franchisor's name, trademarks, equipment or other material or immaterial property rights as well as ongoing assistance, advice and training from the franchisor. Although the franchisee acts on its own behalf and at its own risk, the franchisor reserves, as a general rule, the right to give instructions and exercise control over the franchisee's business activity. The Federal Supreme Court stated, however, that the variety of forms in which franchise agreements are drawn up makes it impossible to define a franchise agreement 'with sufficient precision'. In any event, the relationship involves very close cooperation between the franchisor and the franchisee.

Law stated - 21 June 2024

Laws and agencies

13 | What laws and government agencies regulate the offer and sale of franchises?

The offer and sale of franchises are not specifically governed by any law in Switzerland. In terms of law, the general provisions of the Swiss Civil Code (CC) and the Swiss Code of Obligations (CO) apply, as well as the [United Nations Convention on Contracts for the International Sale of Goods](#), if not waived. The General Data Protection Regulation of the European Union, the [Swiss Federal Act on Data Protection](#) and the Swiss laws on intellectual property may also apply to the offer and sale of franchises. The important role of the principle of good faith in relation to the behaviour of the parties, who must act in a serious manner (serious intent to contract), as well as the disclosure of information during contractual negotiations, should also be stressed.

Where general terms and conditions (GTC) are involved, although the general rules of the CC and the CO apply, case law of the Federal Supreme Court has developed specific rules regarding the adoption and interpretation of the GTC, which must also be taken into account. In particular, the GTC must be validly incorporated in the contract to be effective and, in any case, the agreement between the parties has priority over the GTC's content. Moreover, the Federal Act against Unfair Competition prohibits the use of GTCs

that provide for a significant and unjustified imbalance between the rights and obligations of a business and a consumer to the latter's detriment.

Accordingly, there is no government agency regulating franchises. However, Swiss Distribution, which is a self-regulated private commercial organisation with no governmental function, provides a framework for its members.

Law stated - 21 June 2024

Principal requirements

- 14** | What are the principal requirements governing the offer and sale of franchises under the relevant laws?

This is not relevant in Switzerland.

Law stated - 21 June 2024

Franchisor eligibility

- 15** | Must franchisors satisfy any eligibility requirements in order to offer franchises? Are there any related practical issues or guidelines that franchisors should consider before offering franchises?

Swiss law does not provide for such requirements. However, Swiss Distribution does require franchisors and master franchisees aspiring to become members to meet certain requirements, such as a proof of concept, a minimum of two years of franchising and a franchise system comprising of at least two franchisees. It should, moreover, be noted that franchisees cannot join Swiss Distribution.

Law stated - 21 June 2024

Franchisee and supplier selection

- 16** | Are there any legal restrictions or requirements relating to the manner in which a franchisor recruits franchisees or selects its or its franchisees' suppliers? What practical considerations are relevant when selecting franchisees and suppliers?

Swiss law does not provide for any special regulations in this area and gives free scope to contractual freedom. Franchisors and master franchisees may, with the consent of their co-contractor, apply possible restrictions. Notwithstanding the foregoing, the new provisions of the Federal Cartel Act provide for new behavioural obligations for companies with relative market power.

In line with EU rules, if the franchisees' network qualifies as a selective distribution system based upon quantitative or qualitative criteria, or both, franchisors are required to apply

those criteria in a uniform and non-discriminatory manner when selecting the candidates to a franchise agreement.

Law stated - 21 June 2024

Pre-contractual disclosure – procedures and formalities

17 | What procedures and formalities for pre-contractual disclosure are required or advised in your jurisdiction? How often must the disclosures be updated?

The procedure for making pre-contractual disclosure in connection with franchise contracts is not regulated by special statute under Swiss law. However, according to the principle of good faith, not only must all of the information disclosed during the pre-contractual phase be true, but the prospective franchisee must receive all the necessary information concerning the projected contractual relationship. In this context, Swiss Distribution has issued its Code of Conduct, supplemented by specific advice concerning the pre-contractual phase. Regulations issued by Swiss Distribution are binding only to its members and, in the case of its Code of Conduct, apply only to the relationship between franchisor and franchisee. However, as this information is available on Swiss Distribution's website, it can serve as an illustration for franchisor or master franchisee.

In general, for evidentiary reasons, it is recommended to keep a written record of any information transmitted.

Law stated - 21 June 2024

Pre-contractual disclosure – content

18 | What information is the disclosure document required or advised to contain?

There are no specific pre-contractual statutory disclosure regulations pursuant to Swiss law in a franchise context. According to the principle of good faith, the prospective franchisee must receive all the necessary information concerning the contemplated franchising activities prior to the execution of the franchise agreement. In addition, all of the information disclosed during the pre-contractual phase is to be true and not misleading. For evidentiary reasons, it is recommended to keep a written record of any information transmitted.

In its Code of Conduct, Swiss Distribution lays out specific pre-contractual disclosure obligations that are binding for its members only (soft law). The franchisor member of Swiss Distribution is thus required to provide the prospective franchisee with full written information concerning the terms of the franchise agreement within a reasonable period of time before the execution of the franchise agreement. Moreover, all information provided to the franchisor must be factually correct and void of ambiguity and misleading information.

Law stated - 21 June 2024

Pre-sale disclosure to sub-franchisees

- 19** | In the case of a sub-franchising structure, who must make pre-sale disclosures to sub-franchisees? If the sub-franchisor must provide disclosure, what must be disclosed concerning the franchisor and the contractual or other relationship between the franchisor and the sub-franchisor?

Under Swiss law, sub-franchise relationships are not governed by a special statute or monitored by a specific agency. Therefore, according to the principle of freedom of contract applicable under Swiss law, the parties to the sub-franchising structure decide by consensus which of them will make pre-sale disclosures to sub-franchisees.

Law stated - 21 June 2024

Due diligence

- 20** | What due diligence should both the franchisor and the franchisee undertake before entering a franchise relationship?

Under Swiss Distribution's Code of Conduct, which is applicable to its members, the franchisor must conduct an investigation to determine whether a potential franchisee has the required qualities to operate the franchise in question (in other words, adequate training, financial capacity and personal qualities).

Since the reputation of the franchisor is directly linked to that of its franchisees, it is also necessary to ascertain the practices of the prospective franchisee in its business activity and in particular, if the prospective franchisee has employed staff, to ensure compliance with labour law obligations.

However, the franchisee is advised to carefully examine the franchise it is interested in. In this regard, the Swiss Federal Department of Economic Affairs, Education and Research recommends that potential franchisees consider the following questions:

- How long has the franchisor been on the market?
- What skills and experience does management have?
- Are there any references?
- How is the financial situation presented?
- How is the company image presented?
- How many franchise managers are there and how long have they been franchise managers?
- Does the franchisor perform an aptitude test with applicants?
- Is the franchisor a member of a professional association?
- Is the franchisor trying to manipulate prices?
- Do you have to buy the merchandise and production resources from the franchisor?
- Is professional and commercial knowledge necessary?
- Is there comprehensive training and good preparation for the business?

- Is there a manual on how to manage the business?
- Are help and advice available if required?
- What services does the franchisor offer in terms of buying, advertising and public relations?

Swiss Distribution further invites prospective franchisees to consult the selection criteria applicable to franchisees and to answer a series of questions to determine whether they are 'fit to buy'. Likewise, a 'fit to sell' test is available for franchisor self-assessment. In addition, Swiss Distribution's advice on the pre-contractual phase included in its Code of Conduct is relevant.

Law stated - 21 June 2024

Failure to disclose – enforcement and remedies

- 21 | What actions may franchisees or any relevant government agencies take in response to a franchisor's failure to make required disclosures? What legal remedies are available? What penalties may apply?

Swiss law recognises and applies the culpa in contrahendo (eg, if the franchisor, in breach of the principle of good faith, hides information that would have discouraged the franchisee from entering into the franchise contract with the franchisor) and the 'error as to the basis of the contract' doctrines (eg, if a franchisee enters into a franchise agreement based on a material misrepresentation of the operation), the franchisee may rescind or cancel the franchise agreement.

The damage to be claimed by the franchisee arising out of a culpa in contrahendo is equivalent to the difference between the current wealth of the franchisee in its capacity as the injured party and the wealth it would hypothetically dispose of without the damaging event (namely, the conclusion of the franchise agreement). However, claims based on culpa in contrahendo are only admitted exceptionally by the Swiss courts.

If a franchisee rescinds a franchise agreement based on an error as to the basis of the contract resulting from its own negligence (eg, by not requesting sufficient information before entering into the franchise agreement), the franchisee may be liable to pay damages to the franchisor amounting to the negative interest (namely, the amount of useless cost suffered by the franchisor that was caused by negotiating and entering into the cancelled franchise contract).

Law stated - 21 June 2024

Failure to disclose – apportionment of liability

- 22 | In the case of sub-franchising, how is liability for disclosure violations shared between franchisor and sub-franchisor? Are individual officers, directors and employees of the franchisor or the sub-franchisor exposed to liability? If so, what liability?

Unless the parties have contractually provided otherwise, a sub-franchisor is liable to its sub-franchisee for disclosure violations in the same way that the franchisor is liable to the sub-franchisor. The franchisor is, in principle, not liable to the sub-franchisee. However, on the basis of the reasoning followed in judgment [BGer 118 II 157](#), where the sub-franchisor is in a relationship of subordination to the franchisor, then the franchisor could assume liability for violations by the sub-franchisor in the same way that an employer bears liability for the violations committed by its employee under the provisions governing employment law.

In Switzerland, the liability of individual officers or directors of a franchisor or sub-franchisor is limited if the business is formed as a company limited by shares or a limited liability company. Such executives would only be held directly or indirectly liable in the case of an intentional or negligent breach of duty of care. For damages caused by employees in the performance of their work, liability is generally borne by their employers. Furthermore, where disclosure violations infringe a criminal provision, for instance in matters of unfair competition, individual officers, directors and employees may incur direct liability.

Law stated - 21 June 2024

General legal principles and codes of conduct

23 | In addition to any laws or government agencies that specifically regulate offering and selling franchises, what general principles of law affect the offer and sale of franchises? What industry codes of conduct may affect the offer and sale of franchises?

The offer and sale of franchises are not specifically governed by any law in Switzerland. General provisions of Swiss law remain applicable. However, the CC and the CO apply, as well as the United Nations Convention on Contracts for the International Sale of Goods, if not waived by the parties. Those statutory provisions may impact the terms of the franchise contract; the General Data Protection Regulation of the European Union, the Swiss Federal Act on Data Protection and the Swiss laws on intellectual property may also apply to the offer and sale of franchises. Moreover, the Federal Act against Unfair Competition prohibits the use of general terms and conditions that provide for a significant and unjustified imbalance between the rights and obligations of a business and a consumer to the latter's detriment.

Pursuant to Swiss law, the principle of good faith plays an important role with respect to the conclusion and the performance of a franchise contract, in particular in relation to the behaviour of the parties, which must act in a serious manner (serious intent to contract), as well as the disclosure of information during contractual negotiations.

In contrast to common law jurisdictions, the interpretation of franchise contracts pursuant to Swiss law tends to focus on the real intention of the parties rather than on the terms of the contract. Indeed, should a provision of a franchise contract require interpretation, a judge will first seek to establish the real and common intention of the parties, adopting an empirical approach. When the actual intent of the parties cannot be ascertained on the basis of factual evidence, the provision is to be interpreted in accordance with the principle of trust and in accordance with the rules of good faith. The judge then gives the

unclear provision the meaning that a person placed in similar circumstances, having a similar background as that of the parties, would reasonably do.

There is no government agency regulating franchises. However, Swiss Distribution provides a framework for its members, including its Code of Conduct. Even though the rules and regulations of Swiss Distribution are not binding (at least for non-members of this association), they can serve as an illustration for a franchisor or franchisee.

Law stated - 21 June 2024

Fraudulent sale

24 | What actions may franchisees take if a franchisor engages in fraudulent or deceptive practices in connection with the offer and sale of franchises?

In the case of fraud or deceptive practice, several possibilities are, depending on the circumstances, open to the franchisee. The franchisee may take civil action for breach of contract and claim damages, rescind or terminate the franchise contract as well as claim damages or challenge the franchisor on the basis of the unfair competition act.

The franchisee may also file a criminal complaint if the franchisor's conduct can be qualified as escroquerie or fraud within the meaning of the Swiss Criminal Code. The criminal complaint is, in principle, directed against a physical person. However, if the failing organisation of the incorporated franchisor does not make it possible to determine which person is responsible for the escroquerie or fraud, then the company may be sanctioned with a fine of up to 5 million Swiss francs.

Law stated - 21 June 2024

FRANCHISE CONTRACTS AND THE FRANCHISOR/FRANCHISEE RELATIONSHIP

Franchise relationship laws

25 | What laws regulate the ongoing relationship between franchisor and franchisee after the franchise contract comes into effect?

The general rules of the Swiss Civil Code (CC) and the Swiss Code of Obligations (CO) regulate the ongoing relationship between franchisor and franchisee. Depending on the structure of the contractual relationship between a franchisor and franchisee, the topical regulation of various specific contracts provided for in the CO may additionally apply, in particular the provisions on employment contracts and agency contracts.

Law stated - 21 June 2024

Operational compliance

26 |

What mechanisms are commonly incorporated in agreements to ensure operational consistency and adherence to brand standards?

The right to direct and control the franchisee is reserved to the franchisor in a typical franchise agreement. In this context, the concrete control mechanisms implemented by the franchisor usually consist of an inspection of the franchisee's premises and control of the franchisee's accounts. Usually, the franchisee is also required to report periodically to the franchisor on the conduct and impact of its business. Such reports may cover all matters relating to quality, health, safety, security and environmental friendliness. This could include, for example, customer satisfaction and the labour conditions of employees, if any. In consideration of the long-term nature of the franchise relationship, additional reporting could be provided for, in the case of, for instance, internal incidents, audits or new directives given by the franchisor. The scope of the mechanisms varies according to the standards applicable to the franchise branch. For example, in the gastronomy and food retail sector, a daily report of food freshness and quality management may be introduced and the inspection of the cleanliness of the premises must be particularly thorough to protect the customers' health as well as the reputation of the company.

Law stated - 21 June 2024

Amendment of operational terms

27 | May the franchisor unilaterally change operational terms and standards during the franchise relationship?

Unilateral modifications of the operational terms and standards are admissible if they are contractually provided for by the parties and do not amount to a modification of the contract in itself. Indeed, the contractual freedom of the parties and the principle of *pacta sunt servanda* are limited by the fundamental principle in Swiss law according to which the conclusion and modification of a contract can only take place through the expression of the concordant will of the parties.

Law stated - 21 June 2024

Policy affecting franchise relations

28 | Do other government or trade association policies affect the franchise relationship?

Swiss Distribution's Code of Conduct applies to franchise relationships. These principles are, however, only compulsory for members of the association. Although optional, membership of Swiss Distribution represents a guarantee of professionalism and is notable for its positive impact on the business practice and reputation of the franchisor.

Law stated - 21 June 2024

Termination by franchisor

29 | In what circumstances may a franchisor terminate a franchise relationship? What are the specific legal restrictions on a franchisor's ability to terminate a franchise relationship?

Franchise agreements may be concluded for a fixed or indefinite period. In the first case, the relationship expires at the end of the agreed term without the intervention of the franchisor, unless the parties have agreed otherwise.

Franchise agreements are usually for a fixed period of time, at the end of which the contract is automatically or tacitly extended. In such a case, the contract is then considered to be of indefinite duration and comes to an end, if the parties have not provided otherwise, by termination with six months' notice (by analogous application of the rules on partnership contracts, according to the majority of the legal literature), by mutual agreement or, exceptionally, by the invocation of a motive (good cause) justifying the immediate termination of the relationship (on the basis of the [BGer 4A 241/2017](#) judgment). According to case law of the Federal Supreme Court concerning an exclusive distribution contract ([BGer 107 II 216](#)), the contract must in any case extend over a sufficiently long period of time for the franchisee to make a return on its initial investment of capital and preparatory work. Should the franchisee not be exclusively related to the franchisor, a court might take into account the reduced scope of the relationship compared to an exclusive relationship.

Even in the absence of an express rule, the immediate termination of the relationship for good cause is presumed to be justified when the continuation of the contractual relationship would, according to the rules of good faith, be deemed unacceptable to the terminating party. Notice of immediate termination must reach the other party within a relatively short period of time after the occurrence of the good cause. To provide guidance to the parties, the contract may define and illustrate the notion of good cause. However, in a case concerning a franchise agreement ([BGer 4A 148/2011](#)), the Federal Supreme Court stated that such clauses do not bind the judicial authorities if they limit the possibility of immediate termination when a good cause that is not listed, or that does not correspond to the definition of the parties, arises. While the Federal Supreme Court has recognised the principle of immediate termination of a franchise agreement for good cause, it has not yet had the opportunity to decide on the effects of such termination in the absence of any valid good cause.

The case law of the lower courts as well as the Swiss legal literature consider that the absence of good cause prevents the immediate termination of a franchise agreement. The parties, therefore, remained bound to fulfil their contractual obligations, failing which a civil injunction could be issued against the recalcitrant party ([BGer 125 III 451](#)). If the concrete relationship between the parties justifies the application by analogy of the provisions of the CO on employment contracts, an unjustified immediate termination would still be effective and the franchisee would be entitled to compensation, the amount of which, determined according to all the circumstances of the case, would correspond at most to the amount that the franchisor would have earned if the contract had been terminated at the agreed expiry or after the applicable notice period. Likewise, any other type of abusive termination entitles the franchisee in a relationship of subordination towards the franchisor to claim compensation ([BGer 118 II 157](#)).

In the event of non-renewal of the franchise agreement or termination with notice, the franchisee may also claim compensation for, depending on the situation, loss of customers and not amortised investments. However, the issue remains in doubt because the Swiss Federal Supreme Court has not ruled on the matter and there is no unanimity among the Swiss legal literature in this regard. However, the compensation due to the franchisee in such a case can be expected to vary according to the regime applicable by analogy to the concrete situation.

Law stated - 21 June 2024

Termination by franchisee

30 | In what circumstances may a franchisee terminate a franchise relationship?

Regarding the termination of contractual relations, the franchisee disposes of the same means and is subject to the same rules as the franchisor. It should be pointed out, however, that in the event of non-renewal of the franchise agreement or termination with notice, it is unlikely that the franchisor would be eligible for compensation for customer loss since clientele tend to remain loyal to the brand rather than to the franchisee.

Law stated - 21 June 2024

Renewal

31 | How are renewals of franchise agreements usually effected? Do formal or substantive requirements apply?

Unless the parties have provided for a particular form or substantive requirement, the common will of the parties to renew a franchise agreement of limited duration must be expressed in the same form as the initial agreement or by means of an amendment. Nevertheless, if the parties continue to perform their respective services after the expiry of the contract, the latter may be deemed to be tacitly renewed. If the franchise agreement is of unlimited duration or renews itself from year to year without the intervention of the parties, no formal renewal is necessary.

Law stated - 21 June 2024

Refusal to renew

32 | May a franchisor refuse to renew the franchise agreement with a franchisee? If yes, in what circumstances may a franchisor refuse to renew?

By virtue of the contractual freedom of the parties, the franchisor is in principle entitled to refuse to renew an agreement with a franchisee. However, the refusal to maintain business relationships by a franchisor with a dominant market position could be unlawful according to the Federal Cartel Act. In such a case, the franchisor's refusal to renew the franchise

agreement would not be legally justifiable. The new provisions of the Federal Cartel Act introduce new obligations for entities with relative market power. Indeed, companies upon which other companies are dependent in terms of supply or demand, even though they do not reach a 40 to 50 per cent market share threshold on the relevant market, are subject to the existing provisions regarding the abuse of a dominant position and therefore may be restricted in their capacity to refuse to deal with dependant companies. A company may be considered a dependant of an entity with relative market power if it does not have sufficient or reasonable possibilities to switch to other companies.

Furthermore, regardless of their position in the market, should franchisors refuse to renew the franchise agreement, they may be liable to compensate any investments that the franchisee may have made in good faith (namely, on the basis of a promise or intention to renew the franchise agreement expressed by the franchisor). Along the same lines, one must also take into consideration the potential compensation due to the franchisee if the term of the contract was not sufficiently long to allow for the amortisation of the franchisee's investments.

Law stated - 21 June 2024

Transfer restrictions

33 | May a franchisor restrict a franchisee's ability to transfer its franchise or restrict transfers of ownership interests in a franchisee entity?

Such restrictions are admissible to the extent provided for in the franchise agreement.

Depending on the will of the parties, the restrictions may consist of a prohibition, such as a right to terminate the entire franchise agreement in the event of a transfer of ownership (change of control clause), or a limitation on any transfer of ownership, including pledges, by requiring the franchisor's approval. The requirement for prior written approval from the franchisor for transfers is, however, the most common modality in practice.

Law stated - 21 June 2024

Fees

34 | Are there laws or regulations affecting the nature, amount or payment of fees?

The nature, amount or payment of fees generally depends on the choice of the parties expressed in the franchise agreement. However, the provisions and general principles applicable to contracts subject to Swiss law allow the franchisee to terminate the contract within one year of its conclusion and claim for the reimbursement of the entry fees paid under two conditions (which are strictly assessed):

- the fee to be paid by the franchisee is manifestly disproportionate to the franchisor's counter-performance to the detriment of the franchisee; and
- such disparity results from the exploitation by the franchisor of the franchisee's distress, inexperience or thoughtlessness.

Law stated - 21 June 2024

Usury

35 | Are there restrictions on the amount of interest that can be charged on overdue payments?

The general provisions of the CO provide for an interest rate of 5 per cent. However, the franchise agreement may provide for a lower or higher interest rate. In such a case, the rate must not be excessive, otherwise, it is considered as usury punishable by a pecuniary penalty or imprisonment for up to 10 years. This limit is estimated to range between 10 per cent and 15 per cent.

Law stated - 21 June 2024

Foreign exchange controls

36 | Are there laws or regulations restricting a franchisee's ability to make payments to a foreign franchisor in the franchisor's domestic currency?

No, provided that the parties have agreed upon the chosen currency.

Law stated - 21 June 2024

Confidentiality covenant enforceability

37 | Are confidentiality covenants in franchise agreements enforceable?

Confidentiality covenants in franchise agreements are enforceable. In the case of a breach of contract, the damaged party may initiate a civil action to order compliance with the clause and claim damages. It is recommended to add to the contract, in addition to the confidentiality clause, a penalty clause stipulating that any breach of contract will be punished through the payment of a predefined fee or any other contractual penalty. Besides encouraging the parties to comply with the contract, such a clause helps to avoid the additional difficulty often encountered in proving the amount of damages in civil proceedings by fixing a lump-sum compensation in advance.

Depending on the information revealed to a third party, a breach of confidentiality may also constitute a criminal act.

Law stated - 21 June 2024

Good-faith obligation

38 |

Is there a general legal obligation on parties to deal with each other in good faith during the term of the franchise agreement? If so, how does it affect franchise relationships?

Objectively, good faith is the foundation of loyalty in business and governs the whole area of contract law. The idea is that everyone involved in a legal relationship is bound by general duties that dictate their conduct, which means that everyone must behave in the same way as an honest, loyal and respectful person would behave towards others. The principle is therefore based on social ethics and on a sense of justice. The normative consequences of this principle are mostly developed by case law. Good faith thus has many applications. For example, [BGer 125 III 257](#) developed the prohibition of contradictory behaviour of the parties to a partnership agreement on the basis of good faith. Such reasoning could apply to franchise agreements as well.

Subjectively, good faith is the feeling of acting lawfully despite the existence of a legal irregularity. It may represent a legal requirement or influence the burden of proof.

Law stated - 21 June 2024

Franchisees as consumers

39 | Does any law treat franchisees as consumers for the purposes of consumer protection or other legislation?

As a general rule, franchisees are treated as entrepreneurs and not as consumers under Swiss law and jurisdiction. Franchisees who are considered a weak party with respect to their franchisor's position may benefit from the protection afforded to employees, but are not entitled to consumer protection.

Law stated - 21 June 2024

Language of the agreement

40 | Must disclosure documents and franchise agreements be in the language of your country?

Disclosure documents and franchise documents must be made in a language understood by the parties. Franchisors and franchisees are free to choose which of these official languages they wish to use in their contracts. The parties must nevertheless be aware of the consequences of their choice on possible legal proceedings.

Law stated - 21 June 2024

Restrictions on franchisees

41 | What types of restrictions are commonly placed on the franchisees in franchise contracts?

By virtue of freedom of contract, restrictions placed on franchisees are subject to the parties' will. Restrictions may consist of a prohibition of performance by substitution, or an obligation to obtain supplies principally or exclusively from the franchisor and to apply, where appropriate, the prices indicated or recommended by the franchisor. However, such restrictions are regulated by the Federal Cartel Act. Furthermore, the principle of good faith as well as the CC and the CO may protect the franchisee against excessive or overly restrictive commitments.

Law stated - 21 June 2024

Courts and dispute resolution

42 | Describe the court system. What types of dispute resolution procedures are available relevant to franchising?

The Swiss Court system distinguishes between civil, criminal and administrative courts.

Legal proceedings are conducted in one of the three official languages: German, French or Italian. The language is, in principle, that of the place where the proceedings were initiated. Evidence in a language other than the language of the proceedings must be translated. However, some courts (the Federal Patent Court, if the parties to the proceedings agree, and some commercial courts) may accept the filing of evidence in English.

Typically, proceedings may be conducted successively in three levels of courts. The cantons usually provide for two courts. In civil matters, the cantons may introduce commercial courts as the sole cantonal instance for commercial matters. Sole cantonal instances further exist in all cantons for disputes in connection with intellectual property rights, antitrust and unfair competition law. In addition, certain cases are directly and exclusively handled by a federal authority. For example, this is the case for patent disputes, for which the Federal Patent Court has exclusive jurisdiction.

The Federal Supreme Court, the highest court in Switzerland, acts as the last ordinary Swiss court of appeal.

The majority of Swiss judges are professionals. However, some of them are laymen (namely, they have not received any legal training). Some cantons provide for specific commercial courts, composed of specialised lay judges, chosen for their expertise in the relevant area of litigation. Technical cases can thus be handled with a combination of legal and technical expertise.

Although the Swiss court system is exhaustively governed by the applicable law, franchisors and franchisees have the right to elect a forum and a law applicable to their dispute. When making such a choice, however, the [Federal Act on Private International Law](#) (PILA) and the Lugano Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters (applicable in Switzerland) must be taken into account. Thus, despite a choice of court, a breach of competition rules by one of the parties in the performance of the contract could, for example, be subject to proceedings before the court of the place where the damage occurred, provided that the contractual aspect of the dispute is not preponderant ([CCIV.2017.3 judgment of 25 September 2018 by the Cantonal](#)

[Court of the Canton of Neuchâtel](#)).

In lieu of Swiss courts, the parties may agree to arbitrate their disputes.

Law stated - 21 June 2024

Governing law

- 43** | Are there any restrictions on designating a foreign governing law in franchise contracts in your jurisdiction? How does the governing law affect the contract's enforceability?

The parties to a franchise agreement are generally free to agree on the governing law and to choose a foreign governing law. The choice of law may be made or amended at any time. If a choice of law is made after the execution of the contract, it has a retroactive effect as of the time of conclusion of the contract (article 116, paragraph 3 of the PILA).

Although it is not recommended, disputes arising from franchise agreements governed by a foreign law may be subject to the Swiss courts, provided they have jurisdiction. In such case, it is the responsibility of the parties to prove the content of the chosen foreign law. However, Swiss courts will not apply foreign governing law if it breaches Swiss public policy or Swiss mandatory laws that, by reason of their special purpose, are applicable regardless of the chosen governing law (articles 17 and 18 of the PILA).

Law stated - 21 June 2024

Arbitration – advantages for franchisors

- 44** | What are the principal advantages and disadvantages of arbitration for foreign franchisors considering doing business in your jurisdiction? Are any other alternative dispute resolution (ADR) procedures particularly favoured or disfavoured in your jurisdiction?

Arbitration has the advantage of providing a tailor-made dispute resolution system because the parties are free to determine the terms of the procedure. In cases where the award is not subject to appeal and the documents are not in one of the official Swiss languages, arbitration may enable the parties to save time. Moreover, arbitration is particularly suitable for disputes that the parties wish to resolve with all available confidentiality.

Swiss law fully recognises the coexistence of state judgments and arbitral awards, whether they are rendered to parties based in Switzerland or abroad. Arbitral awards are also taken into account, recognised and even protected by the Federal Supreme Court. Indeed, according to consistent federal case law, only a gross violation of fundamental rights (such as the right to be heard and the right to a fair trial) constitutes grounds for appeal against an arbitral award before the Federal Supreme Court. The legal remedies available to challenge arbitrators' decisions are thus particularly limited. Furthermore, the Swiss Arbitration Centre (successor of the Swiss Chambers' Arbitration Institution), offers means

of dispute resolution based on the Swiss Rules of International Arbitration. It is probably for these reasons that Switzerland is a particularly popular place for arbitration.

However, the Swiss courts have a good reputation and solutions that are particularly suitable for commercial disputes are available. Before opting for arbitration, foreign franchisors should evaluate whether arbitration would be advantageous in their particular situation. For example, the costs of arbitration remain high (despite the absence of appeal) even where a dispute involves a small monetary amount. Moreover, arbitration requires the agreement of the parties as well as a supplementary prior investment by the parties in its organisation.

In short, even if Switzerland is particularly attractive for arbitration proceedings, it is recommended to reserve this mode of dispute resolution for disputes involving large sums of money or that must be kept secret.

Law stated - 21 June 2024

National treatment

45 | In what respects, if at all, are foreign franchisors treated differently (legally, or as a practical matter) from domestic franchisors?

In Switzerland, foreign franchisors are treated differently from domestic franchisors with respect to the acquisition of real estate and, only for natural persons, with respect to obtaining residence and work permits.

Owing to the particularly close relations between Switzerland and other European countries, citizens of EU and EFTA countries benefit from the free movement of persons and, therefore, have an advantage over other foreign nationals in obtaining residence and work permits.

Law stated - 21 June 2024

UPDATE AND TRENDS

Legal and other current developments

46 | Are there any proposals for new legislation or regulation, or to revise existing legislation and regulation? Are there other current developments or trends to note?

Increased reporting and due diligence requirements

On 29 November 2020, the Swiss electorate rejected the Responsible Business Initiative, which aimed to legally oblige corporations based in Switzerland to incorporate respect for human rights and the environment into their business activities in Switzerland and abroad. A counterproposal from the government, with similar objectives but less intrusive sanctions, has been adopted. Consequently, Swiss companies of public interest (namely, listed companies and companies in the financial sector supervised by the Swiss Financial

Market Supervisory Authority) that have at least 500 full-time equivalents on an annual average (together with the companies they control in Switzerland and abroad) and that exceed either total assets of 20 million Swiss francs or an annual turnover of 40 million Swiss francs, have increased their reporting and due diligence requirements to ensure that their business activities comply with human rights and international environmental standards.

These companies must report annually on certain non-financial matters (environment, social and governance reporting (ESG)) including environmental concerns (eg, carbon dioxide emissions), social and employee concerns, human rights and the fight against corruption.

An implementing ordinance on due diligence and transparency in relation to minerals and conflict-affected areas and child labour (the Due Diligence and Transparency Ordinance) entered into effect on 1 January 2022 together with the new articles 964a et seq of the Swiss Code of Obligations. The new due diligence requirements apply for the first time for the financial year beginning in 2023. Consequently, the first ESG reporting must be issued in the first semester of 2024 with respect to financial year 2023. In that context, the Swiss government also published in March 2022 a draft ordinance that specifies the climate-related reporting obligations to be integrated into the general ESG report. The ordinance is scheduled to enter into force on 1 January 2024.

Draft legislation for partial revision of the Federal Cartel Act

On 24 November 2021, the Swiss government published a preliminary draft for the revision of the Swiss Federal Cartel Act and opened the consultation process. The main objective of the proposed revision is the modernisation of Swiss merger control, by changing the current qualified market dominance test to the significant impediment to effective competition (SIEC) test. The merger control regulations are to be adapted to the standards already prevailing in the European Union and the threshold for prohibiting a transaction will thus become lower.

In addition, the proposed revision clarifies the assessment of hardcore agreements by reintroducing the effects control of hardcore anticompetitive agreements. In reaction to the introduction by the Gaba case of the concept of per se significance of certain agreements, a parliamentary motion requested to take into account both qualitative and quantitative criteria when assessing the significance of hardcore anticompetitive agreements.

The preliminary draft aims also to strengthen the civil enforcement of competition law and to modify the cartel administrative procedure. Indeed, the revision contemplates extending the possibility of civil action to end customers suffering damage resulting from unlawful agreements between undertakings.

The public consultation on the preliminary draft ended on 11 March 2022. On 24 May 2023, the Federal Council unveiled its draft legislation for partial revision of the Swiss Federal Cartel Act and adopted the related dispatch. This draft legislation is now being deliberated in the Swiss Parliament. Entry into force is expected in 2025 at the earliest.

Draft legislation on the transparency of legal entities

On 22 May 2024, the Federal Council adopted its message concerning the draft Federal Act on the Transparency of Legal Entities, which aims to enhance the fight against money laundering. This draft legislation addresses a global issue: legal entities and trusts are often misused to conceal assets not only for the purpose of evading sanctions but also for money laundering, terrorist financing or corruption. As a major financial centre, Switzerland is also exposed to these risks. Therefore, to account for the evolving risks, the Federal Council proposes to strengthen the current anti-money laundering framework.

This draft legislation notably includes the introduction of a federal register – the transparency register – in which companies and other legal entities must disclose the identity of their beneficial owners. Associations and foundations, as well as other forms of companies such as single-shareholder companies and limited liability companies (GmbH), among others, will be subject to a simplified reporting procedure. This register will enable law enforcement authorities to more quickly and reliably determine who is actually behind a legal structure, thereby preventing legal entities from being used in Switzerland for money laundering or asset concealment purposes. The register, which will not be public, will be maintained by the Federal Department of Justice and Police, leveraging the existing infrastructure and expertise of the commercial registry authorities.

In case of non-compliance with this reporting obligation, the draft legislation provides for a system of penal fines.

This draft legislation will be submitted to the Federal Parliament. As for its entry into force, it is expected to take place in 2026 at the earliest. The proposed measures align with the international standards of the Financial Action Task Force concerning the fight against money laundering and terrorist financing, as well as the recommendations of the Global Forum on Transparency and Exchange of Information for Tax Purposes.

Law stated - 21 June 2024



Christophe Rapin
Vincent Jäggi
David Ginolin

christophe.rapin@kellerhals-carrard.ch
vincent.jaeggi@kellerhals-carrard.ch
David.ginolin@kellerhals-carrard.ch

Kellerhals Carrard

[Read more from this firm on Lexology](#)

Türkiye

[Hatice Ekici Tağa](#), [Burak Özdağistanli](#), [Cennet Sümeyye Uçar](#), [Öykü Su Sabancı](#)

[Özdağistanli Ekici Attorney Partnership](#)

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MARKET OVERVIEW

Franchising in the market

- 1 | How widespread is franchising in your jurisdiction? In which sectors is franchising common? Are there any economic or regulatory issues in the market that are more or less hospitable to franchising or make it economically viable in your jurisdiction?

Foreign franchising in Turkey started in 1986 with McDonald's, and continues to grow to this day. There are no official statistics available; however, according to the Turkish Franchising Association, in 2023, the country's franchise sector employed over 300,000 personnel and offered an estimated market share of US\$50 billion, which is expected to reach US\$55 billion in 2024.

Turkey's geographic location and wide market appeal provide it with recognition among foreign franchisors worldwide. Franchising is likewise the preferred form of business in a vast range of industries in the country. The most common sectors for franchising are fast food, coffee chains, retail, cosmetics and transportation.

Turkey does not have a specific franchise regulation, and the majority of franchise agreements are freely executed. The market is generally quite hospitable to franchising, owing to the country's efforts to strengthen its economy, its approach to foreign investors and a dynamic, young population.

Law stated - 13 May 2024

Associations

- 2 | Are there any national or local franchise associations? What is their role in franchising, including any impact on laws or regulations? Are there any rules of conduct or membership requirements?

The Turkish Franchising Association was founded in 1991. Since its foundation, it has contributed to sectoral development, the promotion of local brands, the country's integration into the international markets, and the protection of the rights of franchisees and franchisors.

The Turkish Franchising Association adopts the European Franchise Federation's European Code of Ethics for Franchising; however, it has no force of law. The association accepts permanent and supporting members, but membership is not mandatory for franchisors and franchisees.

Law stated - 13 May 2024

BUSINESS OVERVIEW

Types of vehicle

- 3 | What forms of business entities are relevant to the typical franchisor?

Franchisors are free to form partnerships with any type of company. There are only a few forms of business entities under [Turkish Commercial Code No. 6102](#):

- joint-stock companies;
- limited liability companies;
- collective partnerships;
- en commandite partnerships; and
- partnerships limited by shares, joint ventures, branches or liaison offices.

The most common types of business entities in Turkey are joint-stock companies and limited liability companies. Tax obligations and other legal liability matters differ based on the nature of business entities.

Foreign franchisors do not have to establish a business entity in Turkey to grant franchise rights. However, foreign franchisors may establish a business entity of their choice or prefer to establish a branch in Turkey.

Law stated - 13 May 2024

Regulation of business formation

4 | What laws and agencies govern the formation of business entities?

Turkish Commercial Code No. 6102 governs the formation of business entities, which must be registered with the trade registry of the city where the company has its headquarters, pursuant to the Trade Registry Regulation. The country's Ministry of Trade is the governing body of business entities.

Law stated - 13 May 2024

Requirements for forming a business

5 | Provide an overview of the requirements for forming and maintaining a business entity.

Companies in Turkey must be registered at the trade registry. To do this, they need a company name, an address, at least one shareholder and an authorised person or entity. They must also draft and sign an article of association. There are tax and social security notification duties for newly established companies.

The requirements for forming and maintaining a business entity vary depending on its type. The most common business entities – joint-stock and limited liability companies – can be formed by a single shareholder. For limited liability companies, there is a maximum shareholder limit of 50. Shareholders of a business entity can be natural persons or business entities. Whereas joint-stock companies require a minimum capital of 250,000 Turkish lira (approximately US\$7,765), the minimum capital required for forming

limited liability companies is 50,000 Turkish lira (approximately US\$1,550). Limited liability companies can pay their capital within 24 months; however, joint-stock companies must deposit 25 per cent of their capital during the formation process and pay the remainder within 24 months. Shares of joint-stock companies can be assigned through a written contract, while shares of limited liability companies can only be assigned through a written contract signed before a notary.

In certain sectors – banking, insurance, financial leasing, etc – business entities must be formed as joint-stock companies. Only joint-stock companies can make a public offering.

Companies must hold an annual general assembly meeting within three months of the conclusion of each financial year and submit the meeting minutes to the trade registry. They are also required to register any changes to the company structure.

Law stated - 13 May 2024

Restrictions on foreign investors

6 | What restrictions apply to foreign business entities and foreign investment?

The main regulation in this instance is [Foreign Direct Investment Law No. 4875](#), which adopts equal treatment of foreign investors. Foreign investors can freely establish an entity, open a branch and acquire shares of an existing company – except in the case of certain regulated sectors, such as energy, telecommunication, banking, insurance and mass media, or where it is part of a merger and acquisition that is subject to the Turkish Competition Board's approval – and conclude know-how or technical assistance agreements with domestic companies.

Since [Decree No. 32 on the Protection of the Value of Turkish Currency](#), broad restrictions on the use of foreign currencies in transactions in Turkey have come into force. Therefore, it is important to determine the conditions for exemptions to these restrictions before conducting any transaction that includes a foreign currency.

Law stated - 13 May 2024

Taxation

7 | What aspects of the tax system are relevant to franchisors? How are foreign businesses and individuals taxed?

Turkish tax legislation can be classified under three main categories: income tax, tax on expenditure and tax on wealth.

Individual and corporate incomes are subject to income tax. Turkey taxes its residents on their worldwide income, whereas non-residents are taxed on Turkish-source earnings only. Individual income tax rates vary from 15 per cent to 40 per cent. The corporate income tax rate for 2024 is 25 per cent.

Taxes on expenditure consist of the following:

- value added tax (VAT): commercial, industrial, agricultural and independent professional goods and services, imported goods and services, and deliveries of goods and services as a result of other activities are all subject to VAT, which varies at the rates of 1 per cent, 8 per cent, 18 per cent and 20 per cent;
- special consumption tax (SCT): petroleum products, automobiles and other vehicles, tobacco and tobacco products, alcoholic beverages and luxury products are subject to SCT, which is collected only once;
- banking and insurance transaction tax: transactions and services performed by banks and insurance companies are subject to this tax; and
- stamp duty: this applies to a wide range of documents including contracts, notes payable, capital contributions, letters of credit, letters of guarantee, financial statements and payrolls, varying from 0.189 per cent to 0.948 per cent depending on the value of the document.

There are three kinds of taxes on wealth:

- property tax;
- motor vehicles tax; and
- inheritance and gift tax.

In Turkey, tax on royalties paid to foreign entities must be withheld at the source, and royalty payments arising from franchise agreements are subject to a 20 per cent withholding tax. However, where the franchisor is a non-resident, the withholding tax percentage may be reduced depending on the terms of the double taxation treaty between Turkey and the franchisor's country of origin.

Royalty payments are also subject to VAT if the franchising operations take place in Turkey. Where the franchisor is a non-resident, the franchisee must declare and pay the VAT. There is also stamp tax duty for signing a franchise agreement.

Law stated - 13 May 2024

Labour and employment

8 | Are there any relevant labour and employment considerations for typical franchisors?

The main factors of general service agreements are service, payment and dependency, as regulated under [Turkish Code of Obligations No. 6098](#). Even though these three elements may be part of a franchise agreement, the franchisee is legally independent from the franchisor. The fact that the franchisee is dependent on the franchisor's instructions has generated discussion in the doctrine on the nature of the employment relationship between the parties. However, the dominant opinion is that dependency on the franchisor's instructions does not affect the independence of the franchisee, as potential risks belong to the franchisee who acts on its own behalf and account.

Law stated - 13 May 2024

Intellectual property

9 | How are trademarks and other intellectual property and know-how protected?

In Turkey, trademarks and other intellectual property rights are mainly protected under [Industrial Property Law No. 6769](#) and [Law on Intellectual and Artistic Works No. 5846](#), alongside international agreements such as the Paris Convention and the Madrid Protocol.

Industrial Property Law No. 6769 stipulates that any sign (word, letter, number, design, logo, etc) that distinguishes the goods or services of a company from others may be registered as a trademark. This provides an exclusive right for the trademark holder to use the trademark on the registered goods and services for 10 years, which can be renewed an unlimited number of times. Well-known trademarks within the scope of article 6-bis of the Paris Convention benefit from additional protection even if they are not registered. Trademark applications are submitted to the Turkish Patent and Trademark Office. There are no requirements regarding residency, headquarters or nationality for trademark holders. Turkey is also a member of the Madrid Protocol; therefore, national registration can be supplemented by international registration via the World Intellectual Property Organization.

No proof of use is required for trademark registration; however, if the trademark holder does not use the trademark for five years following registration, their right may be forfeited and action may be taken to cancel the registration if the reason for non-use is not presented.

The application for the registration of an industrial design should also be filed with the Turkish Patent and Trademark Office. An industrial design can be registered if it is novel and has an individual character. Registered design protection starts from the application submission date and lasts for five years. It can be renewed for four consecutive periods of five years each, meaning that an industrial design can be registered for a total of 25 years. Unregistered industrial designs are protected under unfair competition provisions and the Industrial Property Law, provided that they are novel and individual in character and that they are made available to the public for the first time in Turkey. Such protection starts from the moment the design is made available to the public and lasts for three years.

An invention is patentable in Turkey if it is novel, involves an inventive step and is capable of industrial application. Patent applications are filed with the Turkish Patent and Trademark Office, and protection starts from the date of the application. The term of protection is 20 years and is not renewable. The rights provided by a patent cannot be claimed against bona fide third parties unless registered in due form.

Copyrights are mainly protected under Law on Intellectual and Artistic Works No. 5846. Registration is not required to establish rights. Copyright protection is obtained automatically when the work is created and lasts for 70 years after the author's death. Cinematographic and musical works and video games – the latter of which is categorised under cinematographic works by the State Council – must be registered with the General Directorate of Copyrights, which is part of the Ministry of Culture and Tourism, to exploit related rights and facilitate proof of ownership, but not for the creation of the rights themselves.

Turkish law provides an effective enforcement procedure for the protection of intellectual property rights. Once an infringement has been committed, sending a cease-and-desist letter from a notary public is usually the first step to an easier and faster relief for the intellectual property owner. Furthermore, it is possible to enforce intellectual property rights before the criminal law courts and civil law courts.

Protection against an infringement concerning an unregistered mark is offered under the unfair competition clauses of Turkish Commercial Code No. 6102.

Outside the scope of copyrights pertaining to entities such as software, know-how is not protected by explicit legislation in Turkey. It is, however, protected under the unfair competition clauses of Turkish Commercial Code No. 6102, and unfair competition acts are subject to imprisonment or monetary fines.

Law stated - 13 May 2024

Real estate

10 | What are the relevant aspects of the real estate market and real estate law? What is the practice of real estate ownership versus leasing?

An individual or a legal entity may own property in the forms of full ownership, co-ownership or joint ownership. The land registry records are kept in an electronic centralised system known as the Land Registry and Cadastre Information System and in physical title books maintained by the relevant land registry directorate.

As a general practice, the acquisition of real property by non-Turkish nationals in or nearby military zones and other security zones is not allowed. There are also some restrictions specific to the total land area that individual non-Turkish nationals may acquire. With some exceptions, the acquisition of real property by Turkish legal entities with foreign shareholdings requires the prior written consent of the relevant governorship where the real property is located, if the foreign shareholders own 50 per cent or more of the shares or have the privilege to appoint or dismiss the majority of the members of the board of directors of such company.

Lease relationships are governed under the provisions of the Turkish Code of Obligations No. 6098. There is no statutory format for lease agreements; however, the general practice is to have written lease agreements. Parties are entitled to conclude lease agreements with a fixed or indefinite term at their own discretion. If a lease agreement is concluded for a fixed term, it shall automatically terminate following the expiry of the term. However, a fixed-term agreement may turn into an indefinite-term agreement if the tenant continues to use the leased property following the expiry of the term without there being an explicit agreement between the tenant and the landlord. Where a residence or workplace is leased, the lease agreement shall be automatically extended for consecutive one-year periods, unless the tenant notifies the landlord of their intention to terminate the lease agreement at the end of the term with at least 15 calendar days prior notice. The only exception to this general rule is the landlord's right to terminate any fixed-term lease agreement after 10 years of renewals by serving the tenant with a three-month prior written notice before the expiry of a subsequent lease term after the tenth year.

A lease agreement can be annotated in the records of the relevant land registry directorate. Such annotation would grant the lessee the right to enforce the terms of the lease agreement against the future owner of the leased property.

It is more common for franchisors and franchisees in Turkey to lease than to purchase real estate for franchising operations, considering the conditions foreigners are expected to adhere to when purchasing real estate. There is no legislation regarding real estate specific to franchising. In practice, franchisors usually require franchisees to add in their lease agreements with the third-party landowner an extra clause whereby the property will be assigned to the franchisor upon the termination of the franchise agreement.

Law stated - 13 May 2024

Competition law

11 | What aspects of competition law are relevant to the typical franchisor in your jurisdiction? How is competition law enforced in the franchising sector?

Under the country's main legislation governing competition – [Law on the Protection of Competition No. 4054](#) (the Competition Law) – vertical agreements apply to franchising.

The Competition Law's aim is:

- to inhibit agreements, decisions and practices that prevent, distort or restrict competition in the goods and services markets;
- to prevent the abuse of dominance by undertakings that dominate the market; and
- to ensure the protection of competition by making the necessary regulations and inspections.

Accordingly, inter-undertaking agreements, concerted practices, and such decisions and actions of associations that aim to, whether directly or indirectly, prevent, distort or restrict competition in a particular goods or service market, or that have or may cause such an effect, are illegal and prohibited.

Having said that, the Competition Law authorises the Turkish Competition Board to issue communiqués that provide block exemption to certain agreement types bearing specific conditions. Vertical agreements are the primary agreements that are exempted from the main restrictions of competition rules. The conditions for this exemption are regulated under [the Communiqué on Vertical Agreements \(Communiqué No. 2002/2\)](#) issued by the Competition Board. The communiqué determines those matters that will be evaluated by the Competition Board with regard to block exemptions, and is accompanied by the [Guidelines on Vertical Agreements](#).

Where the franchisor's market share is less than 30 per cent, the franchise agreement may benefit from block exemption if all other conditions are fulfilled. Where the franchisor's market share is more than 30 per cent, the franchise agreement can only benefit from individual exemption provided that all other conditions are fulfilled.

Pursuant to the Communiqué No. 2002/2, vertical agreements are considered to be outside the scope of block exemptions (hence, non-compliant with the Competition Law) if they mainly, but non-exhaustively, include:

- determination of resale prices;
- restrictions on regions and customers;
- selective distribution systems;
- non-compete obligations;
- single branding restrictions; or
- exclusive supply provisions.

Under Communiqué No. 2002/2, the franchisor is prohibited from fixing resale prices. However, non-binding price recommendation and determination of maximum prices is permissible.

As a rule, to benefit from block exemption, the duration of a non-compete clause cannot exceed five years. However, the non-compete obligation in a franchise agreement may be determined for a term longer than five years provided that this is deemed reasonable. Additionally, a post-term non-complete obligation can be imposed, provided that:

- it does not exceed one year after the expiry of the franchise agreement;
- it is for goods and services subject to the agreement and is limited to the facility or land where franchise operations took place during the agreement; and
- it is considered to be necessary for the protection of the transferred know-how.

Online sales are evaluated as passive sales and, therefore, general prohibition of online sales is considered a hardcore restriction pursuant to Communiqué No. 2002/2.

The Turkish Competition Board is the authority that enforces competition rules in the franchising sector. Violation of competition law may lead to the invalidation of the franchising agreement and may result in an administrative fine of up to 10 per cent of the annual gross income (in practice, applied as income generated in Turkey only) at the end of the fiscal year.

Law stated - 13 May 2024

OFFER AND SALE OF FRANCHISES

Legal definition

12 | What is the legal definition of a franchise?

There is no legal definition of franchise under Turkish legislation, due to a lack of specific regulation. Even so, the Turkish Franchising Association defines 'franchise' as:

The franchisee undertaking the right and obligation to use the franchisor's trade name, service trademark, know-how, business and technical methods, system and other industrial or intellectual property rights in return for a direct or indirect price, with the commercial and technical support it will receive continuously within the term and scope of the written franchise agreement made between the parties.

And according to Communiqué No. 2002/2:

Franchise agreements contain licences related to know-how and intellectual property rights such as trademarks and signs, which will be used in the distribution of goods or services. The franchisor usually provides commercial and technical assistance to the franchisee during the term of the agreement. Licences and assistances are integral parts of the business method in the franchise package. The franchisee pays the franchisor a franchise fee in return for these services. Franchising allows the franchisor to establish a uniform distribution network for their products with a limited investment.

Law stated - 13 May 2024

Laws and agencies

13 | What laws and government agencies regulate the offer and sale of franchises?

The offer and sale of franchises are not controlled by any law or government agency in Turkey.

Franchising agreements are considered as sui generis agreements and are executed freely by the parties on condition that they are in compliance with the general legal principles and competition rules. Different laws may apply to different subjects (and sectors) related to franchising. In general, Turkish Code of Obligations No. 6098, Turkish Commercial Code No. 6102, Law on the Protection of Competition No. 4054 and Industrial Property Law No. 6769 apply to the offer and sale of franchises.

There are no exemptions to or exclusions from these laws because a specifically governed franchise law does not exist in Turkey.

Law stated - 13 May 2024

Principal requirements

14 | What are the principal requirements governing the offer and sale of franchises under the relevant laws?

There are no principal requirements governing the offer and sale of franchises in Turkey.

Law stated - 13 May 2024

Franchisor eligibility

- 15 | Must franchisors satisfy any eligibility requirements in order to offer franchises? Are there any related practical issues or guidelines that franchisors should consider before offering franchises?

No. Having said that, the Turkish Franchising Association adopts the European Franchise Federation's European Code of Ethics for Franchising. By the Code's [Principle of Honesty](#), the franchisor must have successfully run its business for a reasonable period of time and in at least one example business; and by its [Principle of Clarity](#), the franchisor should state how long they have been selling their name right with the franchising system in their field of activity, and the last five year's work experience of the franchisor's executives. Additionally, the Turkish Franchising Association, in its [2024 Franchising Guide](#), references the American Association of Franchisees & Dealers' rules regarding franchisor eligibility. However, these principles and guides do not have any force of law.

Law stated - 13 May 2024

Franchisee and supplier selection

- 16 | Are there any legal restrictions or requirements relating to the manner in which a franchisor recruits franchisees or selects its or its franchisees' suppliers? What practical considerations are relevant when selecting franchisees and suppliers?

No. Having said that, the Turkish Franchising Association adopts the European Franchise Federation's European Code of Ethics for Franchising, and by the Code's Principle of Honesty, a franchisor should, upon reasonable investigation, select and accept individual franchisees provided that their basic skills, education, personal qualities and financial resources are sufficient to carry on the franchise business. However, this principle does not have any force of law.

Law stated - 13 May 2024

Pre-contractual disclosure – procedures and formalities

- 17 | What procedures and formalities for pre-contractual disclosure are required or advised in your jurisdiction? How often must the disclosures be updated?

There are no pre-contractual disclosure requirements related to franchising in Turkey.

Law stated - 13 May 2024

Pre-contractual disclosure – content

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18 | What information is the disclosure document required or advised to contain?

There are no pre-contractual disclosure requirements related to franchising in Turkey.

Law stated - 13 May 2024

Pre-sale disclosure to sub-franchisees

19 | In the case of a sub-franchising structure, who must make pre-sale disclosures to sub-franchisees? If the sub-franchisor must provide disclosure, what must be disclosed concerning the franchisor and the contractual or other relationship between the franchisor and the sub-franchisor?

There are no pre-sale disclosure requirements related to sub-franchising in Turkey.

Law stated - 13 May 2024

Due diligence

20 | What due diligence should both the franchisor and the franchisee undertake before entering a franchise relationship?

The franchising parties are under no specific due diligence obligations. However, according to the general principles of the Turkish Civil Code, a pre-contractual trusting relationship requires the parties to diligently disclose any information material to the business. All facts material to the franchisee's decision to enter into the franchising agreement must be disclosed by the franchisor.

Law stated - 13 May 2024

Failure to disclose – enforcement and remedies

21 | What actions may franchisees or any relevant government agencies take in response to a franchisor's failure to make required disclosures? What legal remedies are available? What penalties may apply?

There are no disclosure requirements related to franchising in Turkey.

Pursuant to the general principles of the Turkish Civil Code and to the culpa in contrahendo principle under the Turkish Code of Obligations, parties are responsible to each other and must act in a trustworthy manner until the signing, which includes disclosing facts and not providing false information. If acting contrary to these principles causes damage to a party, such as making an investment or expenses, or both, this damage must be compensated.

Additionally, pursuant to the Turkish Code of Obligations, if one of the parties to a contract deliberately deceives the other parties to enter an agreement under false pretences, this will result in the contract being declared invalid, provided the claim by the deceived is

brought within one year of the date of learning about the deceit. Additionally, the deceiving party will be responsible for providing compensation for damages.

Damages are generally calculated based on negative interest and positive interest – in other words, the difference between the wealth of the franchisee as a result of the injury and the wealth they would have accumulated without the damaging event (missing opportunities of executing other franchising agreements). Either way, the franchisee would need to prove that the damage resulted from the franchisor's failure to provide the required or correct information.

Law stated - 13 May 2024

Failure to disclose – apportionment of liability

- 22** | In the case of sub-franchising, how is liability for disclosure violations shared between franchisor and sub-franchisor? Are individual officers, directors and employees of the franchisor or the sub-franchisor exposed to liability? If so, what liability?

There are no disclosure requirements related to franchising in Turkey.

In principle, damage claims can be brought against the parties to a contract and therefore, unless agreed otherwise, the franchisor would not be liable for the subfranchisor's acts regarding disclosure violations.

The liability of officers and directors is limited if the entity is formed as a joint-stock or limited liability company. These executives can be held liable in cases of intentional or negligent breach of duty of care. For damages caused by employees in the performance of their work, liability is generally borne by their employers. For infringement of criminal provisions (eg, unfair competition clauses), officers, directors and employees may be liable directly.

Law stated - 13 May 2024

General legal principles and codes of conduct

- 23** | In addition to any laws or government agencies that specifically regulate offering and selling franchises, what general principles of law affect the offer and sale of franchises? What industry codes of conduct may affect the offer and sale of franchises?

Pursuant to the Turkish Code of Obligations, for a contractual relationship to be established, the main elements of an agreement – that is, factors that would affect the other party's decision to enter into the agreement – shall be disclosed and the parties' wills must be coherent and compatible.

Pursuant to the principle of culpa in contrahendo, a party's reliance on the relationship arising from contractual negotiations is protected by law, and that party has the right to claim damages in relation to such.

There are no formal requirements that apply to franchising agreements; both written and oral franchising agreements are binding and valid. However, pursuant to the Industrial Property Law, legal transactions related to trademark and patent must be in written form to be valid, and as franchising agreements mainly include trademark and patent licence clauses, they are executed in written form.

If a franchise agreement includes standardised terms that are used in agreements with other franchisees, the franchisor is obligated to inform the franchisee of such terms. These terms cannot be unilaterally changed by the franchisor, especially if the changes place the other party at a disadvantage.

Under the Turkish Civil Code, every individual must exercise their rights and fulfil their obligations according to the principles of good faith.

Law stated - 13 May 2024

Fraudulent sale

24 | What actions may franchisees take if a franchisor engages in fraudulent or deceptive practices in connection with the offer and sale of franchises?

Pursuant to the Turkish Code of Obligations, if a party has entered into a contractual relationship as a result of fraudulent acts carried out by the other party, they shall not be bound by the contract.

Law stated - 13 May 2024

FRANCHISE CONTRACTS AND THE FRANCHISOR/FRANCHISEE RELATIONSHIP

Franchise relationship laws

25 | What laws regulate the ongoing relationship between franchisor and franchisee after the franchise contract comes into effect?

There are no specific laws regulating the ongoing relationship between franchisor and franchisee. The terms of the franchising agreement usually define such a relationship. In cases where the relationship is not determined in the franchising agreement, the general rules of the Turkish Civil Code, the Code of Obligations and the Commercial Code apply.

Law stated - 13 May 2024

Operational compliance

26 | What mechanisms are commonly incorporated in agreements to ensure operational consistency and adherence to brand standards?

Franchising agreements usually include clauses granting the franchisor the right to inspect and audit the franchisee's books and records for compliance with operational obligations. It is more common for foreign franchisors to require audits on technology and reports (eg, financial, operational, sales and expenses) than physical inspection and audit. There are also practices where franchisors have key employees working with the franchisee to ensure compliance.

Law stated - 13 May 2024

Amendment of operational terms

27 | May the franchisor unilaterally change operational terms and standards during the franchise relationship?

The franchisor may reserve the right to change operational terms and standards during the franchise relationship. However, under the Turkish Code of Obligations, a party cannot unilaterally change any standard term during a contractual relationship, especially if these changes place the other party at a disadvantage.

Law stated - 13 May 2024

Policy affecting franchise relations

28 | Do other government or trade association policies affect the franchise relationship?

Not directly.

Law stated - 13 May 2024

Termination by franchisor

29 | In what circumstances may a franchisor terminate a franchise relationship? What are the specific legal restrictions on a franchisor's ability to terminate a franchise relationship?

There are no specific termination conditions regarding franchise relationships. However, under the general principles of law, unless determined otherwise in the franchising agreement, definite-term franchising agreements can only be terminated with a just cause or in return for compensation, while indefinite-term franchising agreements can be terminated at any time with a termination notice.

Law stated - 13 May 2024

Termination by franchisee

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30 | In what circumstances may a franchisee terminate a franchise relationship?

There are no specific termination conditions regarding franchise relationships. However, under the general principles of law, unless determined otherwise in the franchising agreement, definite-term franchising agreements can only be terminated with a just cause or in return for compensation, while indefinite-term franchising agreements can be terminated at any time with a termination notice.

Law stated - 13 May 2024

Renewal**31** | How are renewals of franchise agreements usually effected? Do formal or substantive requirements apply?

There are no specific requirements concerning renewals of franchise agreements in Turkey.

Law stated - 13 May 2024

Refusal to renew**32** | May a franchisor refuse to renew the franchise agreement with a franchisee? If yes, in what circumstances may a franchisor refuse to renew?

There are no specific requirements concerning renewals of franchise agreements in Turkey. Principally, pursuant to the contractual freedom of the parties, parties are free to refuse to renew an agreement, without any justification.

Law stated - 13 May 2024

Transfer restrictions**33** | May a franchisor restrict a franchisee's ability to transfer its franchise or restrict transfers of ownership interests in a franchisee entity?

Franchising agreements are principally transferable, unless otherwise agreed by the parties.

Law stated - 13 May 2024

Fees**34** | Are there laws or regulations affecting the nature, amount or payment of fees?

No. The parties to a franchise agreement are free to determine such conditions.

Apart from common franchise fees, 'portfolio compensation' should be paid to franchisees where claimed. Portfolio compensation is regulated under the Turkish Commercial Code for commercial agency agreements, where the agent has the right to compensation after the relationship expires or is terminated but the principal continues to benefit from the customer base and market reputation developed by the agent.

The Supreme Court and the Turkish doctrine agree that certain provisions regarding commercial agency agreements, including portfolio compensation, apply to franchise agreements. Portfolio compensation must therefore be paid to franchisees; however, the compensation cannot exceed the average value of the franchise fees or limit the other party's liability arising from gross fault or gross negligence.

Law stated - 13 May 2024

Usury

35 | Are there restrictions on the amount of interest that can be charged on overdue payments?

Pursuant to Turkish Commercial Code No. 6102, commercial business interest rates can be determined freely by the parties. Where there is no provision determining the interest rate for overdue payments, Law on Legal Interest and Default Interest No. 3095 shall apply, according to which, where there is no rate determined by the agreement, the default legal interest rate will be 9 per cent per annum. There is also an option to apply the rate determined by the Central Bank of the Republic of Turkey (51.75 per cent at the time of writing) if this rate is higher than the default legal interest rate.

For overdue payments in foreign currency, Law on Legal Interest and Default Interest No. 3095 regulates that in cases where a higher contractual or default interest is not agreed on, the highest interest rate paid by the state banks to a one-year deposit account in that currency is recognised as the interest rate of the foreign currency debt.

Law stated - 13 May 2024

Foreign exchange controls

36 | Are there laws or regulations restricting a franchisee's ability to make payments to a foreign franchisor in the franchisor's domestic currency?

No.

Law stated - 13 May 2024

Confidentiality covenant enforceability

37 | Are confidentiality covenants in franchise agreements enforceable?

Yes. The common practice is to determine a penalty in the case of a breach of confidentiality. However, in the case of a dispute, penalties exceeding the damage as a result of a breach may be reduced.

Law stated - 13 May 2024

Good-faith obligation

38 | Is there a general legal obligation on parties to deal with each other in good faith during the term of the franchise agreement? If so, how does it affect franchise relationships?

There is a general principle governed under Turkish Civil Code No. 4721, which stipulates that every person must act in good faith when exercising their rights and performing their obligations. This principle may apply to the bargaining process in circumstances where the more powerful party (often the franchisor) must act in good faith when bargaining with the less powerful party (often the franchisee). Moreover, in principle, Turkish law does not protect the party who is acting maliciously.

Law stated - 13 May 2024

Franchisees as consumers

39 | Does any law treat franchisees as consumers for the purposes of consumer protection or other legislation?

No.

Law stated - 13 May 2024

Language of the agreement

40 | Must disclosure documents and franchise agreements be in the language of your country?

Pursuant to Law on the Mandatory Use of the Turkish Language in Commercial Enterprises No. 805, agreements between commercial enterprises must be in Turkish. If there is a foreign entity involved, the agreement can include another language, provided that the Turkish version prevails. Even though agreements executed in another language are not deemed to be invalid, it is recommended to draft agreements bilingually to avoid claims relating to unclear terms and conditions.

Law stated - 13 May 2024

Restrictions on franchisees

41 | What types of restrictions are commonly placed on the franchisees in franchise contracts?

Franchise agreements will usually include clauses on grant of rights, exclusivity, right to sub-franchise, term and renewal, fees and taxes, operations, territory, obligations, advertisement, marketing, audits and reports, intellectual property, confidentiality, non-competition, management and ownership, transfers, termination and remedies, indemnification, governing law and dispute resolution.

Law stated - 13 May 2024

Courts and dispute resolution**42** | Describe the court system. What types of dispute resolution procedures are available relevant to franchising?

Under the Turkish legal system, courts are either categorised as judicial or administrative. Judicial courts, which constitute the broadest section of the Turkish judicial system, are subdivided into two branches consisting of civil courts and criminal courts. Administrative courts are subdivided into administrative courts and tax courts.

Turkey's judicial system has a multipartite structure. All courts consist of three levels:

- first instance courts;
- district courts; and
- supreme courts.

A franchise dispute may be subject to arbitration if mutually agreed upon by the parties, and mediation is mandatory for commercial disputes related to monetary claims. Voluntary mediation is also available as an alternative dispute resolution method for parties to franchise agreements.

Law stated - 13 May 2024

Governing law**43** | Are there any restrictions on designating a foreign governing law in franchise contracts in your jurisdiction? How does the governing law affect the contract's enforceability?

The parties to a franchise agreement are free to choose the governing law of the agreement. However, pursuant to International Private and Procedural Law No. 5718, certain mandatory laws will apply notwithstanding the choice of jurisdiction. The same law requires that demands concerning prevention of competition are subject to the regulations of the state whose market is directly affected by such prevention (namely, Turkish competition legislation applies to franchising agreements taking effect in Turkey).

Law stated - 13 May 2024

Arbitration – advantages for franchisors

44 | What are the principal advantages and disadvantages of arbitration for foreign franchisors considering doing business in your jurisdiction? Are any other alternative dispute resolution (ADR) procedures particularly favoured or disfavoured in your jurisdiction?

In Turkey, in large commercial disputes, especially where one party is foreign, the most favoured manner of resolution is arbitration. For foreign franchisors, the principal advantages of arbitration are:

- the procedures are more flexible;
- the process is faster, costs less than court proceedings and remains confidential; and
- arbitrators can be selected among experts.

The principal disadvantage could be that in practice arbitration costs more than litigation where the disputed amount is high.

On 11 March 2021, Turkey ratified the United Nations Convention on International Settlement Agreements Resulting from Mediation (the Singapore Convention). This allows commercial international mediation settlement agreements to be enforced in member states without the need for full court proceedings, which are more time-consuming and costly. It also promotes mediation as an alternative dispute resolution measure in international commercial disputes and fills the void for international mediation in international trade law.

In Turkey, mediation is mandatory for commercial disputes related to monetary claims before filing commercial lawsuits. In addition to mandatory mediation, voluntary mediation is also regulated under Turkish law, which offers a fast-paced and economically advantageous resolution to contractual disputes or other private law conflicts of any type.

Law stated - 13 May 2024

National treatment

45 | In what respects, if at all, are foreign franchisors treated differently (legally, or as a practical matter) from domestic franchisors?

Foreign franchisors are treated no differently from domestic franchisors. However, there are legal conditions relating to, for example, owning immovable property, owning 100 per cent shares in certain sectors, and the use of foreign currency in specific situations, that may apply to foreign franchisors, especially if they have no presence in Turkey.

Law stated - 13 May 2024

UPDATE AND TRENDS

Legal and other current developments

46 | Are there any proposals for new legislation or regulation, or to revise existing legislation and regulation? Are there other current developments or trends to note?

At the time of writing, there are no proposals for new legislation or regulation, and no proposals for revising existing legislation or regulation.

Law stated - 13 May 2024



Hatice Ekici Tağa
Burak Özdağıştanlı
Cennet Sümeyye Uçar
Öykü Su Sabancı

hekici@iptech-legal.com
bozdagistanli@iptech-legal.com
sucar@iptech-legal.com
osabanci@iptech-legal.com

Özda 1stanlı Ekici Attorney Partnership

[Read more from this firm on Lexology](#)

United Kingdom

[Damian Humphrey, John Chambers](#)

[Ashtons Legal](#)

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MARKET OVERVIEW

Franchising in the market

- 1 | How widespread is franchising in your jurisdiction? In which sectors is franchising common? Are there any economic or regulatory issues in the market that are more or less hospitable to franchising or make it economically viable in your jurisdiction?

The franchise sector in the United Kingdom remains healthy and vibrant. A survey on the state of franchising is due to be published by the British Franchise Association (BFA) later in the year. According to the last franchise industry survey published in 2018 by NatWest bank and the BFA, it is estimated that the sector contributed in excess of £17 billion to the UK economy, an increase of £2 billion since the survey was last undertaken in 2015. The number of franchise businesses operating in the United Kingdom is now around 48,000. It is expected that the new survey will show that the trend for growth has continued in the past six years. However, it will be interesting to see whether the rate of growth has been maintained in light of the covid-19 pandemic.

Given its strong economy and relatively benign regulatory environment, coupled with the fact that English is widely spoken throughout the rest of the world, the United Kingdom is internationally recognised as a popular destination for franchisors from outside of the United Kingdom looking to expand their overseas operations.

The food and beverage market continues to be a buoyant sector within the franchising space, particularly given the appetite from overseas brands to expand into the United Kingdom. However, during the past few years rising interest rates, energy costs and food prices have proved challenging. In addition, given the United Kingdom's ageing population, the domiciliary care networks are thriving and the number of children's activity and education franchises continues to rise.

Given the continuing uncertainty of the global economic landscape, the success of the franchise industry is bound to the banks' ability to lend. However, the banks in the United Kingdom look more favourably on lending to franchised businesses as opposed to independent businesses.

Law stated - 15 May 2024

Associations

- 2 | Are there any national or local franchise associations? What is their role in franchising, including any impact on laws or regulations? Are there any rules of conduct or membership requirements?

The BFA is the main voluntary self-regulatory body in the franchise sector. The aim of the BFA is to promote ethical franchising in the United Kingdom. The BFA also acts as a spokesperson for the interests of the sector both on a domestic and international level. It has, for many years, successfully argued that the regulation of franchising through legislation is not necessary and would do more harm to the franchising sector than good.

Its members agree to be bound by the [Code of Ethics](#) that, at its core, promotes fair dealing between the franchisor and the franchisee from the outset of the franchising relationship through to its termination.

Law stated - 15 May 2024

BUSINESS OVERVIEW

Types of vehicle

3 | What forms of business entities are relevant to the typical franchisor?

In the United Kingdom, it is usual for a franchisor to operate as a limited liability company. This is also true for most substantial businesses operating outside of the franchising sector. A company is a separate legal entity, distinct from its directors and shareholders, which enables it to enter into contracts in its own name.

A franchisor may also operate as a limited liability partnership (LLP). An LLP combines the flexible structure of a partnership with the benefits of limited liability for its members. Like a company, an LLP has a legal personality separate from that of its members, one of which must be a natural person.

The franchisor may also operate as a sole trader or as an unlimited partnership. Unlike an LLP, an unlimited partnership is not a distinct legal entity from its partners and, therefore, its partners are jointly and severally responsible for the business's debts and liabilities.

Law stated - 15 May 2024

Regulation of business formation

4 | What laws and agencies govern the formation of business entities?

Companies are formed under and governed by the [Companies Act 2006](#), and LLPs are formed under and governed by the [Limited Liability Partnership Act 2000](#). Unlimited partnerships are governed by the [Partnership Act 1890](#).

Law stated - 15 May 2024

Requirements for forming a business

5 | Provide an overview of the requirements for forming and maintaining a business entity.

Companies must be registered at Companies House. To incorporate a company, those looking to set one up will need to pick a suitable company name, identify an address that will act as the registered office address of the company, have at least one director who is a natural person and have at least one shareholder. Companies also need to adopt a

set of articles of association, which are the written rules that will govern the running of the company and the relationship between the shareholders. Companies generally use standard model articles, but these can be tailored to the company's structure or business. Once incorporated, Companies House will issue an incorporation certificate and company number. A set of company books must be maintained that detail certain information about the company and should be updated to reflect any changes. Certain changes and information will need to be filed at Companies House, including confirmation statements (detailing the shareholders) and company accounts. When incorporating, companies are required to identify and record the people who own or control the company, known as people with significant control (PSC). Information about a company's PSC is kept within a central public register at Companies House and should be updated to reflect any changes to the PSC. The PSC register helps to increase transparency over who owns and controls UK companies.

Limited liability partnerships must also be registered at Companies House. They are also required to file annual confirmation statements, annual accounts and update Companies House of any changes to its membership or registered office address. There is no specific requirement within the Limited Liability Partnerships Act 2000 for an LLP to have an LLP agreement. In the absence of such an agreement, the governance of the LLP is detailed in the default provisions set out in the Limited Liability Partnerships Regulations 2001. It is unlikely that the default provisions set out in those Regulations would be adequate for the governance of most modern LLPs. LLPs are also required to provide information about its PSC to Companies House.

Partnerships are not registered at Companies House and are deemed to have been formed once they satisfy the definition of a partnership under the Partnership Act 1890. The governance of a partnership is detailed in the Act, except where the provisions of the Act have been amended by any partnership agreement entered into between the partners. As with LLPs, it is unlikely that the provisions set out in the Act would be adequate for the governance of most modern partnerships.

Law stated - 15 May 2024

Restrictions on foreign investors

6 | What restrictions apply to foreign business entities and foreign investment?

The United Kingdom is a popular destination for foreign businesses seeking to expand overseas. Business regulation in the United Kingdom is relatively light-touch, as evidenced by its approach to franchising.

The Department for International Trade promotes foreign businesses trading in the United Kingdom and encourages investment from overseas. In general, there are no restrictions on ownership by foreigners of UK assets and foreign businesses and individuals are allowed to be both shareholders and directors in UK companies. UK immigration laws highlight how foreign investment is encouraged, allowing individuals from overseas to apply for visas based on their investment into certain UK companies. Of course, since Brexit, citizens of EU member states no longer have the automatic right to live and work in the United Kingdom,

which may make franchising more complicated in some instances. Brexit has certainly had an impact on the domiciliary care sector in this regard.

Law stated - 15 May 2024

Taxation

7 | What aspects of the tax system are relevant to franchisors? How are foreign businesses and individuals taxed?

Companies resident in the United Kingdom are required to pay corporation tax on their worldwide profits. Companies are taxed based upon their accounting reference period and can choose when their accounting period ends. Companies are required to file their annual accounts with a tax return with His Majesty's Revenue and Customs (HMRC) within 12 months of the accounting reference period end. The accounts must also be filed with Companies House (there is reduced disclosure for smaller companies) and, therefore, the accounts become a matter of public record.

A company that is not resident in the United Kingdom will not be liable to tax merely as a result of trading with United Kingdom businesses. However, when a non-resident company is trading through a permanent establishment in the United Kingdom, it will be subject to corporation tax on the profits made by that permanent establishment, measured on an arm's-length (market value) basis. A company not resident in the United Kingdom may be able to claim relief for tax suffered in the United Kingdom under the laws of the territory in which it is based, or under any double tax treaty (DTT) between the territory and the United Kingdom. In some cases, accounts from the permanent establishment are also required to be filed at Companies House.

Where a franchisor establishes a United Kingdom-resident subsidiary, that company will be taxed in its own right, as set out above. Transfer pricing rules of the United Kingdom or of the territory in which the franchisor is resident may apply to require transactions between the franchisor and United Kingdom subsidiary to be computed on an arm's-length (market value) basis for the purposes of tax computations.

If a company not resident in the United Kingdom is centrally managed and controlled in the United Kingdom, HMRC may seek to claim that the company is resident in the United Kingdom for tax purposes and subject to corporation tax in the United Kingdom on its worldwide profits. The territory that would ultimately have taxing rights could be determined under any DTT between the United Kingdom and that other territory, but in the absence of a DTT the company could become dual tax resident with associated complications.

LLPs are not subject to corporation tax, but members, as with partners in a partnership, will be taxed individually.

The tax year for individuals ends on 5 April and an individual is taxed on the profits of his or her accounts during that tax year. He or she can choose when his or her accounting year ends. The accounts are required to be filed with a tax return with HMRC on or before 31 January following the end of the tax year.

Individuals are now subject to a statutory residency test that determines if that person is resident in the United Kingdom or not. The test is based on both the number of days of physical presence in the United Kingdom and some further connection factors.

An individual resident in the United Kingdom is taxed on his or her worldwide profits and capital gains, although in some cases before 6 April 2025 (and potentially to some extent thereafter subject to transitional provisions and circumstances) resident but non-domiciled individuals may only be taxed on profits remitted to the United Kingdom. As a general rule, individuals who are non-resident in the United Kingdom will be liable to income tax on profits arising in the United Kingdom. However, the DTT with the country in which they reside should determine which country has the taxing rights and any income tax suffered in the United Kingdom is likely to be relievable against tax in their domestic country under the DTT.

A non-resident company or individual generating royalties, licence fees or interest in the United Kingdom may suffer a withholding tax on that income retained and paid to HMRC by the paying company. Any DTT between the United Kingdom and the company's or individual's country of residence may reduce the rate of the withholding tax. The non-resident may be able to recover this withholding tax against their own domestic tax.

The franchise agreement therefore should stipulate whether the franchisee is obliged to gross up any payment or cooperate with the franchisor in recovering any sums paid to HMRC (where appropriate) under any DTT.

Law stated - 15 May 2024

Labour and employment

8 | Are there any relevant labour and employment considerations for typical franchisors?

There are a number of employment law duties and discrimination protections that franchisors must be mindful of in relation to their own businesses and when providing support to their franchisees. Some are 'time served' protections, such as unfair dismissal rights that accrue after two years, and others are 'day one' employee rights, such as the protection from discrimination. As the landscape of work continues to evolve franchisors should also be mindful that some staff, although not considered employees, may hold 'worker' status, which provides certain basic employment rights, such as holiday pay and working time protections. Franchisors engaging individuals on a self-employed contractor basis should also be mindful of challenges that arise with this, such as ensuring an arms-length relationship to avoid the contractor being considered either an employee or worker. A general election will be held on 4 July. If the opposition to the current government is successful we may well see the introduction of new employment laws to increase both worker and trade union protections.

Franchisors are not considered to be the employers (or joint employers) of franchisees' employees. However, in the context of franchisors and franchisees, employment status has been a fast-moving area of case law development in recent years and it is entirely possible, if the relationship is not structured and documented correctly, for a relationship described

as that of franchisor and franchisee to be deemed to be one of employer and employee (or worker).

In the post-Brexit era, there are business immigration controls for franchisors to consider. Employers must now sponsor non-British or Irish nationals to work in the United Kingdom if they are not 'settled workers' or do not have some other immigration permission allowing them to work in the United Kingdom. Often this may require sponsorship as 'skilled workers', for which the employing entity will need to hold a sponsor licence.

Law stated - 15 May 2024

Intellectual property

9 | How are trademarks and other intellectual property and know-how protected?

Trademarks in relation to goods or services can be registered at the Intellectual Property Office (IPO).

Anyone considering franchising in the United Kingdom should ensure that its trademarks are registerable, as the registration of the trademark normally gives the owner the exclusive right to prevent others from using the mark and there is a market expectation that any trademark being licensed is registered or is at the very least in the process of being registered.

The registration of trademarks at the IPO is a relatively simple and inexpensive process so long as no opposition to the registration is lodged.

As a result of Brexit, with effect from 1 January 2021, the IPO created a comparable independent UK trademark for every registered EU trademark, which has the same legal status as if registered under UK law. The UK trademark will keep the original EU trademark filing date.

Where a franchisor has either not yet registered or cannot register a trademark, the franchisor may have a claim for 'passing off' if a competitor imitates the goods or services it offers in such a way that the public believes them to be those of the franchisor. A claim will be successful if there is goodwill and a reputation attached to the goods or services it offers, and the franchisor has suffered a loss.

Know-how relating to the franchise system will invariably be detailed in the system's manual. It cannot be protected by registration and is, therefore, protected through the franchise agreement. The franchise agreement will contain a requirement on the franchisee to keep any know-how and other confidential information belonging to the franchisor confidential both during and after the currency of the franchise agreement.

Law stated - 15 May 2024

Real estate

10 | What are the relevant aspects of the real estate market and real estate law? What is the practice of real estate ownership versus leasing?

Property law in England and Wales is based on the common law system, and as such, proprietary interests in land derive from either freehold (where the freeholder owns the property outright and is free to dispose of it) or leasehold (where the leaseholder is entitled to occupy the premises for an agreed period subject to the terms of the lease including an obligation to pay rent to the landlord) interests. How the property from which the franchise business operates is occupied usually depends on the franchisor's business model and it is crucial that the agreements to occupy any premises dovetail with the franchise agreement.

It is common for a franchisee to take a direct lease, in which case the franchisor may require step-in rights, which can usually be exercised (depending on the terms of those step-in rights) in the event of default by the franchisee of the terms of the lease or termination of the franchise agreement, and a right of pre-emption, which would benefit the franchisor if the franchisee wanted to assign its interest in the lease. These would allow the franchisor to take on the franchisee's rights and obligations under the lease.

Where the premises are critical to the success of the franchise, the franchisor may take a head lease and grant a sublease to its franchisee. This allows the franchisor to have more control over the premises, but comes with an increased financial risk.

If the franchisor owns the freehold itself and grants a direct lease to its franchisee or is granting a sublease to the franchisee, it is crucial that the security of tenure provisions otherwise conferred by the [Landlord and Tenant Act 1954](#) are excluded, so that the franchisor retains an element of control over the occupation of the premises, otherwise the franchisee tenant can benefit from a right to occupy the premises after expiry of the lease, and even have a right to request a new lease. This legislation does not apply in Scotland, which has a different real estate system.

Law stated - 15 May 2024

Competition law

11 | What aspects of competition law are relevant to the typical franchisor in your jurisdiction? How is competition law enforced in the franchising sector?

Chapter I of the [Competition Act 1998](#) prohibits agreements that may affect trade within the United Kingdom, and have as their object or effect the prevention, restriction or distortion of competition within the United Kingdom. In practice, post-Brexit, franchisors operating within the United Kingdom initially saw no substantive change to the competition law regime, as Chapter I was modelled on article 101 of the Treaty of the Functioning of the European Union. Although article 101 no longer applies in the United Kingdom, it will apply to UK businesses that enter into agreements that have an effect in the European Union.

Whether a franchise agreement falls within the scope of Chapter I of the Competition Act 1998 will depend on a number of factors, including the parties' relevant market share. In practice, most franchisors draft their domestic agreements so that they benefit from the Vertical Agreements Block Exemption Order (the Block Exemption Order). This replaced the European Union's Vertical Block Exemption Regulation following Brexit. If a franchise agreement falls within the terms of the Block Exemption Order, it will be exempt under Chapter I of the Competition Act 1998. For example, a five-year initial term is common in

franchise agreements, as they typically contain in-term non-compete restrictions, which, if longer than a five-year period, will not benefit from the Block Exemption Order.

Furthermore, any hardcore restrictions contained in the franchise agreement will lead to the exclusion of the franchise agreement from the scope of the Block Exemption Order. These include an obligation on franchisees to sell goods or services for a minimum price (resale price maintenance) or restrictions on franchisees from responding to unsolicited requests from customers to provide goods or services (passive sales) outside of an agreed territory. Restrictions on passive sales also prevent franchisors from prohibiting franchisees from operating their own websites, but not from requiring that such websites meet certain specifications.

Competition issues are regulated domestically by the Competition and Markets Authority. Sanctions include financial penalties or the voiding of provisions within the franchise agreement.

Law stated - 15 May 2024

OFFER AND SALE OF FRANCHISES

Legal definition

12 | What is the legal definition of a franchise?

There is no legal definition of franchising under UK law, which is indicative of the absence of regulation in the sector. However, the British Franchise Association's (BFA) Code of Ethics adopts its definition of franchising from the European Code of Ethics for Franchising and describes franchising as:

A system of marketing goods and/or services and/or technology that 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 to its individual franchisees the right, and imposes the obligation, to conduct a business in accordance with the franchisor's concept.

In exchange for fees or other financial consideration, the franchisor grants a franchisee the right to use the franchisor's trade name, know-how, technology and systems and other intellectual property rights, supported by continuing provision of commercial and technical assistance, within the framework of a written franchise agreement.

Law stated - 15 May 2024

Laws and agencies

13 | What laws and government agencies regulate the offer and sale of franchises?

There are no government agencies or specific legislation that regulate the offer and sale of franchises.

However, the BFA Code of Ethics places obligations on member franchisors in relation to the offer and sale of franchisees. Membership of the BFA is voluntary.

Franchising arrangements may be subject to the [Trading Schemes Act 1996](#) and the [Trading Schemes Regulations 1997](#), which were enacted to tighten up the existing legislation regulating pyramid selling through trading schemes, namely the [Fair Trading Act 1973](#). Franchisors must be mindful of the legislation owing to its broad drafting.

The Trading Schemes Regulations 1997 (the Regulations) do not place a prohibition on trading schemes. However, if the franchising relationship is considered a trading scheme, then the Regulations place obligations on franchisors in relation to advertising and can impose contractual requirements, including a cooling-off period. These requirements would make franchising an unattractive business model. Therefore, in practice, franchise networks in the United Kingdom are structured to ensure that a franchisor is exempt from the legislation.

A franchisor can ensure that it is exempt from the legislation by either operating as a single tier (namely by having one level of franchisee) or by being, and making certain that all the franchisees (and all other relevant participants) are, value added tax-registered.

If the franchisor is unable to benefit from one of the exemptions and subsequently breaches the legislation, it may become subject to criminal sanctions, or find itself subject to civil claims from a franchisee for breach of its statutory duties. In addition, any obligation on the franchisee to pay fees to the franchisor will be unenforceable.

Law stated - 15 May 2024

Principal requirements

14 | What are the principal requirements governing the offer and sale of franchises under the relevant laws?

There are no laws governing the offer and sale of franchises. However, where franchisors are members of the BFA, they are required under the terms of their membership, but not as a matter of law, to comply with the Code of Ethics to ensure that all advertising for the recruitment of franchisees is free of ambiguity and misleading statements.

Law stated - 15 May 2024

Franchisor eligibility

15 | Must franchisors satisfy any eligibility requirements in order to offer franchises?
Are there any related practical issues or guidelines that franchisors should consider before offering franchises?

There are no specific laws or regulations.

The BFA Code of Ethics requires that, prior to franchising, the franchisor has operated at least one pilot franchise operation, has the right to use its brand, and provides its franchisees with initial training and continuing assistance.

It is important to note that where, as part of the process of offering and subsequently awarding the franchise, the franchisor requests that the franchisee pays a deposit, the BFA Code of Ethics stipulates that the deposit must be refundable, subject to the franchisor retaining any quantifiable directly related expenses incurred by it and that the terms upon which any deposit is taken are set out in writing.

Law stated - 15 May 2024

Franchisee and supplier selection

- 16 | Are there any legal restrictions or requirements relating to the manner in which a franchisor recruits franchisees or selects its or its franchisees' suppliers? What practical considerations are relevant when selecting franchisees and suppliers?

No, there are no such laws or regulations.

However, the BFA Code of Ethics states that the franchisor may only select and accept franchisees who appear to possess the basic skills, education, personal qualities and financial resources to carry on the franchise business.

Law stated - 15 May 2024

Pre-contractual disclosure – procedures and formalities

- 17 | What procedures and formalities for pre-contractual disclosure are required or advised in your jurisdiction? How often must the disclosures be updated?

There is no legal requirement to disclose information to a prospective franchisee and as such there are no procedural formalities.

The BFA Code of Ethics requires that franchisees are provided with an up-to-date copy of the Code, along with a full and accurate written disclosure of all information material to the franchise relationship within a reasonable time prior to execution of the franchise agreement.

Even where a franchisor is not a member of the BFA, it should consider preparing some form of disclosure document to give to prospective franchisees to enable it to give accurate and consistent responses to due diligence enquiries.

Law stated - 15 May 2024

Pre-contractual disclosure – content

- 18 | What information is the disclosure document required or advised to contain?

Although there is no legal requirement as to what information is disclosed to a prospective franchisee, the BFA Code of Ethics sets out the type of information that its members are required to disclose. Even where a franchisor is not a member of the BFA, it should consider preparing some form of disclosure document providing similar information.

Under the BFA Code of Ethics, franchisors must give prospective franchisees all information that they require to be able to make a properly informed decision about whether to invest in a franchise. This will include:

- the financial status of the franchisor;
- how long the franchisor has been operating and franchising;
- information about the franchisor's directors and key individuals within the franchise;
- a description of the franchise's business model;
- proper verifiable financial forecasts of the franchise model;
- information about the performance of the network;
- details of franchisees;
- details of any 'purchasing incentives' or commissions; and
- a copy of the franchise agreement.

Law stated - 15 May 2024

Pre-sale disclosure to sub-franchisees

- 19** | In the case of a sub-franchising structure, who must make pre-sale disclosures to sub-franchisees? If the sub-franchisor must provide disclosure, what must be disclosed concerning the franchisor and the contractual or other relationship between the franchisor and the sub-franchisor?

There is no legal requirement to disclose information to a prospective sub-franchisee.

Where the sub-franchisor is a member of the BFA, it would be obliged under the Code of Ethics to provide franchisees with a full and accurate written disclosure of all information material to the franchise relationship within a reasonable time prior to execution of the franchise agreement. This would include disclosure of the fact that the sub-franchisor is licensed by the franchisor to grant franchises and a clear explanation of the sub-franchisor's relationship with the franchisor.

Law stated - 15 May 2024

Due diligence

- 20** | What due diligence should both the franchisor and the franchisee undertake before entering a franchise relationship?

The franchisor should satisfy itself that franchisees are of suitable character, and have the necessary skills base and (if applicable) qualifications to operate the franchise. Franchisors should also ensure that franchisees have sufficient funding to both open and operate the franchise. It is important to ensure that the individuals who will be operating the franchise have the legal right to reside in the United Kingdom throughout the term of the franchise agreement.

A franchisee should review in detail any disclosure document provided by the franchisor, to ensure an understanding of the costs involved in running the franchise and the expected financial returns. A franchisee should check that the franchisor has the right to license the relevant trademarks to the franchisee, and it is market practice for a franchisee to instruct a lawyer to prepare a report on the franchise agreement highlighting its key commercial terms and any issues that should be raised with the franchisor. A franchisee should enquire about the number of franchises within the network, including the number of franchise failures, and speak to existing franchisees to understand their views on operating within the network.

Law stated - 15 May 2024

Failure to disclose – enforcement and remedies

- 21 | What actions may franchisees or any relevant government agencies take in response to a franchisor's failure to make required disclosures? What legal remedies are available? What penalties may apply?

A franchisor could find itself the subject of a claim for misrepresentation from a franchisee. Such a claim would arise if the franchisor were to make an untrue statement of fact that induces the franchisee to enter into a franchise agreement. This would typically be some form of earnings claim with little basis in fact. Depending on the circumstances in which the statement is made, the franchisor may then be subject to a claim for one or more of innocent, negligent or fraudulent misrepresentation. Such statement can be made either orally or in writing. In the case of a successful claim for misrepresentation, depending on the facts, the franchisee may be able to rescind the agreement or, where it has suffered loss, claim for damages, or both. If the misrepresentation was innocent, then the court may rescind the agreement or award damages in lieu of rescission, but not both. In the case of fraudulent or negligent misrepresentation, a court can award damages and rescind the agreement. If an agreement is rescinded, the parties are restored to the position in which they would have been had the agreement never been entered into.

The franchisor will invariably insert provisions into the franchise agreement to restrict or exclude liability for misrepresentation. The effectiveness of such clauses is subject to both statute and common law. Where a clause seeks to limit liability for misrepresentation, it would be subject to the test of reasonableness under the [Unfair Contracts Terms Act 1977](#). Any clauses seeking to restrict or exclude liability from fraudulent misrepresentation will be ineffective. The case of *Papa Johns (GB) Ltd v Doyley* [2011] makes it clear that the courts are reluctant to allow franchisors to benefit from such provisions due to the inequality of bargaining power and, as such, franchisors should ensure that they are careful and organised about the information provided to franchisees rather than solely relying on exclusion or limitation of liability clauses.

Law stated - 15 May 2024

Failure to disclose – apportionment of liability

- 22 | In the case of sub-franchising, how is liability for disclosure violations shared between franchisor and sub-franchisor? Are individual officers, directors and employees of the franchisor or the sub-franchisor exposed to liability? If so, what liability?

Where a sub-franchisee has a claim for misrepresentation, it will be against the sub-franchisor and not the franchisor. On the assumption that the franchisor or the sub-franchisor is a limited liability entity then individual officers, directors or employees will not generally be exposed to personal liability.

Law stated - 15 May 2024

General legal principles and codes of conduct

- 23 | In addition to any laws or government agencies that specifically regulate offering and selling franchises, what general principles of law affect the offer and sale of franchises? What industry codes of conduct may affect the offer and sale of franchises?

The offer and subsequent sale of franchises will be subject to general principles of contract and tort law, and therefore the laws relating to misrepresentation will offer protection to franchisees.

The parties must be mindful of the concept of caveat emptor (buyer beware) and, therefore, carry out an appropriate level of due diligence. The concept of culpa in contrahendo, common in civil jurisdictions, places a duty to negotiate with care that could extend to making pre-contract disclosures, but this concept does not apply in the United Kingdom. Nor is there, as the law currently stands, a general implied duty of good faith.

Law stated - 15 May 2024

Fraudulent sale

- 24 | What actions may franchisees take if a franchisor engages in fraudulent or deceptive practices in connection with the offer and sale of franchises?

A franchisee can claim against the franchisor for fraudulent misrepresentation and, if successful, may rescind the agreement, or claim damages, or both.

Any clauses in the franchise agreement that seek to restrict or exclude liability from fraudulent misrepresentation will be ineffective.

Law stated - 15 May 2024

FRANCHISE CONTRACTS AND THE FRANCHISOR/FRANCHISEE RELATIONSHIP

Franchise relationship laws

- 25 | What laws regulate the ongoing relationship between franchisor and franchisee after the franchise contract comes into effect?

There are no specific laws that regulate the ongoing relationship between the franchisor and the franchisee after the franchise contract comes into effect.

Law stated - 15 May 2024

Operational compliance

- 26 | What mechanisms are commonly incorporated in agreements to ensure operational consistency and adherence to brand standards?

Franchise agreements will normally contain an obligation on franchisees to provide the franchisor with financial information including management accounts, annual accounts and value added tax returns (if applicable) enabling the franchisor to both monitor the franchisee's financial performance and provide guidance and feedback on it. In practice, franchisees generally allow franchisors (through the terms of the franchise agreement) online access to this data. Franchisees may also be required to provide the franchisor with a business plan each year.

In addition, there will typically be an ability for the franchisor to carry out a complete audit of the franchisee's business to ensure compliance with operational standards. Where the franchisee's business is falling below those standards, typically there will be a requirement to remedy those failings. If the franchisee fails to do this then such a provision may allow the franchisor to treat the failure as a breach of the franchise agreement, remove a franchisee's territorial exclusivity or terminate the franchise agreement.

Law stated - 15 May 2024

Amendment of operational terms

- 27 | May the franchisor unilaterally change operational terms and standards during the franchise relationship?

Yes, the franchise agreement, if drafted correctly, will allow the franchisor to unilaterally change the operational terms and standards by amending the manual, with which the franchisee will be required to comply. This assumes that the change does not conflict with the franchise agreement. While the franchise agreement will contain an obligation on the franchisee to comply with the manual in its entirety, where there are key policies and procedures that the franchisor envisages being updated periodically, it is advisable that

the franchise agreement makes specific reference to the franchisee's need to comply with those policies and procedures.

Law stated - 15 May 2024

Policy affecting franchise relations

28 | Do other government or trade association policies affect the franchise relationship?

There are no mandatory government or trade association policies affecting the franchise relationship.

Franchisors that choose to become members of the British Franchise Association (BFA) are obliged to comply with its Code of Ethics.

Law stated - 15 May 2024

Termination by franchisor

29 | In what circumstances may a franchisor terminate a franchise relationship? What are the specific legal restrictions on a franchisor's ability to terminate a franchise relationship?

The circumstances in which a franchisor may terminate the franchise relationship are detailed in the franchise agreement. Typically, there is a right to terminate the franchise agreement with immediate effect if the franchisee:

- ceases to operate the business;
- brings the brand into disrepute;
- commits a criminal offence;
- is the subject of an insolvent event or insolvency proceedings;
- repeatedly breaches the franchise agreement; or
- fails to remedy a breach within an agreed time frame.

The franchisor also has the right at common law to terminate the franchise agreement in the event of a repudiatory breach of it by the franchisee. A repudiatory breach is essentially a breach that goes to the core of the contract and deprives the innocent party of its benefit.

Law stated - 15 May 2024

Termination by franchisee

30 | In what circumstances may a franchisee terminate a franchise relationship?

Generally, a franchise agreement will not contain any express provisions allowing the franchisee to terminate it prior to the expiry of its term. However, the franchisee has the right at common law to terminate the franchise agreement in the event of a repudiatory breach of it by the franchisor.

Law stated - 15 May 2024

Renewal

- 31** | How are renewals of franchise agreements usually effected? Do formal or substantive requirements apply?

The franchisee will be required on renewal to enter into the franchisor's standard franchise agreement. There are no laws setting out how franchise agreements are to be renewed or containing any requirements to be complied with on their renewal. Typically, there will be an obligation on the franchisee to notify the franchisor that it wishes to renew the franchise agreement during a time period specified in the franchise agreement.

Law stated - 15 May 2024

Refusal to renew

- 32** | May a franchisor refuse to renew the franchise agreement with a franchisee? If yes, in what circumstances may a franchisor refuse to renew?

There are no laws stipulating whether and on what terms the franchisor must renew the franchise agreement. Furthermore, there is no requirement under the BFA Code of Ethics that there must be a renewal of the franchise agreement.

The basis of renewal is a contractual one and the franchise agreement will set out conditions that must be met for the franchisor to agree to renew it. These will typically include a requirement that the franchisee is not in breach of the agreement, pays a renewal or administration fee and undertakes any required updates of its business operations or premises.

Law stated - 15 May 2024

Transfer restrictions

- 33** | May a franchisor restrict a franchisee's ability to transfer its franchise or restrict transfers of ownership interests in a franchisee entity?

A franchisor can and normally does restrict such transfers. The franchise agreement usually stipulates that the franchisor's consent to any transfer is required, which will be given subject to certain conditions being met. These conditions include the franchisor being satisfied that the prospective purchaser is a suitable candidate as a franchisee and the

franchisee paying all sums owed to the franchisor, as well as certain costs associated with the transfer process. These provisions normally contain a right of pre-emption in favour of the franchisor, allowing it to buy the franchise business from the franchisee.

Law stated - 15 May 2024

Fees

34 | Are there laws or regulations affecting the nature, amount or payment of fees?

There are no such laws or regulations.

Law stated - 15 May 2024

Usury

35 | Are there restrictions on the amount of interest that can be charged on overdue payments?

A franchisor may impose interest on overdue payments, which is typically specified in the franchise agreement. However, a franchisor must be wary that if the rate of interest is too high it may be considered a penalty clause and, therefore, be unenforceable.

Where no express provision is included in the franchise agreement, the default rate pursuant to the [Late Payment of Commercial Debts \(Interest\) Act 1998](#) shall apply and the annual rate currently stands at 8 per cent above the Bank of England base rate.

Law stated - 15 May 2024

Foreign exchange controls

36 | Are there laws or regulations restricting a franchisee's ability to make payments to a foreign franchisor in the franchisor's domestic currency?

Generally, there are no such laws or restrictions. However, if a franchisor is operating in a country on which the United Kingdom has imposed financial sanctions, restrictions may apply.

Law stated - 15 May 2024

Confidentiality covenant enforceability

37 | Are confidentiality covenants in franchise agreements enforceable?

Yes.

Law stated - 15 May 2024

Good-faith obligation

38 | Is there a general legal obligation on parties to deal with each other in good faith during the term of the franchise agreement? If so, how does it affect franchise relationships?

As the law currently stands, there is no general legal obligation on the parties to a franchise agreement to deal with each other in good faith.

Case law on this has been unsettled on this subject for some time. In *Yam Seng Pte Ltd v International Trade Corporation Ltd* [2013] EWHC 111, the High Court commented on the importance of recognising the concept of good faith in 'relational contracts', including franchise agreements. However, in *Carewatch Care Services Ltd v Focus Caring Services Ltd* [2014] EWHC 2313 (Ch), the High Court dismissed an argument from the franchisee that the franchise agreement contained an implied term that the franchisor and franchisee act in good faith towards each other. The Court took the view that, as the franchise agreement contained detailed terms dealing with all aspects of the franchise relationship, it was not necessary to imply any further terms.

Recent case law has suggested that the courts are becoming ever more willing to imply a duty of good faith into certain contracts, potentially including franchise agreements. In *Sheikh Tahnoon Bin Saeed Bin Shakhboot Al Nehayan v Kent* [2018] EWHC 333 (Comm), it was held that the parties to a joint venture arrangement, entered into orally, owed each other a duty of good faith. Subsequently in *Bates & Ors v the Post Office Ltd* [2019] EWHC 3408 (QB), it was held that a duty of good faith should apply as a matter of law to all 'relational' contracts and provided some guidance as to what a 'relational' contract might be. Under this guidance, franchise agreements may well be classed as relational contracts. However, in the case of *TAQA Bratani Ltd v Rockrose UKCS8 LLC* [2020] EWHC 58 (Comm), the High Court made it clear that the status of a contract as relational did not automatically imply that the parties owed each other a duty of good faith.

There is no doubt that, while there is not a general implied duty of good faith, the courts are willing to imply a duty of good faith with regard to certain contracts and this continues to be a developing area of law.

The BFA Code of Ethics requires parties to a franchise agreement to exercise fairness in their dealings with each other, and to resolve complaints, grievances and disputes with good faith.

Law stated - 15 May 2024

Franchisees as consumers

39 | Does any law treat franchisees as consumers for the purposes of consumer protection or other legislation?

Franchisees are not currently treated in law as consumers.

Law stated - 15 May 2024

Language of the agreement

- 40** | Must disclosure documents and franchise agreements be in the language of your country?

There is no such legal requirement. However, the BFA Code of Ethics requires that the franchise agreement is translated into the language of the franchisee's country and in which the franchisee is competent.

Law stated - 15 May 2024

Restrictions on franchisees

- 41** | What types of restrictions are commonly placed on the franchisees in franchise contracts?

Given the nature of franchise systems and the level of control that franchisors will wish to retain over the network, during the term of the franchise agreement franchisees will typically be subject to a number of restrictions. These include obligations to operate from specific premises or within specific territories, to purchase certain products or services from the franchisor or its nominated suppliers and not to be involved or interested in another business. Franchise agreements may also place restrictions on franchisees from selling goods or services above a particular price.

In addition, after the term of the franchise agreement, franchisors will seek to restrict franchisees from being involved or interested in a competing business from the premises or the territory in which the franchisee previously operated, or from competing with the rest of the network. These may also include restrictions on poaching certain employees or soliciting customers. These restrictions will only be enforceable to the extent that they go no further than is reasonably necessary to protect the franchisor's legitimate business interests.

Law stated - 15 May 2024

Courts and dispute resolution

- 42** | Describe the court system. What types of dispute resolution procedures are available relevant to franchising?

The United Kingdom is made up of more than one legal jurisdiction, with England and Wales along with Scotland being the largest two jurisdictions. Civil claims proceed differently in each jurisdiction, although the burden of proof is the same; namely, the balance of probabilities. In England and Wales, a franchisor would be expected to follow

a pre-action protocol prior to commencing proceedings. A claim would be heard in either a local county court or the High Court. The High Court will ordinarily only hear claims with particular complexity, high-value or cross-jurisdictional elements. Claims in Scotland proceed in the local sheriff court or in the Court of Session. Unlike in England and Wales, a claim can be commenced without the need to follow a pre-action protocol.

There is a strong emphasis on resolving disputes without resorting to litigation and different forms of alternative dispute resolution, such as mediation, are encouraged and may well become mandatory in the near future. Unreasonably refusing to engage in alternative dispute resolution can result in a party being punished in costs, regardless of whether they are the successful party at court.

The BFA runs a mediation and arbitration scheme to resolve franchise disputes. It is common for franchise agreements to contain provisions requiring the parties to consider mediation before commencing proceedings, or that disputes are to be resolved by way of arbitration, rather than through the courts. Mediation should therefore be refused only after careful consideration and advice.

Given the length of time that claims take to progress through the court system, which can be years rather than months, some franchisors and franchisees are choosing to resolve their disputes through arbitration.

Law stated - 15 May 2024

Governing law

- 43** | Are there any restrictions on designating a foreign governing law in franchise contracts in your jurisdiction? How does the governing law affect the contract's enforceability?

There are no restrictions on designating a foreign governing law in franchise agreements. However, the parties to the agreement will remain subject to certain mandatory laws that will apply notwithstanding the choice of jurisdiction, for example, the Transfer of Undertakings (Protection of Employment) Regulations 2006, which seek to protect employees and workers in business transfers.

Law stated - 15 May 2024

Arbitration – advantages for franchisors

- 44** | What are the principal advantages and disadvantages of arbitration for foreign franchisors considering doing business in your jurisdiction? Are any other alternative dispute resolution (ADR) procedures particularly favoured or disfavoured in your jurisdiction?

The advantages of arbitration in the United Kingdom are similar to most jurisdictions, in that it generally offers a speedier and potentially less costly alternative to court proceedings, hearings are confidential to the parties and if the matter has particularly technical points an arbitrator with relevant expertise can be selected. The London Court of International

Arbitration is recognised as a world-leading institution. The United Kingdom is a signatory to the New York Convention, allowing for enforcement of arbitral awards through convention protocols.

The parties to a franchise agreement may also decide to mediate. The Centre for Effective Dispute Resolution is a respected organisation offering mediation services. Members of the BFA also benefit from its mediation scheme.

Law stated - 15 May 2024

National treatment

45 | In what respects, if at all, are foreign franchisors treated differently (legally, or as a practical matter) from domestic franchisors?

Foreign franchisors are treated in the same way as domestic franchisors.

Law stated - 15 May 2024

UPDATE AND TRENDS

Legal and other current developments

46 | Are there any proposals for new legislation or regulation, or to revise existing legislation and regulation? Are there other current developments or trends to note?

Franchisors should be aware of legislation that has either been passed or is likely to be passed in the near future.

- The Economic Crime and Corporate Transparency Act 2023, which is gradually coming into force throughout the course of 2024, is aimed at preventing the abuse of corporate structures and tackling economic crime. Part of the reforms introduced by this Act includes a requirement for all newly appointed and existing directors, all newly registrable and existing persons of significant control and anyone who delivers documents to Companies House (either on their behalf or on behalf of another) to verify their identity to Companies House. These reforms will prohibit any person from being a director of a company unless their identity has been appropriately verified.
- The Digital Markets, Competition and Consumers Bill passed its third reading in the House of Commons on 21 November 2023. The proposed legislation is intended to introduce legislation relating to Digital Markets, Consumer Law and Competition Law. Perhaps the most significant aspect for franchisors that operate in the business-to-consumer space is that the legislation will give the Competition and Markets Authority administrative powers to enforce consumer laws without the need to enforce through the courts. The Competition and Markets Authority will also be able to impose fines on companies for certain consumer law breaches of up to £300,000 or 10 per cent of annual global turnover (whichever is higher).

Law stated - 15 May 2024

Ashtons

LEGAL

Damian Humphrey
John Chambers

damian.humphrey@ashtonslegal.co.uk
john.chambers@ashtonslegal.co.uk

Ashtons Legal

[Read more from this firm on Lexology](#)

USA

Eli Besignor

Lathrop GPM

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MARKET OVERVIEW

Franchising in the market

- 1 | How widespread is franchising in your jurisdiction? In which sectors is franchising common? Are there any economic or regulatory issues in the market that are more or less hospitable to franchising or make it economically viable in your jurisdiction?

Franchising is woven into the fabric of the US economy. Franchised businesses operate in over 75 business sectors or industries. While restaurants and other food service operations account for approximately one-third of all franchise establishments, franchising is well represented in many sectors, such as automotive services, hotels, retail products and home healthcare services. Franchising is regulated at both the federal and state level, so companies seeking to franchise in the United States must be mindful of a broad array of legal considerations. Nonetheless, due to well-established financial and lending markets, real estate practices and legal systems, franchising has flourished in the United States.

Law stated - 16 May 2024

Associations

- 2 | Are there any national or local franchise associations? What is their role in franchising, including any impact on laws or regulations? Are there any rules of conduct or membership requirements?

The pre-eminent franchise association in the United States is the International Franchise Association (IFA), which was founded in 1960. Generally, all franchisors, franchisees, and individuals and companies that supply goods or services to franchise systems can join the IFA. The IFA's mission is to protect, enhance and promote franchising. Membership of the IFA is voluntary. The IFA has adopted a [code of ethics](#), which has no force of law.

There are, and have been, other organisations and associations related to franchising in the United States. Some of these have developed to address certain issues or subgroups (eg, the American Association of Franchisees and Dealers). There are also industry-specific franchise-related associations (eg, the National Auto Dealers Association and the Asian American Hotel Owners Association).

Law stated - 16 May 2024

BUSINESS OVERVIEW

Types of vehicle

- 3 | What forms of business entities are relevant to the typical franchisor?

Franchisors are free to operate in whatever corporate form they choose. Limited liability companies and corporations are the most common forms of business entities used by

franchisors. There are tax implications and other legal liability concerns that accompany a franchisor's choice of business entity.

Law stated - 16 May 2024

Regulation of business formation

4 | What laws and agencies govern the formation of business entities?

Business entities are almost always formed pursuant to state law, typically by making an application to the relevant secretary of state. Foreign companies are free to choose the state in which they would like to form their business entity, although there are legal, tax and other implications that can impact this decision. It is common for foreign (and domestic) franchisors to choose Delaware as the state of formation. However, all states have enacted laws that govern the formation of business entities. When operating in multiple states, an entity formed in one state must register to do business in another state as a foreign entity, which is a simple ministerial process.

Law stated - 16 May 2024

Requirements for forming a business

5 | Provide an overview of the requirements for forming and maintaining a business entity.

The requirements vary significantly depending on the type of business entity that a franchisor seeks to form. For instance, a general partnership can be formed by default if two or more individuals or entities operate a business together. Other types of entities, such as limited liability companies or corporations, must be filed with the relevant secretary of state or a similar state agency. The nature and substance of the documentation to be filed vary depending on the type of entity and the state's process. States typically require periodic document filing and fees to maintain the business entity. Commencing in 2024, entities must comply with the Corporate Transparency Act, which requires non-exempt entities (domestic or foreign) that are created or registered to do business in the United States to report certain beneficial ownership information to the Financial Crimes Enforcement Network.

Law stated - 16 May 2024

Restrictions on foreign investors

6 | What restrictions apply to foreign business entities and foreign investment?

Foreign businesses are generally treated the same as domestic businesses under US laws. There are, however, a variety of laws that apply to foreign investment, many of which were enacted in the interest of national security. For instance, [the Exon-Florio Amendment to](#)

[the Defense Production Act of 1950](#) provides the federal government with the authority to review foreign investments in the United States for potential national security concerns. The [USA PATRIOT Act](#) and [Executive Order 13,224](#), which are aimed at deterring terrorism, include restraints on transactions that involve suspected terrorists. Franchisors are prohibited from dealing with individuals included on the [Specially Designated Nationals and Blocked Persons List](#) maintained by the US Treasury Department's Office of Foreign Assets Control. Foreign investors are also subject to certain reporting and disclosure requirements under the [International Investment and Trade in Services Survey Act of 1976](#).

Law stated - 16 May 2024

Taxation

7 | What aspects of the tax system are relevant to franchisors? How are foreign businesses and individuals taxed?

Taxes are imposed in the United States by federal, state and local governments. A foreign franchisor is subject to the tax laws of the jurisdictions in which it operates. If the foreign franchisor establishes a US-based subsidiary as the US franchisor, that entity would be subject to US tax laws. Franchisors are subject to income taxes, which are generally assessed on revenues or income after certain deductions and adjustments. The federal tax rate ranges from 10 per cent to 37 per cent of taxable income. State and local taxes vary from zero per cent to 13.3 per cent of income. If the entity that is being taxed is a corporation, double taxation is possible, with income tax also imposed on the shareholders or owners. For certain entities (eg, limited liability companies and partnerships), the tax is passed through to the owners of the entities. The typical revenue received by a franchisor – such as initial franchise fees and royalty fees – are treated and taxed as ordinary income, and not at the lower capital gains rates.

Even if it does not have a physical place of business in the United States, a foreign franchisor is taxed on its US sources of income. If the foreign franchisor operates in the United States or creates a US subsidiary, the state in which the headquarters are located or in which the entity is formed may assess taxes on that entity. In addition, more states are seeking to assess taxes on out-of-state entities that are doing business in the state, even if they are not physically located there. Therefore, some states are seeking to assess income tax on foreign entities that merely have franchises operating in that state. Hence, an out-of-state franchisor may be subject to tax on the royalty income it receives from a franchisee located in a particular state. Out-of-state franchisors may be able to obtain credit on their home state taxes for taxes paid in other jurisdictions. States including California, Arizona, Kansas, New Mexico and Hawaii, among others, all take the view that foreign franchisors may be liable for state income tax if the entity has a substantial nexus with a state.

Federal law also requires that the tax on royalties paid to a foreign entity be withheld at the source and paid to the US Internal Revenue Service. However, certain tax payments may be reduced or exempted from withholding under some tax treaties.

Law stated - 16 May 2024

Labour and employment

8 | Are there any relevant labour and employment considerations for typical franchisors?

Generally, franchisors and franchisees are not considered to be in an employer-employee relationship. Rather, franchisees are classified as independent contractors and operate as separate legal entities. However, in recent years, some courts have found that franchisees may be deemed employees of their franchisor for purposes of labour, tax and other laws where the franchisor exercises excessive controls over the franchisees. The results in these cases turn on the specific facts at issue and the state-specific analytical frameworks, which vary. There have been several well-known cases that examine alleged employee misclassification and the franchise relationship in the janitorial services industry. Franchisors can mitigate the risk of having their franchisees classified as employees by structuring and implementing the franchise relationship in a manner that is consistent with state independent contractor laws. In addition, some franchisors only grant franchises to business entities, rather than individuals, in part to diminish the risk of misclassification.

In addition, franchisors operating in the United States face the risk that they may be deemed joint employers of their franchisees' employees. If a franchisor is deemed a joint employer, it can be liable for employment-related claims at a franchised business, such as wage and hour claims, harassment or discrimination. As a general rule, franchisors can be at risk of a joint employer determination if the franchisor controls, or has the right to control, the franchisee's employment-related decision-making. This could be either through operational realities, or through language in franchise agreements, franchise disclosure documents (FDD), manuals or other procedures and guidelines. Franchisors can mitigate the risk of joint employment by making certain changes to their franchise documents to emphasise the franchisee's status as an independent contractor and through certain operational practices, such as by providing only voluntary recommendations on employment issues.

Law stated - 16 May 2024

Intellectual property

9 | How are trademarks and other intellectual property and know-how protected?

One of the principal means for franchisors to protect their trademarks is through registration. Trademarks can be registered at state and federal level, although nationwide protection can be achieved only through federal registration. Unregistered rights in a trademark are governed by the common law and extend only to the geographic territory where the mark is used.

At the federal level, registration with the US Patent and Trademark Office (USPTO) gives the franchisor a nationwide priority of rights in the trademark. Once a trademark is registered with the USPTO, there is a rebuttable presumption that the registrant is the owner of the mark, that the mark is valid and that the registrant has the exclusive right to use it. The trademark owner may license others to use the mark and to pursue enforcement action

against infringers. After five years, the registrant's rights in the mark become incontestable, which shields the registrant from certain challenges to the mark's validity.

The US Copyright Office also has a system for registering copyrights. A copyright attaches to an original work of authorship when it is created. While registration with the Copyright Office is not required, if the owner of a copyright wishes to bring a lawsuit for copyright infringement, the owner must register the work before bringing a claim.

Franchisors can take other practical steps aside from registration to protect their trademarks in the United States. For example, franchisors can ensure the continuing strength of their trademarks by using the marks consistently and avoiding changes in their appearance and presentation; using trademark notices (eg, the ® symbol for federally registered marks and the ™ symbol for all other marks) to demonstrate their ownership rights; and taking action against infringers.

With regard to know-how, US law recognises the value in confidential methods and knowledge that become trade secrets. A trade secret is any information in any form that derives independent economic value from not being generally known or readily ascertainable and is the subject of reasonable efforts to maintain its secrecy. There is no documentation that must be filed with the government for information to be recognised as a trade secret. In 2016, the federal government enacted the [Defend Trade Secrets Act](#) for the protection of trade secrets. Forty-nine states have also adopted the Uniform Trade Secrets Act. For information to retain its status as a trade secret, a franchisor must monitor the information and take measures to maintain its secrecy. Anyone who has access to the information should be subject to strict written confidentiality obligations.

Law stated - 16 May 2024

Real estate

10 | What are the relevant aspects of the real estate market and real estate law? What is the practice of real estate ownership versus leasing?

All US states and many other jurisdictions have laws that address ownership, leasing, sub-leasing and transfers of real estate. These laws are not specific to franchising. However, there are real estate issues that a franchisor may wish to consider. Namely, franchisors should take steps to exercise control over the premises of the franchised business so that, on termination or expiration of a franchise agreement, they do not lose valuable customer exposure, the location or signage.

Frequently, a franchisee leases the franchised premises from a third-party landlord. In that situation, a franchisor may want to require the franchisee to execute a conditional assignment of the lease, through which the franchisee and the lessor agree to assign the property to the franchisor upon termination or expiration of the lease, sub-lease or the franchise agreement. A franchisor may also require a franchisee's lease to contain certain prescribed terms, such as the right to receive notices of default under the lease, the right to cure a franchisee's default under the lease or the right to retrieve property that the franchisee abandons after the end of the lease term.

Law stated - 16 May 2024

Competition law

11 | What aspects of competition law are relevant to the typical franchisor in your jurisdiction? How is competition law enforced in the franchising sector?

Several aspects of competition law in the United States are relevant to franchising. For instance, sourcing and price controls imposed by a franchisor are subject to certain limitations under federal and state antitrust laws, and under state franchise relationship laws.

It is permissible for a franchisor to require franchisees to buy products and services only from the franchisor, or its designated or approved suppliers. These restrictions must be disclosed in the franchisor's FDD. While a franchisee may challenge those restrictions as an unlawful tying arrangement under antitrust laws, such claims rarely succeed. With some exceptions, provided that the sourcing requirements were disclosed through the FDD or other pre-sale communications with the franchisee, these arrangements do not usually expose franchisors to antitrust liability. However, certain state franchise relationship laws (eg, the Washington Franchise Investment Protection Act) place limitations on sourcing requirements.

In addition, federal and state antitrust laws regulate pricing restrictions. Vertical agreements between franchisors and franchisees setting minimum or maximum resale prices are generally lawful under federal law. State law on this issue varies.

Most modern franchise agreements contain a non-compete covenant. The enforceability of a non-compete is principally governed by state law. Some states do not enforce a non-compete as a matter of public policy. However, many courts will enforce a non-compete if it is reasonable in terms of its durational and geographic restrictions, and necessary to protect the franchisor's legitimate business interests.

In April 2024, the Federal Trade Commission (FTC) issued a rule that generally prohibits non-compete covenants between a 'worker' and an 'employer', which is set to go into effect in August 2024. However, the FTC specifically excluded from the rule non-compete provisions that apply to franchisees in the context of franchisor-franchisee relationships. The rule still prohibits non-executive employees of franchisors and franchisees of being subject to non-compete covenants. There are expected to be legal challenges to this rule.

Law stated - 16 May 2024

OFFER AND SALE OF FRANCHISES

Legal definition

12 | What is the legal definition of a franchise?

While federal and state jurisdictions share common definitional approaches, there is no universal definition of a franchise. Moreover, each jurisdiction has its own mix of definitional exclusions and exemptions.

Generally, a franchise is defined by the coexistence of three elements:

- a grant of rights to use another's trademark to offer, sell or distribute goods or services;
- the grantor (or franchisor) providing significant assistance to, or exercising control over, the grantee's (franchisee's) business, which may take the form of a prescribed marketing plan; and
- the payment of a required fee.

If these three elements exist, the business arrangement is a franchise and the franchisor must comply with the applicable laws.

Law stated - 16 May 2024

Laws and agencies

13 | What laws and government agencies regulate the offer and sale of franchises?

At the federal level, franchising is regulated by the Federal Trade Commission (FTC) primarily through the FTC's [Franchise Rule](#) (the FTC Rule). The FTC also has a [Business Opportunity Rule](#) that can apply to franchises.

At state level, 14 states have laws that regulate pre-offer and pre-sale disclosures and require franchise registration. These states are California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Rhode Island, South Dakota, Virginia, Washington and Wisconsin. Oregon has a franchise-specific law that does not require documentation to be filed with the government. In addition, 25 states have business laws that apply to business opportunities or seller-assisted marketing plans. Most of these contain exemptions for franchisors that meet certain criteria. However, of those states, six impose pre-offer and pre-sale documentation filing requirements on franchisors. These states are Connecticut, Florida, Kentucky, Nebraska, Texas and Utah. Also, 25 states and territories have laws that regulate the terms of the franchisor-franchisee relationship (after the grant or sale of a franchise). These states are: Alaska, Arkansas, California, Connecticut, Delaware, Hawaii, Idaho, Illinois, Indiana, Iowa, Louisiana, Maryland, Michigan, Minnesota, Mississippi, Missouri, Nebraska, New Jersey, North Dakota, Rhode Island, Virginia, Washington and Wisconsin, as well as Puerto Rico and the US Virgin Islands. State relationship laws typically pertain to franchise terminations, renewals and transfers.

There are many exclusions and exemptions from both the FTC Rule and state laws, which are nuanced. There is no nationwide exemption from franchise laws.

Finally, the North American Association of Securities Administrators (NAASA) has guidance documents concerning franchise disclosures, which are deferred to by state regulators. Some states elect to codify parts of NAASA's guidance into state law.

Law stated - 16 May 2024

Principal requirements

14 | What are the principal requirements governing the offer and sale of franchises under the relevant laws?

The federal and state franchise laws and regulations are varied and include the following principal requirements:

- federal-level pre-sale franchise disclosure requirements;
- state-level pre-sale franchise registration and disclosure requirements; and
- state-level franchise relationship laws that govern the ongoing relationships between franchisors and franchisees, as well as between manufacturers and dealers or distributors, which impose requirements on terminations, renewals and transfers of franchises.

The federal and state laws regulating the offer and sale of business opportunities or seller-assisted marketing plans may also impose filing or disclosure requirements, or both.

Law stated - 16 May 2024

Franchisor eligibility

15 | Must franchisors satisfy any eligibility requirements in order to offer franchises? Are there any related practical issues or guidelines that franchisors should consider before offering franchises?

Neither federal nor state laws impose experience or similar threshold requirements as a prerequisite to offering franchises. However, some of the registration states may require inexperienced franchisors to defer their collection of initial franchise fees until the franchisor has completed its initial obligations and the franchisee has opened for business. Fee deferral may also be required based on a state's analysis of a franchisor's financial condition. Of course, a franchisor must comply with any applicable registration and disclosure requirements before offering franchises.

Law stated - 16 May 2024

Franchisee and supplier selection

16 | Are there any legal restrictions or requirements relating to the manner in which a franchisor recruits franchisees or selects its or its franchisees' suppliers? What practical considerations are relevant when selecting franchisees and suppliers?

No. The franchisor is generally free to contract with suppliers and franchisees of its choosing.

Law stated - 16 May 2024

Pre-contractual disclosure – procedures and formalities

- 17 | What procedures and formalities for pre-contractual disclosure are required or advised in your jurisdiction? How often must the disclosures be updated?

At the federal level, the FTC Rule requires that franchisors who offer franchises anywhere in the United States must prepare a franchise disclosure document (FDD) and provide the FDD to prospective franchisees at least 14 days before signing a franchise agreement or accepting any consideration for the right to enter into a franchise relationship. The FDD must include 23 disclosure items and certain required appendices. Disclosures must be updated annually 120 days after the franchisor's fiscal year end and within a reasonable time after the close of each quarter to reflect material changes.

Fourteen states have pre-sale franchise disclosure and registration laws, although the disclosure period varies slightly by state. In these jurisdictions, a franchisor may not offer franchises in the state or to that state's residents unless the franchise offering is registered with the state. State laws require that FDDs must be updated at least annually or upon the occurrence of a material change, although what constitutes a material change and the exact timing of the required update varies by state.

Law stated - 16 May 2024

Pre-contractual disclosure – content

- 18 | What information is the disclosure document required or advised to contain?

A US FDD must include 23 specific disclosure items, including:

- information regarding the franchisor and its business experience;
- fees payable by the franchisee;
- an estimate of the initial investment required to begin operations;
- information regarding support provided by the franchisor before and after the business opens; and
- a summary of the key terms of the franchise agreement.

The FDD must also include the franchisor's financial statements, copies of the forms of the franchise agreement and other contracts that a franchisee must sign, and contact information for all existing franchisees in the system.

A franchisor must obtain from the prospective franchisee a signed and dated FDD receipt page as evidence of proper disclosure.

Law stated - 16 May 2024

Pre-sale disclosure to sub-franchisees

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- 19 | In the case of a sub-franchising structure, who must make pre-sale disclosures to sub-franchisees? If the sub-franchisor must provide disclosure, what must be disclosed concerning the franchisor and the contractual or other relationship between the franchisor and the sub-franchisor?

Both the franchisor and sub-franchisor are jointly liable for compliance with disclosure laws. A sub-franchisor must provide an FDD to prospective franchisees. Certain aspects of the sub-franchisor's relationship with the franchisor must be disclosed in the sub-franchisor's FDD, such as the parties' trademark licensing arrangement. However, the parties' fee arrangement need not be disclosed. Additional disclosures pertaining to the franchisor must be disclosed in the sub-franchisor's FDD, including litigation and bankruptcy information about the franchisor.

Law stated - 16 May 2024

Due diligence

- 20 | What due diligence should both the franchisor and the franchisee undertake before entering a franchise relationship?

Prospective franchisees should review the FDD, franchise agreement and related documents detailing the terms of the franchise relationship to understand the costs involved, the control exercised by the franchisor and the support services offered. Prospective franchisees should also speak to as many of the franchisor's current and former franchisees as possible. Prospective franchisees should also evaluate competing brands. Prospective franchisees should consider engaging financial and legal advisers, as well as industry-specific trade associations, to help assess the franchise opportunity.

Franchisors should establish criteria to assess each prospective franchisee, which should include:

- whether the franchisee is a good fit for the system;
- whether the franchisee has the appropriate experience (such as in business, management and human resources);
- whether the prospect meets minimum capital requirements;
- the availability of territory in the franchisee's ideal market; and
- whether it makes sense for the franchisor to expand into that region.

Law stated - 16 May 2024

Failure to disclose – enforcement and remedies

- 21 | What actions may franchisees or any relevant government agencies take in response to a franchisor's failure to make required disclosures? What legal remedies are available? What penalties may apply?

The FTC may initiate an investigation or enforcement action against a franchisor for violation of the FTC Rule. This action can result in a court order that imposes penalties, such as rescission of agreements or payment of fines, and enjoins the franchisor from continuing the violation. There is no private right of action available to franchisees under the FTC Rule. Only the FTC may pursue a violation of the FTC Rule.

States may also initiate an investigation or enforcement action against a franchisor for violation of a state registration or disclosure law (including business opportunity laws). States also routinely impose cease-and-desist orders, and require rescission of agreements and payment of fines. Some state laws also provide for criminal liability for violations of state franchise laws.

FTC and state enforcement actions must usually be disclosed in a franchisor's FDD.

Law stated - 16 May 2024

Failure to disclose – apportionment of liability

- 22** | In the case of sub-franchising, how is liability for disclosure violations shared between franchisor and sub-franchisor? Are individual officers, directors and employees of the franchisor or the sub-franchisor exposed to liability? If so, what liability?

A franchisor is jointly liable with a sub-franchisor for disclosure violations. As in a unit franchising relationship, officers and directors of the franchisor or sub-franchisor may also be held liable.

Law stated - 16 May 2024

General legal principles and codes of conduct

- 23** | In addition to any laws or government agencies that specifically regulate offering and selling franchises, what general principles of law affect the offer and sale of franchises? What industry codes of conduct may affect the offer and sale of franchises?

There are several general principles that apply to most contracts, such as common law concepts of fraud and misrepresentation.

Law stated - 16 May 2024

Fraudulent sale

- 24** | What actions may franchisees take if a franchisor engages in fraudulent or deceptive practices in connection with the offer and sale of franchises?

In registration states, if a franchisor fails to provide proper disclosure or appropriately register, the franchisee may bring a claim under the applicable state law. Remedies available under state franchise laws may include rescission of the franchise agreement and damages. Similar relief is available for violations of business opportunity laws.

In addition, while there is no private right of action available to franchisees under the FTC Rule, states have passed unfair and deceptive trade practices acts, which are sometimes called Little FTC Acts. Many of these Little FTC Acts make violation of the FTC Rule a per se violation of the state's Little FTC Act. Aggrieved franchisees may also bring claims under these little FTC Acts. Common remedies also include rescission and damages, including punitive damages.

Law stated - 16 May 2024

FRANCHISE CONTRACTS AND THE FRANCHISOR/FRANCHISEE RELATIONSHIP

Franchise relationship laws

25 | What laws regulate the ongoing relationship between franchisor and franchisee after the franchise contract comes into effect?

Twenty-five states and territories have enacted franchise relationship laws, and many of them govern the manner and procedure by which a franchisor may terminate, decline to renew or consent to a transfer of a franchise. For example, most franchise relationship laws require that a franchisor must have good cause to terminate a franchise and impose certain time periods during which a franchisee may cure defaults. Some of these laws are more limited, such as voiding venue selection clauses that force a franchisee to appear in court outside its home state or prohibiting the imposition of changes among similarly situated franchisees.

Law stated - 16 May 2024

Operational compliance

26 | What mechanisms are commonly incorporated in agreements to ensure operational consistency and adherence to brand standards?

Franchisors generally reserve inspection and audit rights to monitor compliance with brand standards. Such inspections and audits may include formal or informal site visits by a representative of the franchisor, mystery shopper programmes or review of a franchisee's business records through remote access to a computer or point-of-sale system.

Law stated - 16 May 2024

Amendment of operational terms

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27 | May the franchisor unilaterally change operational terms and standards during the franchise relationship?

The franchisor is not permitted to unilaterally alter the terms of the franchise agreement. However, franchisors commonly reserve the right to alter the operations manual to modify the brand standards to reflect trends in the marketplace or new marketing techniques, technologies, and products and services.

Law stated - 16 May 2024

Policy affecting franchise relations

28 | Do other government or trade association policies affect the franchise relationship?

The International Franchise Association has a code of ethics, but it has no force of law. Other associations that are formed may establish policies, but these policies would not have force of law.

Law stated - 16 May 2024

Termination by franchisor

29 | In what circumstances may a franchisor terminate a franchise relationship? What are the specific legal restrictions on a franchisor's ability to terminate a franchise relationship?

The terms of the franchise agreement establish the grounds on which a franchisor may terminate the franchise agreement. Common defaults include:

- insolvency or bankruptcy;
- abandonment of the franchised business;
- failure to pay amounts due;
- violations of health and safety laws; and
- failure to comply with system standards.

Franchise agreements commonly distinguish between curable and incurable defaults. If applicable, state relationship laws may override the terms of a franchise agreement.

Law stated - 16 May 2024

Termination by franchisee

30 | In what circumstances may a franchisee terminate a franchise relationship?

Typically, franchise agreements expressly address when a franchisee may terminate a franchise agreement. In addition, common law may provide the franchisee with a right to terminate the franchise agreement upon a franchisor's material breach. Recission of the franchise agreement is permitted under some state laws if a franchisor failed to comply with disclosure requirements.

Law stated - 16 May 2024

Renewal

31 | How are renewals of franchise agreements usually effected? Do formal or substantive requirements apply?

The terms of the franchise agreement generally establish the renewal requirements. Common renewal conditions include:

- prior notice of the franchisee's intent to renew;
- the payment of a renewal fee;
- execution of a general release of claims;
- good standing;
- a remodel of the premises; and
- the execution of the franchisor's then-current form of franchise agreement.

Disclosure is generally required on renewal if the franchisee would be required to sign a materially different form of franchise agreement than the agreement under which it had been operating.

Law stated - 16 May 2024

Refusal to renew

32 | May a franchisor refuse to renew the franchise agreement with a franchisee? If yes, in what circumstances may a franchisor refuse to renew?

If a franchisee has not complied with the conditions for renewal that are established in the franchise agreement, the franchisor may generally refuse to renew the franchise agreement. If applicable, state relationship laws may impose certain restrictions on a franchisor's refusal to renew.

Law stated - 16 May 2024

Transfer restrictions

33 | May a franchisor restrict a franchisee's ability to transfer its franchise or restrict transfers of ownership interests in a franchisee entity?

Yes. Franchisors typically reserve the right to approve or disapprove a sale of the franchised business and any change in ownership of the franchisee entity. The terms of the franchise agreement dictate the processes applicable to a transfer. Common transfer conditions include:

- prior notice of the intent to transfer;
- the payment of a transfer fee;
- a remodel of the premises; and
- execution of a general release of claims.

The transferee must also meet the franchisor's standards for new franchisees, execute the franchisor's then-current form of franchise agreement and complete any required training. Franchisors also commonly reserve a right of first refusal to acquire the franchised business if a franchisee desires to transfer.

Certain state-specific franchise relationship laws may also affect transfers.

Law stated - 16 May 2024

Fees

34 | Are there laws or regulations affecting the nature, amount or payment of fees?

No. Franchisors typically designate standard fees, which are disclosed in the franchise disclosure document (FDD), although franchisees are free to negotiate these fees.

Law stated - 16 May 2024

Usury

35 | Are there restrictions on the amount of interest that can be charged on overdue payments?

Laws that limit the interest rate that may be charged (usury laws) have been enacted in all states.

Law stated - 16 May 2024

Foreign exchange controls

36 | Are there laws or regulations restricting a franchisee's ability to make payments to a foreign franchisor in the franchisor's domestic currency?

No. Generally, the United States does not impose currency or exchange controls on the transfer of money by a US-based entity (eg, a US franchisee) to a foreign entity, unless the

foreign entity's home country is subject to sanctions. However, intellectual property-based payments to a foreign franchisor, such as royalty payments, may be subject to a 30 per cent withholding tax. If the United States and the foreign country are parties to an income tax treaty, the foreign franchisor may be entitled to a reduction or exemption.

Law stated - 16 May 2024

Confidentiality covenant enforceability

37 | Are confidentiality covenants in franchise agreements enforceable?

Typically, yes. Reasonable confidentiality agreements are often enforced to protect the franchisor's intellectual property, trade secrets and other confidential information.

Law stated - 16 May 2024

Good-faith obligation

38 | Is there a general legal obligation on parties to deal with each other in good faith during the term of the franchise agreement? If so, how does it affect franchise relationships?

Courts have held that an implied covenant of good faith and fair dealing generally applies to contracts, including franchise agreements. As applied by many courts, this covenant requires parties to deal with each other honestly and fairly, and a party cannot act to deny the other party the benefit of the bargain. However, the covenant of good faith and fair dealing cannot contradict the express terms of a contract. Therefore, franchise agreements are explicit in their description of each party's rights and responsibilities to reduce potential uncertainty, and to minimise potential claims alleging a breach of this covenant.

Law stated - 16 May 2024

Franchisees as consumers

39 | Does any law treat franchisees as consumers for the purposes of consumer protection or other legislation?

Treatment of franchisees as consumers varies by state. For instance, every state has an unfair and deceptive acts or practices statute, but the protections offered by those laws are state-specific.

Law stated - 16 May 2024

Language of the agreement

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40 | Must disclosure documents and franchise agreements be in the language of your country?

It is assumed that FDDs and agreements will be provided in English. FDDs and agreements filed in the registration states must be in English.

Law stated - 16 May 2024

Restrictions on franchisees**41** | What types of restrictions are commonly placed on the franchisees in franchise contracts?

For the protection of the franchisor's brand, franchise agreements typically require the franchisee to closely follow the franchisor's business system. Accordingly, franchise agreements often require franchisees to sell all (and only) the goods or services that the franchisor designates, in accordance with the franchisor's standards and specifications. Usually, the franchisor may prescribe certain approved or designated suppliers, or a process by which a franchisor may vet alternate suppliers. Similarly, franchise agreements often contain tight restrictions on the franchisee's use of the franchisor's trademarks. The franchisor's business system is typically described in greater detail in an operations manual that is expressly referenced throughout the franchise agreement.

It is also typical in the United States for franchise agreements to designate an exclusive territory in which the franchisee must operate, although the size of the territory and level of exclusivity granted varies widely. Restrictions pertaining to confidentiality are also routinely included in franchise agreements, as well as both in-term and post-term covenants against competition (though the enforceability of such covenants varies by state). Franchise agreements also contain lengthy provisions that pertain to dispute resolution, which may include requirements for mediation and arbitration, as well as the franchisor's choice of law and forum selection, which are also subject to state law.

Most franchise agreements contain restrictions relating to the transfer of the franchised business. Franchisors often require that the franchisee first obtain the franchisor's prior approval before transferring the franchise, although these requirements are also subject to state law.

Law stated - 16 May 2024

Courts and dispute resolution**42** | Describe the court system. What types of dispute resolution procedures are available relevant to franchising?

The US federal court system, or the judicial branch, is one of three constitutionally prescribed branches of the US government. Due to federalism, US states have also

established their own courts. The United States has a common law court system, which involves a formal adjudication process that creates law by establishing precedents.

Alternative dispute resolution methods are also commonly used to resolve franchise disputes. US law strongly favours the enforcement of arbitration agreements and many franchisors include broad arbitration clauses in their franchise agreements covering disputes arising from or relating to the franchise relationship (though some state laws purport to limit these arbitration agreements). Accordingly, a significant percentage of franchise disputes are arbitrated.

In addition, some franchisors and franchisees agree to pre-suit mediation as an alternative means of dispute resolution. Franchise agreements may even require that the parties first engage in mediation before initiating litigation or arbitration, and those provisions are generally enforceable.

Law stated - 16 May 2024

Governing law

43 | Are there any restrictions on designating a foreign governing law in franchise contracts in your jurisdiction? How does the governing law affect the contract's enforceability?

The parties are generally free to choose the governing law of the franchise agreement. However, some state laws prohibit franchisors from designating a governing law that is different from the franchisee's home state.

Law stated - 16 May 2024

Arbitration – advantages for franchisors

44 | What are the principal advantages and disadvantages of arbitration for foreign franchisors considering doing business in your jurisdiction? Are any other alternative dispute resolution (ADR) procedures particularly favoured or disfavoured in your jurisdiction?

Arbitration has traditionally been viewed as offering several advantages over litigation, including:

- greater efficiency and lower costs due to more limited discovery and streamlined pre-hearing procedures;
- the ability to select an arbitrator with specialised experience;
- the ability to have the venue for the arbitration in the franchisor's home state (or country) and not in the franchisee's home state (if the Federal Arbitration Act applies);
- the opportunity to keep the proceedings confidential; and
- the general lack of a preclusive effect of an adverse arbitration award.

However, in practice, arbitration can be as costly and time-consuming as litigation. In addition, arbitration results in a binding decision and there are limited rights to appeal or challenge arbitration awards.

Law stated - 16 May 2024

National treatment

45 | In what respects, if at all, are foreign franchisors treated differently (legally, or as a practical matter) from domestic franchisors?

US franchise laws apply equally to US and foreign franchisors. One aspect of the US franchise disclosure laws that may affect foreign franchisors relates to financial statements. In its FDD, a franchisor must include its audited financial statements for the three most recent fiscal years (with certain adjustments for start-ups), prepared in accordance with US Generally Accepted Accounting Principles (US GAAP). Therefore, a foreign entity seeking to become a US franchisor must prepare its financial statements under US GAAP or include detailed conversions from international standards to US GAAP.

Law stated - 16 May 2024

UPDATE AND TRENDS

Legal and other current developments

46 | Are there any proposals for new legislation or regulation, or to revise existing legislation and regulation? Are there other current developments or trends to note?

Concerns pertaining to joint-employer liability and employee misclassification persist in the United States. The state of the law is very much in flux. In 2023, the National Labor and Relations Board (NLRB) announced a new rule and analysis for determining whether an entity is a joint employer of another party. The new rule was broader in scope, and among other factors, provided that indirect or reserved control, even if never exercised, may result in an entity being classified as a joint employer. A federal court then held that the new rule was unconstitutional in March 2024, but it is expected that the NLRB will appeal that finding. As of May 2024, joint-employer status continues to be analysed under the prior rule established in 2020.

In April 2024, the Federal Trade Commission (FTC) issued a rule that generally prohibits non-compete covenants between a 'worker' and an 'employer', which is set to go into effect in August 2024. However, the FTC specifically excluded from the rule non-compete provisions that apply to franchisees in the context of franchisor-franchisee relationships. The rule still prohibits non-executive employees of franchisors and franchisees of being subject to non-compete covenants. There are expected to be legal challenges to this rule.

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Eli Besignor

eli.besignor@lathropgpm.com

Lathrop GPM

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