

THE FRANCHISE LAW REVIEW

SEVENTH EDITION

Editor
Mark Abell

THE LAWREVIEWS

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PREFACE

Since the publication of the sixth edition of *The Franchise Law Review*, there has been little let-up in major economic and geopolitical developments and these continue to have a significant impact on world trade; the ongoing Sino-American trade war, sanctions on Iran and Brexit being only three of these. Through all this, however, the apparently inexorable march towards the globalisation of commerce has continued unabated. While there have been some economic bright spots, the global economy is still not performing as well as it might, and there remain concerns that the US economy may yet crash.

As a consequence, businesses are often presented with little choice but to look to more vibrant markets in Asia, the Middle East and Africa for their future growth. At the same time, South–South trade is on the increase, perhaps at the expense of its North–South counterpart. All of this, coupled with the unstable wider geopolitical landscape, presents business with only one near certainty: there will be continued deleveraging of businesses in the coming years and, thus, growing barriers to international growth for many of them. All but the most substantial and well-structured of such businesses may find themselves facing not only significant difficulties through reduced access to funding for investment in their foreign ventures, but also challenges arising from their lack of managerial experience and bandwidth.

Franchising, in its various forms, continues to present businesses with one way of achieving profitable and successful international growth without the need for either substantial capital investment or a broad managerial infrastructure. In sectors as diverse as food and beverages, retail, hospitality, education, healthcare and financial services, franchising continues to be a popular catalyst for international commerce and makes a strong and effective contribution to world trade. We are even seeing governments turning to it as an effective strategy for the future of the welfare state as social franchising gains still more traction as a way of achieving key social objectives.

Given the positive role that franchising can play in the world economy, it is important that legal practitioners have an appropriate understanding of how it is regulated around the globe. This book provides an introduction to the basic elements of international franchising and an overview of the way that it is regulated in 28 jurisdictions.

As will be apparent from the chapters of this book, there continues to be no homogenous approach to the regulation of franchising around the world. Some countries specifically regulate particular aspects of the franchising relationship. Of these, a number try to ensure an appropriate level of pre-contractual hygiene, while others focus instead on imposing mandatory terms upon the franchise relationship. Some do both. In certain countries, there is a requirement to register certain documents in a public register. Others restrict the manner in which third parties can be involved in helping franchisors meet potential franchisees. No two countries regulate franchising in the same way. Even those countries that have

a well-developed regulatory environment seem unable to resist the temptation to continually develop and change their approaches – as was well illustrated by changes to the Australian regulations in the recent past. The unstoppable march towards franchise regulation continues, with countries such as Argentina, which previously had not specifically regulated franchising, adopting franchise-specific laws in the past year or so.

Many countries do not have franchise-specific legislation but nevertheless strictly regulate certain aspects of the franchise relationship through the complex interplay of more general legal concepts such as antitrust law, intellectual property rights and the doctrine of good faith. This heterogeneous approach to the regulation of franchising presents yet another barrier to the use of franchising as a catalyst for international growth.

While this book certainly does not present readers with the complete answer to all the questions they may have about franchising in all the countries covered – that would require far more pages than it is possible to include in this one volume – it does seek to provide the reader with a high-level understanding of the challenges involved in international franchising in the first section, and then, in the second section, explains how these basic themes are reflected in the regulatory environment within each of the countries covered. I should extend my thanks to all of those who have helped with the preparation of this book, in particular Caroline Flambard and Nick Green, who have invested a great deal of time and effort in making it a work of which all those involved can be proud. It is hoped that this publication will prove to be a useful and often-consulted guide to all those involved in international franchising, but needless to say it is not a substitute for taking expert advice from practitioners qualified in the relevant jurisdiction.

Mark Abell

Bird & Bird LLP

London

January 2020

WHAT IS FRANCHISING?

Mark Abell¹

In 2010, the estimated turnover of franchised businesses in the United States was US\$868.3 billion. However, its importance is not just restricted to the United States. In the EU it was an estimated US\$300 billion.²

For some years, franchising has been ‘playing an ever greater role in a wide range of national economies’³ and institutions, such as the European Commission, have recognised its role in ‘stimulat[ing] economic activity by improving the distribution of goods and/or the provision of services’ by allowing small and medium-sized businesses to ‘establish a uniform network with limited investments’, and ‘to set up outlets more rapidly and with a higher chain of success than if they were to set up without the franchisor’s experience and assistance’,⁴ resulting in them being better able to compete with larger distribution undertakings.

Unfortunately, although franchising enjoys considerable commercial success, legislators and trade bodies around the world have failed to agree on how it should be defined. Perhaps the most complete, non-legal definition is offered by Blair and Lafontaine, who identify the brand, the business format, independence, ongoing support to the franchisee by the franchisor, the economic interests of both parties and the control and enforcement of the brand standards by the franchisor as the defining elements of a franchise.⁵

While currently in widespread use, the DNA of franchising shows it also to have been a long-lived and versatile mode of business that throughout history, time and time again, has provided effective solutions to problems thrown up by economic and technological changes. It has played a key role in enabling growing businesses to develop multichannel strategies to meet the challenges presented by changing economic environments and new technologies.

In the 1800s, it enabled brewers to create and sustain a market for their products. In the late 19th and early 20th centuries, companies such as Singer, Ford and Coca-Cola found that their then cutting-edge technology placed demands on market infrastructure that could

1 Mark Abell is a partner at Bird & Bird LLP.

2 PWC 2010 Franchise Business Economic Outlook, www.franchise.org.

3 UNIDROIT, Model Franchise Disclosure Law, Preamble.

4 Commission Regulation (EEC) No. 4887/88.

5 R Blair and F Lafontaine, *The Economics of Franchising* (Cambridge University Press, 2005), p. 294. ‘[T]he franchisor maintains ownership over the trade name and marks and . . . develops a complete “recipe” to run each outlet. It then licences the right to operate under the central trade name and business format in a given market for a certain period of time to individuals or small firms in exchange for various fees. The ownership stake of the franchisee in current and future profit leads him or her to put significant effort into the outlet. At the same time, the ongoing fees the franchisee pays to the franchisor ensure that the latter has incentives to maintain the value of the brand by, among other things, screening and monitoring the franchisees and keep abreast of market trends.’

not be met by the then traditional methods of distribution and product support. Franchising enabled them to create a full sales network that provided a requisite level of ongoing customer support across the vast expanse of North America. In the mid 20th century, similar logistical challenges led small family-based fast food businesses with significant growth aspirations, such as McDonald's, KFC and Dairy Queen, to use franchising to achieve those ambitions. In the late 1960s and 1970s, European brands such as Wimpy, Dyno Rod, Ihr Platz and Obi adopted similar growth strategies and by the mid 1970s franchising was being used to facilitate international growth.⁶

This boom in the use of franchising inevitably led to it being regulated and 1971 saw the adoption of the first franchise law, in the form of the California Franchise Investment Law, followed soon after by other US states.

The advent of regulation has not inhibited the growth of franchising. Businesses tend to adopt it as a part of their multichannel strategy to access appropriately qualified managerial resources and capital. There are also other commercial advantages that attract businesses to franchising, such as bulk purchasing, economies of scale and enhanced product development.

Franchisees are attracted to franchising as it increases the chance of success and allows them to be their own boss.

FRANCHISING AS PART OF AN INTERNATIONAL MULTICHANNEL STRATEGY

*Mark Abell*¹

I SUBSTANCE NOT FORM

Franchising offers a range of exciting strategic possibilities to businesses looking to expand internationally, but its full potential is often not appreciated. To some it is an obvious and ready-made way of internationalising their businesses; others associate it with hamburgers and pizzas, and discount it as an option. Both groups have become too focused on the label they put on the international structure they adopt at the cost of objectively analysing the substance of a particular structure and how it can support and promote their business objectives. When considering how to develop an international business structure involving third parties, it is worth forgetting the form and focusing on the substantive needs of the business and how they can best be met.

Although franchising offers businesses an adaptable mechanism for expanding domestically and internationally, it often comprises one element of a broader multichannel market strategy. As a result, 'vanilla' franchising is increasingly less common than hybrid adaptations tailored to the precise needs of each business. Franchising may or may not be the best word to describe some of these structures, but it is essential that any existing prejudices or misunderstandings about the term do not deflect a business from developing an appropriate structure or misdirect its legal advisers as to how a particular legal structure will be regulated. How a structure is labelled will have no bearing on whether it is regulated by franchise rules or other regulations.

A range of third-party channel and relationship structures are available to companies that wish to re-engineer their approach to their target market. These include corporate or contractual joint ventures, business format franchises, a host of licensing arrangements, exclusive and non-exclusive distribution and agency agreements, and more complex 'hybrid' structures, such as subordinated equity arrangements.

All these third-party channel structures share four common features. To a greater or lesser extent they all involve:

- a* profit-sharing;
- b* investment by a third party;
- c* a divestiture of some degree of operational control; and
- d* risk-sharing.

¹ Mark Abell is a partner at Bird & Bird LLP.

The structures listed above all present different risk profiles for both parties involved. Franchising and its related hybrid structures present business with a versatile, effective and road-tested route to both domestic and international growth.

II WHY IS FRANCHISING SO POPULAR?

John Y Brown, the former president of KFC, identified one substantial attraction of franchising when he stated that the only way he could access the US\$450 million he needed to establish KFC's first 2,700 stores was through franchising.² Franchising can also provide the management expertise necessary to expand the business. It solves the problems concerning capital and management that often face growing businesses (resource society theory). Franchising also helps to improve managerial performance by establishing a community of interest that incentivises managers to work hard (agency theory).

Aliouche and Schlentrich³ suggest that franchising offers business an efficient way of increasing its value. This 'value creation' or 'transaction cost theory' is demonstrated by their survey of the US restaurant sector during the 10 years from 1993 to 2002. It suggests that franchised businesses create more value than their non-franchising competitors because they have a higher prospect of creating market value and economic value than non-franchisors and generate on average higher added value than non-franchisors.

Economies of scale lead to cost savings, and increased brand recognition is created more cost-effectively.

III INTEGRATED CORPORATE OR FRANCHISE STRUCTURES

Companies such as McDonald's have successfully developed a strategy of operating both company-owned outlets and franchised outlets. Costa Coffee is another example of a franchisor that has very effectively developed a split model of company-owned outlets in major towns and markets, and a 'hub' franchise model enabling it to operate effectively and bring its brand to consumers in smaller regional markets that are operated by franchisees.

This combined approach ensures that the franchisor has continual access to the operational realities of its format and is able to review and develop it on an ongoing basis. Corporate outlets generally yield higher profits for the brand owner than franchised outlets. However, the more rapid rate of growth and need for lower investment per unit gives rise to a 'multiplier effect', which leads to a higher return investment, greater market share and ultimately higher gross earnings for the brand owner.

2 See C Wormald and M Abell, 'Introduction: Alternative strategic techniques for the board agenda', in C Wormald (ed.), *Alternative Corporate Re-engineering* (The European Lawyer Reference, 2011), p. 9.

3 E Hachemi Aliouche and Udo Schlentrich, 'Does Franchising Create Value? An Analysis of the Financial Performance of US Public Restaurant Firms', Southern New Hampshire University Working Paper Series, 2005-02 (Manchester, NH, 2005), cited in Wormald and Abell, 'Introduction: Alternative strategic techniques for the board agenda', *ibid.*, p. 9.

IV FRANCHISING AS A PART OF WIDER-RANGING MULTICHANNEL STRATEGIES

There is nothing particularly new about the concept of businesses having a multichannel retail strategy. As noted by the authors of a 2009 Harvard Business School working paper,⁴ retailers have for some time started their businesses by exploiting one particular channel and then expanding it into others. In 1925, the US retailer Sears opened its first store as a way of complementing its existing catalogue business, which had been around since the early 1880s; Eddie Bauer and Spiegel's followed the same path, and more recently, we have seen television retailers HSN and QVC moving into the internet space.⁵ The advent of integrated multichannel retailing is due to the rapid development of the internet as a new selling channel since the dot-com boom in the mid 1990s, when many envisioned consumers abandoning 'bricks' for 'clicks' and buying most products and services over the internet. However, the internet has become a facilitating technology, which enables traditional bricks-and-mortar retailers to broaden their offering by establishing websites and riding the wave of online shopping. This not only gives them access to more customers but also improves operational efficiency. However, the internet does not meet all of every brand's marketing and sales needs, and franchising has evolved to further facilitate growth and development in the way that brands access potential clients, as both retailers and service providers face many new challenges and opportunities in the multichannel retailing environment: in developing international multichannel strategies; in creating synergies across channels; in deciding how to decide product mix; and in understanding how multichannel retailing will evolve over time in different geographic markets.

Perhaps the certainties are that improved financial performance will require continuing flexibility and that cannibalisation between channels and differences in prices and margins across channels will always be a risk. Multichannel retailing is continually developing as new channels, such as m-commerce, evolve into still newer channels. The legal documentation structuring these multichannel approaches to the market needs to provide for these certainties; this presents the draftsman with substantial technical challenges.

Brands generally develop their multichannel strategies by opportunistically adding new channels to existing ways to market. As a result of this fast-changing environment, and although historically it has been used in one of three vanilla forms (namely unit franchising, master franchising and development agreements), over the past few years franchising has increasingly been used as one element in a variety of more complex and sophisticated structures developed in a bespoke manner to meet the exact multichannel, and other, needs of brand owners. These more sophisticated hybrid structures deliver not only an increased range of flexibility for customisation to businesses' individual needs, but also more complex challenges for their lawyers.

4 Jie Zhang, Paul W Farris, John W Irvin, Tarun Kushwaha, Thomas J Steenburgh and Barton A Weitz, 'Crafting Integrated Multichannel Retailing Strategies', Working Paper 09-125 (Harvard Business School, 2009).

5 *ibid.*

V VANILLA FRANCHISING

i Unit franchising

This is the most basic form of franchising. It is most often used in domestic franchises. The franchisor directly grants the franchisee a right to operate one unit or a number of units. The burden it places on the franchisor means that it is rarely used internationally.

ii Master franchise agreements

In this relationship the franchisor grants to another party, described as a master franchise (or sometimes a 'sub-franchisor'), the right to open franchise outlets itself, and to franchise third parties, described as 'sub-franchisees', to open franchise outlets within a specified or exclusive territory.

iii Development agreements

In this relationship, the franchisor grants exclusive rights to a party described as the 'developer' to develop a territory by opening a number of franchise outlets itself. Developers must have substantial capital and managerial resources and are usually experienced operators.

VI HYBRID STRUCTURES

i Subordinated equity agreements

Companies are increasingly finding that their longer-term international strategic aims are not always met by vanilla franchising. Their commercial aims require more sophisticated, hybrid structures, often involving taking equity in the corporate vehicle that the franchisee has created to develop the brand in the territory. There is a wide range of these subordinated equity structures available, the appropriateness of which will depend upon the franchisor's commercial priorities, its longer-term market-entry strategy, the franchisor's shareholders' ultimate exit strategy, tax planning, and so on.

Joint ventures are sometimes used to try to add further flexibility to traditional franchising structures, but more often than not these result in a head-on clash between the control dynamics present in a traditional shareholders' agreement and the brand owner's need to have unfettered control of the brand. Subordinated equity agreements enable the parties to circumvent these inherent tensions and equity interests to become a part of the brand owner's overall strategy.

In many jurisdictions these can have a substantial impact on the regulatory and tax issues that the franchisor has to deal with. As a result subordinated equity arrangements tend to be tailored to each market, while at the same time not compromising the integral homogeneity of the overall international structure.

Subordinated equity structures are sometimes used in conjunction with other 'extra-franchise' structures, such as management agreements of various types.

ii 'Manchising'

Management agreements tend to be used when the foreign developer has sufficient capital to invest in establishing the brand in the target market, but does not have access to the level and depth of operational expertise and resources required to help ensure its success in that market. It also offers the franchisor a further income stream, allied to, but distinct from, that which

it receives by way of the franchise agreement. Historically, these have been most common in the hotel sector, but more recently they have become part of hybrid franchise structures in a range of sectors, including the retail and restaurant sectors.

iii 'Francubating'

There are two basic barriers to a brand using franchising as a way of growing its profits and market share. One is a lack of talented individuals to become franchisees. The other is a lack of individuals with the capital required to invest in a franchise. Access to an appropriate talent pool is an issue beyond the skills of legal advisers; however, providing undercapitalised potential franchisees with a soft entry to becoming a franchisee is not. A variety of structures 'incubate' talented individuals by allowing them to purchase their franchise from the income they generate as a manager of a corporate store.

VII CONCLUSION

The stereotypical view of franchising as a way of cloning fast-food outlets is outdated and reflects the realities of the 1980s far more than those of the current decade.

It is now more often than not just one part of a more sophisticated multichannel approach to the international market. This increases the complexity of the regulatory environment in which franchising operates and raises greater challenges for lawyers practising in the field.

THE REGULATION OF FRANCHISING AROUND THE WORLD

Mark Abell¹

As will become apparent from the chapters of this book, franchising is regulated in some countries by specific franchise laws. These can be categorised as competition law regulations, foreign trade or investment regulations and core franchise regulations. Competition law regulations seek to prevent the restriction of trade. They are concerned with issues such as the tying in of peripheral or unconnected goods, price maintenance, exclusivity and so on. The EU (in the form of Article 101 of the Treaty on the Functioning of the European Union and the Vertical Restraints Block Exemption), Japan² and Venezuela³ are examples of countries that regulate franchising in this manner.

Developing markets such as China, Indonesia, Kazakhstan, Korea, Moldova, Russia, Ukraine, Belarus, Barbados and Vietnam use foreign trade and investment regulations to protect their economies and often have political and social aims, such as the creation and distribution of wealth. Core franchise regulations are concerned with the way that franchises are sold, particularly the creation of what might be called pre-contractual hygiene. They do this by a variety of means, including mandating pre-contractual disclosure and the terms of the in-term relationship between the franchisor and its franchisees. More developed franchise markets such as the United States, Australia, Canada, Brazil, Taiwan, Mexico, France, Spain, Italy, Belgium and Sweden tend to take this approach. Some countries have adopted a hybrid approach to the regulation of franchising. For example, the South African Consumer Protection Act 2009 is a cross between competition law regulations and core franchise regulations, while both Malaysia and China have a mixture of foreign trade and investment franchise laws and core franchise regulations. Some countries, such as Croatia, define franchise agreements but do not regulate them.⁴

In addition to the 30 countries that have franchise-specific laws, Tajikistan⁵ is also currently contemplating enacting one. The New Zealand government has recently rejected the need for a franchise-specific law.⁶ The majority of these franchise regulations can be

1 Mark Abell is a partner at Bird & Bird LLP.

2 Japan Fair Trade Commission Guidelines, April 2002. These provide for disclosure and offer guidance on vertical restraints.

3 The Venezuelan Pro-Competition Agency's Guidelines for the Evaluation of Franchise Agreements, 7 January 2000. These are based upon the previous EU Franchise Block Exemption (Reg EU 4087/88).

4 Croatian Regulation on block exemption granted to certain categories of vertical agreements, Article 3(6).

5 Lena Peters of Unidroit in 'Update on Franchising Development outside the United States', 8 July 2009.

6 Stewart Germann, 'New Zealand – Government says no to Franchising Regulation', *International Journal of Franchising Law*, Volume 7, Issue 5, 2009.

best categorised as foreign trade and investment regulations. They are more concerned with regulating foreign investment and trade than ensuring the potential franchise abuses are prevented or at least reduced.

I THE DEFINITION OF FRANCHISING

The search for clarity in legislative definitions of franchising is unfortunately not particularly helped by the United States. The definition of franchising used by the Federal Trade Commission (FTC) for more than 20 years is widely used, although in the 15 states that have their own franchise disclosure and registration laws and the more than 20 states and territories that have their own relationship laws (some states have both, sometimes in the same statute), there is no single definition of the term ‘franchising’.

Nevertheless, the two basic approaches taken by the US legislators when attempting to define franchising have had a significant impact upon many of those jurisdictions that have adopted franchise-specific regulations.

The ‘prescribed marketing plan or system’ approach⁷ to defining a franchise is most prevalent in the US states. Other states take a broader approach and refer to a ‘community of interest’ in the marketing of goods or services.⁸ Even within these two general categories, there are noteworthy differences.

The prescribed marketing plan or system approach raises the issues of ‘control and assistance’, and the use of the franchisor’s brand. These are dealt with in differing ways by the various statutes and the FTC.

The state of California’s franchise legislation was the United States’ first franchise law when it was introduced in 1970.⁹ It adopts the prescribed marketing plan or system approach and defines a franchise as a contract or agreement, either express or implied, whether oral or written, between two or more persons by which:

- a* a franchisee is granted the right to engage in the business of offering, selling or distributing goods or services under a marketing plan or system prescribed in substantial part by a franchisor;
- b* the operation of the franchisee’s business pursuant to such a plan or system is substantially associated with the franchisor’s trademark, service mark, trade name, logo type, advertising or other commercial symbol designating the franchisor or its affiliate; and
- c* the franchisee is required to pay, directly or indirectly, a franchisee fee.

The definition has been extended to include petroleum dealers. There are also definitions of franchisor, franchisee and franchise fee. This fairly general definition is typical of those to be found in many other US state franchise laws.

The Amended Federal Trade Commission Franchise Rule requires the franchisor to exert control over the franchisee’s method of operation or to provide significant assistance in the franchisee’s method of operation.

⁷ See Cl. Corp. Code, Section 31005.

⁸ Haw. Rev. Stat. Ann., Section 482E-2; Minn. Stat. Section 80C.01.4, Wis. Stat., Section 135.05(1).

⁹ Cal. Corp. Code Section 31005(a)(1).

The FTC definition is a broad one and, when originally enacted, its first part related to business format franchises¹⁰ and the second part extended it to business opportunities such as vending machine businesses.¹¹ Certain specific types of relationship are expressly excluded.¹² When the FTC Franchise Rule was amended in 2007, the business opportunity rule was spun off into a separate regulation.¹³

In any event, under the Amended FTC Franchise Rule, the franchisee must operate under the franchisor's brand – either by selling goods, commodities or services bearing the brand or operating under the brand and selling goods, commodities or services meeting the franchisor's quality standards.

There is little substantive difference between the FTC Franchise Rule and the various state approaches.

The community-of-interest approach is used in states such as Wisconsin¹⁴ and New Jersey.¹⁵ It defines a franchise as an agreement between two or more persons in which:

- a* the franchisee is granted the right to engage in the business of offering or distributing goods or services using the franchisor's trade name or marks;
- b* the franchisor and franchisee share a community of interest in the marketing of the goods or services; and
- c* the franchisee pays a franchise fee.

Community of interest generally means a continuing financial interest between the parties in the operation of the franchisee's business or the resale of the franchisor's products. Since most commercial relationships involve some type of continuing financial interest, this definition is potentially broader in application than most marketing-plan definitions.

Community of interest is defined by the Wisconsin statute as a 'continuing financial interest between the grantor and the grantee in either the operation of the dealership business or the marketing of such goods or services'.¹⁶ Since most dealership and franchise relationships involve some type of continuing financial interest, the community-of-interest definition of a franchise has a potentially wider application than the prevailing marketing-plan definition.

10 FTC Rule, Section 436.1(h).

11 FTC Rule, Section 437.2(1).

12 FTC Rule, Section 436.8(a).

13 16 CFR, Part 437.

14 Wisconsin Fair Dealership Law.

15 New Jersey Franchise Practices Act.

16 Wisconsin Statute Chapter 135.02(1).

Most of the cases addressing whether a community of interest exists have arisen under the Wisconsin or the New Jersey statute. The 1987 *Ziegler* decision by the Wisconsin Supreme Court¹⁷ lists factors that should be considered in determining whether a community of interest exists under the dealership law.¹⁸

In determining whether a community of interest exists for purposes of the New Jersey statute, courts have focused on the extent of the alleged franchisor's control over the alleged franchisee, the franchisee's economic dependence on the franchisor, the relative bargaining power of the parties, and the presence of franchise-specific investments by the franchisee. A primary factor in this equation is interdependence, which generally arises when the franchisee invests heavily in the franchise business such that its economic health hinges on the continuation of that business.

Interdependence has been found where a distributor was contractually obliged to develop demand for a supplier's products, was barred from developing or selling competing products,¹⁹ performed joint sales and marketing activities with the supplier, and derived 97 per cent of its revenue from sales of the supplier's products. The percentage of revenues or sales attributable to the franchisor's products is not dispositive of the interdependence issue, but franchisees and dealers whose revenues attributable to a supplier's products are relatively small generally have a hard time establishing interdependence and a community of interest.

As evidenced by the following sections, the definitions of franchising adopted in other jurisdictions can be categorised as taking the approach of either a prescribed marketing plan or system, or a community-of-interest approach.

II INFLUENCE OF THE PRESCRIBED MARKETING PLAN OR SYSTEM APPROACH ON OTHER JURISDICTIONS

The key characteristic of the prescribed marketing plan or system definition is that the business must be 'substantially associated' with the franchisor's trademark, trade name, or other commercial symbols to qualify as a franchise. There is often an element of control to be exercised by the franchisor as well.

A classic example of this is the definition used by the state of Alberta in Canada, which, not surprisingly given its proximity to the United States, focuses on the marketing plan. Its definition of franchising includes a 'marketing or business plan prescribed by the franchisor', a 'substantial association with trademarks' and 'significant operation control' by the franchisor.²⁰

17 *Ziegler Co. v. Rexnord Inc* [1987] 139 Wis.2d 593 N.W.2d 873.

18 These factors include: (1) the duration of the parties' relationship; (2) the extent and nature of the parties' obligations; (3) the percentage of time or revenue devoted to the grantor's products or services; (4) the percentage of the grantee's gross proceeds or profits derived from the grantor's products or services; (5) the extent and nature of the grantee's territory; (6) the use of the grantor's trademarks or logos; (7) the grantee's financial investment in the inventory, facilities, and goodwill of the alleged dealership; (8) the personnel devoted to the alleged dealership; (9) the amount of money and time spent on advertising and promotions for the supplier's products and services; and (10) the extent of supplemental services provided by the grantee to purchasers of the grantor's products or services.

19 *Instructional Systems Inc. v. Computer Curriculum Corporation* (NJ S Ct 1992) BFG 1992–1993 para. 10, 119.

20 Alberta Franchises Act, Section 1(d).

Australia also takes a very comprehensive approach. Clause 5(1) of the Competition and Consumer (Industry Codes – Franchising) Regulation 2014 (New Code) defines a franchise agreement as an agreement:

- (a) *that takes the form, in whole or part, of any of the following:*
 - (i) *a written agreement;*
 - (ii) *an oral agreement;*
 - (iii) *an implied agreement; and*
- (b) *in which a person (the franchisor) grants to another person (the franchisee) the right to carry on the business of offering, supplying or distributing goods or services in Australia under a system or marketing plan substantially determined, controlled or suggested by the franchisor or an associate of the franchisor; and*
- (c) *under which the operation of the business will be substantially or materially associated with a trade mark, advertising or a commercial symbol:*
 - (i) *owned, used or licensed by the franchisor or an associate of the franchisor; or*
 - (ii) *specified by the franchisor or an associate of the franchisor; and*
- (d) *under which, before starting or continuing the business, the franchisee must pay or agree to pay to the franchisor or an associate of the franchisor an amount including, for example:*
 - (i) *an initial capital investment fee; or*
 - (ii) *a payment for goods or services; or*
 - (iii) *a fee based on a percentage of gross or net income whether or not called a royalty or franchise service fee; or*
 - (iv) *a training fee or training school fee;**but excluding:*
 - (v) *payment for goods and services supplied on a genuine wholesale basis; or*
 - (vi) *repayment by the franchisee of a loan from the franchisor or an associate of the franchisor; or*
 - (vii) *payment for goods taken on consignment and supplied on a genuine wholesale basis; or*
 - (viii) *payment of market value for purchase or lease of real property, fixtures, equipment or supplies needed to start business or to continue business under the franchise agreement.*

The definition then goes on to state that a transfer, renewal or extension of a franchise agreement and motor vehicle dealerships²¹ are included within the definition. A list of other relationships, such as employer–employee, landlord and tenant and cooperatives are excluded from the definition.²²

Certain limited types of franchise agreements are also exempted from the Code.²³

This definition is one of the most comprehensive and can be interpreted to cover a broad range of arrangements. Although the term ‘franchise’ is normally used to describe business format franchising, the definition in the Australian Code has the potential to capture

²¹ Trade Practices (Industry Codes-Franchising) Regulations, Section 4(2).

²² id., Section 4(3).

²³ id., Section 5. The two main types of exempted franchise agreement are where the franchisor is resident outside Australia and only grants one franchise or master franchise to be operated in Australia. The other main exemption is ‘fractional franchises’, where the franchise agreement is for goods or services substantially the same as those previously supplied by the franchisee and the sales under the franchise are likely to provide no more than 20 per cent of the franchisee’s gross turnover.

a wide range of licensing, distribution and agency arrangements not traditionally considered to be a franchise arrangement. Having an express list of non-qualifying arrangements is also an effective way of excluding non-franchise relationships.

The Australian definition succeeds in being comprehensive, but sacrifices succinctness.

Although Australia and Alberta require 'substantial association' with marks, Indonesian franchise law shows interchangeability between the brand and other intellectual property. It defines franchising as 'an agreement in which one party is given the right to utilise and/or use the right over the intellectual property or invention or unique business characteristics owned by another party against a fee'.²⁴ This interchangeability is unique and sets the Indonesian definition apart from most others.

Certain jurisdictions stipulate that the franchisor should assist the franchisee in running the business. In South Korea, the franchisor is required to 'support, educate and control' the franchisee in the ways of its business.²⁵ In Malaysia, the definition of franchising includes a responsibility on the franchisor to 'provide assistance to the franchisee to operate his business, including help with the provision or supply of materials, services, training, marketing, business or technology'.²⁶ This is an interesting addition to a marketing-plan definition and acknowledges the fact that most franchisees will need assistance to start up the business. Interestingly, the more detailed definition used in Australia is not as comprehensive in this area.

Most of the definitions mentioned above include the payment of a fee. Mexican law, however, is interesting in that it does not.²⁷ This potentially broadens the impact of the law to include relationships that are between not-for-profit organisations or that are peer networks. Although this extension may be valuable in catching some additional arrangements, the vast majority of franchisees will be paying some sort of fee.

The influence of the prescribed system approach is not restricted to franchise-specific laws. It can be found in case law and non-governmental organisations.

For example, neither the Hungarian Civil Code nor any other piece of legislation in Hungary defines franchising. Instead, definitions have been developed by the courts. One judgment suggests that the main feature of a franchise is, that 'a company (franchisor) transfers the exclusive right of selling goods and services to retail units which were introduced by him onto the market under a trade mark'.²⁸

A more thorough definition is offered in another judgment. It defines a franchise as an atypical, unregulated contract whose main characteristics are that: 'the franchisor has an obligation of transferring a complex system to the franchisee, a system which has been worked out diligently from a professional and trading point of view and has already been effectively tested under market circumstances with the right of usage of a trade name and complete training'.²⁹

It is noteworthy that both of the definitions offered take a prescribed system approach and refer to the marks' trade name.

24 The Provisions on and Procedure for the Implementation of Franchised Business Registration (Decree of the Minister of Industry and Trade No. 259/MPP/Kep/7/1997, dated 30 July 1997), Chapter 1, Article 1.1.

25 Act on Fairness in Franchise Transactions, Chapter 1, Article 2.1.

26 The Franchise Act 1998, Part 1, Section 4(d).

27 Law on Industrial Property, Title 4, Chapter VI, Article 142.

28 Judgment No. BH 2003.269.

29 Judgment No. 1 Gf 40.203/1996.4.

The International Institute for the Unification of Private Law has drafted a definition that falls into the prescribed-system category with the intention of it being compatible with most private law systems.³⁰

The use of the word 'prescribes' and the phrase 'substantially associated' follows the approach seen in the United States, Australia and Alberta. Interestingly there is an element of 'assistance', as seen in the Korean definition, and master franchise agreements are expressly included (as they are in Alberta) to avoid any doubt, so avoiding the risk found in Lithuania that master franchises are not within the definition.

This definition is fairly succinct and accurately describes the franchise relationship. It focuses upon the form of remuneration paid by the franchisee to the franchisor so as to distinguish it from selective distribution channels. However, it seems to simply rearrange definitions that are already in existence and offers nothing groundbreaking that captures the imagination. Interestingly, it has not been adopted by any of the legislators that have sought to define franchising.

No countries have adopted a 'pure' community of interest approach, probably because the definitions based on it are broader and lack the detail or accuracy of some of the lengthier marketing-plan definitions.

However, many definitions contain certain elements of it mixed in with those of a prescribed system approach.

Italy has a definition of franchising that covers intellectual property (IP) rights, commercial assistance and fees very concisely.³¹ It does not deal with control by the franchisor. It merely describes the business aspect as a 'franchising network' and is therefore not detailed enough to give an accurate description of what a franchise entails. The Romanian version is equally succinct and requires the parties to 'continually cooperate' and be 'financially independent' from each other.³² It requires the parties to be named as franchisor and franchisee, however, and is silent on intellectual property rights, which is far from ideal.

Spanish law³³ offers a very broad definition that relates entirely to the rights granted by the franchisor and apparently the use of the words 'franchisor' and 'franchisee'. It defines a franchise as an activity that 'is carried out by virtue of an agreement or contract by which a company, known as the franchisor, grants to another, known as a franchisee, the rights to exploit its own system of commercialisation of products or services'. Although this can still be classified as a marketing plan or prescribed system approach, it is so broad that it is almost meaningless. Describing the business as a 'system of commercialisation products or services' does not adequately describe the IP rights exploited by the franchisee and there is no mention of a fee. Furthermore, if a strict interpretation is used, the definition will not catch any arrangement where the terms 'franchisor' or 'franchisee' are not used by the parties.

The Lithuanian definition of franchising³⁴ still has its roots in the Russian Civil Code defining the agreement as a contract between the 'right holder' and a 'user' rather than franchisor and franchisee. Reflecting both the country's socialist past and again the Russian

30 Unidroit, Model Franchise Disclosure Law, Article 2.

31 Law of 6 May 2004, No. 129 Article 1.1.

32 Ordinance Regarding the Legal Status of Franchises (Government Ordinance 52/1997) as approved and modified by Law 79/1998, Chapter 1, Article 1(a).

33 Article 62 of the Act 7/1996.

34 Lithuanian Civil Code, Article 6.766(1).

pedigree of the Code, it expressly states that the parties to a franchise agreement must be either legal entities or entrepreneurs.³⁵ Presumably this is to avoid a government agency being involved in a franchise.

The definition covers the basic elements of a franchise contract, remuneration and the use of intellectual property rights or trademarks, but limits the latter two to exclusive rights only.³⁶ This ignores the possible existence of master franchise agreements under which the master franchisee does not enjoy exclusive rights and is therefore somewhat rudimentary.

The Brazilian Franchise Law defines a franchise as:

*[A] system whereby a franchisor licenses to the franchisee the right to use a trademark or patent, along with the right to distribute products or services on an exclusive or semi-exclusive basis and, possibly, also the right to use technology related to the establishment and management of a business or operating system developed or used by the franchisor, in exchange for direct or indirect compensation, without, however, being characterised as an employment relationship.*³⁷

While this has something in common with the community of interest approach, the interchangeability of the brand and a patent is an interesting and unique concept that differentiates it from most other definitions, but draws some comparisons with the interchangeability in the Indonesian system. There are also elements of the prescribed plan approach, as the franchisor's 'operating system' must be used.

Taiwan's Guidelines on the Business Practices of Franchisors³⁸ seem to confuse the marketing plan or prescribed system and the community-of-interest approach and define a franchise operating relationship in terms of a community of interest as 'a continuing relationship in which an enterprise, through contractual means, licenses its trademarks or operating know-how for use by another enterprise and assists or offers guidance to that other enterprise in its operations, and for which the other enterprise provides specific consideration'.³⁹ This shows the kind of relationship required for a community of interest approach but also the assistance and guidance seen in the marketing-plan approach.

III THE NEED FOR FRANCHISES TO HAVE BEEN PILOTED

There is sometimes a concern that until a franchise model has been tested in a new market it is not fit to be franchised to third parties. As a result, some countries such as China and Vietnam prohibit franchising until the concept has been piloted in the local market. In China there is a requirement that the franchisor establish and operate two company-owned units for more than one year before granting franchises to third parties.⁴⁰ Although the original regulation required that this pilot had to be in China, this requirement has been modified mirroring the debate in Italy, so that the pilot can be anywhere.

35 id., Article 6.766(3): 'Parties to the franchise contract may be enterprises (entrepreneurs) only.'

36 id., Article 6.766(2).

37 Brazilian Franchise Law, Article 2.

38 The Fair Trade Commission Disposal Directions (Guidelines) on the Business Practices of Franchisors.

39 id., Article 1.

40 Article 7 of the Regulation of Administration of Commercial Franchises 2007.

Article 2 of the Vietnamese Commercial Law of 2001 requires that franchisors must hold a Vietnamese business licence⁴¹ and that the franchise system has been in operation for at least a year before a franchise can be granted. The Vietnamese master franchisee of a foreign brand is required to have operated the franchise business for 12 months or more prior to granting sub-franchises to unit franchisees.⁴²

IV DISCLOSURE

Pre-contractual disclosure is the most common form of franchise-specific regulation and all those countries that require this are heavily influenced by the US Uniform Disclosure Document (US UFDD).

i Timing of disclosure

Pre-contractual disclosure must usually be given between 10 and 21 days prior to the execution of the franchise agreement. Malaysia, Taiwan and Brazil require disclosure at least 10 days prior to the execution of a franchise agreement. Korea requires only five days, while the Canadian states all require 14 days, Mexico 30 days, China 20 days and Vietnam 15 days.

ii Cooling-off period

A number of countries such as Malaysia, Mexico and Taiwan require a cooling-off period during which the franchisee can withdraw from the relationship without penalty. These range from a 30-day cooling-off period in Mexico⁴³ to five days in Taiwan.⁴⁴

iii Contents

Following the lead of the US UFDD, most countries that require pre-contractual disclosure require the same sort of information to be disclosed to the potential franchisees, although the details tend to vary. The information generally required to be disclosed is discussed below.

Basic details of the franchisor

Every country with franchise-specific disclosure legislation requires the franchisor to give some basic details about its business. The amount of detail that has to be disclosed varies from rudimentary information about the franchisor (like in Indonesia or Japan), to more detailed information about the franchisor's business experience, its history of development and information about the business experience of the main people involved on the franchisor's side such as its directors and manager. Not surprisingly, the countries with pure franchise regulations such as Canada and Malaysia require a franchisor to provide more franchise-specific information than others.

41 Article 6 of Decree No. 35/2006/ND-CP issued by the government to regulate franchises.

42 id., Article 5(1).

43 id., Article 142 of Mexico's Industrial Property Law.

44 Article 4 of the Fair Trade Commission Disposal Directions (Guidelines) on the Business Practices of Franchisors.

Description of the franchise and of the market

Almost all disclosure countries require the franchisor to give a short description of the franchise in question. In addition, some countries such as France, Brazil and Vietnam also require the franchisor to provide details of the territory or the market where the franchise is supposed to operate.

Financial information about the franchisor

Although the requirements regarding this item do not seem to be as strict as those set out in the US UFDD in that the bankruptcy history of the franchisor and its affiliates usually does not have to be disclosed (with the exception of Brazil, Canada, China and Malaysia), most disclosure countries require the franchisor to provide the prospective franchisee with balance sheets and financial statements for the past two years with the exception of Japan, Mexico and Taiwan.

Details of the franchise network

Most disclosure countries require the franchisor to give details about the franchise network, including providing the prospective franchisee with names and addresses of existing franchisees and information about franchisees who left the franchise network. The period that needs to be covered varies from 12 months before the franchise agreement is signed (in Brazil) to three years in the case of Canada.

Litigation details

Details concerning litigation that has to be provided can be divided into franchise-related litigation and general civil or criminal litigation regarding the franchisor and its directors or managers involved in the sale of the franchise. Some disclosure countries follow this distinction and refer to two separate items (e.g., Canada or China); others simply refer to details about litigation in general, depending how detailed the disclosure laws are.

Initial fee, initial investment and continuing fees

Most disclosure laws list the disclosure of fees and other payments that have to be made in accordance with the agreement as separate disclosure items (with the exception of Indonesia). Nevertheless, all disclosure countries require the franchisor to disclose the amount of initial fees and ongoing fees that are payable to the franchisor. Japan and Taiwan also explicitly require the franchisor to specify under which circumstances the initial fee is repayable to the franchisee. When it comes to giving details about the initial investment the franchisee will have to make, not all countries require the franchisor to do so. Unlike the United States under the UFDD, no other country requires the franchisor to disclose during which period the franchisee's initial investment will be amortised, not even Canada (where it is optional to do so), whose legislation most resembles the US franchise-specific legislation. The disclosure laws of Indonesia, Japan and Taiwan do not even require the disclosure of the initial investment.

Earnings claims

With the exception of the United States, Canadian and Japanese franchise legislation, no other disclosure legislation mentions earnings claims. In Canada and Japan, it is optional for the franchisor to make such claims in the disclosure document. The only condition is that if earnings claims are made, they have to have a reasonable basis. Franchisors in Canada are also

required to include the material assumptions underlying the preparation and presentation of the earnings claims and they have to indicate the place where the prospective franchisee would be able to inspect substantiating documents.

Restrictions on the franchisee

Restrictions on the franchisee during the ongoing relationship consist of restrictions on the goods or services that can be provided by the franchisee, non-competition covenants and restrictions on the sale of the franchisee's business. The general rule is that restrictions on the franchisee's economic freedom of action have to be disclosed in every country. Similar to the litigation item, some countries with more sophisticated disclosure laws list the restrictive covenants that have to be disclosed separately (e.g., Canada or Malaysia); other simply refer to 'the general obligations of the franchisee' (e.g., Indonesia) or 'conditions or limitations on the franchisee's business' (e.g., Korea).

Descriptions of the obligations that the parties owe towards one another

Although there is a primary focus on information that has to be provided about the obligations of the franchisee, the obligations of the franchisor, in particular with regard to training and assistance during the pre-opening, but also regarding continuing support during the ongoing franchise relationship, have to be disclosed to prospective franchisees.

Purchase ties and personal involvement of franchisee

If the franchisee is required to purchase certain goods from the franchisor, then this generally has to be disclosed, even though it might not be specifically mentioned in the disclosure law, but would fall under the broad heading 'obligations of the franchisee'. The Canadian franchise legislation even goes a step further in that a franchisor not only has to disclose whether the franchisee has to purchase certain goods exclusively from it, but also any rebates from its suppliers on products that are sold on to the franchisee this way. In addition, any details about the franchisee's personal involvement have to be given, if required under the franchise agreement (as in Brazil, Canada, Malaysia and Vietnam, where this is a separate disclosure item).

Term, termination, renewal

Surprisingly, two disclosure countries do not require a franchisor to make specific disclosure about the term of the agreement, its termination provisions and a possible renewal (Brazil and China). But it is important to note that some of the countries that do not require this separate information to be given require the franchisor to furnish the franchisee with a copy of the franchise agreement.

Details about franchisor's IP rights

Only the following countries deal specifically with the disclosure of IP-related items: Brazil, China, Indonesia, Malaysia, Mexico, Taiwan and Venezuela.

Details of financing arrangements offered by the franchisor

Japan, Malaysia, Canada and Indonesia require the franchisor to disclose details about any financial arrangement offered to the prospective franchisee. In addition, a franchisor is also required in Japan to disclose whether it is prepared to provide financial assistance to a franchisee that finds itself in a difficult financial position.

Exclusivity

Most disclosure countries require the franchisor to specifically disclose whether the franchise granted is exclusive or non-exclusive and whether the franchisor retains the right to operate corporate units in the territory granted (like in Japan).

Country-specific disclosure items

There are a number of countries that require disclosure of specific items that are unusual and shall therefore be mentioned in this section.

In Brazil, franchisors have to give a profile of the 'ideal' franchisee in the disclosure document, in particular with details of its business experience and educational background.

Under the Mexican franchise law, the franchisor has to provide detailed information about the method of calculation for determining profit margins and franchise commissions. This is a very burdensome requirement for franchisors.

In Taiwan, the franchisor has to give information about its management programme in the franchisee's areas of operation.

iv Consequences of non-compliance

Failure to comply with the disclosure regulations generally results in the franchisee being able to reject the agreement so long as it does so within a reasonable time of entering into the agreement. Fines are also imposed in some jurisdictions.

In Canada, in the provinces of Alberta, Ontario, Prince Edward Island and New Brunswick, a prospective franchisee is able to rescind the franchise agreement on notice either 60 days after receiving the disclosure document or no later than two years after the franchise is granted, whichever is earlier.⁴⁵ A right to damages also arises if the franchisee suffers a loss because of misrepresentation in the disclosure document.

In Brazil, failure to comply with the disclosure requirements entitles the franchisee to request the annulment of the agreement and require the reimbursement of all sums that may have already been paid to the franchisor or to any third party designated by the franchisor as franchise fees or royalties, monetarily corrected by the index of variation applicable to savings deposits, plus damages and losses.⁴⁶

Reflecting the central government control of commercial laws, in China, if the franchisor fails to disclose material information or makes a misrepresentation, in addition

45 Alberta Franchises Act, Section 13, the Arthur Wishart Act (Franchise Disclosure) 6(1) and (2); the Prince Edward Island Franchises Act, Chapter 36, Bill 43, Section 6(1); the New Brunswick Franchises Act, Section 6(1).

46 Law No. 8,955 of 15 December 1994, Article 4.

to the franchisee being entitled to terminate the contract, the government can also impose fines. These range from 10,000 to 100,000 yuan. In addition, a public announcement of the violation will be made if it is a serious one.⁴⁷

Jurisdictions with antitrust regulations take a slightly different approach to failure to properly disclose. In Japan, for example, failure to provide necessary disclosure amounts to the unfair trade practice of deceptive customer inducement and can result in the Japanese Fair Trade Commission issuing a cease-and-desist order or the franchisee obtaining an injunction in the courts.⁴⁸

In Malaysia, violations of the disclosure law are punishable by the imposition of a fine. The court can also declare a franchise void, order refunds of all payments from the franchisee, and prohibit the franchisor from entering into new agreements.⁴⁹

In Mexico, failure to comply with the disclosure requirements will subject a franchisor to a variety of administrative penalties, including fines, temporary closure of the business for up to 90 days, and administrative arrest for up to 36 hours.⁵⁰

In Vietnam, Section 4 of the Decree provides for penal administrative provisions for, inter alia, non-compliance with the disclosure requirements.⁵¹

V MINIMUM TERM

It is unusual for a minimum term to be mandated for the franchise agreement. Nevertheless, in Malaysia the franchise agreement must be for a minimum period of five years.⁵² While in Indonesia, master franchise agreements must be for at least 10 years.⁵³

VI A GENERAL DUTY OF GOOD FAITH

The imposition of a duty of good faith on the franchise relationship is currently being hotly debated in a number of jurisdictions, such as Australia, the United Kingdom and the United States. Some countries such as the Canadian provinces, China, Korea and Malaysia already impose a duty of good faith on both the franchisor and the franchisee.

Although it does not have franchise-specific laws, Germany imposes a heavy duty of good faith on franchisors, including, but not restricted to, the pre-contractual obligation to make proactive and full disclosure (*culpa in contrahendo*).

47 Article 28 of the Regulation on Administration of Commercial Franchises 2007.

48 Act No. 101 of 29 September 1973, as amended in April 2002, Section 12(1).

49 The Malaysian Franchise Act 1998 Part VI.

50 Law on Industrial Property, 23 November 1994, Title Seven, Chapter II, Article 213.

51 Article 24(1) of Decree No. 35-2006-ND-CP.

52 The Franchise Act 1998, Part III, Section 25.

53 Cornwallis, *International Journal of Franchising Law*, 2006, Volume 4, Issue 3, p. 5.

VII THIRD PARTIES

In Malaysia, Korea and Kazakhstan the role of third parties in franchising is regulated.

Malaysia regulates the activities of franchise brokers.⁵⁴ These are defined as persons 'doing business as an agent or representative of a franchisor to sell a franchise to any person for a certain consideration but does not include any director, officer or employee of the franchisor or franchisee'.⁵⁵

In Kazakhstan, licence brokers, which are defined as those 'engaged in mediation activities in the course of concluding and performance of the complex business licence contract',⁵⁶ are regulated by the law, which states that they 'may act both on their own behalf and at their own risk, and on behalf and at the risk of the licensor, licensee or other subjects of franchising relations in consideration for a licence broker's fee, which can be payable in the form of a fixed single or periodic payment, fixed payments or otherwise, as provided by the contract'.⁵⁷

In Korea, the law provides for the registration at the Fair Trade Commission of Franchise Consultants,⁵⁸ who are involved in:

- a* matters related to the business prospects of the franchise;
- b* matters related to the preparation and revision of a franchise agreement and the information disclosure document;
- c* matters related to the obligations of the franchisee and the conditions to the business operations of a franchise, etc.; and
- d* matters related to the provision of education and guidance to the franchisee.

Consultants have a duty to act 'with dignity and honestly'⁵⁹ and can be struck off for inappropriate behaviour.⁶⁰

VIII DISCLOSURE BY POTENTIAL FRANCHISEES

Interestingly, in Vietnam, not only does the franchisor have to disclose information to the franchisee, but so does the franchisee to the franchisor. Article 9 of the Vietnamese Commercial Law states that if the franchisor reasonably requests the franchisee to make full disclosure to it, the franchisee is under an obligation to do so.

IX REGISTRATION REQUIREMENTS

Some jurisdictions require the franchisor to register relevant details and documentation with a government agency. In developing markets this seems to be to enable the government to monitor franchisors doing business in the market, while in more developed economies (such as the United States and Spain) it is to ensure transparency and maintain a certain level of quality. Franchisors who sell franchises in China need to file relevant information with the

⁵⁴ The Franchise Act 1998, Part II, Section 14.

⁵⁵ *id.*, Part Im Section 4.

⁵⁶ Law on Complex Business Licence (Franchising) (Law No. 330: 24 June 2002), Chapter 1, Article 1(5).

⁵⁷ *id.*, Chapter 3, Article 13.

⁵⁸ Act on Fairness in Franchise Transactions, Chapter III, Article 28.

⁵⁹ *id.*, Article 30.

⁶⁰ *id.*, Article 31.

competent commercial authority. If a franchisor wants to sell franchises in just one province, the information has to be filed at the local office of the MOFCOM of that province. For cross-province franchising, the application has to be filed with MOFCOM itself.

An application has to be made within 15 days of the execution of the franchise agreement and has to contain the following:⁶¹

- a* basic information about the franchise system;
- b* information about all the franchisees within China;
- c* the market plan of the franchisor;
- d* a copy of the business licence or any other qualification certificate of the franchisor;
- e* a copy of the registration certificate for the registered trademark, patent and other operational resources concerning the franchising activities;
- f* a document issued by the commercial authority at city level certifying that the franchisor owns at least two directly operated outlets that have been in operation for more than one year. For the directly operated outlets located outside China, the notarised and authenticated certificate of incorporation must be provided by the franchisor;
- g* a sample franchise contract;
- h* the index of the franchising operation manual;
- i* if the products or services that are franchised are subject to the approval of relevant authorities, the relevant approval documents shall be provided by the franchisor;
- j* a statement for the authenticity and the veracity of the filed information affixed with the signature of the franchisor's legal representative and the franchisor's corporate seal; and
- k* information regarding the execution, rescission, renewal and modification of franchise contracts within the preceding year. This information has to be updated by 31 March every year.

In Moldova, the franchise agreement must be registered with the State Agency for the Protection of Industrial Property,⁶² which must be informed when the agreement has ended.⁶³ The Law does not provide for any consequences in the event the parties do not register the franchise agreements with the Agency. 'The franchise agreement is considered to be valid from the day it is signed or the day determined by the parties.'⁶⁴ Thus the validity of the franchise agreement does not depend on its registration with the Agency.

Russian law requires that franchise agreements are registered at the register of commercial concessions, which is maintained by the tax authorities. Failure to register it means that it is not valid as against third parties.⁶⁵ In addition to information about the franchisor and franchisee, three copies of the agreement have to be filed. Termination of a franchise agreement prior to its expiration must be registered by the franchisor.⁶⁶

The Indonesian franchise law takes the unusual step of requiring that it is the duty of the franchisee rather than the franchisor to register the franchise agreement and disclosure

61 Article 8 of the Administration Regulations and Article 5 of Administration Rules on Commercial Franchise Filing – Decree of Ministry of Commerce 2007 (No. 15).

62 Article 9(4) of the Moldovan Law on Franchising No. 1335 dated 1 January 1997 provides: 'The franchise agreement is registered with the State Agency for the Protection of Industrial Property.'

63 Article 10(3) of the Moldovan Law on Franchising provides: 'If the contract has ended, parties have the obligation to cease their activity and to inform the Agency within one month.'

64 Article 9(3) Moldovan Law on Franchising.

65 Russian Civil Code Part II, Chapter 54, Article 1028(2).

66 Russian Civil Code Part II, Chapter 54, Article 1037.

statement.⁶⁷ Failure to register results in the revocation of the franchisee's trade licence.⁶⁸ Franchise licences between a foreign franchisor and a master franchisee are registered at the Ministry of Trade, while those between a master franchisee and sub-franchisees are registered at regional or municipal offices. This has led to a considerable reduction of the time for registration, namely from 150 days to around 30 days as many of the applications are now delegated to the regional offices.⁶⁹

Malaysia takes a different approach and the franchisor and the franchisee are jointly required to effect the registration.⁷⁰ The filing of false or inaccurate documents is an offence.⁷¹ The franchisee of a foreign franchisor must also register itself.⁷² Failure to register can result in penalties between 5,000 and 50,000 ringgit and up to five years' imprisonment. In addition to this, the court can declare the franchise agreements null and void, order the franchisor to refund any payment obtained from the franchisee and prohibit the franchisor from entering into any new franchise agreement. There is provision for an annual update of the documents filed.⁷³

In Mexico, although the disclosure document does not need to be registered with the government authorities, franchisors must record all franchise agreements at the Mexican Institute of Industrial Property on execution.⁷⁴ The franchise agreement will not be registrable unless it is in writing and contains certain minimum provisions.

X COMPULSORY CONTENTS OF FRANCHISE AGREEMENTS

A number of countries insist that a franchise agreement contains certain standard clauses. There is a wide variety of approaches and no general trend or pattern can be identified other than a general desire for comprehensiveness.

In Indonesia, a franchise agreement must contain the following clauses:⁷⁵

- a* the name, address and domicile of the company of each party;
- b* the name and position of each party authorised to sign the agreement;
- c* the name and type of right over intellectual property, invention or a unique business characteristic, for example a management system, a selling or display method or a distribution method that constitutes a special characteristic that is the object of a franchise;
- d* the rights and obligations of each party and the aid and facility given to a franchisee;

67 Regulation of the Minister of Trade No. 12/M-DAG/PER/3/2006 dated 29 March 2006, which revoked the Provisions on and Procedure for the Implementation of Franchised Business Registration (Decree of the Minister of Industry and Trade No. 259/MPP/Kep/7/1997, dated 30 July 1997), Chapter III, Article 11.1.

68 *id.*, Chapter VI, Article 22.

69 Bryan Cave International Trade, Regulatory Development in Asia, Indonesia, May 2007, www.bryancavetrade.com.

70 The Franchise Act 1998, Part II, Section 6(2) provides that failure to register amounts to an offence (unless exempted under Section 58 of the Act).

71 The Franchise Act 1998, Part II, Section 7(6).

72 *id.*, Part VIII, Section 55.

73 *id.*, Part II Section 16.

74 Regulations Under the Law on Industrial Property (23 November 1994) Title I, Chapter II, Article 5.

75 Regulation of the Minister of Trade No. 12/M-DAG/PER/3/2006 dated 29 March 2006, which revoked the Provisions on and Procedure for the Implementation of Franchised Business Registration (Decree of the Minister of Industry and Trade No. 259/MPP/Kep/7/1997, dated 30 July 1997), Chapter II, Article 7.1.

- e* the marketing area;
- f* the period of the agreement and the method of and the requirements for the extension of the agreement;
- g* the method for settling a dispute;
- h* mutually agreed basic provisions that may result in the termination or expiration of an agreement;
- i* compensation in the event of agreement termination;
- j* the procedure for the payment of compensation;
- k* the use of domestically produced goods or materials produced and supplied by small-scale enterprises; and
- l* nurturing guidance and training for franchises.

Malaysia takes a less detailed approach and simply prohibits discrimination between franchisees in respect of the charges offered or made for franchise fees, royalties, goods, services, equipment, rentals or advertising services if such discrimination will cause competitive harm to a franchisee who competes with a franchisee who receives the benefit of the discrimination, unless it can be objectively justified.⁷⁶ It also requires that termination must be for good cause,⁷⁷ be by written notice, and offer an opportunity to remedy a breach⁷⁸ cited as cause for termination. A franchisor refusing to renew or extend a franchise at the end of its term must compensate the franchisee if it does not waive the post termination restrictive covenants or give the franchisee six months prior notice of the termination or non-renewal.⁷⁹

Russian law stipulates the rights and obligations of both the franchisor and franchisee by providing the essential elements of the relationship. It grants a right of renewal to franchisees,⁸⁰ although case law suggests that this can be circumvented in some circumstances.⁸¹ It also states that either party can terminate the franchise agreement upon six months' notice⁸² and that the transfer of the franchise to another franchisee is not a breach that gives rise to a right to terminate the agreement.⁸³

In Ukraine, the law⁸⁴ imposes statutory liability of the franchisor for defective products sold by the franchisee. This is symptomatic of socialist legal traditions and is also found in Latvian and Estonian franchise law.

The Georgian Civil Code⁸⁵ specifies the obligations of the parties, including confidentiality and the liability of the franchisor.

⁷⁶ The Franchise Act 1998, Part III, Section 20.

⁷⁷ *id.*, Part III, Section 31(2).

⁷⁸ *id.*, Part IV, Section 30(1).

⁷⁹ *id.*, Part IV, Section 32.

⁸⁰ Russian Civil Code, Part II, Chapter 54, Article 1035.

⁸¹ Decision of the Federal Arbitrazh Court of East-Siberian District (FAS VSO decision) of 16 October 2003, Case No. NA19-3914/03-13-FO2-3459/03-C2.

⁸² Russian Civil Code Part II, Chapter 54, Article 1035.

⁸³ *id.*, Article 1037.

⁸⁴ Ukrainian Civil Code, Chapter 76, Articles 1115 to 1129.

⁸⁵ Adopted on 26 June 1997, Book Three, Special Part, Title One, Chapter Seven (Articles 607–614).

Article 16 of the Vietnamese law states that a franchisee may terminate the franchise agreement unilaterally if the franchisor is in breach of those obligations imposed upon it by Article 287 of the Commercial Law. The franchisor on the other hand is entitled to unilaterally terminate the franchise agreement in the following circumstances:

- a* the franchisee no longer holds the necessary business licence or equivalent papers required by law;
- b* the franchisee is involved in winding-up or bankruptcy proceedings pursuant to Vietnamese law;
- c* the franchisee commits a serious legal violation that has the potential to harm the reputation of the franchise network; and
- d* the franchisee fails to remedy immaterial breaches of its obligations under the franchise agreement within a reasonable time.

Under the Vietnamese Decree a franchisee may transfer its rights to another franchisee subject to:⁸⁶

- a* the assignee being also in the possession of a valid business licence; and
- b* the franchisor giving its prior consent.

To obtain consent, the franchisee has to inform the franchisor in writing of its intention to assign its rights to a third party. Within 15 days of receiving the request, the franchisor then has to reply in writing. It may object to the transfer of rights on one of the conditions set out in Article 3 of the Decree, namely because:⁸⁷

- a* the assignee failed to fulfil its financial obligations under the franchise agreement;
- b* the assignee has not yet fulfilled the criteria for being chosen as a franchisee by the franchisor;
- c* the transfer might have an adverse effect on the existing franchise system;
- d* the assignee does not agree in writing to fulfil its obligations under the franchise agreement; or
- e* the franchisee has not yet fulfilled its obligations towards the franchisor.

XI DISPUTE RESOLUTION

Some jurisdictions impose certain requirements concerning dispute resolution. The New Brunswick Franchises Act is the first of the provincial statutes to provide for a comprehensive dispute resolution mechanism. The Franchises Act sets out that any party to the franchise agreement who has a dispute with another party to the agreement may deliver a notice of dispute.⁸⁸ Within 15 days of delivery of the notice of dispute, the parties shall attempt to resolve it.⁸⁹ If the parties fail to resolve the dispute within 30 days of the notice, the Franchises Act provides that any of the parties may deliver a notice to mediate the dispute.⁹⁰ The mediation notice cannot be delivered prior to the expiration of the initial 15-day period. However,

86 Decree No. 35/2006/ND-CP, Article 15(1).

87 *id.*, Article 15(3).

88 Section 8(1) of the New Brunswick Franchises Act 2007 (26 June).

89 *id.*, Section 8(2).

90 *id.*, Section 8(3).

neither delivery of a notice of dispute nor a notice to mediate precludes a party from taking any other judicial measures.⁹¹ The Korean franchise law also provides for a dispute resolution mechanism and establishes a Franchise Transaction Dispute Mediation Committee.⁹²

XII DOES REGULATION HAVE A SIGNIFICANT IMPACT ON FRANCHISING?

There is, and has always been, a good deal of debate about the need for, desirability of and impact of regulation on franchising.

The strength of franchising in the world's most heavily regulated jurisdiction (the United States), somewhat undermines the suggestion that regulation per se has a significant and adverse impact upon franchising. Clearly, bad regulation will have a negative impact upon franchising, but that does not mean that good regulation cannot have a positive impact upon franchising. Indeed the lack of good regulation can have an adverse impact on franchising. Conflict between differing regulatory regimes in a single economic region can have an even greater adverse impact upon franchising. This is what happened in the European Union. For example, the 9,971 or so franchise networks operating in the EU and the 405,000 or so outlets make a substantial contribution to the GDP of a number of Member States, with a roughly estimated total turnover of €215 billion. However, closer examination suggests that it is over-concentrated in a small number of EU Member States and a comparison with the size of franchising in the United States and Australia suggests that its potential to contribute to the single market and the growth of trade between Member States is far from being fulfilled at present, an estimated 83.5 per cent of its turnover being concentrated in only 25 per cent of the Member States.

The underachievement of franchising in the Single Market can be attributed, at least in part, to the way in which it is regulated. The regulations fail to protect and re-enforce the business reasons that attract franchisors and franchisees to franchising.

The regulatory environment in the EU comprises franchise-specific laws in six Member States. Each law is different from the others. Franchisors embarking upon a European roll-out of their concepts therefore encounter delays and costs that are a direct result of this heterogeneous approach – an artificial barrier to pan-European expansion that actively discourages franchisors to grow their businesses across the European Union.

This impact upon franchising is further exacerbated by non-franchise specific laws that can also be divided into pre-contractual, contractual and post-contractual.

The pre-contractual laws often comprise some or all of the following; a duty not to misrepresent facts, an obligation to disclose relevant information to potential franchisees, an extra-contractual obligation to disclose relevant information to potential franchisees, an extra-contractual obligation of confidentiality, an obligation to enter into the franchise agreement once negotiations have passed a certain point and a right to withdraw from the contract within a limited period. Each country takes a different approach to each of these issues resulting in the lack of any homogenous approach.

The ongoing franchisor–franchisee relationship is often regulated by antitrust, unfair competition and consumer law. A duty of good faith also impacts upon franchising in civil law jurisdictions, although not in common law jurisdictions, which take a very different

91 *id.*, Section 8(10).

92 Korean Act on Fairness in Franchise Transactions, Chapter IV.

approach to the concept of good faith. For example, whereas German and French law takes a loose approach based upon the Roman law concept of bona fides, English law takes a far more literal approach to contracts, using a variety of legal tools to ensure the fairness of the relationship.

This exotic cocktail of laws only further strengthens the technical barrier to cross-EU expansion.

XIII CONCLUSION

When seeking to internationalise a franchise, it is important to have a full understanding of the challenges that will be presented by the legal systems of each target market. These challenges must be anticipated and taken into account not only in the drafting of the standard documentation but also in the way in which the roll-out is planned, budgeted and implemented.

Companies using franchising as a vehicle through which they will internationalise their business must expect to encounter a range of different legal challenges in each jurisdiction.

INTELLECTUAL PROPERTY

Allan Poulter and Robert Williams¹

I INTRODUCTION

Intellectual property (IP) rights are invariably at the heart of a franchise agreement. It is often the ability, through the ownership of IP rights, to prevent unauthorised third parties from reproducing aspects of the franchised business model that enables the franchisor to demand a royalty payment from prospective franchisees. These IP and related rights include trademarks, patents, trade secrets, confidential information or know-how, copyrights and designs. Some of the key features of these rights are set out below.

II TRADEMARKS

One of the most valuable assets of a franchised business is often the goodwill associated with the brand name. Trademark registrations represent the embodiment of this goodwill in a tangible asset that provides a monopoly right to use a name in relation to the goods and services covered by the registration. This confers the right to prevent the unauthorised use of the name or a confusingly similar name by a potential competitor. In addition to the brand name and logo traditionally associated with a business, there are many other aspects of a company's trade dress or get-up that may be protected through trademark registration. The definition of a trademark in many countries has been extended to include other potentially distinctive elements of a brand such as colours, shapes, sounds, animated marks and even smells, tastes and touch. Recently, the actual get-up of a retail outlet has been the subject of successful trademark applications.

It is important to remember that registered trademark rights are territorial, and a registration in one country will give no rights to the use of that name or get-up in another country. Indeed, the mere fact of having secured a registered trademark in one country will be no guarantee that the same mark will be available for use or registration in any other country. Therefore, where international expansion is anticipated it is essential to conduct initial clearance searches to identify any potential infringement risks and, if available, apply for the appropriate trademark registration to cover that territory. This is dealt with in more detail below.

A potential franchisee considering entering into an agreement to be a user of the brand name in a specific country is likely to require confirmation that appropriate searches have been conducted and registrations applied for. Suitable warranties and indemnities to this effect will be requested from the franchisor.

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i Trademark registration

Most countries of the world have a national trademark register. It is also possible to file for a European Union-wide trademark registration (an EU trademark (EUTM)) and a single registration covering a number of African countries (an African Intellectual Property Organization trademark). There is also an international filing system that provides a cost-effective method of filing national applications in certain countries that are signatories to the Madrid Agreement and Protocol. Following the United Kingdom's decision to leave the European Union (Brexit), it is important to consider securing registration at the UK Intellectual Property Office in addition to an EUTM registration, which will not cover the United Kingdom if or when it ceases to be a Member State. However, it should be noted that owners of existing EU registrations will be automatically granted a corresponding UK registration following Brexit at no cost.

When filing a trademark application, it is necessary to identify the specific goods and services to be covered by the registration, and identify the classes within which the goods and services fall. Most countries have adopted the Nice Classification System, which divides the register into 45 classes. It is usual for a trademark application to go through an examination process, which will assess whether the mark applied for satisfies the criteria for registration within that particular country. There is also, generally, an opposition period when third parties can seek to prevent the registration if they have an earlier conflicting right or if there is some other basis on which the registration should be refused.

One of the key values of a trademark registration is that potentially the rights can last in perpetuity. As long as the registration is renewed (the normal period for registration is 10 years) and the mark continues to be used correctly, then the registration will probably remain valid.

ii Clearance searches

Before launching a brand in a new geographical region or in respect of an extended range of goods and services, it is imperative that trademark clearance searches are first conducted to identify any potential infringement risks. In some cases, when an established brand in Country A takes the decision to expand its commercial activities through a franchise into Country B, the clearance searches will locate a local registration that could be relied upon by its owner to prevent the proposed use of that name in that country. In this situation, it will either be necessary to look at ways of overcoming the local registration (which could be by way of attacking the validity of the registration, acquiring the registration, or agreeing some form of coexistence with the owner of the conflicting right) or to consider adopting a new brand name for that particular country. This is clearly not ideal if the intention is to create a single brand for use within all countries into which the business intends to expand. An alternative, and usually less attractive, option would be to consider a rebrand of the entire business.

It is also important to bear in mind any local cultural or linguistic issues that may arise from the use of the brand name within a new country. A name that is perfectly suited to one country may have negative connotations in another.

iii Unregistered trademarks

In many countries it is possible to acquire enforceable rights in a name even in the absence of a trademark registration. However, relying upon unregistered rights should not be seen as a substitute for securing trademark registrations where these are available. It is generally

more expensive and difficult to establish an infringement of an unregistered right than it is to succeed in an infringement action based on a registered trademark. Furthermore, the existence of the trademark registration itself can prove to be a deterrent to a third party's use of the same or similar name (assuming, of course, that they have bothered to conduct clearance searches before adopting the name).

When conducting clearance searches in countries that recognise unregistered rights it is important, in addition to conducting searches of the trademark registers, to conduct further research to ascertain whether the name is being used in relation to relevant goods and services. This will generally involve internet searches and searches of local domain names and company registers and directories.

III PATENTS

A patent (like a registered trademark), is a territorially limited monopoly right, which enables its proprietor to prevent third parties from exploiting the invention claimed in the patent specification. Patent protection can be sought for products and processes that are both novel and inventive over the 'state of the art' as at the priority or filing date of the application for the patent (i.e., to be patentable the invention claimed in the patent specification must not have been disclosed publicly before the priority or filing date of the application, and must also not be obvious over the state of the art at that date). To be patentable, the claimed invention must also meet a number of other criteria – in particular, it should be borne in mind that there are certain things that are exempt from patent protection in various jurisdictions – for example, computer programs, methods of doing business and mathematical methods. However, these exclusions vary from country to country, and so, for example, an invention that might fall foul of the computer program or method of doing business exceptions in the United Kingdom might nevertheless be patentable in the United States (albeit that the scope for obtaining such patents in the United States has narrowed over the course of the past few years).

In practice, while patents are less likely to form the key IP rights in a franchising model than trademarks, they may, in certain circumstances, form an extremely important part of the package of IP rights that are being licensed by the franchisor to the franchisee. This is particularly the case for businesses that provide technical information or equipment to the franchisee to enable them to operate the franchised business successfully. In such situations, certain processes (e.g., to manufacture the products to be sold by the franchisee) may be patented, and a licence under the relevant patents will have to be granted to the franchisee under the franchise agreement. It may also be the case that the product being sold by the franchisee is itself patented – a historical example of such a case is that pertaining to Singer sewing machines, which were patented, and which were distributed in the United States via a network of franchisees in the 1850s.

i Patent registration

Most countries in the world grant patents, which must be applied for on a country-by-country basis. However, there is a centralised system for seeking patent protection in a number of European countries (including several that are not EU Member States, such as Turkey, Norway and Switzerland), via the European Patent Office (EPO). Patent applications filed at the EPO are examined centrally, and if the claimed invention is deemed patentable, the application will mature into a bundle of national patents in the various countries in which the applicant chooses to designate and validate the patents. It was hoped that in the not too

distant future there would be scope to obtain a 'unitary patent' covering up to 25 of the current members of the EU (not currently including Spain, Croatia and Poland) via a single application at the EPO. However, the details and implementation date of the system have not been finalised and complications have arisen because of a pending constitutional challenge to this system in Germany and the potential impact of Brexit. There is also a system operated by the World Intellectual Property Organization, which permits an applicant for a patent in a country that is a member of the Patent Cooperation Treaty (PCT) to designate other PCT member countries. This streamlines the application process (and allows the applicant to rely on the initially filed application for the purposes of the patent's 'priority date', which is the date against which the novelty and inventiveness of the claimed invention is assessed). However, the application will still have to be examined (and if considered patentable, granted) on a national basis.

During the examination process, most patent offices will review the substantive patentability of the claimed invention following the completion of a search for 'prior art', as well as by reference to the relevant exclusions (e.g., for computer programs and methods of doing business, in the EPO). During the examination process, it is possible in some countries for third parties to file 'observations' with the examining patent office to try to persuade them that the patent should not be granted. Additionally, if the claimed invention is deemed patentable, in certain countries (and the EPO), there is an opposition period, during which third parties may challenge the validity of the patent.

Unlike registered trademarks, patents generally have a fixed maximum term of 20 years from the priority date. However, they have to be renewed annually, so it is possible for a patent to lapse in a particular country where it was originally registered, if the relevant renewal fees are not paid.

ii Petty patents or utility models

As a final point, it is worth mentioning that in some countries it is possible to obtain a lower form of patent protection, sometimes referred to as petty patents or utility models. These rights are intended to protect technical advancements (which may be incremental improvements to a previously patented product) that may not be sufficiently inventive to pass the threshold to obtain a full patent. They are generally of shorter duration (most commonly between six and 10 years), and are not formally examined in the same way as 'full' patents. Nevertheless, they may still be of value in the context of a franchising arrangement.

IV TRADE SECRETS, CONFIDENTIAL INFORMATION AND KNOW-HOW

The term 'trade secrets' is often used interchangeably with the terms 'confidential information' and 'know-how', to describe business or commercial information that has not been made public. Such information may be technical in nature (e.g., the specific parameters or tolerances to be employed in a manufacturing process, or the identity and specific amounts of ingredients to be used in a recipe for a food or drink product) or non-technical (supplier or customer data, financial data relating to pricing, etc.). Accordingly, it will be appreciated that in a franchising arrangement there will almost always be information and documentation disclosed by the franchisor to the franchisee that incorporates trade secrets that are necessary to run the franchised business successfully (and in accordance with the franchisor's standards).

While there is no internationally recognised definition of what constitutes a trade secret, there are a couple of overarching principles that are generally applicable. First, the

relevant information must be secret, in other words, it must not be generally known or be easily accessible by the public (although it may still be known by a significant number of individuals); and secondly, the information must have been subject to reasonable steps by its 'owner' to keep it secret. There is no method by which trade secrets can be registered, and they are arguably not a true IP right, in the sense that they cannot be formally assigned. However, in the context of a franchising arrangement, the use of trade secrets is certainly licensed, in the sense that the franchisor agrees contractually to disclose the relevant information to the franchisee, and to permit its use for certain specified purposes as set out in the franchise agreement. An EU directive covering trade secrets (including a definition of what constitutes a trade secret) was passed in 2016 and its provisions have now been implemented by all Member States (except for Cyprus). This should therefore lead to greater consistency of protection for trade secrets and confidential information in the EU in the future.

In theory, and provided the information in question does indeed remain secret (and restrictions on its disclosure are strictly maintained), a trade secret may last for ever. For example, the recipe for Chartreuse liqueur is still a secret although the product has been on the market for over 400 years. However, this is an exceptional situation and most trade secrets do not end up retaining that status for even a fraction of that period. Nevertheless, to preserve the status of the franchisor's trade secrets for as long as possible, it is very important for the franchise agreement to set out clearly the details of the trade secrets being disclosed and the obligations on the franchisee to keep those trade secrets confidential. Indeed, it may be necessary, in relation to certain particularly fundamental trade secrets (e.g., the specific ingredients of a secret recipe) to strictly limit the disclosure of the information to a small number of individuals under very restrictive conditions and terms of use.

V COPYRIGHT

Copyright protects the physical embodiment of literary, dramatic, musical and artistic works (and therefore covers a very wide range of subject matter). However, in the context of a franchise arrangement, literary and artistic works are often the most important (literary works include reports, brochures, tables, marketing or training materials, and computer programs, and artistic works include photographs, logos, drawings, diagrams, plans, etc.). The aesthetic or artistic standard required to qualify for copyright protection is generally fairly low, although this does vary somewhat from country to country. Bearing in mind the range of works that are protected by copyright, it should be appreciated that there will always be copyright works the use of which will have to be licensed in a franchise agreement.

Copyright is not a strict monopoly right (like patents and registered trademarks) since the proprietor can only prevent actual copying of the relevant work. Accordingly, if a third party independently creates an identical (or more likely very similar) work, that will not infringe, since it is not the idea underlying the work that is protected, but rather the specific embodiment of that idea by way of the work. The proprietor of a copyright work is generally the person who actually creates the work (and not the person who commissions and pays for the work). The main exception to this arises when a person creates a work during the conduct of their employment. In those circumstances, the copyright in the work will generally belong to the employer (although the specific circumstances do vary from country to country).

There is no requirement to register a work for copyright to subsist, but in certain countries, most notably the United States, it is possible to register copyright works to establish a verifiable record of the date and content of the work in question, which may assist

if infringement proceedings have to be pursued at some point in the future. In accordance with an international convention (the Berne Convention), to which the majority of the world are signatories, copyright works first published in any Berne Convention signatory country are also recognised (and hence enforceable) in any other signatory country. The duration of copyright protection varies from country to country (and in some countries depending on the type of work). However, in most of the world, for literary and artistic works, copyright lasts for the life of the author plus either 50 or 70 years.

In a number of countries, databases are specifically protected by a separate right (in particular, an EU-wide database right exists). These database rights are distinct from copyright and protect against the copying of substantial parts of a database (whereas copyright may protect the selection, arrangement or presentation of the data). Database rights (like copyright) do not have to be registered but are generally of shorter duration than copyright (e.g., the EU database right has a term of 15 years).

VI DESIGNS

Perhaps of less relevance to most franchised businesses is the protection that may be afforded through registration of designs, or in some cases through unregistered design rights.

Design protection may be available in respect of the visual features of a product or, indeed, surface decoration or even other visual images such as logos. However, unlike trademark protection, the protection of design rights has seen little by way of international harmonisation, and local advice will generally be necessary to ascertain the availability and scope of design protection.

As a general rule, it is important to seek this advice and file any appropriate applications for the registration of a design before it is disclosed to the public or made commercially available (although some countries do allow for a limited period after public disclosure when a design application can be filed). As with trademarks, there is an EU-wide design registration system whereby a single design registration can be secured covering the entire European Union. The EU also recognises and protects unregistered designs although these rights confer a lower level and shorter period of protection. There is also an international filing system (the Hague Agreement) that can be utilised to secure cost-effective filings for design protection in those countries that are signatories to that particular agreement. Furthermore, the need to secure UK registrations following the decision of the United Kingdom to leave the European Union has to be considered.

DATA PROTECTION

Ruth Boardman, Francis Aldhouse and Elizabeth Upton¹

I THE ORIGINS AND EVOLUTION OF DATA PRIVACY LAWS

In Europe, the right to privacy is primarily intended as a protection from interference by the state so that individuals can develop their personalities in their relations with other human beings. Data protection, conversely, has evolved in parallel to the growth of information technology as a tool to protect individuals from potential abuses related to the processing of an individual's data; however, although these concepts are, in principle, separate and distinct, they both exist to protect fundamental rights, including an individual's right to a private life. Accordingly, there is a considerable overlap between privacy and data protection.

i Origins of privacy instruments

Although the concept of privacy law can be traced back as early as 1890,² modern national privacy laws in Europe only began to take shape after the Second World War, when the General Assembly of the United Nations adopted, on 10 December 1948,³ Article 12 of the Universal Declaration of Human Rights:

No one shall be subjected to arbitrary interference with his privacy, family home or correspondence, nor to attacks upon his honour and reputation.

Since the Second World War, the right to privacy or private life has been enshrined in a number of other regional fundamental rights instruments⁴ in Europe, culminating in Article 8 of the European Convention on Human Rights (ECHR),⁵ which provides that:

- 1 *Everyone has the right to respect for his private and family life, his home and his correspondence.*
- 2 *There shall be no interference by a public authority with the exercise of this right except such as is in accordance with the law and is necessary in a democratic society in the interests of national*

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2 Samuel D Warren and Louis D Brandeis, 'The Right to Privacy', *Harvard Law Review*, Vol. 4, No. 5 (15 December 1890), pp. 193–220.

3 Subsequently embodied in Article 17 of the International Covenant on Civil and Political Rights adopted by the General Assembly of the United Nations 16 December 1966.

4 For example, Article 11 of the American Convention on Human Rights, San José, Costa Rica, 22 November 1969.

5 Convention for the Protection of Human Rights and Fundamental Freedoms, Rome, 1950 Council of Europe European Treaty Series 5.

security, public safety or the economic well-being of the country, for the prevention of disorder or crime, for the protection of health or morals, or for the protection of the rights and freedoms of others.

While some fundamental rights are absolute and unqualified, the right to private life, at least in the European view, is not absolute and must be weighed against other fundamental rights, such as the right to freedom of expression to be found in Article 10 of the ECHR.⁶

The 1980 OECD guidelines on privacy were a powerful stimulus to national legislation in OECD member countries and beyond.⁷ These were developed at the same time as the Council of Europe's 1981 Data Protection Convention⁸ (Convention 108) and updated in 2013. The OECD's focus was the risk of national privacy laws prejudicing transborder data flows, whereas the Council of Europe emphasised the protection of fundamental rights.

ii Origins of data protection

'Data protection' as distinct from 'privacy' has a shorter legal history. It is a European concept and derives from concerns that rose to prominence in the 1970s⁹ about the power of automatic data processing – especially by state organisations. Following legislation in Sweden, Germany and France, but also building on the work of the Younger Committee¹⁰ in the United Kingdom, the fundamental principles of fairness, lawfulness, accuracy, necessity and security were brought together in Convention 108.¹¹

Data protection legislation is largely procedural rather than substantive and was developed to address concerns by legislators about the ease with which data could be transferred across borders. Safeguards were subsequently integrated into data protection legislation alongside the principles described in, inter alia, Convention 108, to ensure the protection of citizens' privacy rights, while recognising the speed of developments in technology.

At a European level, the European Data Protection Directive 95/46/EC was adopted on 24 October 1995 and implemented by Member States (and other EEA countries) thereafter. On 25 May 2018, this data protection framework was replaced by the General Data Protection Regulation 2016/679 (GDPR), which became directly effective in all Member States and significantly increased the obligations placed on those organisations that process personal data. The modernised Convention 108 and the GDPR were developed in parallel and are both consistent and complementary.

6 For guidance on how to weigh one right against another, see *Axel Springer v. Germany* App No. 39954/08 (ECtHR, 7 February 2012) and *Von Hannover v. Germany* (No. 2) App Nos. 40660/08 and 60641/08 (ECtHR, 7 February 2012).

7 *OECD Guidelines on the Protection of Privacy and Transborder Flows of Personal Data*, Organisation for Economic Co-operation and Development, Paris 2002, ISBN 92-64-19719-2.

8 Council of Europe Convention for the Protection of Individuals with regard to Automatic Processing of Personal Data, European Treaty Series 108, Strasbourg 1981.

9 For a history see Chapter 2, Colin J Bennett, *Regulating Privacy: Data Protection and Public Policy in Europe and the United States* (Ithaca, NY and London: Cornell University Press, 1992).

10 Home Office, Lord Chancellor's Office and Scottish Office Report of the Committee on Privacy (Cmnd 5012, July 1972).

11 On 18 May 2018, the European Council adopted an Amending Protocol updating Convention 108. As at 4 November 2019, this had been signed by 34 states (including the United Kingdom) but it will not come into force until ratified by five member states (no ratifications currently). Council of Europe membership is significantly wider than that of the European Union and the EEA Member States.

II DATA PROTECTION CHALLENGES FOR INTERNATIONAL FRANCHISE RELATIONSHIPS

Many franchise arrangements will involve the collection and handling of customer data as well as employee and other business contact data. Much of this data will be personal data, the use of which is protected by data protection and privacy laws across the world. Currently, there are at least 100 countries in the world with such laws and Europe has some of the most stringent. Anyone thinking of setting up or expanding their franchise arrangement needs to be aware of these rules as non-compliance can lead to fines, claims for compensation, reputational damage and, in some cases, to prosecution for criminal offences.

i Which laws will apply to my franchise arrangement?

One of the key challenges facing any international franchise relationship will be for companies to work out which data protection laws will be applicable to their business arrangements. Outside Europe, privacy laws tend to be country-specific (e.g., Australia, Argentina and Taiwan), state-specific or applied to specific sectors (e.g., financial services, health or marketing services). However, such laws can apply on the basis of where the individual is located rather than where the organisation that is processing their data is based (this is especially true for many Asian countries). Within Europe, the GDPR has a wide territorial scope and applies to organisations based not only within, but also outside the EU if they monitor or offer goods and services to individuals in the EU. The GDPR increases the obligations on those who process personal data, and individuals will have stronger rights. It contains significantly tougher powers of enforcement for national data protection authorities, with powers to fine organisations up to €20 million or 4 per cent of their total worldwide annual turnover for infringements. The remainder of this chapter focuses on the main obligations under the GDPR.

There are additional privacy rules relating to the use of electronic communications set out in the Privacy and Electronic Communications Directive 2002/58 EC (as amended). This Directive is also under review; a draft e-Privacy Regulation has been proposed but progress has been slow and its future remains uncertain at the time of writing. Some of the existing rules are specific to certain communications service providers (internet service providers (ISPs) and telecommunications companies (telcos)), such as the rules relating to security and confidentiality, breach notification and restrictions on the use of traffic and location data. There are also provisions that apply to all organisations making use of electronic communications, including:

- a* requirements for notice and consent to use cookies and similar technologies; and
- b* rules relating to unsolicited marketing by email, fax and text, which can require opt-in consent in some situations.

These rules will be more relevant as franchisors and franchisees look to engage customers across a variety of channels. For example, if a franchisor wants the right to control the e-marketing campaigns to all customers, its franchisees often have to provide access to their customer databases as a matter of course. If this is the case, the parties need to think carefully about the relevant consents that may be required (particularly given the tougher requirements for obtaining valid consent under the GDPR). These rules are also relevant to organisations involved in targeted advertising programmes or that are interested in profiling their customers based on their online behaviour and browsing activities.

Loyalty schemes are another area where the rules can apply. In particular, organisations need to be clear who is participating in the scheme and whether they have appropriate consents to be able to contact the customers.

While the GDPR is directly effective in Member States without the need for implementing legislation, there are numerous areas where the GDPR permits or requires Member States to implement national laws. Thus local law advice can still be required in every country relevant to the franchise arrangement.

As mentioned above, the GDPR further extends the reach of EU data protection laws: it applies to data controllers and data processors that have EU establishments and where personal data are processed in the context of such establishments (whether or not the actual data processing takes place in the EU). The GDPR also applies to controllers and processors that are not established in the EU but that process personal data about data subjects in the EU in connection with (1) the offering of goods or services (payment is not required) or (2) the ‘monitoring’ of the data subjects’ behaviour within the EU (this would include tracking individuals online to create profiles, including where this is used to take decisions to analyse or predict personal preferences, behaviours and attitudes).

ii Who and what is covered by the European data protection rules?

The GDPR applies to the processing of personal data held electronically or in structured paper files and it places obligations on controllers and processors of the data.

The controller is ‘the natural or legal person, public authority or agency or any other body which, alone or jointly with others, determines the purposes and means of the processing’. It is clear that franchisors will be data controllers in respect of the personal data they process. In many cases, the franchisees will also be independent data controllers with separate obligations to meet applicable privacy law requirements as they will also determine the purposes and the means of the processing.¹² The roles the parties play, however, is not always clear-cut and there may be circumstances in which the franchisees are acting as processors (i.e., people – other than employees of a data controller – who process personal data on behalf of a data controller and have no independent control over the personal data). This distinction is important as more obligations fall on controllers under the GDPR. However, even though franchisees may be independent data controllers, franchisors will still need to put controls in place (in the franchise agreement) to protect the customer data belonging to the ‘brand’ (even though this is not mandated by the GDPR). For example, a franchisor may, while protecting the IP in any customer database, wish to consider ensuring that the customer data are the confidential information of the franchisor and can only be used for the purposes of the franchise business, thereby ensuring that the data are destroyed or returned to the franchisor on termination of the franchise arrangement. Under the GDPR, while processors have fewer direct obligations, they are required (for the first time) to: (1) document their processing activities (carried out on behalf of the controller); (2) cooperate with supervisory authorities; (3) implement appropriate security; (4) designate a data protection officer (if applicable); (5) notify the controller of any security breaches; and (6) comply with the international data transfer rules. Breach of these obligations can expose the processor to compensation claims

12 Note that the law can apply both to corporate organisations and to sole traders.

from individuals and administrative fines under the GDPR. There are also specific provisions under the GDPR relating to joint controllers, requiring them to have arrangements in place determining their roles and responsibilities and risking joint and several liability.

Personal data are broadly defined and include information relating to a directly or indirectly identifiable natural person (i.e., an individual, not a company). This includes details such as name, postal address and email address, as well as online identifiers, device identifiers, cookie IDs and IP addresses. Customer data, employee data and business contact data (including details held about franchisees) are caught by the definition. However, truly anonymous data, such as aggregated statistics, are not regulated by the GDPR (but pseudonymous data is still treated as personal data).¹³ Some data are to be regarded as special categories of data and can only be processed under strict conditions. Such data include racial or ethnic origin, political opinions, religious or other beliefs, trade union membership, health, sex life or sexual orientation, genetic data and biometric data used for the purposes of uniquely identifying a natural person.

Personal data are caught by the GDPR if they are processed wholly or partly by automated means (broadly speaking, on computer) or in certain structured paper files. This would therefore include personal data captured online via social media and apps, as well as CCTV and voice recordings. The GDPR defines a 'filing system' as any structured set of personal data that is accessible according to specific criteria, whether centralised, decentralised or dispersed on a functional or geographic basis.

The definition of processing is broad under the GDPR and applies to almost any operations performed on personal data, from collection to transfer, disclosure, storage and destruction.

iii What are the main obligations under European data protection laws for franchisors or franchisees to consider?

Compliance with data protection principles

Franchisors and franchisees must comply with certain principles whenever they are processing personal data. In summary, these specify that personal data is to be: processed lawfully, fairly and in a transparent manner; collected for specified, explicit and legitimate purposes; adequate, relevant and limited to what is necessary; accurate and up to date; kept for no longer than necessary; and kept securely.

There is also a new accountability principle, which requires a controller to be able to demonstrate that it has followed the relevant principles. This will be evidenced by adopting data protection by design and by default, developing policies and procedures, staff training programmes and undertaking audits. Controllers and processors are required to maintain records of processing activity (which replaces the notification regime) and carry out privacy impact assessments in certain circumstances. Data protection officers may also have to be appointed. All data controllers will be subject to a general data-breach notification regime.

The GDPR continues to regulate transfers of data outside the EEA, which is of particular significance to international franchise arrangements. In short, if personal data

13 Pseudonymisation is defined under the GDPR as the processing of personal data in such a manner that the personal data can no longer be attributed to a specific data subject without the use of additional information, provided that the additional information is kept separately and is subject to technical and organisational measures to ensure that the personal data are not attributed to an identified or identifiable individual.

belonging to EEA franchisors or franchisees are being transferred outside the EEA, then the relevant organisations must show that there is 'adequate protection' for the data, otherwise the transfer will be prohibited. For example, this is relevant where an EEA franchisor or franchisee uses a US cloud provider to store its customer data. There are a number of solutions that can currently be relied upon to demonstrate adequacy, including Commission-approved standard contractual clauses contracts, binding corporate rules, the EU–US Privacy Shield framework,¹⁴ and unambiguous consent. Appropriate legal advice should be sought early in the establishment of any international arrangement. Franchisors engaging with cloud providers would also have to ensure that the contract provides sufficient assurances around data security and access to data, particularly in the event that the franchisees are to be given some level of access. The GDPR also requires specific contractual obligations to be imposed on data processors, including consent to appoint subprocessors, and audit rights.

Compliance with individuals' rights

The GDPR expands the rights granted to individuals to whom information relates (data subjects), including the rights to request:

- a* access to their personal data;
- b* data portability (a right to require their personal data to be provided in a commonly used electronic form or transmitted to another controller);
- c* correction, deletion or restriction of the processing of their personal data;
- d* to object to certain types of processing; and
- e* not to be subject to solely automated decisions that produce legal effects (such as computerised decisions regarding job applications).

Individuals also have the right to an effective judicial remedy against a controller or processor and have a right to compensation from a relevant controller or processor for material or immaterial damage resulting from an infringement of the GDPR. Individuals can also complain directly to the data protections supervisory authority about such infringements.

iv Cybersecurity

Franchisors and franchisees are becoming increasingly aware of the need to protect essential assets such as customer databases from theft, damage, destruction or unauthorised use and in particular from the threats posed by cyberattacks. Franchisors and franchisees will need to identify what assets need to be protected, identify the impact a cyberattack could have on their business, and have in place measures to protect the business (e.g., increased security controls, malware protection, restrictions on the use of removable media). This is a rapidly evolving field that is increasingly attracting regulatory attention. For example, there are already European laws (which predate the GDPR) requiring certain EU telcos and ISPs to notify security breaches to both the regulator and the affected individuals. In July 2016, the Network and Information Security Directive (the NIS Directive) was adopted, and Member States had until 9 May 2018 to implement its provisions into national laws and a further six months to identify 'operators of essential services'. This Directive sets out measures

¹⁴ This replaces the US Safe Harbor scheme, which was declared invalid in October 2015 following the *Schrems* case. The standard contractual clauses and EU–US Privacy Shield are also being challenged on similar grounds, so this must be kept under review.

designed to ensure critical IT systems in central sectors of the economy such as banking, energy, health and transport are secure. It applies to operators of such essential services and to 'relevant digital service providers'. Each EU country determines which organisations in their jurisdiction are operators of essential services and subject to the rules in line with criteria set out in the Directive, and determines its own 'effective, proportionate and dissuasive' penalties for infringement. All organisations in these sectors that are identified by the Member States as operators of essential services will have to take appropriate security measures and notify significant incidents to the relevant national authority. The same applies to all entities that meet the definition of relevant digital service providers. Micro and small enterprises are excluded from the scope of the NIS Directive. The NIS Directive also requires Member States to adopt their own cybersecurity and NIS strategies, defining strategic objectives and appropriate policy and regulatory measures, and to designate national authorities competent for monitoring the application of the NIS Directive at national level.

The GDPR and the NIS Directive address different things: the GDPR concerns personal data while the NIS Directive address the security of systems, but there is considerable overlap as security considerations are relevant to both, and most organisations covered by the NIS Directive will be data controllers (as well as being data processors in some situations).

The NIS Directive applies to fewer organisations but is expected to have a knock-on impact for suppliers to relevant digital service providers and operators of essential services. NIS incidents can be (but are not always) a personal data breach under the GDPR, which is reportable to the competent authority (under the NIS Directive) and the data protection authority (under the GDPR). As the GDPR and NIS Directive are separate laws, organisations may face regulatory action (including monetary penalties) under both pieces of legislation.

III KEY DATA PROTECTION RISKS

Each Member State has a supervisory authority or authorities that enforce data protection and must ensure that there are remedies and enforcement arrangements. Enforcement can result in administrative and criminal proceedings imposing fines and imprisonment; civil damages claims; and bad publicity, damage to goodwill, brand image and loss of consumer trust. Therefore, it is important for any international franchise arrangement to implement appropriate data protection measures to avoid such enforcement actions. Under the GDPR, the supervisory authorities will have the power to fine organisations up to €20 million or 4 per cent of their total worldwide annual turnover for infringements of the new rules.

TAX CONSIDERATIONS

*Zoe Feller*¹

I INTRODUCTION

This chapter looks at tax issues relating to franchising. Specifically, it focuses on the tax rules that commonly apply to franchising arrangements, the tax parameters under which franchising operations should be structured, the tax structuring options to consider and the anti-avoidance rules, which are increasingly focusing on international tax structuring. In this respect the main rules to be considered are those concerning the tax treatment of trading transactions and intellectual property (IP), as these are at the heart of any franchising arrangement.

In looking at these tax rules, we consider corporate franchisors and franchisees – partly for the sake of brevity and partly because (as far as franchisors are concerned) these are the entities most commonly involved in franchising arrangements.

We also look in this chapter at the rules from a UK perspective. While many of the principles of international taxation can be applied generically in a number of jurisdictions, tax is by its very nature highly jurisdiction-specific. In looking at the UK rules we hope to highlight those principles while grounding them in a real-life legal framework. This approach will give the reader a broad understanding of the tax principles that apply to any situation while leaving him or her free to take more detailed local advice in any specific circumstance. It should be noted, however, that on 23 June 2016 the United Kingdom voted to leave the European Union (EU). The United Kingdom is due to leave the EU on 31 January 2020, and has reached agreement with the EU regarding the proposed terms of the withdrawal agreement. In spite of the uncertainty regarding the terms of Brexit, we have, where possible, set out how the proposed withdrawal agreement will affect certain areas discussed in this chapter, in particular access to EU treaties and those UK tax laws that are based upon EU law, such as value added tax (VAT).

Finally, franchisors and franchisees are businesses and as such are concerned with all the tax issues that any business would be. This is not a tax book and we have therefore focused only on those issues that are specific to franchising businesses, namely the tax issues arising from the assets and services that make up the franchising arrangements. While we have in parts mentioned other tax issues that may be relevant, we have only done so in passing.

In broad outline, this chapter will consider the following tax issues in order:

- a* the general framework for the taxation of companies;
- b* withholding taxes that may be applicable on payment of franchise fees and royalties;
- c* the franchisor's tax position;

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- d* franchisor tax planning;
- e* the franchisee's tax position;
- f* transfer pricing; and
- g* value added tax.

II THE GENERAL FRAMEWORK FOR THE TAXATION OF COMPANIES IN THE UNITED KINGDOM

To understand how corporate franchisors and franchisees are taxed in the United Kingdom requires a broad understanding of the UK corporation tax regime – in particular as it applies to IP-based trading entities. We therefore commence with a very broad overview of the relevant UK corporation tax rules before applying these to the franchising context.

The corporation tax regime in the United Kingdom operates to tax companies. A company is defined as any body corporate or unincorporated association but does not include a partnership, a local authority or local authority association.² The amount on which corporation tax is chargeable is the sum of income computed under the various charging provisions and chargeable gains computed in accordance with the rules in the Taxation of Chargeable Gains Act 1992 (TCGA).

A company is subject to corporation tax in the United Kingdom:

- a* if it is a UK resident – on all its profits and gains regardless of the source of the profits or gains or whether they are remitted to the United Kingdom³ unless such profits or gains arise in a permanent establishment situated outside the United Kingdom in which case they may be exempt from tax under the branch exemption rules contained in Part 2 Chapter 3A of the CTA 2009; or
- b* if it is non-UK resident but carries on a trade through a permanent establishment in the United Kingdom – on all its profits arising from its trade through that establishment⁴ and chargeable gains on assets situated in the United Kingdom and used for the trade or permanent establishment.⁵ The Finance Act 2019 introduced provisions preventing non-UK resident companies from artificially organising their business to avoid falling under the definition of a UK permanent establishment and, with effect from 6 April 2020, extended corporation tax to the UK property income of non-resident companies. Corporation tax also applies to non-resident property trading or developing companies, even if the company does not have a permanent establishment.

Companies that are not within the charge to corporation tax can still be subject to income tax on certain UK-sourced income (generally where tax is deducted at source).

Broadly speaking, a company is a resident of the United Kingdom if it is either:

- a* incorporated in the United Kingdom;⁶ or
- b* has its central management and control in the United Kingdom.⁷

² Corporation Tax Act 2010 (CTA 2010), Section 1121.

³ Corporation Tax Act 2009 (CTA 2009), Section 5(1).

⁴ CTA 2009, Sections 5(2) and (3).

⁵ TCGA, Section 10B(1).

⁶ CTA 2009, Section 14.

⁷ *De Beers Consolidated Mines Ltd v. Howe* 5 TC 198.

Where a company is resident in both the United Kingdom and elsewhere (e.g., because it is incorporated in the United Kingdom but managed and controlled in another jurisdiction), it is necessary to consider whether there is a tiebreaker clause in the relevant double-taxation treaty. Action 6 of the Action Plan on Base Erosion and Profit Shifting (BEPS) project introduced a tie-breaker provision based on a mutual agreement between the relevant tax authorities rather than the previous provision based on the place of 'effective management'.

Subject to certain exemptions for preparatory or auxiliary activities, a company will have a permanent establishment in the United Kingdom if it has a fixed place of business in the United Kingdom through which its business is wholly or partly carried on, or its agent (other than an independent agent acting in the ordinary course of its business) has and habitually exercises in the United Kingdom authority to do business on its behalf. A fixed place of business includes a branch, office, factory, workshop, place of management or a building site.⁸ The final report for Action 7 of the BEPS project (see Section V.iv) significantly expanded the Organisation for Economic Co-operation and Development (OECD) definition of permanent establishment to include situations in which the agent plays the principal role leading to the conclusion of contracts that are routinely concluded without modification, whether the contracts are in the name of the enterprise or for supplies of goods, rights, property or services by the enterprise. Although the United Kingdom has decided against amending its domestic definition of permanent establishment to reflect Action 7, the new OECD definition has been adopted in certain jurisdictions and thus has an impact on the overseas operations of UK companies.

i Profits chargeable to corporation tax

Corporation tax applies to profits of a company. The term profit is defined as income and chargeable gains except insofar as the context otherwise requires⁹ and is as adjusted for tax purposes. In the case of a non-resident company with a permanent establishment in the United Kingdom, its chargeable profits will be profits from its trading income arising directly or indirectly through, or income from property or rights used or held by or for, the permanent establishment and chargeable gains subject to corporation tax.¹⁰ However, there is an exemption from tax for most dividends or other distributions received from other companies (unless, generally speaking, the dividends or distributions are out of untaxed income).

Under the corporation tax regime, income is classified into different charging provisions, such as:

- a* trading income;
- b* property income;
- c* loan relationships and derivative contracts;
- d* intangible fixed assets;
- e* intellectual property, know-how and patents; and
- f* miscellaneous income.

8 CTA 2010, Section 1143.

9 CTA 2009, Section 2.

10 CTA 2009, Section 19.

As profits include chargeable gains, corporation tax applies to chargeable gains rather than capital gains tax¹¹ (which applies for individuals). Chargeable gains are generally calculated in accordance with the capital gains tax rules. However, the intangible fixed assets regime covers gains from assets included within that regime instead of the chargeable gains rules.

Expenditure that is allowed for tax purposes to reduce profits is determined in accordance with specific charging provisions. So, any disbursement or expense of an income nature wholly and exclusively laid out or expended for the purposes of trade is deductible against profits of that trade for corporation tax purposes in the same manner as for income tax.

Additionally, there are specific rules outside the charging provisions that allow tax deductions against total profits; for example:

- a* capital allowances; and
- b* relief for accounting losses on loan relationships and derivative contracts.

The rules on trading income generally take precedence over other charging provisions.

Trading profits

The taxable profits of a trade must be calculated in accordance with generally accepted accounting practice but are subject to any tax adjustments.¹² Therefore, the starting point for determining taxable trading profits is to use the profit before tax as disclosed in the accounts and adjust it for tax.

Some income and expenses may be excluded. For example, depreciation will not be allowed as a deduction for tax purposes,¹³ although expenditure 'capitalised' in accounts may be deferred revenue expenditure that could be deducted when amortised under generally accepted accounting principles. For capital expenditure, capital allowances relief may be available. Also, capital receipts are not chargeable to tax as income and should, therefore, not be included in calculating the trading profits unless there is a specific rule to the contrary.¹⁴

What is a 'trade'?

There is no statutory definition for 'trade' provided in the legislation and hence the term is interpreted in accordance with its ordinary meaning. The final report of the Royal Commission on the Taxation of Profits and Income in 1955 summarised the most important considerations in determining whether a taxpayer has engaged in trade (termed 'badges of trade'). The main factors to look at to indicate whether a transaction is trading in nature are as follows:¹⁵

- a* frequency of transaction – repeated transactions (as distinct from a one-off transaction) would be indicative of trading;
- b* relationship to the taxpayer's trade – a transaction relating to the trade that the taxpayer already carries on suggests that activity as being in the course of trade;
- c* subject matter – a transaction involving assets that are normally the subject matter of trading would be suggestive of trading (e.g., a bulk purchase of whisky or toilet paper is essentially a subject matter of trade, not of enjoyment);

11 TCGA, Section 8(1); CTA 2009, Section 4.

12 CTA 2009, Section 46.

13 Income Tax (Trading and Other Income) Act 2005 (ITTOIA), Section 33; CTA 2009, Section 53.

14 ITTOIA, Section 96(1); CTA 2009, Section 93; and Business Income Manual BIM14060.

15 *Marson (Inspector of Taxes) v. Morton* 59 TC 381 at 393.

- d* supplementary work – work done to repair or improve the item prior to sale suggests the transaction as being in the nature of trade; and
- e* profit motive and intention – purchases made with a view to resale at a profit or with the intention to resell in the short term indicates that the transactions are not by way of investment so should be trading.

In *Ransom (Inspector of Taxes) v. Higgs*¹⁶ Lord Reid observed that the term ‘trade’ is used to ‘denote operations of a commercial character by which the trader provides to customers for reward some kind of goods or services’.

Relief for trading expenditure

Expenditure is deductible against trading profits for tax purposes if it is of an income nature and incurred wholly and exclusively for the purposes of trade.¹⁷ If expenditure is incurred for more than one reason, one of which is a non-business reason, then, an identifiable part of the expense that can be attributed as being wholly and exclusively for the purposes of trade will not be disallowed.

ii Intangible fixed assets regime

The intangible fixed assets regime in Part 8 of the CTA 2009 provides a broad base for taxation of IP and relief in respect of IP expenditure. It is based on the accounting treatment, thereby generally eliminating the need to make capital and income distinctions. The regime generally takes priority for corporation tax purposes against other charging regimes.¹⁸

It applies to intangible fixed assets that are:

- a* created by the company on or after 1 April 2002;
- b* acquired by the company on or after 1 April 2002 from an unrelated party; or
- c* acquired by the company on or after 1 April 2002 from a related party and either:
 - the asset was a chargeable intangible asset within Part 8 immediately before acquisition;
 - the seller acquired the asset on or after 1 April 2002 from a person who was not related to the seller or the acquiring company; or
 - the asset was created on or after 1 April 2002.¹⁹

It is therefore often referred to as the ‘post-April 2002’ regime for IP.

Broadly speaking, an intangible asset is regarded as created or acquired on or after 1 April 2002 to the extent that expenditure on its creation or acquisition was incurred on or after that date.²⁰

¹⁶ [1974] 3 All ER 949.

¹⁷ ITTOIA, Section 34(1); CTA 2009, Section 54(1).

¹⁸ CTA 2009, Section 906.

¹⁹ CTA 2009, Section 882.

²⁰ CTA 2009, Section 883, Corporate Intangibles Research and Development Manual (CIRD) 11670.

If part of the expenditure was incurred prior to and some on or after 1 April 2002, the asset is treated as being two separate assets with apportionment being on a just and reasonable basis.²¹ Internally generated goodwill is treated as created before 1 April 2002 if the business was carried on before that date.²²

An intangible fixed asset is 'an intangible asset acquired or created by the company for use on a continuing basis in the course of the company's activities'.²³ The term intangible asset adopts the meaning used in UK generally accepted accounting principles (GAAP).²⁴

From 2015, companies have had to adopt the UK GAAP contained in FRS 101 and 102, and since 2016 a small-company regime within FRS 102 applies, although certain 'micro' entities can account under a new simplified accounting standard, FRS 105. FRS 101 is effectively International Financial Reporting Standards (IFRS) with simplified disclosure. FRS 102 is a new regime based upon IFRS for small and medium-sized enterprises (SMEs). Under both FRS 102 and FRS 105, an intangible asset is an identifiable non-monetary asset without physical substance. Such an asset is identifiable when:

- a* it is separable (i.e., capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, asset or liability); or
- b* it arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

Under IFRS, 'intangible assets' are identifiable non-monetary assets without physical substance. Assets are identifiable if they are separable or arise from contractual or other legal rights (regardless of whether those rights are separable from the entity (paragraphs 8 and 12 of International Accounting Standard 38)).

Intangible assets include any IP, which means:

- a* any patent, trademark, registered design, copyright or design right, plant breeders' rights or rights under Section 7 of the Plant Varieties Act 1997;
- b* any right under the law of a country or territory outside the United Kingdom corresponding to, or similar to, a right within paragraph (a);
- c* any information or technique not protected by a right within (a) or (b) but having industrial, commercial or other economic value; or
- d* any licence or other right in respect of anything within paragraphs (a) to (c) inclusive, such as a licence to exploit a patent or copyright material.

The rules also apply to goodwill (which takes its accounting meaning).²⁵

The regime does not apply to an asset held:

- a* for a purpose that is not a business or commercial purpose; or
- b* for the purpose of activities that are not subject to UK corporation tax (other than where held for an exempt foreign branch).²⁶

21 CTA 2009, Section 883(5) to (7).

22 CTA 2009, Section 884.

23 CTA 2009, Section 713(1).

24 CTA 2009, Section 712; CTA 2010, Section 1127.

25 CTA 2009, Section 715.

26 CTA 2009, Section 803.

Even though an asset may fall into the definition, there are exclusions such as assets for which plant and machinery capital allowances have previously been made, rights over tangible movable property, rights enjoyed by virtue of an estate, interest or right in or over land, etc.

Royalties and other credits

The post-April 2002 regime treats all royalties and disposal proceeds (credits) as income and treats most costs (debits) on the acquisition and development of intangible fixed assets as expenses on the same basis as for accounting purposes.

Credits can arise as follows:

- a* receipts or royalties recognised in the company's profit and loss account;²⁷
- b* accounting gains in respect of the revaluation of intangible fixed assets²⁸ (up to the debits previously brought into account). No gain would be brought into account if the asset is depreciated for tax purposes on a fixed 4 per cent basis (see below);
- c* accounting gains in respect of negative goodwill written back following a business acquisition;²⁹
- d* accounting gains in respect of the reversal of previous accounting losses that led to deductible debits;³⁰ and
- e* accounting gains in respect of realisation of intangible fixed assets.³¹ A realisation means an asset ceases to be recognised in the company's balance sheet because it has been sold or there is a reduction in the accounting value of the asset as the result of a transaction (in accordance with UK GAAP). Assets with no balance sheet value are deemed to have one for these purposes.

Debits

Debits are brought into account for tax purposes in respect of expenditure on intangible fixed assets when recognised for accounting purposes. For example, debits can arise:

- a* where expenditure is recognised in the profit and loss account;³²
- b* where an accounting loss arises from capitalised expenditure because of amortisation or an impairment review;³³
- c* on the realisation of an intangible asset;³⁴ and
- d* on reversals of previous accounting gains.³⁵

Alternatively, a company may elect to write down an intangible fixed asset for tax purposes at a fixed 4 per cent per annum instead of the accounting rate of amortisation. An irrevocable

27 CTA 2009, Sections 721–722.

28 CTA 2009, Section 723.

29 CTA 2009, Section 724.

30 CTA 2009, Section 725.

31 CTA 2009, Sections 733–741.

32 CTA 2009, Section 728.

33 CTA 2009, Section 729.

34 CTA 2009, Section 735.

35 CTA 2009, Section 732.

election must be made in writing to HM Revenue & Customs (HMRC) within two years of the end of the accounting period in which the asset is created or acquired.³⁶ The election will take effect with respect to all capitalised expenditure in respect of that asset.

Following changes made in 2015, it was no longer possible to obtain a debit for the cost of acquired goodwill or similar IP. However, the Finance Act 2019 has reinstated the relief for goodwill and customer-related IP acquired on or after 1 April 2019 as part of a business acquisition with eligible IP assets and the goodwill is neither a 'pre-FA 2019 relevant asset' nor acquired as part of a business incorporation.

Where transfers of intangible assets take place between related parties, the transfer is generally treated as taking place at market value, either under Section 845 of the CTA 2009 or under transfer pricing rules.

The manner in which debits and credits are brought into account will depend on the use to which the IP is put. Assets held for the purposes of a trade will give rise to trading credits or debits. Assets held for a property business are taxed as profits or losses of that business. Non-trading assets give rise to a separate head of non-trading profits. If there is a non-trading loss then the taxpayer is entitled to deduct the non-trading loss against total profits of the relevant accounting period, surrender it by group relief or carry it forward to relieve in future periods.³⁷

iii Pre-April 2002 regime

For IP that is not within the intangible fixed assets regime (see above), the old corporation tax rules continue to apply, which are in many cases equivalent to income tax rules. We refer to these rules as the 'pre-April 2002 regime'.

Under the pre-April 2002 regime for corporation tax, amounts are generally included in or deducted from income to the extent that such items are not capital in nature and amounts are within the chargeable gains rules to the extent that they are capital in nature. So it is crucial to determine whether a receipt or expense is income or capital in nature. The distinction must be interpreted in accordance with the ordinary meaning of the terms by having regard to case law.

A leading authority on this topic, *Inland Revenue Commissioners v. John Lewis Properties plc*³⁸ provides the following considerations to determine whether a receipt is income or capital in nature:

- a* if the payment is for the disposal of an asset that has an enduring or long-lasting quality then the payment is likely to be capital;
- b* if the payment is of a single lump sum for the once and all disposal of a particular asset, it is more likely to be a capital payment. If the payment is one of a series of recurring payments made at frequent intervals, it is likely to be income in the hands of the payee; and
- c* if the disposal of the asset is accompanied by a transfer of risk in relation to it, this suggests that the sum paid for the asset is capital.

³⁶ CTA 2009, Section 730.

³⁷ CTA 2009, Section 753.

³⁸ [2003] STC 117.

The following receipts have been held to be income:

- a* payments from a number of overseas companies for the sale of know-how relating to aero-engine manufacture, where the repetitive exploitation of know-how was seen as an extension of trade;³⁹
- b* payment (comprising lump sum and royalty) for a non-exclusive licence to manufacture not more than 75,000 ammunition boxes on a non-exclusive basis at a specific royalty;⁴⁰ and
- c* lump sum consideration for information consisting of secret processes and formulae.⁴¹

The following receipts have been held to be capital:

- a* lump sum for the grant of a 10-year sole licence in the United Kingdom;⁴²
- b* lump sum payments in respect of exclusive licences to foreign companies in various countries in which the taxpayer covenanted to keep out of that country;⁴³ and
- c* lump sum payment for the taxpayer agreeing not to establish another tyre soling plant, which was effectively an exclusive covenant not to compete.⁴⁴

Expenditure will be classified as capital if it is incurred with a view to bringing into existence an asset or advantage for the enduring benefit of the trade.⁴⁵ For example, a sum paid for the acquisition of a business was held to be capital in nature.⁴⁶ In *Tucker v. Granada Motorway Services Limited*,⁴⁷ the House of Lords determined that expenditure incurred for a variation of a lease was capital in nature even though it had no balance sheet value. Having regard to the case law,⁴⁸ HMRC offers the following guidance to indicate capital expenditure:

- a* expenditure on an intangible benefit or advantage (for example, trading agreements, licences or other intangibles) in which the identifiable asset is sufficiently substantial and enduring;⁴⁹
- b* expenditure that secures a permanent commercial advantage such as the closing down of a potentially damaging competitor;⁵⁰
- c* expenditure incurred in connection with the acquisition, alteration, enhancement or defence of the fundamental structure of a business;⁵¹ and

39 *Jeffrey v. Rolls-Royce* (1962) 40TC443.

40 *Rustproof Metal Window Co Ltd v. IRC* [1947] 2 All ER 454.

41 *Coalite & Chemical Products v. Treeby (HM Inspector of Taxes)* 48 TC 171.

42 *British Salmson Aero Engines v. IRC* (1938) 3 All ER 283.

43 *Murray (HM Inspector of Taxes) v. Imperial Chemical Industries Ltd* (1967) 44 TC 175.

44 *Margerison v. Tyresoles Ltd* (1942) 25 TC 59.

45 *British Insulated and Helsby Cables v. Atherton* [1926] AC 205, HL.

46 *Triage Services Ltd v. HMRC* Sp C 519 [2006] SCD 85.

47 [1977] STC 353.

48 See also *Strick v. Regent Oil Ltd* (1965) 43 TC1; *Vallambrosa Rubber Co Ltd v. Farmer* (1910) 5 TC; *Sun Newspapers Ltd v. Federal Commissioner of Taxation* (1938) 61 CLR 337.

49 Business Income Manual BIM35505.

50 Business Income Manual BIM35510.

51 Business Income Manual BIM35525.

- d* a payment that secures an enduring benefit to the business in terms of a change in organisation or structure is likely to be capital⁵² as distinct from one that has the effect of preserving the existing business, its goodwill or assets (which would be on revenue account).⁵³

Other specific charging provisions

If a company receives income or gains from IP rights, which do not amount to profits of its trade, then there are a number of specific charging provisions that could catch such receipts.

However, as the intangible fixed asset regime also applies to royalties relating to pre-April 2002 IP,⁵⁴ the pre-April 2002 corporation tax regime for intangibles is in almost all circumstances limited to rules relating to capital disposals of such IP and certain specific circumstances, which are excluded from the regime. The general position would be that capital disposals of pre-April 2002 IP should be within the chargeable gains rules. There are, however, some specific rules that override this treatment. We now consider these specific rules.

Disposals of know-how

There are four specific tax rules that could apply to disposals of pre-April 2002 know-how:

- a* disposals in the course of a trade: Section 177 of the CTA 2009;
- b* disposals of know-how as part of a disposal of trade: Section 178 of the CTA 2009;
- c* other disposals of know-how: Sections 408–410 of the CTA 2009; and
- d* capital allowances charges: Section 462 of the Capital Allowances Act 2001 (CAA 2001).

In respect of the first rule, receipts from the disposal of know-how in the course of trade⁵⁵ are specifically treated as trading income – even if capital in nature – under Section 177 of the CTA 2009 unless brought into account under Section 462 of the CAA 2001. Where the trade is also disposed of, the receipt is treated as a capital payment for goodwill although this may be disappplied by election.⁵⁶ The ability to make such an election and the more general trading treatment under Section 177 of the CTA 2009 is disappplied where the transfer is between connected parties.

Profits arising in a year on the disposal of know-how otherwise than in the course of a trade, or for giving or fulfilling an undertaking in connection with such a disposal that restricts any person's activities (whether or not enforceable), are taxed under Sections 908–910 of the CTA 2009. A deduction is allowed for expenditure wholly and exclusively incurred in the acquisition or disposal of know-how (so long as it is only taken into account once). This tax charge does not apply where:

- a* the disposal is taxed as trading income under Section 177 of the CTA 2009;
- b* the consideration is taxed under Section 462 of the CAA 2001 on disposal of the know-how;

52 Business Income Manual BIM35545.

53 Business Income Manual BIM35540.

54 CTA 2009, Sections 882(7) and 896.

55 CTA 2009, Sections 176–179.

56 CTA 2009, Section 178.

- c* where the consideration is treated as a capital receipt for goodwill on the disposal of a trade under Section 178 of the CTA 2009; or
- d* where the disposal is by way of sale between bodies of persons under common control.⁵⁷

The term 'know-how' for the above tax charges is defined as any industrial information or techniques likely to assist in:

- a* manufacturing or processing goods or materials;
- b* working a source of mineral deposits (including searching for, discovering or testing mineral deposits or obtaining access to them); or
- c* carrying out any agricultural, forestry or fishing operations.

There is also a specific capital allowance regime for know-how (see Section VI). Where such capital allowances have been obtained and the know-how disposed of, then the disposal value on such know-how has to be brought into account under Section 462 of the CAA 2001, in which case it will reduce the capital allowances available in the period or, if the company is liable to a balancing charge, be treated as a receipt of the trade.

Disposals of patent rights

Tax is charged on any non-trading profits from the sale of the whole or part of any patent rights.⁵⁸ For non-residents, the tax is charged only on the sale of UK patent rights. The term patent rights means the right to do or authorise the doing of anything that, but for the right, would be an infringement of a patent.⁵⁹ Licences are treated as sales. The grantor of a licence is treated as making a part sale unless the licence is exclusive and for the remaining period of the rights, in which case it is treated as the sale of the whole of those rights.

The profit brought into charge is the difference between any capital sums comprised in the proceeds of sale less any deductible costs.⁶⁰ The deductible costs are the capital costs of the rights sold (less amounts met by certain other persons – e.g., public bodies) and incidental expenses incurred by the seller in connection with the sale of the patent rights.⁶¹

Under spreading rules, the seller (if UK tax-resident) must spread the profits over six years for tax purposes unless he or she elects to tax it all in the year of receipt.⁶² Non-residents selling UK patent rights will be taxed in the year of receipt unless they elect to spread the income over six years.⁶³ Any such election for income tax purposes must be made on or before the first anniversary of the self-assessment filing date for the year of receipt.

Where non-residents are charged to tax under these rules, the person paying the consideration may have to deduct tax at source.

Capital allowances are available for capital expenditure incurred to acquire patent rights for the purpose of a trade within the charge to UK tax⁶⁴ or for patent rights that give rise

⁵⁷ CTA 2009, Section 909.

⁵⁸ CTA 2009, Section 912.

⁵⁹ CTA 2009, Section 912(3).

⁶⁰ CTA 2009, Section 913(1).

⁶¹ CTA 2009, Section 913(2).

⁶² CTA 2009, Sections 914–915.

⁶³ ITTOIA, Section 591; CTA 2009, Sections 916–917.

⁶⁴ CAA 2001, Section 468(1).

to UK taxable income.⁶⁵ Where there is a disposal of patents for which such allowances have been given, then the disposal value will need to be brought into account for capital allowances purposes (limited to the capital expenditure incurred on the patent). If this gives rise to a balancing charge, it would again be taxed as a receipt of the trade (or potentially non-trading income).

Chargeable gains

A company will be within the charge to corporation tax on its chargeable gains if it is resident in the United Kingdom, trading in the United Kingdom through a permanent establishment or, from 6 April 2020, carrying on a UK property business. If trading in the United Kingdom through a permanent establishment, corporation tax on chargeable gains will apply to any UK-situated assets used in or for the purposes of the permanent establishment.⁶⁶

The rules as to whether an IP asset is a UK asset or a non-UK asset are summarised below.⁶⁷

Asset type	UK asset if:
Goodwill	Trade, business or profession carried on in the United Kingdom
Patents, trademarks and registered designs	Registered in the United Kingdom
Rights or licences to use a patent, trademark or registered design	Rights exercisable in the United Kingdom
Copyright, design right, franchises	Rights exercisable in the United Kingdom
Rights or licence to use the copyright, work or design in which the design right subsists	Rights exercisable in the United Kingdom

Capital gains tax (and corporation tax on chargeable gains) applies on a disposal of an asset.⁶⁸ Disposals include part disposals⁶⁹ as well as situations where capital sums are derived from assets,⁷⁰ which includes capital sums received as consideration for use or exploitation of assets and capital sums received for forfeiture, surrender or refraining from exercise of rights. Similarly, the extinction or abrogation of a right or restriction over an asset by the person entitled to enforce it is considered a disposal of such a right or restriction.⁷¹

A chargeable gain or loss is calculated as the proceeds received on disposal (consideration) less the base cost (cost of the asset, expenditure wholly and exclusively incurred for the purpose of enhancing the value of the asset, costs incidental to the acquisition and costs incidental to making the disposal).⁷² For a corporate taxpayer, the base cost can be increased by indexation (i.e., the base cost is increased in line with the retail price index) from the date of acquisition until 31 December 2017 (the allowance being frozen from that date). The consideration will

⁶⁵ CAA 2001, Section 469.

⁶⁶ TCGA, Section 10B.

⁶⁷ TCGA, Section 275.

⁶⁸ TCGA, Section 1.

⁶⁹ TCGA, Section 21.

⁷⁰ TCGA, Section 22.

⁷¹ TCGA, Section 29(5).

⁷² TCGA, Sections 37–38.

be deemed to be the market value (as distinct from the actual amount received) where the transaction is between connected parties or not at arm's length.⁷³ Gains are not chargeable to corporation tax on chargeable gains if they are subject to tax as income.⁷⁴

iv Reorganisations

To allow intra-group transactions to be effected in a tax-neutral manner, there are specific rules that allow assets to be transferred within a UK group without crystallising capital gains tax or a tax charge under the intangible fixed asset rules⁷⁵ subject to 'de-grouping charges' if the transferee leaves the group within six years of the date of the transfer.⁷⁶ A condition of such transfers is that the transferee is within the scope of corporation tax in respect of the asset after the transfer.⁷⁷ The Finance Act 2019 introduced changes to the de-grouping charge, which will no longer apply where a company that owns intangibles leaves a group as part of a share disposal that qualifies for the Substantial Shareholdings Exemption. In these cases, assets that would otherwise have been subject to the charge remain at their written-down value.

To prevent assets being taken out of the UK tax net by migrating companies offshore, there are also charges under capital gains and chargeable intangible asset rules should a company migrate its tax residence offshore,⁷⁸ albeit with potential to postpone any charge if the company remains a 75 per cent subsidiary of a UK company.⁷⁹ Following ECJ case law⁸⁰ and a request from the European Commission to change UK law, the Finance Act 2013 saw an amendment to the migration rules whereby a company can either pay the exit charge in instalments or can pay the tax 10 years after migration or, if earlier, on disposal of the assets.

For chargeable gains assets and for chargeable intangible assets, there are in certain circumstances rules that allow assets to be transferred to companies resident offshore in a tax-neutral manner provided in Section 140, Section 140A, Section 140C, Section 140E and Section 140F of the TCGA and equivalent rules Chapter 11 of Part 8 of the CTA 2009. For example, Section 140 applies to a UK company carrying on a trade outside the United Kingdom through a permanent establishment that transfers the trade for an issue of shares or shares and loan stock whereby it owns after the transaction at least 25 per cent of the transferee's ordinary share capital. Any gain is rolled over into the shares although may still be payable if any of the assets are transferred within six years. The rules in Section 140A to 140F of the TCGA cover situations set out in the EU Merger Directive and EU Tax Merger Directive⁸¹ as well as the European Directive establishing the European Company and European Cooperative Society. The rules on mergers are outside the scope of this chapter, but a franchisor seeking to migrate part of its trade offshore will need to consider whether it could fall within any of these particular rules. It might also consider transferring assets to a foreign permanent establishment, which could be exempt from tax under the exemption in Chapter 3A of the CTA 2009.

73 TCGA, Sections 17–18.

74 TCGA, Section 37.

75 TCGA, Section 171; CTA 2009, Section 775.

76 TCGA, Section 179; CTA 2009, Section 780.

77 TCGA, Section 171(1A); CTA 2009, Section 775(1)(c).

78 TCGA, Section 185; CTA 2009, Section 859.

79 TCGA, Section 186; CTA 2009, Section 860.

80 *National Grid Indus BV v. Inspecteur van de Belastingdienst Rijnmond* C-371/10 (NGI).

81 Council Directive 2005/56/EC and Council Directive 2009/133/EC.

III DEDUCTION OF TAX AT SOURCE

There are a number of provisions that give rise to deduction of tax at source on IP royalties that could apply to franchising arrangements. Section 906 of the Income Tax Act 2007 (ITA) requires a person who pays a royalty or other sum for the use of IP that is within the charge to income tax or corporation tax to a person whose usual place of abode is outside the United Kingdom (or makes a periodic payment to certain persons who have acquired their rights from such a UK person) to withhold tax at the basic rate and to account for that tax to HMRC.

For this purpose, IP means:

- a* copyright of literary, artistic or scientific work;
- b* any patent, trademark, design, model, plan or secret formula or process;
- c* any information concerning industrial, commercial or scientific experience; or
- d* public lending right in respect of a book.

There are exclusions for copyright payments relating to cinematographic films or video recordings, or their soundtracks.

If a payment does not fall within the provisions of Section 906, it may nevertheless give rise to an obligation to deduct tax at source under:

- a* qualifying annual payments (ITA, Sections 900 and 901);
- b* patent royalties (ITA, Section 903); and
- c* capital payments made for patents (ITA, Section 910).

We consider these in more detail below.

i Qualifying annual payments

Qualifying annual payments are subject to deduction of tax under Sections 900 (payments by individuals) and 901 (other payers) ITA. Under Section 899 ITA, a qualifying annual payment must meet the following conditions:

- a* it must be an annual payment;
- b* it must arise in the United Kingdom;
- c* the payment must be charged to tax under various provisions, including:
 - to income tax under:
 - ITTOIA, Section 579 (royalties from IP);
 - ITTOIA, Chapter 4 of Part 5 (telecommunications rights);
 - ITTOIA, Chapter 7 of Part 5 (annual payments not otherwise charged); or
 - to corporation tax under Chapter 7 of Part 10 CTA 2009 if the recipient is a company (annual payments not otherwise charged to tax); and
- d* the payment must not constitute interest and must not include certain other payments (e.g., charitable donations).

An annual payment is one that is payable under a legal obligation and is capable of recurring over a period of more than 12 months.⁸² The amounts must be income receipts, and not a capital receipt, so a capital amount paid in instalments would not constitute an annual

82 *Moss Empires Ltd v IRC* (1937) 21 TC 264.

payment. The amounts must also be 'pure income profit' in the hands of the recipient. Broadly speaking, pure income profit comes to the recipient without the recipient having to do anything in return. Therefore, payments for goods or services cannot be an annual payment.⁸³

An individual who makes a qualifying annual payment will only be required to deduct tax if the payment is made for genuine commercial reasons in connection with the individual's trade, profession or vocation.⁸⁴ There is no similar test for companies.

In the franchising context, this is unlikely to apply following the changes to the deduction of tax rules enacted in the Finance Act 2016. These changes effectively broadened the definition of royalty, simplifying the withholding tax treatment where payments are being made to a person whose usual place of abode is outside the United Kingdom. Therefore, payments to non-residents will be covered by Section 906 ITA and payments to UK companies will generally be excluded from the obligation to deduct tax (see Section III.iv). The qualifying annual payment withholding tax charge will therefore only apply where the franchisor is a UK unincorporated business.

ii Patent royalties

To the extent that a patent royalty is not a qualifying annual payment and is not covered by Section 904 (annual payments made in consideration of dividends or exempt consideration, which is unlikely to be applicable in the context of franchising), it may be subject to deduction of tax under Section 903 of the ITA. This section applies to a royalty or other sum in respect of the use of a patent, which arises in the United Kingdom and is charged to income tax or corporation tax. Again, following the 2016 changes, this will only apply where the franchisor is a UK unincorporated business.

iii Sales of UK patent rights

If a UK person buys rights in a patent from a non-resident seller that is liable for UK tax in respect of the sale under Section 587 of the ITTOIA 2005 or Section 912 of the CTA 2009, then the purchaser is obliged to deduct basic rate tax from the purchase price and account for this to HMRC.⁸⁵ For these purposes 'patent rights' means a right to do or authorise the doing of any thing that, but for the right, would be an infringement of a patent, and thus includes licences. For non-resident sellers the charges only apply to patents granted under UK law.

iv Excepted payments

The above requirements to deduct tax under Sections 901 (qualifying annual payments), 903 (patent royalties), 906 (IP royalties) and 910 (proceeds of sale of patent rights) do not apply where the payer is a company, local authority or partnership (with a corporate or local authority partner) if such a payer has a reasonable belief that the payment is an excepted payment and, in the case of deductions under Sections 901 and 903, the payer itself has no 'modified net income' (calculated under Section 1025 of the ITA) that would be subject to income tax.

83 *Earl Howe v. CIR* (7 TC 289).

84 The Income Tax Act 2007 (ITA), Section 900.

85 ITA, Section 910.

Excepted payments include payments where the person beneficially entitled to the income is:

- a* a company resident in the United Kingdom;
- b* a company not resident in the United Kingdom that carries on a trade in the United Kingdom through a permanent establishment and the payment will be brought into account in computing the UK chargeable profits of the non-resident company;
- c* a body of the type listed in Section 936 of the ITA (broadly, certain public bodies and entities that are generally tax exempt; e.g., charities); or
- d* a partnership beneficially entitled to the income, each partner in which must be an entity within (a) to (c) or the European Investment Fund.

If the payer ‘reasonably believes’ that an exemption applies it may pay gross, but if that belief proves incorrect, the withholding obligation is re-imposed so the payer is at risk. There is no general mechanism for HMRC to certify that payments may be made gross under these rules.

v Source of royalty

The Finance Act 2016 also introduced rules to define the source of royalties or other sums paid in respect of IP where the payer is non-UK resident but the payment is made in connection partly with a trade carried on by a UK permanent establishment of the payer. Under these new rules, the entity will need to apportion on a just and reasonable basis the proportion of the payment that relates to the trade carried on through the UK permanent establishment.

vi Anti-treaty shopping rules

The 2016 changes also introduced anti-treaty shopping rules.⁸⁶ Under these rules, relief will not be available under a double-tax treaty where a payment to a connected person is made under a double-tax treaty tax avoidance arrangement (where obtaining treaty relief is contrary to the object and purpose of the treaty and is the main, or one of the main, purposes of the arrangements) and any tax so deducted is not creditable against corporation tax of a recipient company.

vii EU Interest and Royalties Directive

Council Directive (EC) No. 2003/49 (the Interest and Royalties Directive) introduced a common system of taxation applicable to interest and royalty payments made between associated companies of Member States. These provisions have force in the United Kingdom (ITTOIA, Sections 757–767 and Section 914 of the ITA) and provide an exemption from income tax on royalties where:

- a* the payer of the royalty is a UK company or a UK permanent establishment of an EU company; and
- b* the person beneficially entitled to the income is an EU company but not such a company’s UK permanent establishment or non-EU permanent establishment.

Both companies must be 25 per cent associates, that is, one company holds at least 25 per cent of the capital or voting rights in the other or there must be a parent company of both companies that holds such a share in each.

⁸⁶ Section 917A ITA.

Payment gross is permitted where the payer reasonably believes the exemption applies, but (as for the excepted payments rules) the payer is at risk if that belief is incorrect. As a practical matter, if the payee is an EU company, the payer's risk can be eliminated as the payee company could make a claim under the applicable double-tax treaty that should result in HMRC issuing a payment direction to the payer to apply a reduced or zero rate of withholding (see further below).

Under the terms of the proposed EU withdrawal agreement, the United Kingdom would cease to be a Member State of the EU and UK companies receiving payments from associated companies in EU Member States would no longer benefit under the Interest and Royalties Directive. However, UK companies would still rely on Sections 757–767 ITTOIA and Section 914 ITA to eliminate withholding tax on payments of royalties to associated companies in EU Member States. Any change to this arrangement will require a further change to UK domestic law.

viii Double-tax treaties

Royalties paid by a UK resident to a resident of a country with which the United Kingdom has a double-tax treaty (DTT) may be exempt from withholding taxes as a result of the operation of a royalty article of that DTT. Even if the royalty article does not extinguish the withholding tax liability it will normally impose a restriction on the amount that can be deducted. There are, broadly speaking, three main types of tax treaty upon which most are based; these are the OECD Model Tax Convention, the UN Model Tax Convention (usually adopted by developing nations) and the US Model Tax Convention.

In respect of royalties, Article 12 of the OECD Model Tax Convention provides as follows:

1 Royalties arising in a Contracting State and beneficially owned by a resident of the other Contracting State shall be taxable only in that other State.

[The UN Model treaty specifically allows tax to be deducted at source up to a percentage.]

2 The term 'royalties' as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience.

[The US Model treaty also covers 'other works' as well as certain gains derived from the alienation of any of the above property. The UN Model treaty also applies the royalty provisions to fees for the use of or right to use industrial, commercial or scientific equipment.]

3 The provisions of paragraph 1 shall not apply if the beneficial owner of the royalties, being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties arise through a permanent establishment situated therein and the right or property in respect of which the royalties are paid is effectively connected with such permanent establishment. In such case the provisions of Article 7 (business profits) shall apply.

[The UN Model is similar in this respect save that it also has a carve-out for independent personal services supplied in the state and for other business activities carried on in the state of the same or similar kind as those effected through the permanent establishment.]

4 Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the royalties, having regard to the use, right or information for which they are paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this

Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.

A non-resident licensor must, unless Section 911 of the ITA applies (see below), make an application to its own domestic tax authorities claiming relief under the relevant article of the DTT and demonstrating that it fulfils the requirements of that article. Following the joint project by the OECD and G20 countries to reduce global tax avoidance (or BEPS), 82 countries (including the United Kingdom) signed a multilateral instrument (MLI) to amend their DTTs. These changes tackled a number of key action points arising from the BEPS project, one of which is 'treaty shopping, namely putting a company in a jurisdiction to take advantage of its DTT network. Where both parties to a DTT have signed and implemented the MLI, that DTT will now include a 'principal purpose test', which effectively denies treaty benefits where it is 'reasonable to conclude that obtaining that benefit was one of the principal purposes of any arrangement or transaction'. Even without the principal purpose test, if the recipient is a 'conduit' vehicle, it may struggle to satisfy the beneficial ownership requirement following the case of *Indofood International Finance Ltd v. JPMorgan Chase Bank NA*.⁸⁷ This UK case (the principle in which is being applied generally by many tax authorities – although cf. the Canadian cases of *Prevost*⁸⁸ and *Velcro*⁸⁹) suggests that the meaning of beneficial ownership in tax treaties is more limited than the legal test and will not apply where a conduit vehicle has back-to-back arrangements to pay on receipts of interest or royalties.

Once satisfied the treaty conditions apply, the non-resident's tax authority will certify to HMRC that the licensor is entitled to relief under the relevant DTT and HMRC will then direct the payer to make future payments at the rate specified under the relevant DTT.

Under Section 911 ITA, a UK company that makes a payment of royalties otherwise subject to deduction of tax may, if it thinks fit, calculate the sum of income tax to be deducted by reference to the rate applicable in the relevant tax treaty (if lower than the UK rate) and make the payment on that basis (that is, without receiving a payment direction from HMRC following a treaty claim). However, the company must reasonably believe that, at the time the payment is made, the payee is entitled to relief in respect of the payment under a relevant tax treaty. As before, the payer is at risk if the payee is not entitled to a reduced rate of withholding under the treaty. However, the payee can make a claim under the treaty that will result in the payer receiving a direction to pay at a reduced rate from HMRC and hence, if there is any doubt, mitigate risk.

ix Offshore receipts

Originally proposed as an extension to royalty withholding tax, new rules enacted by Section 15 of and Schedule 3 to the Finance Act 2019 impose an income tax charge on gross receipts received by a non-UK entity where that entity owns IP used to generate sales revenue in the United Kingdom. Although not technically a withholding tax, the tax (which came into effect on 6 April 2019) is collected through self-assessment from the non-UK resident, but members of the same 'control group' (see below) are jointly and severally liable. The rules

⁸⁷ [2006] STC 1195.

⁸⁸ 2009 DTC 5053 (FCA).

⁸⁹ 2012 TCC 57.

have been designed to target multinational groups that hold intangible property in low-tax offshore jurisdictions and use that IP to generate revenue from UK customers or provide sales in the UK. They target groups that realise income from UK sales in low-tax offshore jurisdictions that do not have a full tax treaty with the UK.

There are three exemptions from the income tax charge: where the foreign tax is at least half of the UK tax, where there is business undertaken in the non-UK territory and where the UK sales do not exceed £10 million in the year.

These rules are targeted at multinational groups, but franchisees should be aware that the joint and several liability provisions are widely drawn (Section 608O ITTOIA). If the tax remains unpaid for six months after the payable date, the UK tax authorities can collect that tax from a person in the same control group as the non-UK resident entity at any time in the tax year to which the payment applies. Section 608S ITTOIA provides that two persons will be in the same control group if they are consolidated for accounting purposes, one of them has a 51 per cent investment in the other, or a third person has a 51 per cent investment in each of them.

x Issues relating to royalty payments in the franchising context

A major component in any franchising agreement will be a payment of royalties for use of the brand and other IP licensed to the franchisee. As stated above, a franchisee paying a royalty for use of IP may have to deduct tax at source. The manner in which a deduction will be required will depend on the type of IP and the residence of the payee. In the context of a franchising arrangement, payments are likely to be made to a corporate franchisor that will either be UK tax-resident or non-resident. Payments to UK tax-resident corporate franchisors by UK franchisees should not give rise to any withholding tax issues.

If the payment is to a non-UK tax-resident company by a UK-based franchisee, withholding tax applies to all royalties and other payments in respect of IP. Assuming that the recipient is not trading in the United Kingdom through a permanent establishment, royalties will give rise to an obligation to deduct tax unless the UK rules are overridden by a tax treaty or, assuming there is no specific change of law post-Brexit, the Interest and Royalties Directive (as implemented into UK law in ITTOIA and ITA).

In any event, the franchisor will be carrying out significant activities under the franchising agreement, including exercising control functions and providing support and assistance services on a recurring basis. The manner in which the franchisor carries out these functions may give rise to a permanent establishment of the franchisor in the United Kingdom. In this event, the payments may be treated as received by such a permanent establishment and therefore as excepted payments.

As the franchisee's obligation to deduct tax at source is heavily dependent on the franchisor's tax status (e.g., whether it has a taxable permanent establishment in the United Kingdom), the franchisee must investigate the treatment of the payments it makes in this respect to ensure that it correctly deducts and accounts for any tax. If the franchisee fails to deduct tax at source, it will still have to account for the tax to HMRC together with interest and penalties. It may, depending on the terms of the agreement, be able to deduct the amount it has failed to deduct at source from future payments, but this is likely to be possible only where there has been a genuine error of fact.⁹⁰ Additionally, the franchisee may under

⁹⁰ *Countess Shrewsbury v. Earl of Shrewsbury* (1907) 23 TLR 224, CA; *Turvey v. Dentons* (1923) Ltd [1953] 1 QB 218, [1952] 2 All ER 1025.

the terms of the franchising agreement have a 'gross-up obligation' for any tax deducted on payments. While an agreement to pay royalties without deducting tax under Section 906 is void under Section 909 of the ITA, this is unlikely to apply to a gross-up provision as such a provision will increase the amount payable and therefore also increase the tax deducted at source – so it is not an agreement to pay without deduction of tax.

In practice, even where UK law dictates that there should be a deduction of tax at source for the royalty element of any fees, an appropriate DTT may well apply to give rise to zero or a reduced rate of withholding tax. Under Section 911 the payer need not deduct tax so long as it reasonably believes that at the time the payment is made the payee is entitled to relief under an applicable DTT. The franchisee should therefore seek to ensure that the franchisor (or if different, the relevant entity licensing the IP rights) benefits from relief under the applicable treaty. This may include ascertaining its country of residence, ensuring it is taxable in that country under relevant rules (e.g., not receiving the income in a branch in a third country that is exempt from tax in the country of residence), ensuring that the royalties are 'beneficially' owned by the recipient for treaty purposes and that the franchisor does not have a permanent establishment in the United Kingdom or, if it does, that the royalties are not effectively connected with such a permanent establishment, as well as ascertaining whether anti-avoidance rules, such as Section 917A ITA, apply. As well as investigating the franchisor's ability to obtain treaty relief, the franchisee may seek to obtain warranty protection in this respect under the franchising agreement.

IV TAX PRINCIPLES FOR FRANCHISORS

i Tax treatment of receipts

Although UK franchisors will be taxable on all fees received or receivable, the nature of such taxation will depend on the type of fee. A UK franchisor will therefore need to know how its fees are to be treated for tax purposes.

In this respect a typical franchise agreement will comprise fees payable for the following:

- a* services;
- b* reimbursement of expenses;
- c* royalties for use of trademarks;
- d* payments for know-how;
- e* payments for show-how;
- f* patent royalties;
- g* payments for copyrighted material (e.g., instruction manuals); and
- h* contributions to advertising materials.

The fees are likely to comprise both an initial fee and regular ongoing payments. In practice, the fees are often not separated out in the above constituent elements in the documentation but are simply an 'initial fee' and ongoing 'service fees' plus additional amounts for reimbursement of expenditure and contributions to advertising.

As we have seen, a UK franchisor will, broadly speaking, be paying corporation tax on all its profits albeit under different schedules. UK franchisors will generally be carrying on a trade in the United Kingdom and their profits will be subject to corporation tax as trading profits.

For UK franchisors whose IP was created or acquired on or after 1 April 2002, the profits and losses relating to any intangible assets will be calculated under the intangible

fixed asset regime whether the receipt is capital in nature or not, but such profits and losses will in any event be taxed as part of the franchisor's trading profits to the extent that the relevant IP assets are held for the purposes of a trade carried on by the transferor,⁹¹ which will almost certainly be the case. Therefore, the franchisor should be subject to corporation tax on the profits in its accounts subject to any standard tax adjustments (e.g., for disallowable expenditure or transfer pricing). If the transaction involves a 'realisation' of a chargeable intangible asset, then it is possible that a tax charge under the chargeable intangible assets regime could qualify for rollover relief if reinvested in new IP.⁹² However, realisation for the purposes of these rules means a transaction resulting, in accordance with generally accepted accounting practice, in the asset ceasing to be on the company's balance sheet or in a reduction in the accounting value of the asset (or would do if it had a balance sheet value).⁹³ On this basis it is unlikely in the vast majority of franchising arrangements that a realisation would occur for the purposes of these rules in respect of its activities carried out in the course of its general franchising business.

UK franchisors, whose IP does not fall within the intangible fixed assets regime, may need to analyse transactions in more detail to determine the manner of taxation. For many franchisors, HMRC are likely to accept that all fees simply constitute part of the franchisor's trading profits for corporation tax purposes so in practice, in the vast majority of cases, the tax treatment will be the same as for those in the intangible fixed assets regime. Franchisors may, however, seek to separate the fees into their component parts and tax them accordingly. If HMRC or a taxpayer wish to segregate the income between trading and other elements, the allocation would need to be a reasonable apportionment and justifiable.⁹⁴ If the relevant IP assets are segregated from the trade (e.g., held in a different company from the employees responsible for providing services), then a more detailed analysis of the components of any charge will be necessary.

Should the consideration be split into its component elements these could be taxed as follows.

Initial fee

If payable to a trading company rather than an IP holding company, this is likely to constitute a trading receipt. Arguably there may be a capital sum for a part disposal of goodwill or a capital sum derived from an asset and taxable under Section 22(c) or (d) or Section 29(5) of the TCGA. Where the franchise relates to a new jurisdiction, it will be difficult to say that there has been any disposal of a capital asset; HMRC's view is that there is not generally any reduction in the franchisor's goodwill as a result of entering into any new franchise agreements – on the contrary its goodwill is usually enhanced.⁹⁵ Additionally, under normal principles it would generally be difficult to say for a franchisor that the fees it generates are capital in nature. Therefore, the payment is most likely to be liable to corporation tax on income as a trading profit rather than a capital receipt. HMRC in its guidance cites

91 CTA 2009, Section 747.

92 CTA 2009, Section 754.

93 CTA 2009, Section 734.

94 See *Patterson Engineering Co Limited v. Duff* (1943) 25 TC 43 under which the court is not bound to follow contractual allocations if these do not reflect the real nature of payments.

95 Business Income Manual BIM57610.

*Jeffrey v. Rolls-Royce*⁹⁶ as authority for treating the initial fee as a trading receipt in normal circumstances. Specifically, it highlights that in this case (concerning disposals of know-how that were treated as income) the circumstances have similarities to many franchising cases, in particular:

- a* the transactions were repeated;
- b* there was a deliberate policy of expansion by granting licences;
- c* benefits other than know-how were provided; and
- d* no capital asset diminished in value.⁹⁷

It is irrelevant that the payment is in instalments.⁹⁸

However, if it can be shown that there has been a part disposal of existing goodwill, then this could be taxed within the capital gains rules – for example where the franchisor disposes of existing trading sites to a franchisee. To the extent that there has been a disposal of goodwill subject to capital gains tax (or corporation tax on chargeable gains), then any gain could be subject to rollover relief if the franchisor reinvests the gain in chargeable intangible assets 12 months before or within three years after the disposal.⁹⁹ Similarly, if there has been a realisation of goodwill or other IP within the intangible fixed asset regime, the gain can be rolled over into a new chargeable intangible asset.¹⁰⁰

Know-how

A disposal of know-how may be taxed as income under Section 908 of the CTA 2009 or as part of the trading profits of the company under Section 177(2) of the CTA 2009 (disposal of know-how where trade continues). This will not, however, be the case where the know-how has qualified for capital allowances and is brought into account under Section 462 of the CAA 2001, or it is taxed on disposal of a trade as part of the goodwill of the trade under Section 178 of the CTA 2009 or the disposal is a sale between connected persons.

Show-how

Fees for training the franchisee's staff and ongoing training will normally be part of the trading receipts of the franchisor.

Advertising payments

Where franchisees contribute to central advertising costs incurred by the franchisor, the receipts will typically be revenue receipts taxable as trading profits with a corresponding deduction allowed for the advertising spend. One would expect the income and expenditure to be matched for accounting purposes and generally one would expect advertising expenditure to be an income expense such that there is no net tax payable (unless the franchisor is receiving more than it is spending). To the extent that the expenditure has not been paid, any provision in the accounts will need to be sufficiently accurate to allow a deduction.¹⁰¹

96 [1962] 40TC443.

97 Business Income Manual BIM57610.

98 *British Dyestuffs Corporation (Blakeley) Ltd v. IRC* (1924) 12 TC 586.

99 Chapter 7 Part 8 of the CTA 2009.

100 CTA 2009, Section 898.

101 For example, *Johnston v. Britannia Airways Ltd* [1994] 67TC99.

Capital payments in respect of patent rights

Where patent rights are transferred, any receipt could give rise to a taxable receipt under Section 912 of the CTA 2009, spread over six years unless tax is elected to be paid earlier.

Royalties

As stated, save for franchisors that may hold the IP separately from the rest of the trade, all receipts are likely to constitute taxable trading profits. Therefore, characterising the receipts as royalties is unlikely to have a practical effect for corporation tax purposes. It may, however, affect whether tax needs to be withheld at source from the payments (as discussed above).

Premises

Certain franchisors will seek to provide a franchisee with suitably fitted out and branded premises. The tax treatment of any fees for doing this will depend on the nature of these arrangements.

ii International issues

We now look at the options available for a UK taxpayer when carrying on an international trade. If the franchisor is carrying out its full franchising business, including providing services and licensing all IP from one entity in the United Kingdom, it will be receiving the above mixed supply of services and payments for use of IP. Assuming that the franchisor's activities are not undertaken through a permanent establishment in a different jurisdiction, the fees should all be taxable under the UK corporation tax rules either as trading income, profits from IP or potentially, for the initial fee, chargeable gains (if the franchisor's IP is pre-April 2002 IP).

There used to be a distinction between foreign source income (which was taxed under Schedule D Case V) and UK source income (which was taxed under other schedules – e.g., Schedule D Case I for UK trading income, Schedule D Case III for most UK source royalty payments). This distinction, broadly speaking, disappeared for corporation tax purposes when the tax rules were rewritten into CTA 2009 and CTA 2010. Therefore, all trading income is dealt with under the same provisions of CTA 2009, as is all IP income. There is now no longer a general distinction between UK and foreign source income save that double-tax relief is available on foreign-sourced income.

Double-tax relief in the United Kingdom takes two forms: treaty relief and unilateral relief. Treaty relief is relief granted under an applicable double-tax treaty. Section 2 of the Taxation (International and Other Provisions) Act 2010 (TIOPA) provides for double-tax arrangements in respect of a territory outside the United Kingdom with a view to affording relief from double taxation to have effect by means of an Order in Council. The taxes covered by such arrangements include income tax, corporation tax, capital gains tax and taxes imposed outside the United Kingdom of a similar character to these taxes. As well as invoking the 'royalties' provision of any applicable tax treaty, a number of other provisions may be applicable to a franchisor, such as (in the case of the OECD Model Treaty):

- a* Article 7 (Business Profits) – which, broadly speaking, restricts the right of a territory to tax business profits unless earned through a permanent establishment in that territory (which is in turn defined in Article 5);

- b* Article 13 (Capital Gains) – which again restricts the right of a territory to tax capital gains to those accruing to a permanent establishment in that territory although in this case it can also tax gains from immovable property situated in that territory; and
- c* Article 23 (Double Taxation) – which seeks to avoid double taxation and provide relief through exemption or credit.

Unilateral relief (i.e., double-tax relief given in the absence of any protection under a double-tax treaty) is provided under Section 9 of the TIOPA in respect of income ‘arising’ and gains ‘accruing’ in the territory for which tax relief is sought. Unilateral relief is provided in respect of tax on income or capital gains that corresponds to income tax, capital gains tax or corporation tax and includes state, provincial or local income taxes or taxes levied by a municipality or any other local body.¹⁰²

Double-tax relief can be problematic in the following respects:

- a* where the receipts relate to a trade exercised in the United Kingdom, HMRC may seek to argue that the source of the income is the UK trade and not the payments for IP arising offshore. Equally where the IP rights are, say, UK registered rights for which the franchisor could but has not yet made subsequent registrations locally, then arguably the source of the income would be the UK rights. In these circumstances income from overseas franchisees is technically UK source income. However, this is covered by extra-statutory concession B8.¹⁰³ This states as follows:

A UK resident may receive income consisting of royalties or ‘know-how’ payments from a foreign resident. While in particular cases there may be special circumstances that will require to be taken into account, in general such income should be dealt with as follows.

a) Payments made by a person resident in a foreign country to a person carrying on a trade in the UK as consideration for the use of, or for the privilege of using, in the foreign country any copyright, patent, design, secret process or formula, trademark or other like property may be treated for the purpose of credit (whether under double-taxation agreements or by way of unilateral relief) as income arising outside the UK, except to the extent that they represent consideration for services (other than merely incidental services) rendered in this country by the recipient to the payer. b) Traders resident in the UK are not entitled to claim credit for any tax which is levied in the foreign country in respect of payments for services which are rendered in the UK and are not merely incidental services. In any such case the net amount of the payment (after deduction of any foreign tax borne by them on the payments) is included in the computation of profits for UK tax purposes.

The prohibition on credit for foreign tax charged on payments for services rendered in the UK may be overruled by the terms of those double-taxation agreements which have a royalties Article which includes technical services in the definition of royalties (see INTM153130) or a separate technical fees Article (see INTM153140) and those agreements deem the source of such payments to be in the country of which the payer is a resident. In such cases, even though the services are rendered in the UK, credit is due for the foreign tax charged on these payments.

If the owner of a right such as a patent, trademark or copyright is not engaged in any trade to which the right relates but derives income by exploiting that right, the source of the income may be regarded for the purpose of credit as located in the country where the right is enforceable.

102 TIOPA, Section 9(6).

103 HMRC manuals, International Manual INTM161130.

- b* Where a franchisor is providing services as well as IP from the United Kingdom, any local tax deducted at source on the service element will not qualify for double-tax relief as a credit unless specifically allowed as technical services under an appropriate double-tax treaty or unless it is merely incidental to the provision of IP. In the absence of a credit relief the foreign tax may be treated as a deduction from income.¹⁰⁴
- c* Where the franchisee has sub-franchisees in a different jurisdiction, then relief may not be available. Unilateral relief for foreign tax in a territory is provided against income 'arising' in the territory. In this case, depending on how the arrangements are structured, the sub-franchise income may not be income of the franchisor but of the franchisee and it may not arise in the 'territory' but in a third country. This position is relaxed in the rare circumstance that a franchisee is in the Isle of Man or the Channel Islands as there is no requirement for income to arise in these territories to allow credit for tax charged there.¹⁰⁵ Similarly, tax treaties will also provide double-tax relief for losses in the other treaty state. Care should therefore be taken to avoid this situation or to ensure that the appropriate tax leakage is dealt with correctly in the relevant documentation. To the extent that relief is not available, again the tax may be deductible as an expense of the trade.
- d* Unilateral relief provides credit for overseas tax calculated by reference to income arising or a gain accruing against UK tax calculated by reference to that income or gain. Similarly, treaty relief is limited to relief against UK tax arising on the same source of income as bears the tax. Therefore, if a company with foreign source income does not have any UK tax to bear (e.g., because there are deductible expenses or trading losses to set against it), the credits cannot be used against other sources of income (e.g., if the double-tax relief is against trading profits, it cannot be used against investment income).

V FRANCHISOR STRUCTURING

Over the past 30 years, as businesses have become increasingly mobile and international, and particularly since the rise of the internet, multinational operations have increasingly used tax planning as a tool to maximise their after-tax returns. There has been a game of cat and mouse between multinational operations and the revenue authorities as more sophisticated structures have grown up to minimise taxes, tax authorities have introduced rules to block such structures and well-advised businesses have introduced even more sophisticated tax structures and mitigation strategies to overcome such rules.

Today, with a difficult worldwide economic situation and the tight budgetary conditions facing many Western economies, politicians, press and public are increasingly scrutinising the tax affairs of multinational companies. This is particularly the case in the sectors of the economy that rely heavily on intangible assets such as brands that are highly mobile and that can, if located in low-tax jurisdictions with minimal substance requirements, have a dramatic downward effect on a group's effective corporate tax rate.

This increasing scrutiny is leading to increased crackdowns on international tax avoidance behaviour and tax arbitrage, with measures such as the BEPS project, which is being run by the OECD and G20 (see Section V.iv). At the same time, however, many governments are seeking to reduce corporate tax rates and provide corporate tax incentives to attract

104 TIOPA, Section 112.

105 TIOPA, Section 9(7).

inward investment. In an area such as franchising, where profits substantially derive from IP, there have traditionally been significant opportunities to locate IP in a low-tax jurisdiction to minimise taxes. However, the effect that an overly aggressive tax structure may have on reputation is becoming a key business concern, particularly for consumer-facing businesses.

This section gives a general overview of the tax strategies a franchisor may consider in looking to reduce its effective tax rate and outlines the anti-avoidance rules that have been introduced to limit overly aggressive planning.

A common form of tax planning for franchisors was to take their IP and operations offshore from the United Kingdom to a jurisdiction with a lower tax rate. By doing this they would hope that income could be rolled up in a lower-taxed jurisdiction thus avoiding or at least deferring UK tax.

For tax purposes, a relevant IP holding entity (IP Co) ideally should not be subject to:

- a* profits tax in that entity;
- b* withholding taxes on payments by that entity (e.g., dividends or interest); and
- c* withholding taxes on royalty payments to that entity.

Therefore, tax planning would involve considering which entity would be effective in reducing profits tax and withholding tax, thereby assisting to lower the effective rate.

This entity could either be:

- a* an entity subject to tax (taxable entity) such as a company incorporated in the United Kingdom; or
- b* an entity not subject to tax (non-taxable entity) such as a company incorporated in a tax haven.

As tax havens do not have decent tax treaty networks, withholding taxes may dictate having an entity with a low level of taxation in the structure (and therefore access to a tax treaty network). Examples of relevant jurisdictions that may meet these criteria are the United Kingdom, Luxembourg, Belgium, the Netherlands, Cyprus and Ireland. The availability of certain tax advantages in these jurisdictions could, depending on the circumstances, give rise to a competitive effective tax rate. Such advantages to be considered may include:

- a* a low corporate tax rate on royalty income;
- b* the availability of relief – the ‘taxable’ jurisdiction may offer attractive relief for holding IP or undertaking research and development (R&D) activities. For example, ‘patent box’-type regimes in the United Kingdom, Netherlands, Belgium and Luxembourg give rise to low tax rates or partial exemption for certain types of IP royalties. The states may also provide taxable amortisation of purchased IP; actual and in certain cases deemed deductions for interest expenses and R&D tax credits; and
- c* the availability of double-tax treaties or the EU Interest and Royalties Directive to reduce withholding taxes and maximise double-taxation relief, as detailed in Section III.vii.

An increasingly important factor to bear in mind when looking at the location of any vehicle is that the vehicle is likely to require ‘substance’ to obtain the relevant tax benefits. It is therefore almost always better to locate companies in jurisdictions where there are people with the requisite skills and experience to manage the business carried on by such a company. This requirement for substance has been particularly enhanced following the BEPS project (e.g., the new transfer pricing regime for intangibles).

If IP is held in a taxable structure, tax planning will concentrate around minimising the tax rate (e.g., using special tax regimes applicable in that jurisdiction), maximising reliefs (e.g., amortisation of acquisition cost, R&D reliefs and finance costs) and avoiding withholding taxes.

For an IP Co to be tax-efficient, the licensees would be residents of jurisdictions that do not apply withholding tax on payments to the IP holding vehicle or that have suitable double-tax treaties to reduce or eliminate any withholding tax.

One further way to reduce withholding taxes used to be by using another entity (royalty company) through which the royalties would flow. By flowing the royalties through a royalty company (1) with a suitable tax treaty with the licensee's jurisdiction (eliminating or reducing withholding taxes on royalties); and (2) incorporated in a country that does not levy withholding tax on royalty payments (or has a suitable tax treaty with the jurisdiction in which the IP Co is located), withholding taxes on the royalties could be mitigated (subject to anti-avoidance rules).

However, various tax treaty provisions prevent 'treaty shopping'. Again the BEPS project has made planning through 'conduit' and similar structures more difficult, as it has resulted in the inclusion in tax treaties of various provisions that prevent treaty abuse. Additionally, anti-avoidance rules may apply to deny treaty benefits or the tax authorities may not view the royalty company as being entitled to the royalties for treaty purposes.¹⁰⁶

If a UK entity were to set up a structure with an offshore subsidiary IP Co or royalty company, the following hurdles would need to be overcome to achieve its aims:

- a* Tax charge on transfer of IP: if any of the IP transferred has a value then the transfer is likely to be taxable; if the franchisor is prepared to accept some tax now to enter into the structure what would be the level of taxation?
- b* Controlled foreign company (CFC) rules: if the IP is in an offshore entity, could its profits in any event be attributed to the United Kingdom under CFC or similar rules?
- c* Substance: will the offshore company be treated as non-resident or trading in the United Kingdom through a permanent establishment in any event and will it have sufficient substance to be seen as the owner of the IP and to benefit from tax treaties etc.?
- d* Diverted profits tax: this applies to certain structures that do not have sufficient economic substance or that artificially avoid having a permanent establishment in the United Kingdom.

In addition, all relevant anti-avoidance measures and the offshore receipt rules (see Section III.ix) would need to be considered in detail and overcome. In summary, it is increasingly difficult for a UK business to transfer its IP out of the UK to minimise the business's effective tax rate.

i Tax charges on transferring IP to an offshore licensing entity

A taxable gain may be crystallised when a franchisor disposes of the relevant assets to an offshore company. In seeking to transfer IP to an offshore entity, the franchisor will have to consider the assets to be transferred carefully.

¹⁰⁶ See *Indofood International Finance Ltd v. JP Morgan Chase Bank NA London Branch*; see also the revised commentary on the meaning of 'beneficial ownership' as set out in the 2014 update to the OECD Model Convention.

If we consider the nature of the assets to be transferred, each will have a slightly different treatment when seeking to either transfer the asset or simply register new classes of such IP in an offshore jurisdiction. In this respect it should be borne in mind that different IP has different characteristics. Goodwill can be very local to a business or it can be worldwide; patent rights, however, cannot be enforced outside the jurisdiction of registration but may confer priority registration rights overseas. A franchisor looking to transfer IP offshore will therefore have to analyse carefully each asset from both a legal and an economic perspective to determine whether any value is being transferred to the offshore entity and whether such a transfer is therefore taxable (either because the offshore acquirer pays a market price or is deemed to do so under transfer pricing or similar rules).

Specifically, different assets will be taxed as follows:

- a* for trading companies subject to the intangible fixed asset regime, disposals of intangibles will be taxed as trading profit under Part 8 CTA 2009. Rollover relief under Chapter 7 of Part 8 may apply if the proceeds of sale (if any) are reinvested in intangibles; and
- b* for intangible assets that are not in the above regime, the tax treatment will be as described above, that is:
 - goodwill will be taxed as a capital gains asset and will be taxed under Section 21, Section 22(c) or (d) or Section 29(5) of the TCGA with arm's-length pricing substituted if necessary by Section 17 of the TCGA;
 - patents will be subject to tax either as a trading profit or under Section 912 of the CTA 2009 with tax being potentially spread over six years. Potentially, if capital allowances have been claimed, an amount may need to be brought into account under the capital allowance rules;
 - know-how: Section 177, the ability to elect under Section 178 and Sections 908–910 of the CTA 2009 will not apply to transfers between connected parties. In this event, the transfer will either constitute trading profits, give rise to a chargeable gain or be taxed under the capital allowance rules depending on the circumstances; and
 - copyright, trademarks, designs and design rights will similarly be taxed either as trading income or under chargeable gains rules.

Where a company has a solid UK business but is looking to expand internationally through franchising arrangements, it may seek to split its IP between that which relates to the United Kingdom and that which relates to jurisdictions outside the United Kingdom. It may then seek to transfer the non-UK IP to a tax-friendly jurisdiction and argue that the non-UK IP has no or little value at the time of such a transfer. Whether or not this is justifiable is a question of valuation, which will depend on the extent to which the franchisor has already carried on any trade abroad or has any pre-existing enforcement rights in the relevant offshore jurisdictions, including priority registration rights. This will vary between different classes of IP.

Should there be any taxable profit or gain on the transfer, the franchisor will look to see whether it has any tax assets (such as losses) that it can utilise against a gain. Companies looking to migrate their assets offshore may also consider the reorganisation rules outlined above to determine if they could do so without crystallising a tax charge. It should be borne in mind, however, that many of those rules require a bona fide (and not a tax avoidance)

intention to fall within the relevant provisions.¹⁰⁷ Alternatively, a franchisor may consider licensing the IP in a manner that does not give rise to a disposal of the asset but that gives rise to tax on the licence fees over a number of years. Whether a licence amounts to a disposal depends on its terms and whether the receipt falls into income or capital as set out above. An exclusive licence for a long period is likely to constitute a disposal whereas a non-exclusive licence for a short period is not.

ii Controlled foreign company rules

Under the United Kingdom's CFC rules contained in Part 9A of the TIOPA 2010, if a company resident outside the United Kingdom is controlled by persons resident in the United Kingdom, then the profits of the non-resident company (together with any creditable local tax) can be apportioned to UK tax-resident corporate shareholders and charged to UK tax.

Control by UK persons includes cases where a company is controlled by two shareholders each holding 40 per cent or more of the controlling rights and one of which is resident in the United Kingdom. The rules are designed to target transactions that artificially divert profits from the United Kingdom.

The rules relating to CFCs are highly technical and detailed (and therefore beyond the scope of this chapter). However, there are a number of helpful exemptions that eliminate this charge. The main entity-level exemptions to a CFC apportionment are:

- a* the exempt period exemption: broadly speaking allowing a period of grace of at least 12 months from coming under UK ownership;
- b* the excluded territories exemption: this exempts companies resident in certain territories from the CFC rules provided:
 - the CFC's 'bad' income (e.g., income that is exempt from tax locally) is not over 10 per cent of its accounting profits or if more, £50,000; and
 - the CFC does not have significant IP income that derives from IP transferred from related persons resident in the United Kingdom (or if not so resident, the IP was held for a permanent establishment of such persons in the United Kingdom) or IP that otherwise derives from IP held by such persons;
- c* the low profits exemption: broadly speaking this applies where the CFC either has:
 - profits of less than £50,000; or
 - profits of less than £500,000 of which no more than £50,000 are non-trading profits;
- d* the low profit margin exemption: where the CFC's profits are not more than 10 per cent of its relevant operating expenditure; and
- e* the tax exemption: where the CFC's tax is at least 75 per cent of what the corresponding UK tax on such profits would have been.

Anti-avoidance rules attach to prevent the exemptions applying in abusive situations.

Even if the CFC is not exempt under the above rules, its profits are only apportioned to relevant UK shareholders and subject to tax under the CFC rules to the extent that those profits fall within one of the 'gateways'. CFC gateways include:

- a* profits attributable to UK activities;

107 For example, Section 140C, Section 140E(8), 140F(9) TCGA.

- b* non-trading profits;
- c* trading finance profits;
- d* captive insurance business; and
- e* certain subsidiaries of FSA-regulated companies.

Of most relevance for franchising activities will be the first two of these gateways. If a company's profits meet a number of tests as to non-attribution to the United Kingdom, it will not fall within this first gateway. One of these tests is an IP condition that is similar to the above IP test in the excluded territories exemption.

The intention behind these exemptions and gateways is to stop the CFC rules catching commercially driven structures. However, because of the complexity of these rules they may catch what might seem to be commercial structures and therefore need to be considered in all cases where companies are owned directly or indirectly by UK companies.

iii Diverted profits tax

This tax applies where:

- a* payments are made by a UK resident (or the UK permanent establishment of a foreign company) to another person that lacks economic substance and there is an effective tax mismatch, and it is reasonable to assume that without the tax benefit the income would not have been diverted from the United Kingdom; or
- b* a foreign company artificially avoids having a permanent establishment in the United Kingdom.

Where the rules apply, a tax charge at 25 per cent applies to the amount of profits that would otherwise have been taxed in the United Kingdom. In the case of the avoided permanent establishment, the DPT rules also charge to tax any royalties that would have been deemed to be payable had there been a UK permanent establishment. The rules do not apply:

- a* to SMEs (i.e., where, with certain connected persons there are less than 250 employees and either the annual turnover does not exceed €50 million or an annual balance sheet does not exceed €43 million);
- b* where a permanent establishment is avoided and UK sales do not exceed £10 million and UK-related expenses do not exceed £1 million in a 12-month accounting period; and
- c* where the 'diverted profits' are taxed by an amount equal to at least 80 per cent of the UK tax that would have been payable.

iv Anti-avoidance

It is clear that there would, in the absence of rules to the contrary, be significant scope for tax planning as the nature of IP assets means that they are easy to move across borders.

The historic approach to judicial intervention in tax avoidance cases can be seen in *IRC v. Duke of Westminster*,¹⁰⁸ when Lord Tomlin said: 'Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be.' This approach gave rise to a literal interpretation of tax legislation, allowing structures to be easily devised that circumvented the relevant legislation. However, modern jurisprudence,

108 (1936) 19 TC 490.

following a line of cases, including *Ramsay (WT) Ltd v. IRC*,¹⁰⁹ *Furniss v. Dawson*¹¹⁰ and *Barclays Mercantile Business Finance v. Mawson*,¹¹¹ has taken a more purposive interpretation of tax legislation. As Lord Nicholls says in *Barclays Mercantile Business Finance v. Mawson*:

The essence of the new approach was to give the statutory provision a purposive construction to determine the nature of the transaction to which it was intended to apply and then to decide whether the actual transaction (which might involve considering the overall effect of a number of elements intended to operate together) answered to the statutory description.

The courts are therefore no longer prepared to take a blinkered look at each transaction but will consider a tax avoidance scheme as a whole. An example of the current approach in overcoming a tax avoidance scheme can be seen in *Astall & Another v. HM Revenue & Customs*.¹¹² An example of the limits of such an approach, where it was not possible to interpret the purpose of the legislation, can be seen in the case of *Mayes v. HMRC*.¹¹³

Any tax planning and structuring in respect of franchising arrangements and IP licensing structures should therefore always consider whether what is planned falls within the relevant legislation after taking a purposive interpretation of that legislation.

Further specific anti-avoidance rules have been developed to catch the more obvious schemes that have been devised. In any given situation, all relevant specific anti-avoidance rules, sometimes known as targeted anti-avoidance rules (TAARs), will need to be considered. As this is not a tax textbook, we will not consider all possible TAARs in this chapter. There are also rules whereby certain types of tax avoidance schemes have to be notified to HMRC.¹¹⁴

Additionally, the United Kingdom has a general anti-abuse rule (GAAR) that could apply to any given transaction and would need to be considered seriously by anybody seeking to implement any tax planning. The details of the GAAR are set out in Part 5 Finance Act 2013. The GAAR applies to counteract tax advantages arising from tax arrangements that are abusive.¹¹⁵

‘Tax arrangements’ for the purposes of the GAAR are arrangements of which it would be reasonable to conclude, having regard to all the circumstances, that the obtaining of a tax advantage was the main purpose or one of the main purposes. Such arrangements are abusive if they are arrangements the entering into or carrying out of which cannot reasonably be regarded as a reasonable course of action in relation to the relevant tax provisions having regard to all the circumstances, including whether:

- a* the substantive result of the arrangements is consistent with any principles on which the provisions are based and the policy objectives of the provisions;
- b* there are contrived or abnormal steps; and
- c* the arrangements are intended to exploit shortcomings in the provisions.

109 [1982] AC 300.

110 [1984] STC 153.

111 [2005] STC 1.

112 [2009] EWCA Civ 1010.

113 [2009] EWHC 2443 (Ch) (8 October 2009).

114 The primary legislation is to be found in Part 7 and Schedule 2 Finance Act 2004.

115 Section 206 FA 2013, Section 206.

Examples of things that might indicate that tax arrangements are abusive include profits being significantly less than economic profits, deductions significantly greater than economic costs or claims for tax credits relating to taxes that are unlikely to be paid. In contrast, compliance with HMRC practice is indicative that arrangements are not abusive.

A number of taxpayer safeguards are built into the GAAR, including:

- a* requiring HMRC to establish that the arrangements are abusive;¹¹⁶
- b* applying a 'double reasonableness' test. This requires HMRC to show that the arrangements 'cannot reasonably be regarded as a reasonable course of action';¹¹⁷
- c* allowing the court or tribunal to take into account any relevant material as to the purpose of the legislation that it is suggested the taxpayer has abused, or as to the sort of transactions that had become established practice at the time when the arrangements were entered into;¹¹⁸ and
- d* requiring HMRC to obtain the opinion of an independent advisory panel as to whether an arrangement constituted a reasonable course of action, before they can apply the GAAR.¹¹⁹

The legislation is also supported by detailed guidance rules issued by HMRC. In respect of international tax planning the guidance notes state:¹²⁰

B5.1 There is a network of treaties between States setting out rules that govern the taxation of investment and business activities involving more than one State. These treaties (which are typically based on an OECD Model Treaty) are usually referred to as 'double-tax treaties', and their purpose is to avoid subjecting such investments or activities to tax in more than one State and to prevent tax evasion. The United Kingdom has entered into over 100 such treaties, and they are given effect in domestic tax law.

B5.2 Many of the established rules of international taxation are set out in double-taxation treaties. These cover, for example, the attribution of profits to branches or between group companies of multinational enterprises, and the allocation of taxing rights to the different States where such enterprises operate. The fact that arrangements benefit from these rules does not mean that the arrangements amount to abuse, and so the GAAR cannot be applied to them. Accordingly, many cases of the sort which have generated a great deal of media and Parliamentary debate in the months leading up to the enactment of the GAAR cannot be dealt with by the GAAR

B5.3 However, where there are abusive arrangements which try to exploit particular provisions in a double-tax treaty, or the way in which such provisions interact with other provisions of UK tax law, then the GAAR can be applied to counteract the abusive arrangements.

The BEPS project has also changed the global approach to international tax planning and the MLI (see Section III.viii) has significantly reduced the scope for treaty shopping.¹²¹

116 FA 2013, Section 211(1).

117 FA 2013, Section 207(2).

118 FA 2013, Section 211(3).

119 Schedule 43 FA 2013 and Section 211(2)(b) FA 2013.

120 HMRC'S GAAR Guidance (Approved by the Advisory Panel with effect from 28 March 2018).

121 OECD (2013), 'Action Plan on Base Erosion and Profit Shifting', OECD Publishing. See <http://dx.doi.org/10.1787/9789264202719-en>.

In addition, the EU has adopted the Anti-Tax Avoidance Directive (ATAD), which has been applied by Member States since 1 January 2019. The ATAD imposes a minimum standard for a number of the matters set out in this chapter, to be applicable at EU level, including exit taxation (i.e., tax on assets transferred across borders); an EU-wide GAAR; and minimum standards of CFC rules. Furthermore, the EU is looking to impose a common corporate tax base under which corporate tax is calculated in each Member State on the same set of rules; followed by a common consolidated corporate tax base under which tax will be payable on an EU-wide basis and then apportioned to relevant Member States. Given the uncertainty of the UK position post Brexit, we have not analysed these proposals in detail.

v Company residence

As stated, where an entity is established in any jurisdiction to hold IP rights or carry out any other function, it is likely to require the requisite 'substance' commensurate with its functions. Such substance requirements may arise as a result of a number of factors:

- a* local laws may require specific substance requirements to fall within favourable tax regimes or to benefit from tax treaties or EU directives;
- b* transfer pricing analysis will be undertaken on the basis of a functional analysis that in turn will require continued substance commensurate with such analysis;
- c* residence under local law and tax treaties will usually depend on where the company is managed; and
- d* if the company does not carry out its functions in the local jurisdiction, there is a risk that it may be taxable elsewhere through a permanent establishment.

HMRC will apply these tests to determine whether an entity established offshore is actually resident in the United Kingdom. It is usually best practice to ensure that an entity is appropriately managed in its home jurisdiction to ensure that it meets any required substance tests locally and to ensure that it is not resident in the United Kingdom (or another taxable jurisdiction).

As stated above, a company that is not incorporated in the United Kingdom could be treated as resident in the United Kingdom under UK domestic law if it is centrally managed and controlled in the United Kingdom. The meaning of central management and control is not defined in UK statute and has instead been determined according to UK case law principles. Broadly, the central management and control test is a question of fact that looks at where the highest level of control (i.e., the overall strategic management structure, as opposed to the day-to-day management) of an overseas company is physically conducted. As stated in UK case law,¹²² the question depends on where the 'real business is carried on' and this is 'where the central management and control actually abides'. It is also stated that 'it is the actual place of management, not that place in which it ought to be managed, which fixes the residence of a company'.¹²³ If this is in the United Kingdom, the company is UK tax-resident (in the absence of any tax treaty provision to the contrary). Cases have attached importance to the place where the company's board of directors meet, although this is not necessarily

122 *De Beers Consolidated Mines Ltd v. Howe* 5 TC 213.

123 *Unit Construction Co Ltd v. Bullock* [1960] AC 351.

conclusive. HMRC sets out detailed guidance in its manuals as to the meaning of central management and control, including a reproduction of the Statement of Practice,¹²⁴ which sets out its view of the factors relevant to determining residence under the common law test.

In some cases, central management and control may be exercised by a single individual. This may happen when a chairman or managing director exercises powers formally conferred by the company's articles and the other board members are little more than ciphers, or by reason of a dominant shareholding or for some other reason. In those cases, the residence of the company is where the controlling individual exercises those powers.

In general, the place of directors' meetings is significant only insofar as those meetings constitute the medium through which central management and control is exercised. In the case of *Wood and another v. Holden*¹²⁵ the Court of Appeal held that an overseas incorporated company, managed by an overseas trust company, which received advice from professional advisers in the United Kingdom, could not be considered to be UK-resident for tax purposes purely because the trust company acted on the recommendations of the professional advisers. This case showed that there must be clear evidence that the central management and control of a non-UK incorporated company is carried out by its directors, and that the authority of the directors has not been usurped by anybody (such as UK-based directors or advisers) in the United Kingdom.

Where a treaty tiebreaker applies, residence is where the company is 'effectively managed', although, following implementation of the MLI, this is likely to change in many treaties to the jurisdiction agreed by the relevant tax authorities under a mutual agreement procedure. It is usually very difficult to see how the place of the 'central management and control' of a company's business for the purposes of determining its residence under UK domestic law will not be the same as the location of its 'place of effective management' for the purposes of the double-tax treaty. A useful case, which considered in detail a company's residence, was that of *Laerstate BV v. HM Revenue & Customs*.¹²⁶

As well as residence issues, a company will be keen not to have taxable permanent establishments in a jurisdiction outside its place of residence. As well as ensuring that the company does not have an overseas office or other fixed place of business, it should not have dependent agents concluding or substantially negotiating contracts on its behalf outside its jurisdiction of residence. Ideally the company should also not have any employees outside such a jurisdiction.

As a practical matter, companies should follow clear guidelines to ensure their decision-making processes do not inadvertently mean they are resident in a different jurisdiction from that intended – or for that matter trade through a permanent establishment in such a jurisdiction. Examples of matters that could be contained in such guidelines might include:

- a* having a majority of local directors with the necessary requisite skill and knowledge;
- b* holding a minimum number of board meetings each year in the relevant jurisdiction;
- c* making all strategic and other decisions of effective management at those board meetings;
- d* not holding board meetings in any other jurisdiction;
- e* ensuring that there is no or limited participation in board meetings by telephone and no written resolutions;

124 SP1/90 (9 January 1990) now published at INTM120200.

125 [2006] STC 443 (Court of Appeal).

126 [2009] UKFTT 209 (TC).

- f* approval of key contracts should be at board meetings and all contracts should be approved and entered into by local directors;
- g* not substantially negotiating contracts without input from the board. The board should not simply 'rubber stamp' contracts;
- h* having a local company secretary, or similar officer, from which all key documents emanate; and
- i* holding all necessary books and records at the local registered office.

vi Tax issues arising from corporate structuring

As well as the above issues that arise from tax-driven structuring, many tax issues for franchisors can arise from more commercially driven corporate structuring. For example, franchisors may seek equity participation in their franchisees for economic benefits but also to provide the franchisors with a degree of corporate control. The tax implications of such joint-venture arrangements will depend on the precise circumstances but may involve:

- a* the effect of any control arrangements on the tax residence status of the franchisee;
- b* whether the control arrangements make the parties connected for any tax purposes (e.g., transfer pricing);
- c* the ability to claim consortium relief for tax losses and the need to deal with surrenders of tax losses under the relevant documentation;
- d* whether the interest acquired by the transferor is sufficient to obtain any tax relief (e.g., exemption from chargeable gains in the United Kingdom under the substantial shareholdings exemption); and
- e* the tax treatment of any financing arrangements.

VI FRANCHISEE TAX POSITION

While franchisors will generally be companies (and we have therefore concentrated on the corporation tax rules for companies), franchisees may be much smaller businesses and could be run as companies, partnerships or unincorporated small traders. It is beyond the scope of this book to discuss the general tax environment for all such traders. We set out below, however, the tax treatment of the likely payments by corporate franchisees under franchising arrangements. This is generally the reverse of the franchisor treatment. Specifically, a franchisee will want to know:

- a* whether payments are deductible for tax purposes; and
- b* whether it will be required to deduct tax at source from payments under any franchise agreements.

For the franchisee, a greater degree of analysis will generally be required as the nature of the payments will vary more dramatically.

i Initial fee

The crucial question for the franchisee will be whether the initial fee (or fees) payable by it are income or capital in nature. As the fees will be incurred wholly and exclusively for the franchisee's trade, then if income in nature the fees should be deductible as part of the

franchisee's trading profits. If capital in nature, the fees would not be so deductible. The tax treatment will depend on the nature of the fee and the circumstances of the franchisee. Specifically, for corporate franchisees:

- a* If the payment is an acquisition of intangible assets (including goodwill), this will for UK corporate franchisees fall within the intangible fixed asset rules (unless the intangible assets are pre-April 2002 IP, which will be the case if it is pre-April 2002 IP for the franchisor and the franchisor and franchisee are connected). If the intangible fixed assets rules apply, the franchisee should, other than in the case of acquired goodwill (or similar IP), obtain a tax deduction for the accounting amortisation of the IP or, if it elects, a fixed writing-down deduction of 4 per cent per annum. For goodwill, customer-related intangible assets and unregistered trademarks, the franchisee will be treated as having made an election for a fixed writing-down deduction of 6.5 per cent per annum. The franchisee may also qualify for rollover relief in respect of past gains under Chapter 7 of Part 8 or Section 898 of the CTA 2009.
- b* Payments not covered by the intangible fixed asset rules will need to be analysed on a case-by-case basis and analysed as income or capital depending on the facts (see above for a review of what constitutes income or capital expenditure). Generally, franchisors' initial costs are likely to be capital in treatment on the guidelines set out. HMRC confirms this in its manuals on the basis of *S Ltd v. O'Sullivan*¹²⁷ and *Atherton v. British Insulated and Helsby Cables Ltd.*¹²⁸ The costs are to be split as follows:

 - Capital payment for goodwill or franchise rights – for individuals and companies not within the intangible fixed asset rules, goodwill will be an asset for capital gains tax purposes and therefore the acquisition cost will form part of the base cost of the asset but will not give rise to any income tax relief on acquisition. It may be possible to roll over a gain into the expenditure under the rules in Section 152 of the TCGA. However, HMRC takes the view that the amount paid by a franchisee is not for goodwill but for franchise rights, which while being assets for capital gains tax purposes are not assets to which rollover relief applies, and if the licence agreement is less than 50 years, the asset acquired will be a wasting asset for capital gains purposes¹²⁹ the effect of which will be to not only prevent rolling any gains into the asset but also to depreciate its base cost for chargeable gains purposes. Nevertheless, a franchisee can subsequently generate its own goodwill¹³⁰ such that it is able to apply rollover relief on a subsequent sale of its franchised purchase. This was the case in *Balloon Promotions* and HMRC's view of this is set out in Tax Bulletin 83. However, in this case the Special Commissioners accepted that there was substantial goodwill in the actual business as run by the franchisee and not in the franchisor's brand (Pizza Express) at that time. It was also a pertinent fact that the franchise agreement had a six-month termination right for either party such that the court held that there were not substantial valuable rights in the agreement.

127 Irish Tax Cases 108.

128 (1925) 10TC155; Business Income Manual BIM57620.

129 Capital Gains Manual CG68270 and CG76724.

130 *Balloon Promotions Limited v. Wilson* SpC 524/06 [2006] STC (SCD) 167.

- Capital payment for know-how or patents – to the extent that any of the initial fee could be attributed to patents or know-how then capital allowances should be available under Parts 7 or 8 Capital Allowances Act 2001.
- Deferred revenue expenditure – just because an initial lump-sum payment is made, it does not mean that this is necessarily capital and general principles should apply to determine if expenditure is income or capital in nature. For example, a prepayment for ongoing staff training may be income in nature albeit paid up front (c.f., an initial one-off training, which is likely to be capital in nature). Such payments for deferred revenue expenditure could be written off in the accounts up front or over a period of years. The accounting treatment will be important in this respect¹³¹ but not conclusive.¹³²
- Acquisition of trademarks and copyright – these rights would be capital gains assets – possibly wasting assets – and there are no capital allowance rules for such rights.
- Costs of premises are likely to be capital in nature and fit out costs may qualify for relief under the capital allowances code.

HMRC states in its published guidance¹³³ that:

Whether an apportionment between capital and revenue expenditure is appropriate depends on the facts. The facts may show that no part of the initial lump sum fees can be attributed to services of a revenue nature provided by the franchisor because such services are separately charged for in the annual fees.

In practice, franchisees may put forward an apportionment without reference to the franchisor. An apportionment of this type may be difficult to justify in relation to the services provided. For instance, some franchisors are unwilling to negotiate special terms with individual franchisees and the same lump sum is payable irrespective of the actual services required from the franchisor; for example, the number of staff needing training may be irrelevant.

If the agreement terms are such that no part of the initial fee is specifically attributed to revenue items, then the claim for apportionment may need to be critically examined.

ii Capital allowances

A deduction for capital expenditure is available under the capital allowances regime to reduce profits for corporation tax (under the pre-April 2002 regime) and for income tax purposes. Generally, expenditure must be classified as capital and must be incurred on specified assets. Specific rules provide for expenditure on R&D, know-how and patents to be relieved.

The quantum of capital allowance that can be claimed by a taxpayer is provided at a specified rate for each tax year and depends on the type of capital asset and the type of entity incurring the expenditure.

131 For example, *Strick v. Regent Oil Limited* (1965) 43 TC 1; *Johnson v. Britannia Airways Ltd* (1994) STC 763.

132 *EEC Quarries Limited v. Watkis* (1975) STC 175.

133 Business Income Manual BIM57620.

Acquisition of know-how

Where a taxpayer incurs expenditure for the purpose of acquiring know-how from an unconnected person, a capital allowance deduction may be available if the know-how is used in a trade.¹³⁴

'Know-how' is defined as 'any industrial information or techniques likely to assist in manufacturing or processing goods or material; working a source of mineral deposits; or carrying out any agricultural, forestry or fishing operations'.¹³⁵

HMRC takes the view that this definition does not extend to commercial know-how (such as market research, customer lists and sales techniques) because this is not 'industrial information or techniques likely to assist in the manufacture of goods or materials'.¹³⁶ As such, know-how allowances are unlikely to be of relevance in many franchising situations.

The rate of allowance depends on the tax year in which the relief is sought. Where relief is sought, the allowance is:

- a* all years (except the year in which (b) applies) – 25 per cent of the excess of available qualifying expenditure (AQE) for the pool of assets subject to capital allowance deduction over total disposal value (TDV); and
- b* final tax year (e.g., when trade discontinued) – amount by which the AQE exceeds the TDV.¹³⁷ If the TDV exceeds AQE then an assessable balancing charge will arise to the taxpayer.¹³⁸

Broadly speaking, AQE is capital expenditure on know-how that is incurred for the purposes of the trade and TDV is the net proceeds of sale (which consists of capital sums).

Acquisition of patent rights

A capital allowance deduction is available for capital expenditure incurred to acquire patent rights for the purpose of a trade within the charge to UK tax¹³⁹ (or for patent rights that give rise to UK taxable income).¹⁴⁰

Patent rights are defined as rights to do or authorise the doing of anything that would, but for that right, be an infringement of a patent.¹⁴¹

There is a separate pool of expenditure for each trade and a pool for non-trading expenditure. The writing down allowance available is 25 per cent of the excess of the AQE over total disposal receipts¹⁴² each tax year with similar rules for balancing charges or allowances as know-how. Where the patent rights are not used for a trade, any allowance is given against patent income only.

¹³⁴ CAA 2001, Section 454(1).

¹³⁵ CAA 2001, Section 452(2).

¹³⁶ Capital Allowances Manual CA70030.

¹³⁷ CAA 2001, Sections 458(1), (6); 457(4), (5).

¹³⁸ CAA 2001, Sections 457(3); 458(5).

¹³⁹ CAA 2001, Section 468(1).

¹⁴⁰ CAA 2001, Section 469.

¹⁴¹ CAA 2001, Section 464(2).

¹⁴² CAA 2001, Section 472.

iii Ongoing fees

Ongoing payments will almost always constitute deductible expenses for the purposes of calculating the franchisee's trading profits as they should be income in nature and wholly and exclusively incurred for the purposes of the trade. The key question for such expenses will be whether they are subject to deduction of tax at source – which may also be a question for some capital expenditure included in the initial fee (e.g., if patents have been acquired). Whether or not this is an issue for the franchisee will depend on whether or not the agreement includes a gross-up clause, pursuant to which the fees are increased such that the franchisor stays in the same after-tax position.

As well as the above issues that are specific to the agreement, franchisees will have to contend with all the same tax issues as many other small businesses would have to contend with. For example, it would have to consider:

- a* If it is a start-up, should the franchisee establish itself as a sole trader, a partnership or a company?
- b* How are its real estate costs treated? Can it make sure its rental payments are deductible?
- c* Will it obtain tax deductions for depreciating capital items (e.g., under the capital allowances rules)?
- d* Are interest expenses tax deductible for the franchisee? Will it have to deduct tax at source?
- e* Can the franchisee attract investors by offering tax-incentivised equity (e.g., under the UK enterprise investment scheme rules or the seed enterprise investment scheme)?
- f* Can it minimise VAT in respect of its supplies to the public?

VII TRANSFER PRICING

Where transactions take place between related, associated or connected companies, there is an incentive for profits to be 'moved' from a company with a relatively high tax rate to another company with a relatively low tax rate. This could be achieved, for example, in the context of a trademark licence, by an inflated royalty being charged by a licensor in a low-tax jurisdiction to a licensee resident in a high-tax jurisdiction (thus stripping taxable profits out of the high-tax jurisdiction).

The transfer pricing regime seeks to prevent this type of practice by requiring an arm's-length price to be paid (in the above case, an arm's-length royalty to be paid by the licensee). This is a general rule, which is similar to the specific rules, which impose market value prices on transactions between connected persons (e.g., for capital gains tax, TCGA 1992, Section 17 and for chargeable intangible assets, CTA 2009, Section 845).

Many countries have a transfer pricing regime and, although the precise mechanics vary from country to country, many are based on the OECD's transfer pricing guidelines, which were most recently updated in 2017 to bring them into line with the BEPS action points. The United Kingdom's transfer pricing rules are in TIOPA 2010, Part 4. Broadly speaking, the provisions seek to adjust the tax return of a person who obtains a potential UK tax advantage from its non-arm's length dealing with another person. The tax return is adjusted as though the transaction had been at arm's length. SMEs may be exempt from transfer pricing rules under Section 166 TIOPA unless the transaction is with a party in a non-qualifying territory

(broadly speaking, a tax haven), although HMRC may by notice, in the case of medium-sized enterprises (and where the UK Patent Box applies, small enterprises), disapply the exemption. The definition of an SME follows the general EU definition.¹⁴³

The regime applies where provision has been made or imposed between two ‘affected persons’ by a transaction or series of transactions, the participation condition is met, and the actual provision differs from what would have been the actual provision between independent enterprises dealing on arm’s-length terms (the ‘arm’s-length provision’). The UK rules apply even where the transactions are between two UK parties.

To meet the participation condition, one person must control the other or they must be under the control of the same person. ‘Control’ means voting control or control by virtue of powers conferred by the articles of association or other document regulating the powers of a company whereby the company’s affairs are conducted in accordance with the wishes of the controller.¹⁴⁴ In the context of a partnership, control means the right to a share of more than one half of its assets or income. The definition is extended in certain circumstances (e.g., to include rights held by connected persons, rights that will be acquired in the future or persons who own 40 per cent or more of the controlling shares in a company where there is another such 40 per cent or more shareholder).

Where the provisions apply, penalties may be assessed to the extent of tax lost because of fraud or negligent conduct. However, HMRC indicates that where the taxpayer makes an honest and reasonable attempt to comply with the legislation, HMRC will not impose a penalty.¹⁴⁵

In practice, determining the arm’s-length value, particularly one that is acceptable to the revenue authorities of two countries, is a difficult exercise. This is particularly the case for intangible assets such as IP, which are often unique to the company or group concerned.

The OECD Transfer Pricing Guidelines¹⁴⁶ describe valuation methods that are generally acceptable to tax authorities around the globe and that have been accepted by HMRC. These are divided into traditional transaction methods and transactional profit methods.

i Traditional transaction methods

Comparable uncontrolled price

The comparable uncontrolled price (CUP) method simply compares the price charged between the connected parties (the ‘controlled transaction’) with the price in a comparable uncontrolled transaction (i.e., a comparable transaction between unconnected third parties – an ‘uncontrolled transaction’). The price in the uncontrolled transaction may need to be substituted for the price in the controlled transaction if the two are comparable. The two transactions should be comparable if:

- a* there are no differences between the transactions being compared or between the enterprises entering into the transactions, which could materially affect the price charged in the open market; and
- b* where there are differences, reasonably accurate adjustments can be made to eliminate their effect.

143 As set out in the Annex to Commission Recommendation 2003/361/EC of 6 May 2003 (concerning the definition of micro, small and medium-sized businesses).

144 CTA 2010, Section 1124.

145 International Tax Manual, INTM 483120.

146 OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, July 2017.

While the CUP method is the most reliable method for transfer pricing, identifying good, reliable comparable uncontrolled transactions can be difficult in practice, as was demonstrated in the case of *DSG Retail Ltd and others v. HMRC*.¹⁴⁷

Resale minus (resale price)

This method is most useful where a company purchases goods for distribution from a connected party (the minus effectively corresponds to a commission and represents the amount out of which the reseller would seek to cover its expenses and, in the light of its functions (taking into account assets used and risks assumed), make an appropriate profit).

Cost plus

This method is most useful for services or where semi-finished goods are transferred between related parties (e.g., a manufacturing company selling to a distribution affiliate), or where joint facility agreements have been concluded. It is in effect the opposite of resale minus, looking at costs incurred and stating that an independent third party would expect to make a fixed profit in addition to such costs. The starting point is therefore the costs incurred by the supplier of the goods or services. A percentage is then added to this to give the supplier a profit appropriate to the functions carried out and the market conditions. The profit element is determined by looking at comparable uncontrolled transactions carried out by the supplier with independent third parties (an 'internal comparable'). If the supplier does not enter into comparable uncontrolled transactions, the mark-up that would have been earned in comparable transactions by an independent enterprise (an 'external comparable') should be considered. As cost-plus generally gives rise to a low fixed profit, it is more suitable to low-risk, low-value functions and is likely to be challenged where the functions or risk involved should give rise to a variable and potentially high level of profits. A risk and functional analysis of what the supplier actually provides is therefore key as to the application of this (and all transfer pricing methodologies). In looking at comparables, it is therefore important to demonstrate similar risk allocations in comparable circumstances. Cost plus can also be used for R&D services, provided that the functional analysis and allocation of risk justify this methodology and any realistically available options or alternative structures in pricing the transaction. In this sense it is sometimes necessary to consider not just who contractually takes the entrepreneurial risk but who would take the entrepreneurial risk were the parties independent.

ii Transactional profit methods

There are two further methods supported by the OECD guidelines that do not look so much at each transaction undertaken by a party but at what level of profit should be allocated to the party. These two methods are the profit split method and the transactional net margin method.

Profit split

This method seeks to determine the division of profits that independent enterprises would have expected to realise from the relevant transactions. It is a 'two-sided' method as it looks at both (or all the) parties to the transaction. The other methods are 'one-sided' in that they only test the appropriate return for a single party without considering the effect on the return

147 TC00001.

of the other party. The method is useful for complex trading relationships where it can be difficult to evaluate transactions separately. The most recent OECD Guidelines make clear that application of a profit split methodology should split the profits on an economically valid basis, which approximates the division of profits that would have been anticipated and reflected in an agreement made at arm's length. This part of the OECD Guidelines was updated as a result of the BEPS project to provide more guidance and examples on when this might be the most appropriate method to use and how it should be applied.

Transactional net margin method

The transactional net margin method looks at the net profit relative to a particular base (e.g., costs, sales, assets) that a taxpayer realises from a controlled transaction. In this sense it is similar to cost plus or resale minus. So in this sense internal comparable should be considered in the first instance followed by external comparables. The OECD Guidelines emphasise finding comparable transactions based on functional analysis.

Applying transfer pricing principles to transactions involving intangible assets, including disposals of such assets and royalty payments, is a particularly difficult area because of the uniqueness of most IP and therefore the lack of comparables. There is a specific chapter of the OECD Guidelines dedicated to intangible property. Similarly, there are special chapters dedicated to intra-group services, cost contribution arrangements and business restructurings – all of which may need to be considered in the context of franchising arrangements. The chapter relating to intangible assets was rewritten as part of the BEPS project.¹⁴⁸ This provides new guidance on defining intangibles, identifying transactions involving intangibles and for determining arm's-length terms for transactions involving intangibles. In a key change resulting from this project, it has been highlighted that IP income should accrue to entities that perform value-creating functions relating to the development, enhancement, maintenance, protection and exploitation of the intangible asset (known as the 'DEMPE functions'). The net effect of this is that it will be more difficult for multinational enterprises to argue that a company in a low-tax jurisdiction that simply funds IP development (e.g., R&D or marketing expenses) can accrue the income from the resulting IP, as it will not have sufficient substance in terms of people functions.

Whichever valuation method is chosen, evidence will be needed to justify the value given. Documentation should be kept to prove the relevant relationship, nature, terms and prices of the relevant transactions, the valuation method used (particularly how the arm's-length price was determined, including any functional analysis or comparable study). The basis for any computational adjustment required to reach an arm's-length value should be retained, and the terms of relevant commercial arrangements with both third-party and affiliated customers. Such documentation should be kept for at least six years from the end of the chargeable period to which it relates.

The extent of documentation should be such 'as is reasonable given the nature, size and complexity (or otherwise) of their business or of the relevant transaction (or series of transactions) but which adequately demonstrates that their transfer pricing meets the arm's-length standard'.¹⁴⁹

It should also be borne in mind that where transfer pricing is relevant to any transaction, a taxpayer may apply pursuant to Section 223 of the TIOPA for an advance pricing agreement

¹⁴⁸ Guidance on Transfer Pricing Aspects of Intangibles, BEPS Action 8: final report dated 5 October.

¹⁴⁹ INTM 483030.

to seek clarity on the terms of a transaction for transfer pricing purposes. Such agreements can be unilateral (i.e., only agreements with HMRC) or bilateral (i.e., where the agreement relates to a cross-border transaction seeking agreement with HMRC and the tax authority in the other jurisdiction).

VIII VALUE ADDED TAX

Broadly speaking, VAT is an indirect tax, chargeable on consumer expenditure. In the EU, it is based on the EU VAT Directive.¹⁵⁰ VAT is implemented under the VAT Directive and various other EU regulations thereunder as well as local implementing laws in each jurisdiction. In the United Kingdom, the main implementing law is the Value Added Tax Act 1994 (VATA).

Under the UK rules, VAT applies to any supply where:

- a* there is a supply of goods or services (including anything related to that supply);
- b* the supply is made in the United Kingdom;
- c* the supply is a taxable supply;
- d* the supply is made by a taxable person for (monetary or non-monetary) consideration (albeit certain supplies can be deemed to arise even without consideration); and
- e* the supply must be made in the course or furtherance of a business carried on by the taxpayer.¹⁵¹

There are in addition separate VAT charges where goods are ‘imported’ into the United Kingdom from outside the EU and also where there is an ‘acquisition’ of goods in the United Kingdom from another EU Member State.¹⁵²

VAT is collected and payable by the supplier or by the person making the importation or acquisition. The ‘cost’ of VAT is intended to be borne by the end user, but the tax is collected at different stages in the supply chain.

A VAT-registered person must charge VAT (output tax) on its VATable supplies and can recover the VAT it pays (input tax) on supplies received by it to the extent that this can be attributed to taxable (i.e., VATable or zero-rated) supplies. It pays to the UK tax authority, HMRC, (generally on a monthly or quarterly basis) the difference between its output and input tax (or receives a repayment where input tax exceeds output tax).

Input tax is generally only recoverable to the extent it is attributable to taxable supplies. Therefore, where a VAT-registered person makes both taxable and non-taxable (i.e., exempt, non-business, or certain other outside the scope of VAT) supplies, only a proportion of his or her input tax will be recoverable.

Businesses that make taxable and exempt supplies are generally referred to as ‘partially exempt traders’, typical examples of which are banks and insurance companies. The recovery of input tax attributable to ‘outside the scope’ supplies varies. However, recovery is not blocked in the case of exports of services that would be taxable if made in the United Kingdom.

There are no specific VAT laws for franchising in the United Kingdom, or in the EU VAT Directive, so general VAT principles apply to franchising arrangements. The United Kingdom’s Brexit withdrawal terms also broadly propose that UK VAT laws should continue

150 Council Directive 2006/112/EC on the common system of value added tax.

151 VATA, Sections 1(2), 4.

152 VATA, Section 1(1)(b) and (c).

to be aligned with EU VAT laws during any transitional period and for a five-year extended period in respect of certain transactions involving a cross-border element. However, after these periods, Great Britain would not be part of the EU's customs union and VAT system, so it could then unilaterally introduce specific UK VAT laws for franchising arrangements. Northern Ireland may remain aligned with the rules of the EU's customs union and thus would not be able to introduce specific rules. It is therefore unlikely that the rest of the United Kingdom would deviate substantially from the EU's approach in the medium term.

i Taxable person

VAT applies to supplies made by a taxable person. Therefore, a person who is a taxable person must charge VAT on taxable supplies made by him or her at the appropriate rate and a person who is not a taxable person must not charge VAT in respect of any supply.

A 'taxable person' is essentially a person (including a company or a partnership) who makes taxable supplies in the United Kingdom in the course or furtherance of a business carried on by him or her and the aggregate value of the supplies that have been made by him or her in the previous 12 months or less, or are expected to be made in the forthcoming 12 months (or in the next 30 days alone), exceeds the prevailing registration limit (this is currently £85,000 in the United Kingdom). This threshold has, however, been removed with effect from 1 December 2012 for all non-UK traders without a UK establishment who make taxable supplies for VAT purposes of any value in the United Kingdom (such as supplies relating to UK land or supplies of stock stored in the UK). Businesses may also register voluntarily for VAT (thus becoming taxable persons).

ii Supply of goods and services

A 'supply of goods' means the supply of the whole property in goods but the transfer of an undivided share in property or of the possession of goods is a supply of services (unless possession is transferred under a sale agreement or in certain other circumstances (e.g., hire purchase agreements). Additionally, certain other supplies are specifically treated as supplies of goods (e.g., supplies of power or certain supplies of land).¹⁵³

A 'supply of services' is defined as anything that is not a supply of goods but is done for a consideration (including, if so done, the granting, assignment or surrender of any right).¹⁵⁴ Granting IP rights will generally be supplies of services for VAT purposes.

iii Time of supply

For goods, the time of supply is when they are removed or otherwise made available. If the goods are removed before it is known whether they are to be supplied, the time of supply is when the supply becomes certain or, if sooner, 12 months after removal.¹⁵⁵

The 'time of supply of services' is when the services are performed.¹⁵⁶ An exception to this general rule is where there is a continuous supply of services, in which case the time of

153 VATA, Schedule 4 paragraphs 1–3.

154 VATA, Section 5(2)(b).

155 VATA, Section 6(2).

156 VATA, Section 6(3).

supply is the earlier of when the payment is received by the supplier and when the supplier issues the invoice.¹⁵⁷ In the case of royalties, the time of supply is the earlier of when the royalties are received and a VAT invoice is issued.¹⁵⁸

For both goods and services, it is possible to accelerate the time of supply by the issue of a VAT invoice or receipt of payment.¹⁵⁹ Further special time-of-supply rules apply in respect of reverse charge services received by UK businesses from outside the United Kingdom¹⁶⁰ and in respect of intra-EU acquisitions of goods to the United Kingdom.

iv Taxable supply

A taxable supply is a supply of goods or services made in the United Kingdom other than an exempt supply.¹⁶¹ There are three rates of VAT on taxable supplies, 20 per cent, 5 per cent (on a limited class of supplies) and nil (on zero-rated supplies). Supplies of certain services or types of stock may be exempt or subject to a reduced (for example, zero) rate of VAT, but this will depend on the nature of the services or goods in question and whether they form part of a mixed or composite supply with other goods or services.

An exempt supply is a supply specified in Schedule 9 of the VATA. Exempt supplies include financial and insurance services, but supplies of IP are not generally exempt. Zero-rated supplies are set out in Schedule 8 of the VATA and include, subject to detailed conditions, food, children's clothing, and medicines prescribed by pharmacists.

There are two other categories of supply, which are important for VAT purposes: 'outside-the-scope' supplies and other supplies treated as not involving a supply of goods or services with the result that VAT is not chargeable. Examples of such supplies include non-business supplies, the supply of certain international services (e.g., a transfer of IP to a customer outside the United Kingdom) and a transfer of a business as a going concern (TOGC). UK TOGC rules can cover IP supplies or licensing, or both. The expression 'going concern' generally refers to a business that is still in existence, live or operating and has all parts and features necessary to keep it in operation, as distinct from being only an inert aggregation of assets. A business scaled down because of financial difficulties or in anticipation of a sale, or even in liquidation, receivership or bankruptcy, can still be a going concern.

TOGC rules are not implemented in a harmonised way across Europe, and different local considerations will apply. In the United Kingdom, TOGC treatment for transfers of franchise businesses can be available provided several conditions are met, including that the same kind of business is transferred from a franchisor to a franchisee and that the new franchisee intends to carry on the same kind of business, without a significant break in trading after the transfer, and the transfer will not be followed by other immediately consecutive transfers of the business (e.g., to another new franchisee). Where only part of a business is sold, it must be capable of separate operation. HMRC guidance notes the importance of establishing whether a franchisor has actually operated the business being transferred. If so, it is capable of being a TOGC. Otherwise, merely granting a franchise is not a TOGC, as such a grant is not the same kind of business as making supplies of goods and services under a franchise agreement. TOGC for VAT purposes may also be available in circumstances

157 SI 1995/2518, Regulation 90(1).

158 SI 1995/2518, Regulation 91.

159 VATA, Section 6(4).

160 SI 1995/2518, Regulation 82.

161 VATA, Section 4(2).

where a franchisee gives up a franchise and the franchisor ‘installs’ another franchisee in the premises. In those circumstances, one would have to examine whether the new franchisee was buying the premises, stock or fixtures and fittings from the old franchisee and that what was being transferred was the possession of a business as a going concern that could be carried on by the new franchisee on a lasting basis. The fact that the permission of the franchisor may be necessary for the assets to be sold should not prevent the transaction from being a TOGC. In addition, where the transferor is a taxable person (i.e., UK VAT registered), the transferee must be a taxable person (VAT registered) already or immediately become one as the result of the transfer (with the VAT registration usually being in place by and with effect from completion).

Where land is transferred as part of a TOGC, there are certain extra conditions that have to be met for the transfer of the land or lease, etc. to be given TOGC (non-VAT) treatment. One such condition is that the transferee may have to make an election (called an ‘option to tax’) before completion to waive any VAT exemption relating to a transfer of the property in question, and also notify that this option will not be revoked under certain anti-avoidance rules.

v Place of supply

The complex ‘place-of-supply’ rules determine in which Member State, if any, a supply of goods or services should be taxed. The result is that UK VAT is only chargeable where the place of supply under these rules is the United Kingdom. UK VAT is not chargeable if the place of supply is outside the United Kingdom, even if made by a taxable person. If the place of supply is another Member State of the EU, that Member State has the jurisdiction to charge its local equivalent of VAT on the supply. If the place of supply is outside the EU, no Member State has the jurisdiction to charge VAT on the supply although VAT or sales tax may be chargeable outside the EU.

There are detailed rules for both goods and services and the rules vary depending on whether supplies are to ‘taxable persons’ (broadly speaking, businesses) or not. In the context of franchising we would assume that all supplies by franchisor to franchisee are business-to-business supplies.

The Place of Supply of Services Directive (Council Directive 2008/8/EC of 12 February 2008 amending Directive 2006/112/EC as regards the place of supply of services) has applied in the EU since 2010. Changes came into effect in 2011 (certain services supplied where performed) and in 2015 (relating to broadcasting, telecommunications and electronically supplied services) (BTE)) providing that such BTE supplies are subject to VAT where the customer resides. As a result of more changes, a Mini One-Stop Shop (MOSS), an electronic registration and payment system, was introduced to facilitate suppliers’ VAT administration for their BTE supplies to non-business consumers in the EU. This MOSS concept is now planned to be extended for supplies of tangible goods ordered online both within and outside the EU (see below), and potentially in the future, for all (cross-border) supplies of services.

The place of supply of services ultimately depends on various factors, such as the nature of the services, whether or not the recipient is a taxable person, and where the service is carried out. Nonetheless, subject to future changes, in summary, the present position is that the general place-of-supply rule for services is as follows:

- a* for business-to-consumer (B2C) supplies, the general rule is that the supply is made where the supplier belongs; and

- b* for business-to-business (B2B) supplies, the general rule is that the supply is made where the recipient belongs.

However, this general rule is subject to so many exceptions that it should not be looked upon as the normal position; it is the position should no exception apply. For example, as noted above, for BTE supplies, the supply is treated as made where the recipient belongs, irrespective of whether the recipient is in business or not. For IP royalty income – either the general B2B rule applies for UK VAT place-of-supply purposes (so VAT is chargeable where the business customer belongs) or, where applicable, a special rule applies for UK-outbound IP supplies to non-business consumers outside the EU whereby such supplies are not subject to UK VAT.

A crucial question to determine place of supply in respect of services is normally where the supplier or recipient ‘belongs’. For a relevant business person, it is broadly the place where that person has its business establishment or some other ‘fixed establishment’ or (in the United Kingdom at least), if it has more than one business establishment, the establishment that is most directly concerned with the supply of services in question. How these provisions should be interpreted, as well as the meaning of terms such as ‘fixed establishment’, has been subject to a substantial body of UK and EU case law. Non-business persons are treated as belonging in the country of such a person’s usual place of residence.¹⁶²

Business-to-business supplies of services

Supplies of services by a supplier to a relevant business person are treated as supplied in the country in which the recipient belongs. For this purpose, a relevant business person is a person registered for VAT in the United Kingdom, Isle of Man or EU or any person who independently carries out in any place any economic activity.¹⁶³

Again this can be overridden; for example, for telecommunications, broadcasting and electronically supplied services where ‘use-and-enjoyment’ provisions may apply in the context of international supplies to the United Kingdom from a non-EU jurisdiction and vice versa (the use-and-enjoyment provisions do not apply in respect of intra-EU transactions, albeit this could have more relevance in other European jurisdictions post-Brexit when the UK becomes a non-EU jurisdiction).

Business-to-business supplies of goods

These rules are more complicated than the rules for services and we do not go into them in detail here on the assumption that the heart of a typical franchising arrangement is the licensing of IP and the supporting services. Nevertheless there can be associated agreements for the supply of goods, so the rules would then have to be considered, including in light of the EU Commission’s proposals derived from its Action Plan on VAT (see below).¹⁶⁴

Section 7 VATA sets out a priority for the place of supply of goods. If a supply does not involve the removal of the goods to or from the United Kingdom, they shall be treated as supplied in the United Kingdom if they are in the United Kingdom. There is then a complicated hierarchy of rules that follow this to determine place of supply. In any event, if

¹⁶² VATA, Section 9.

¹⁶³ VATA, Section 7A(4).

¹⁶⁴ See, e.g., COM(2016) 148 final: ‘Towards a single VAT area – Time to decide’, and a follow-up Communication, COM(2017) 566 final.

goods are supplied in the United Kingdom, supplies of goods to EU registered businesses are zero-rated provided the goods are removed from the United Kingdom within three months of the supply. Similarly, supplies involving the exporting of goods outside the EU are also zero-rated. However, intra UK-EU trade in goods post-Brexit will be subject to VAT rules on imports and exports and customs supervision and UK businesses may require local fiscal representation to provide trade (including providing services) within the EU.

Irrespective of Brexit, further changes proposed by the EU could affect all suppliers trading within the EU, building upon the 2015 place-of-supply changes introduced for digital services. The proposals include new rules for intra-EU B2C online sales of goods from January 2021 and substantially changing the VAT treatment of intra-EU B2B transactions in goods from July 2022, and subsequently making changes to cross-border services (with certain exceptions), the proposals for which have yet to be determined. The expected changes form part of the EU's VAT Action Plan proposals to overhaul its existing VAT regime and create a single destination-based VAT system for all cross-border transactions, under which supplies would be taxed in the destination Member State at the VAT rate applicable in that Member State.

vi Importation of services from other countries

Where a supplier belonging outside the United Kingdom makes a supply to a taxable person in the United Kingdom and such a supply is treated under the above rules as taking place in the United Kingdom, the 'reverse charge' rules apply. Under the reverse charge, the recipient of the services (rather than the supplier of the services) is required to account for VAT at the rate applicable in the Member State in which he or she belongs to the relevant tax authority. The rules also allow the recipient an input tax deduction in respect of purchases related to taxable outputs. The effect of the reverse charge in the United Kingdom, therefore, is to treat services brought in from outside the United Kingdom in the same way as services that are actually supplied in the United Kingdom if the recipient of the services is VAT registered but with the recipient applying the relevant VAT formalities. The reverse charge procedure may also be used on intra-EU acquisitions of goods and by business recipients in the EU in respect of supplies from a UK supplier. However, as noted (and irrespective of Brexit), the EU's proposed changes would end the current practice of allowing an EU supplier to zero-rate intra-EU B2B sales and for the EU purchaser to self-assess and account for (acquisition) VAT on intra-EU purchases using the reverse-charge mechanism. Instead, the practice would be replaced by making suppliers (both within and outside the EU) responsible for charging, collecting and forwarding the EU VAT due on their intra-EU supplies of goods (i.e., supplies involving a transport of goods within the EU) to business customers in other Member States at the rate applicable in the customers' Member States. Eventually this VAT treatment may be extended to all imported, cross-border services, the proposals for which will be implemented at a later date. To mitigate the administrative impact of these changes on suppliers, the EU Commission has simultaneously proposed to expand the use of MOSS as an evolving EU-wide IT solution or scheme (i.e., a one-stop shop) that will allow suppliers to report and pay in a single Member State the EU VAT due on their intra-EU sales in other Member States. This system will also be available in respect of other B2C supplies of services and to distance sales, and to companies outside the EU who want to sell to businesses within the EU and who would otherwise be required to register for VAT in every Member State. However,

we understand that non-EU businesses (so UK businesses post-Brexit) could be required to appoint an EU-based intermediary to use this scheme, with the intermediary fulfilling the obligations laid down in the scheme in the name, and on behalf, of the non-EU business.

The significance of these proposals will obviously depend on the transitional arrangements agreed upon the United Kingdom leaving the EU.

Generally, reverse charges have no effect on recipients who are not taxable persons.

vii Effect of the above rules on franchising arrangements

The net effect of the above rules on franchising arrangements is that generally:

- a* UK franchisors will charge VAT to UK franchisees in respect of all services and goods (assuming the goods are in the United Kingdom) save where the supply satisfies TOGC rules such that TOGC treatment applies;
- b* UK franchisors (assuming they are not VAT registered elsewhere) will not charge VAT to non-UK franchisees in respect of services (which includes IP licences). VAT on the services should be accounted for by EU franchisees under the reverse-charge procedure. The VAT treatment of any goods supplied will depend on the nature of the supply chain;
- c* non-UK franchisors will not need to charge VAT on services supplied (including on the IP licences) to UK-based business recipients. EU-based VAT registered franchisees would account for VAT under the reverse charge procedure. Again, the VAT treatment of any goods supplied will depend in more detail on the nature of the supply chain;
- d* if there is a disagreement over the VAT treatment of any of the supplies under a franchising agreement then the question would then need to be asked as to whether one apportions the fees between supplies with different VAT treatments or whether there is a single composite supply with VAT determined on the principle element of the supply under the principles established in *Card Protection Plan v. C & E Comrs*,¹⁶⁵ and
- e* to the extent a franchisee is VAT registered and carrying out fully VATable services, it should be able to recover the VAT incurred on the franchising fees.

For example, under (a) above, in a franchising context, where a franchisor charges royalties under a standard franchise agreement to a franchisee (i.e., the royalties represent the franchisor's licensing of the franchisor's IP), this would be a B2B supply of IP or services for UK VAT purposes (assuming this licence were not part of a qualifying TOGC transfer of the franchise) and this supply would be inside the scope of UK VAT where supplied between two UK-established businesses. UK VAT would be chargeable, accountable by the franchisor. In the case of inbound IP supplies from a non-UK franchisor to a UK franchisee or licensee, then, as under (c) above, UK VAT would not be charged by the overseas franchisor, but it would be accountable by the UK VAT registered franchisee or licensee under the United Kingdom's reverse-charge mechanism, although, as this is a reporting or simplification mechanism, there should be no net VAT payable by the UK franchisee on the supply (i.e., then the supply should be cash-flow or VAT neutral for the franchisee or licensee) unless it was a partially or wholly exempt business that cannot fully recover UK VAT. Internal licensing of IP between sister franchisor entities would be subject to UK VAT on the same principles, assuming the

165 Case C-349/96 [1999] STC 270, ECJ (Part V11), applied by the House of Lords [2001] UKHL/4 STC 174.

entities were not part of a formal UK VAT group (which would need to be specially registered as such) to disregard such supplies. UK VAT grouping rules presently require group members to have a UK fixed establishment.

There have been some UK VAT cases involving franchising arrangements. One such case is *Kumon Educational Company Limited v. HMRC*,¹⁶⁶ which looked at rewards provided to a franchisee by the franchisor. It was held that these rewards were not for a separate VATable supply but were linked to the franchise fee and in effect amounted to a contingent discount. The franchise fee could therefore be reduced for VAT purposes and VAT previously accounted for repaid.

In *Reeds School of Motoring (Sheffield) Ltd v. C & E Comrs*,¹⁶⁷ driving tuition supplied to pupils was held to be made by the (franchisee) instructors as principals and not by the motoring school, the latter's role being to provide a supporting organisation by which the instructors were provided with the means to give tuition, such as the tuition cars. It was held that the tight control maintained by the school over the instructors was a common feature of franchise agreements, where the franchisor does not carry on the business in question (say for example, one of a chain of restaurants), but instead licenses another (for reward) to do so under a name and method of operation that are, or are intended to be, distinctive and well known. This control was held not to be determinative of the type of relationship between the parties, and it was concluded that the business in question was that of the franchisee while the franchise agreement was in force.

*Tumble Tots UK Ltd v. Revenue and Customs Comrs*¹⁶⁸ involved a franchisor of a chain of play centres for children. To take part in a play session, the child would need to be a member of the National Tumble Tots Club. An annual fee was payable, and this was the subject of the appeal. In return for the annual fee, a member received various benefits including a T-shirt and various newsletters and booklets. HMRC argued that there was one main supply of membership (standard rated), entitling the children to take part in activity sessions at Tumble Tots premises. All other supplies were considered to be incidental to this main supply. Tumble Tots argued that the main supplies were the zero-rated supplies of printed material and children's clothing (T-shirt), so overall it was making a zero-rated supply. The tribunal concluded that the membership was the main benefit, and all other supplies were incidental apart from the T-shirt that had some monetary benefit and importance to the child. However, HMRC appealed¹⁶⁹ to the High Court, which ruled that the aim of the payment made by the customer was to secure attendance at the classes. Other benefits such as the T-shirt were incidental to this main supply. The entire payment made by the customer was therefore subject to VAT.

In the joined cases of *Air France-KLM and Hop!-Brit Air SAS v. Ministère des Finances et des Comptes publics*,¹⁷⁰ (KLM), Hop!-Brit Air SAS (Hop) provided air passenger transport services under a franchise agreement with Air-France-KLM, with Air-France being responsible for marketing and ticket management on the franchised routes. In the context of the franchise agreement, Air-France received the ticket price direct from passengers and paid this on to

166 [2015] UKFTT 84.

167 *Reeds School of Motoring (Sheffield) Ltd v. C & E Comrs* (1995) VAT Decision 13404.

168 *Tumble Tots UK Ltd v. Revenue and Customs Comrs* [2007] EWHC 103 (Ch), [2007] STC 1171.

169 [2007] EWHC 103 (Ch), [2007] SWTI 293, [2007] All ER (D) 274 (Jan).

170 *Air France-KLM and Hop!-Brit Air SAS v. Ministère des Finances et des Comptes publics* (Cases C-250/14 and C-289/14) (KLM).

Hop in relation to each transported passenger. Where there were 'no-shows' or tickets had expired, Air-France paid Hop compensation at an annual flat rate calculated at 2 per cent of the annual turnover (including VAT) received from the routes operated as a franchise. Hop did not account for VAT on these sums and the French authority issued assessments for VAT on these amounts. The question for the Court of Justice of the European Union (CJEU) was whether or not a non-refundable payment for unused tickets was a taxable supply. The taxpayer argued that payments in such circumstances should be treated as compensation and therefore outside the scope of VAT. However, the CJEU held that, looked at objectively, the payments were subject to VAT as they represented consideration for a right to benefit from the airline's obligations under a transport contract, even if they were not actually used by no-show passengers. It also held that the sums paid by Air France-KLM to Hop could not be regarded as compensation for harm suffered. Instead the sums corresponded to the value attributed by the parties to the unused tickets issued for a transport service and were therefore subject to VAT.

TRADE SECRETS AND FRANCHISING

Mark Abell and Jonathan Goldsworthy¹

The core of franchising as a commercial strategy is its use of a business format – a format that is usually a matrix of commercial know-how, which although perhaps not entirely novel in its individual elements, is commercially distinctive and valuable as a composite. A significant amount of this know-how is generally kept confidential and is what distinguishes the franchise format from its competitors.

As this know-how is not patentable, it can only be protected by way of contract and trying to ensure that it is shared only on a need-to-know basis. The problem with this, however, is that once this confidential know-how is shared with a franchisee or its employees, it is impossible to take it back again.

Historically, each jurisdiction has a different way of dealing with the protection of this valuable secret know-how, which makes adapting a homogenised approach to its protection by franchisors something of a challenge. Franchisors have therefore welcomed reforms to trade secret protection laws in the major economic regions.

In the EU, the European Parliament and Council adopted Directive (EU) 2016/943² on 8 June 2016, aimed at standardising the national laws of EU Member States against the unlawful acquisition, disclosure and use of trade secrets. This followed almost immediately the enactment by the US Congress of the Defend Trade Secrets Act of 2016³ in May of that year, introducing federal-level trade secret protection. Protection has also been strengthened in China, and the countries of the ASEAN Free Trade Area have taken steps to harmonise trade secret laws in that region too.

Directive 2016/943 was required to be implemented in all EU Member States by 9 June 2018. This has prompted a raft of new implementing legislation throughout Europe, including in France, Germany, Spain and the United Kingdom. Franchisors therefore have to understand how they can take best advantage of this new regime.

I THE NEED FOR A TRADE SECRETS DIRECTIVE

The primary driver for an EU Directive was an economic one, forming part of the ‘EU 2020 Strategy’, which obliges the European Commission to create an innovation-friendly environment for business as part of its commitment to ensuring the smooth functioning of a single European market.⁴

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2 Directive (EU) 2016/943 on the protection of undisclosed know-how and business information (trade secrets) against their unlawful acquisition, use and disclosure.

3 Public Law 114-153, 130 Stat. 376 enacted May 11, 2016, codified at 18 U.S.C. § 1836, et seq.

4 EC 9870/14, Section I, paragraph 2.

As intangible assets such as trade secrets and confidential information form a significant part of the market value of publicly traded companies, Europe was increasingly at risk of becoming an unattractive environment for innovative businesses to locate themselves in.

Unfortunately, trade secrets law in the EU prior to the Directive could be best described as ‘patchwork’, with different approaches and different levels of protection in Member States creating uncertainty among businesses as to the type of information protectable as a trade secret and with, at times, inadequate enforcement mechanisms.

In part, this inconsistency in trade secrets regulation reflected both the permeation of trade secrets across a wide range of business activities and the fact that different countries have approached the issue from different starting points without any overarching coordination. For example, in France there was legislation to protect against misappropriation of trade secrets in the employment relationship – but not in an intellectual property context, which instead relied on principles derived through case law.⁵ Likewise, in Germany trade secrets have been regulated through both competition law and employment law, but enforcement relied on a system that did not provide for mutual disclosure of evidence, which is often critical in such cases. This picture is complicated further by the fact that this ad hoc development of the law has led some countries to have more than one definition of a trade secret, depending on the legal context. In France, the United Kingdom and Germany, for example, the means of identifying a trade secret has varied, depending on whether or not the information is disclosed in the context of the employment relationship. This is clearly unhelpful for businesses.

It was against this backdrop that the EU Commission proposed the new Directive, concluding that there was an obvious public interest in securing fair competition standards and, at the same time, providing a business environment that encourages and rewards investment in research and innovation.

The Directive aims to harmonise laws across the EU in three main areas:

- a* the definition of ‘trade secret’, and the means by which holders will be protected throughout Europe;
- b* the remedies available to trade secret holders when they suffer a theft or unauthorised use of their trade secrets; and
- c* the measures the court can use to prevent trade secrets leaking during legal proceedings.

II DEFINING TRADE SECRETS

The Directive adopts the 1994 WTO TRIPS definition of a trade secret, which is also reflected in the definition adopted by the United States in the Uniform Trade Secrets Act and the federal Defend Trade Secrets Act.

5 Article L 621-1 of the Industrial Property Code, which protects ‘manufacturing secrets’ in the context of the employer–employee relationship. The definition included in the draft directive does, however, correspond to that developed by French case law under (1) Article L 621-1 of the Intellectual Property Code and (2) disputes involving contractual matters or unfair competition in which violation of a ‘*secret de fabrique*’ or trade secret was alleged.

Article 2 of the Directive defines a trade secret as:

[i]nformation which meets all of the following requirements:

- a) is secret in the sense that it is not, as a body or in the precise configuration and assembly of its components, generally known among or readily accessible to persons within the circles that normally deal with the kind of information in question;*
- b) has commercial value because it is secret;*
- c) has been subject to reasonable steps under the circumstances, by the person lawfully in control of the information to keep it secret. (emphasis added)*

This definition is consistent with definitions that already existed in certain Member States, such as Denmark, Spain and Italy. However it differs from the historical approach taken in countries such as the United Kingdom, Germany, Poland and Hungary, where this prescriptive definition of a trade secret would seem to represent a shift of emphasis.

For example, the classic definition of confidential information under English law is founded in equity and requires that the information (1) has the necessary quality of confidence and (2) is disclosed in circumstances importing an obligation of confidence. This does not require information to have ‘commercial value because it is secret’ for it to be classed as confidential, although that is a factor the courts have, in practice, taken into account when evaluating whether confidential information may be treated as a trade secret.

In the context of confidential information in the employment relationship under English common law, a trade secret is information that an employee is obliged to keep confidential, even after the termination of employment and without any post-termination restrictions. In this context, ‘trade secret’ means information of a sufficiently high degree of confidentiality based on all the circumstances. These circumstances include its importance to the business and the measures taken to protect it. Typically, examples of this category have included the legendary ‘Coca-Cola formula’ as a pure trade secret that is protected regardless of any contractual agreement. This is distinguishable from ‘valuable business information’, which only remains protected after the end of employment if it is covered by express contractual wording.

The Directive’s definition of a trade secret raises a number of issues for consideration in the context of franchising:

- a* The requirement that the information be ‘secret in the sense that it is not . . . generally known or readily accessible’ applies not only to single pieces of information, but also to collections of information. This seeks to ensure that manuals, processes and recipes can all be protected, as long their precise configuration is not generally known outside the business or its contractual supply chain. It should also mean that it will become easier to enforce confidentiality over customer service data and software features and functionality across Europe.
- b* The requirement for ‘commercial value’ raises questions, such as ‘does the information have to have value to the original holder or is it sufficient that it would have value in the hands of another?’ For example, confidential information that is damaging to a company might not have ‘commercial value’ to that company; although it is likely they would take steps to keep the information secret, they cannot exploit it for value. However, in the hands of another organisation such as a competitor or a newspaper or trade publication, the information may have commercial value as it could improve the relative reputation or activities of the competitor or prompt people to buy newspapers.

- c* The requirement that the information ‘has been subject to reasonable steps under the circumstances, by the person lawfully in control of the information to keep it secret’ means that as long as a businesses’ supply chain, licensees, franchise holders and other business partners are required to observe its security requirements for the information, then theoretically it remains ‘secret’ and protectable.
- d* In an employment law context, the Directive may be seen to broaden the definition of ‘trade secret’ under English common law rules. This would appear to present an opportunity for employers to capture a wider range of confidential information within the trade secret classification.
- e* The issue above highlights an important question for Member States: whether implementation of the Directive should come in addition to – or instead of – their national legislation and common law rules. In the United Kingdom, the regulations⁶ implementing the Directive make clear that they are to supplement and sit alongside the existing legal framework. Accordingly, in so far as the measures, procedures and remedies available in an action for breach of confidence provide wider protection to a trade secret holder than that provided under these new regulations, the trade secret holder may apply for those (wider) measures, procedures and remedies in addition or as an alternative to those provided for in the regulations.
- f* The similarities between the European definition and that adopted in the United States should help promote the confidence of international businesses to expand their operations in Europe. Brexit is not expected to change the position in the United Kingdom (as discussed above): the Directive has been implemented into domestic law and, at the time of writing, there is no suggestion that the recently elected Conservative government intends to reconsider legislation in this area.

III NEW HEADS OF LIABILITY AND REMEDIES

i Unlawful use of trade secrets

Article 4 of the Directive sets out the types of liability for infringement of rights in qualifying trade secrets. These relate to the unlawful acquisition, use or disclosure of trade secrets and the production, offering or placing on the market, importation, export or storage of infringing goods. Infringing goods will be those whose design, characteristics, functioning, production process or marketing significantly benefit from trade secrets that have been unlawfully acquired, used or disclosed.

By way of a general summary, the use or disclosure of a trade secret will be unlawful (1) where the user knows (or should know) that it was obtained unlawfully or (2) where the infringing activity is carried out intentionally or with gross negligence by a person who obtained the information unlawfully or in breach of some other duty of confidence. Where a trade secret is obtained from a third party, its use or disclosure may still be unlawful if the user knew or should have known that the person from whom it was obtained was using or disclosing the trade secret unlawfully.

6 The Trade Secrets (Enforcement, etc.) Regulations 2018 [2018 No. 597].

Article 4(2): The acquisition of a trade secret without the consent of the trade secret holder shall be considered unlawful, whenever carried out by:

- (a) unauthorised access to, appropriation of, or copying of any documents, objects, materials, substances or electronic files, lawfully under the control of the trade secret holder, containing the trade secret or from which the trade secret can be deduced;*
- (b) any other conduct which, under the circumstances, is considered contrary to honest commercial practices.*

Article 4(3): The use or disclosure of a trade secret shall be considered unlawful whenever carried out, without the consent of the trade secret holder, by a person who is found to meet any of the following conditions:

- (a) having acquired the trade secret unlawfully;*
- (b) being in breach of a confidentiality agreement or any other duty not to disclose the trade secret;*
- (c) being in breach of a contractual or any other duty to limit the use of the trade secret.*

Article 4(4): The acquisition, use or disclosure of a trade secret shall also be considered unlawful whenever a person, at the time of the acquisition, use or disclosure, knew or ought, under the circumstances, to have known that the trade secret had been obtained directly or indirectly from another person who was using or disclosing the trade secret unlawfully within the meaning of paragraph 3.

The Directive also makes it unlawful to produce infringing goods or place them on the market. In effect, this will be a strict-liability offence, as no particular state of mind is required and liability will follow even if the manufacturer did not know that the goods were infringing.

One aspect of liability that the EU did not insist on within the Directive, however, is the criminalisation of trade secret misuse. Although some states, such as Germany, France and Finland, already have varying degrees of criminal sanctions in this area, the EU has not compelled or encouraged Member States to follow suit.⁷

Interestingly, reverse engineering does not attract any remedy, as is clear from Article 3 of the Directive, which concerns the lawful acquisition, use and disclosure of trade secrets:

The acquisition of a trade secret shall be considered lawful when the trade secret is obtained by any of the following means: . . . [a] . . . [b] observation, study, disassembly or testing of a product or object that has been made available to the public or that is lawfully in the possession of the acquirer of the information who is free from any legally valid duty to limit the acquisition of the trade secret;

ii Limitation periods

The Directive sets down at Article 8 that Member States may determine their own rules on limitation periods, up to a maximum duration of six years. The maximum period has been implemented in England, Wales and Northern Ireland, subject to ‘suspension’ provisions that can be engaged on account of a disability on the part of the rights holder. However, the significance of time limits is often likely to be minimal in any action for the unlawful acquisition, disclosure or use of a trade secret since the very nature of a trade secret means that time is of the essence if a business is to protect itself in the event of a leak.

⁷ EC 9870/14, Section II, paragraph 6: ‘Member States agreed that the draft directive should not interfere with their national prerogatives regarding criminal law.’

iii Remedies

If a trade secret is used, copied or disclosed in breach of the Article 4 standards (including breaches of contractual restrictions in licences, franchise agreements, or non-disclosure agreements (NDAs)), the remedies will include:⁸

- a* injunctions to prevent further use or disclosure of the information;
- b* court orders prohibiting infringing goods from being produced, marketed, sold, stored, imported or exported;
- c* seizure or delivery up of infringing goods (including imported goods) to stop them being circulated in the market;
- d* delivery up of electronic information, even where it is part of a larger file or materials;
- e* court orders compelling product recalls;
- f* orders requiring alteration to the products, so that infringing characteristics are removed (this includes software and electronic data, such as customer databases);
- g* destruction of infringing goods;
- h* publication of judgments in appropriate cases; and
- i* damages.

Use in this context also includes using the information to ‘significantly benefit’ the design, functioning or processes used in other products.

IV HARMONISATION OF COURT MEASURES TO PROTECT TRADE SECRETS DURING LEGAL PROCEEDINGS

Article 9 of the Directive requires Member States to introduce measures to preserve the confidentiality of trade secrets during legal proceedings. This includes, at least, the option to restrict parties’ access to hearings and order them to be carried out solely in the presence of legal representatives and authorised experts.

This requirement is contrary to historical practice in a number of Member States, notably Denmark, Poland, France and Belgium. In particular, the potential for hearings to be held in the absence of the parties to the action is unfamiliar to many legal systems and could be subject to challenge.

The introduction of ‘confidentiality clubs’ to control the dissemination of confidential evidence in trade secrets disputes will also be a novel development in many countries. A confidentiality club (or ‘ring’) is an agreement made by parties in litigation that limits access to confidential documents, so that they are only available to specified people. While the concept has become a common feature of English trade secret litigation, it will require a change to court procedure and practice in other countries, such as Germany, where the use of such clubs or rings is more limited.

V PRACTICAL ISSUES

i Insider threat

Franchisees and their employees and contractors, as well as the franchisor’s own employees and contractors, can be a particular threat to trade secret security, even if they are not malicious.

8 Directive (EU) 2016/943, Section 2, Articles 10 to 15.

The threat is, of course, even greater from staff with malicious intent, and unlawful activities are often achieved with normal levels of access to company data and systems.

In this regard, note that Article 14 of the Directive gives Member States the option of effectively forcing employers to prove intent in employee cases to recover damages. To the extent that this option has been exercised on a country-by-country basis, it will reduce the effectiveness of the Directive to properly compensate businesses in cases of employee trade secret theft. This will compel employers to rely more on the employee contract to ensure they are properly protected.

The requirement to take ‘reasonable steps’ to protect trade secrets will introduce a greater legal impetus for businesses to take more interest in, and place better controls on, the security around their commercially valuable information throughout their supply chains. It will focus similar attention on licensees, franchise holders and other business partners, who will also need to be required to observe mandated security arrangements for the information.

The Directive also abstains from limiting works council representatives in their use of confidential information, leaving that to local laws, the rules of the specific works council and the employers’ contractual rules with the staff representatives.

ii Supply chain problems

As it is often practically necessary for franchisors to share some of their trade secrets with third parties to enable them to operate an effective international supply chain to their franchisees, it is critical to ensure those arrangements adequately protect trade secrets.

The obvious starting point is through the use of suitable confidentiality agreements or NDAs, but it is clear that a one-size-fits-all approach will not be a safe solution. Practical steps to take in preparing appropriate documents include:

- a* properly investigating the requirements of the arrangement – ascertaining with precision what trade secrets will need to be disclosed, and to whom; and
- b* carrying out due diligence on the proposed third party:
 - to determine whether it is an established or well-respected business with a track record of previous similar relationships known to have been successful; and
 - to determine its corporate status: whether additional NDAs with individual subcontractors, partners or other third parties are required.

It will also be important to monitor the way in which the relationship with any third party develops or changes while it is in possession of trade secrets. Arrangements may need to be refreshed and reinforced, particularly as its personnel changes. Once a third-party arrangement concludes, it will be vitally important to ensure that the post-termination obligations are actually complied with – especially those governing the return of confidential documents and data.

VI IMPLICATIONS FOR FRANCHISING

The advent of a new approach to protecting trade secrets is having both a reactive and proactive impact upon franchising.

On the reactive front, it is essential that franchisors have properly audited and identified their trade secrets in order that careful diligence is undertaken as to what trade secrets are disclosed to franchisees, and that franchise agreements are then drafted so as to optimise the protection available within the context of the relevant jurisdiction. This is, of course, nothing

new; however, the need to ensure that new trade secret laws are central to the way that the franchise agreement deals with the issue is novel. On the proactive front, a result of the new trade secret laws is that the information will likely become commercially exploitable in its own right. For example, some franchises are already exploring new charging structures based on their new ability to classify specific sets of data as 'trade secrets'. Franchisors and their advisers need to be alive to the opportunities to exploit previously private processes, recipes or datasets in ways that will generate new income streams. Franchisors will also need to have misappropriation action plans in place to set out a clear road map in the event that trade secrets are lost, stolen or destroyed, in terms of both obtaining appropriate redress from the franchisee and being able to protect the business more generally.

FRANCHISEES AS CONSUMERS

Jiri Jaeger and Frederik Born¹

I INTRODUCTION

Today, more than 12,000 franchise systems with more than 800,000 franchisees exist worldwide.² In some jurisdictions, expanding business operations by way of franchising is a well-established model for facilitating growth, whereas in others it is a pretty modern way for companies to tap into new markets. It is often new for franchisees too. Franchising, therefore, comes with certain risks for franchisees. They might be inexperienced, uninformed and lacking in bargaining power. More often than not franchisees face franchisors who are well informed about their own franchising system, familiar with the risks in their respective markets³ and are strong negotiators. In fact, research shows that between half and two-thirds of all franchisees enter the franchising business coming from a dependent employment.⁴ Franchisors typically hold the bargaining power that enables them to dictate the conditions of the future long-term relationship to the franchisees and ask them to sign their standard terms.

The correspondence between franchisees' 'weakness' and franchisors' strength causes some jurisdictions to regard franchisees as consumers. Usually this is when initially commencing the business by signing the contract, but sometimes, albeit seldom, it is throughout the entire contractual period. Thus, there are (1) some jurisdictions that never regard a franchisee as a consumer; (2) some jurisdictions that apply consumer protection laws where it is found necessary to protect the franchisee, and the franchisee actually acts as a consumer according to the statutory definition of consumer; and (3) even jurisdictions that generally deem a franchisee to be a consumer. This has an impact on various fields of law, such as consumer credit law, doorstep-selling law, law on supply contracts payable by instalments and unfair contract term law. In some jurisdictions, it follows that franchisees may even enjoy protection under laws regarding residential leases.

Whether consumer protection law is a good or a bad thing may differ depending on one's circumstances. On the one hand, obviously, it seems to be in the interests of the franchisee who seeks protection. Franchisors, on the other hand, want to regard franchisees

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2 Source: GTAI; the figures come from a report from 2018, in which the IFA projected the number of franchise establishments to increase by 2.6 percent in 2019. See also Bisio, *Franchise Growth Expected to Continue for 2019* (available at: <https://www.franchisegator.com/articles/growth-expected-in-2019-12744/>, last visited 5 December 2019).

3 In some jurisdictions, the franchisor is even required to operate a trial franchising outlet before contracting with a franchisee.

4 See the summarised results from Australia, France and the United Kingdom by Buchan, *Franchisees as Consumers*, p. 42 et seq. (2013).

as business partners on an equal footing⁵ and uphold the principle of ‘freedom of contract’. According to the franchisors’ mindset, the franchisee makes a well-informed business decision when entering into the franchising system. Consumer protection laws are considered as ‘overregulation’ by most franchisors as they could lead to an overall decrease of franchising in the relevant market; overregulation is generally a hindrance, at least for innovation.⁶ Regulation – good and poor – increases the transaction costs for franchisors. Ultimately, it can cause the franchisor not to invest in the overregulated market or make it less of a priority. However, the other side of the coin is that good regulation with a modest level of protection of franchisees can encourage more franchisees to invest in franchising, therefore increasing the possibilities for franchisors to expand and also their choice of business partners.

The following chapter shall provide a selective overview of the overlap of franchising and consumer protection and will highlight two examples.

II OBJECTS FOR CONSUMER PROTECTION LAWS

The justification for the consumer laws in each jurisdiction examined here does not necessarily differ. The United Nations Guidelines for Consumer Protection encourage nations to maintain a strong consumer protection policy and recognise that ‘consumers often face imbalances in economic terms, educational levels and bargaining power . . . and should have the right of access to non-hazardous products, as well as the right to promote just, equitable and sustainable economic and social development and environmental protection’.⁷ Consumer laws in the various jurisdictions also share a common theme.

In South Africa, for instance, the purpose of the Consumer Protection Act is to promote and advance the social and economic welfare of consumers by, among other things, establishing a legal framework for the achievement and maintenance of a consumer market that is fair, accessible, efficient, sustainable and responsible for the benefit of consumers generally, promoting fair business practices, improving consumer awareness and information, and encouraging responsible and informed consumer choice and behaviour and promoting consumer confidence and empowerment.⁸

Similarly, in Australia, the Australian Government Productivity Commission stated that a consumer policy framework should aim to ensure that consumers are sufficiently well-informed to benefit from competition, prevent business practice that is unfair or contrary to good faith and, ‘meet the needs of those who, as consumers, are most vulnerable

5 However, research from Australia shows that nearly one third of all Australian franchisors do not have experience in starting a business before setting up their franchising network; Frazer, Weaven, Bodey, ‘Franchising Australia 2010’, p. 118, cited by Buchan, *Franchisees as Consumers*, p. 16 et seq. (2013).

6 Financial Services Authority, ‘Financial Services Authority: A New Regulator for the New Millennium’, (January 2000), p. 6 et seq.; Abell, *The Law and Regulation of Franchising in the EU*, 190 (2013).

7 United Nations, Department of Economic and Social Affairs, United Nations Guidelines for Consumer Protection (as revised and adopted in 2015), at I.1 (available at: <https://unctad.org/en/Pages/DITC/CompetitionLaw/UN-Guidelines-on-Consumer-Protection.aspx>, last visited 4 December 2019).

8 Consumer Protection Bill, Chapter 1, Part B.

or at greatest disadvantage'.⁹ Three years later, in 2010, the Australian Consumer Law (ACL) was enacted, which was designed to protect consumers, ensure fair trading in Australia and simplify existing laws.¹⁰

German consumer protection law is mostly part of the general private law, which has consumer law provisions embedded at various points. It is noteworthy that the various acts implementing the new laws into the German Civil Code are comparatively silent on the motives behind consumer protection; it is left to the courts and academics to fill the gaps and provide the theoretical basis.¹¹

In the United Kingdom, the Law Commission and Scottish Law Commission noted that misleading and aggressive trade practices are common and lead to a high level of consumer detriment, especially for vulnerable consumers.¹² Subsequently, the UK Consumer Rights Act 2015 was enacted with the primary objective of clarifying the pre-existing English laws and implementing Directive 2011/83/EU on consumer rights (the Consumer Rights Directive).¹³

It is uncertain whether the objectives of consumer protection laws can be considered to fit with the franchisees' situation, responsibilities and position in the contractual relationship. While fair trade might be an overall principle for consumer and commercial transactions, what might distinguish consumers from franchisees is their vulnerability, as has been pointed out in general by the Commissions in the United Kingdom and Australia, mentioned above.

III OVERVIEW OF THE APPLICABILITY OF CONSUMER PROTECTION LAW TO FRANCHISEES

i Germany

With the implementation of the Consumer Rights Directive, several provisions concerning consumer rights have been renewed. Consequently, the complete harmonisation of the most important aspects should ensure legal certainty in the relation between the consumer and the entrepreneur, and generate uniform consumer protection throughout the EU. However, the huge impact of consumer protection law in Germany arises from the very legal perspective on the problems concerning the 'cooling-off period';¹⁴ 'very legal perspective' because many statutory provisions are applied to franchising relationships that a fair few people outside Germany would regard as provisions that typically protect consumers (principle of good faith, reasonableness of contractual terms, etc.).

9 Australia Government Productivity Commission, Review of Australia's Consumer Policy Framework, Inquiry Report, Vol. 1, No. 45, p. 13 (2008).

10 Explanatory Memorandum, Trade Practices Amendment (Australian Consumer Law) Bill (No. 2) 2010, Consumer guarantees, p. 12.

11 Micklitz, *Münchener Kommentar BGB*, Section 13 at paragraph 67, 5 (8th ed., 2018).

12 Law Commission and Scottish Law Commission, 'Consumer Redress for Misleading and Aggressive Practices' (Law Com No. 332; Scot Law Com No. 226), p. viii. (2012).

13 Explanatory Notes, Consumer Rights Act 2015, paragraph 5 et seq.

14 See Flohr, in *Handbuch des Vertriebsrechts*, Section 29 at paragraph 86 (Martinek, Semler, Flohr, eds., 4th ed. 2016).

ii United Kingdom

As in Germany, the United Kingdom has no specific franchising laws. Since the Consumer Rights Act 2015 was introduced, there has been an ongoing discussion on whether it could apply to franchisees. The Consumer Rights Act sets out a framework that consolidates key consumer rights covering contracts for goods, services, digital content and the law relating to unfair terms. The statute is the result of combining fragmented pieces of legislation protecting consumer rights, which often consisted of existing case law and European directives.

iii South Africa

In South Africa, the Consumer Protection Act 2008 was enacted to provide long-awaited comprehensive legislation for consumers and it is noteworthy also in relation to franchising. Legal commentators have noted that franchisors have faced a huge administrative burden since the Act's enactment. The Consumer Protection Act comes with specific provisions that have been familiar for decades, such as cooling-off periods and the necessity to include mandatory rules in the franchise agreement. However, the new law also goes further and includes rules governing the supply of goods by the franchisor to the franchisee. For instance, according to Section 21 of the Consumer Protection Act, franchisors may not furnish the franchisee with unsolicited goods or services and, according to Section 13 of the Consumer Protection Act, the franchisee has the right to choose a supplier for unbranded goods.

Because of the broad definition of 'consumer', the franchisee is eligible for the wide range of other consumer rights, too. In contrast to other jurisdictions, where franchise law has 'only' turned case law into statutory law, in South Africa, legislation has changed the business model of franchising. The franchise market in South Africa, it is said, is currently on a par with the Australian market, where legislation is very far-reaching.¹⁵

iv Australia

The ACL (see Section II), which is Schedule 2 of the Competition and Consumer Act 2010, is of major importance when it comes to consumer issues with respect to franchisees. The ACL forms part of the Australian national consumer policy framework. The ACL includes core consumer protection provisions prohibiting misleading or deceptive conduct, unconscionable conduct and unfair terms in standard form consumer contracts. More-informed consumers not only make better choices, but also drive competition and innovation in markets.¹⁶

IV WHAT CONSTITUTES A CONSUMER?

While the objectives of consumer protection law across the various jurisdictions might be generally the same, the scope of the law's application differs. The subjective scope is commonly defined by reference to a 'consumer'. But, surprisingly enough, the ideas as to what constitutes a consumer seem to differ even within the European Union.

Under the Consumer Rights Act in the United Kingdom, a consumer is defined as an individual acting for purposes that are wholly or mainly outside that individual's trade,

15 Zeidman, 'Is a franchisee a consumer or not?', *Franchise Times* March 2016 (available at: www.franchisetimes.com/March-2016/Is-a-franchisee-a-consumer-or-not, last visited 4 December 2019).

16 Explanatory Memorandum, Trade Practices Amendment (Australian Consumer Law) Bill (No. 2) 2010, 'Consumer guarantees', p. 12.

business, craft or profession.¹⁷ Most legal commentators strongly disagree that a franchisee falls into this definition and – as far as can be seen – courts have not yet granted franchisees rights under this statute. The United Kingdom thus marks the one side where it is neither ordered nor seems to be intended to treat franchisees as consumers; however, tracing the legislator's will is often a fruitless task in common law jurisdictions.

Germany takes a somewhat different position, concept-wise. Protection under German consumer law currently depends first on the role people assume in their particular legal interactions with others, regardless of their individual weaknesses and capacities; and second, on the specific situations in which weaker parties might find themselves, such as doorstep transactions. Actually, it is not about whether a person is a consumer according to the statutory definition but, in fact, about whether a person has entered into a consumer business or a non-consumer business. A franchisee is not regarded as a consumer. When the franchisee signs the franchise agreement, this action is already viewed as business conduct and, thus, conducted by an entrepreneur. However, it is a matter of ongoing discussion as to whether the franchisee is entitled to similar protection (a cooling-off period) when it comes to the conclusion of a franchise agreement as a business start-up. Furthermore, consumer protection rights could be invoked if the franchisee is required to make consistent purchases from the franchisor and if the franchisor sells the same products in his or her own franchise outlet.

South Africa is a somewhat different animal. South Africa's Consumer Protection Act seems to recognise the difficulty one has by forcing the franchisee into the common consumer definition. Thus, while defining what a consumer is generally in terms of the application of the Consumer Protection Act 2008, it merely adds basically that a consumer is also 'a franchisee in terms of a franchise agreement'.¹⁸ Thus, a franchisee is deemed a consumer. Furthermore, Section 5(7) seems to suggest that even legal entities qualify as consumers under the act. One is tempted to ask when does the franchisee not act as a consumer? It seems that while, for instance, Germany seeks to regard only the potential franchisee as a consumer before entering into the franchise agreement, South Africa extends the consumer protection even to an ongoing contractual relationship. This concept allows for a broad application of consumer protection law.

Australia marks another extreme from the United Kingdom. The concept under the ACL is that one can (already) be a consumer if one acquires goods or services as a consumer to the extent that the price or cost does not exceed A\$40,000, regardless of purpose or use, or if the goods or services are ordinarily acquired for personal, domestic or household use or consumption. It might be possible – and subject to an ongoing discussion – for franchisees to be treated, and have the same protection, as consumers when it comes to supply of goods or services by the franchisor up to that threshold, or in the case of acquisitions where the person acquired the goods for the purpose of resupply or for the purpose of using them up or transforming them in trade or commerce.

V COOLING-OFF PERIOD

A common element of consumer protection law is the cooling-off period, which can also often be found in franchise-specific laws. For certain transactions, consumers are able to withdraw from a contract within a certain period after signing. The cooling-off period is an

¹⁷ Consumer Rights Act 2015, Section 2(3).

¹⁸ Consumer Protection Act, Chapter 1, Part A, Section 1.

exception to the principle of *pacta sunt servanda*, or even a marked easing of the application of this principle, commonly justified by the potential for the distortion of the decision-making process arising from the inferiority of one party.¹⁹ The same weighting is found with respect to dedicated franchising cooling-off periods. However, it is doubtful whether there are a sufficient number of instances (if any) of ‘fly-by-night’ signing of franchise agreements to justify the legal uncertainty of a cooling-off period.

i Germany and the EU

In Germany and other EU Member States, the Consumer Rights Directive has been transposed into national law. The right to withdraw may be available to franchisees, subject to restrictive requirements; for example, if the person enters into certain financial commitments, such as being granted a loan, postponement of payment or delivery by instalments; or is starting a business for the first time or is a consumer. Although this Directive, and its application to franchisees, may differ from Member State to Member State, the impact of the legislation, where applied, does not differ: the consumer is entitled to withdraw from the contract generally within a period of 14 days after conclusion of the contract.²⁰ Although, to the detriment of the franchisor, this period can be easily extended to slightly more than one year in the event of lack of, or insufficient, information about cooling-off rights, prior to the new law, the period was unlimited. Providing the correct information about the right to withdrawal is not necessarily an easy task for the franchisor, however, as the legislation does not provide a pattern but rather (varying) hints for drafting. At least there is a directive now that contains a sample revocation instruction by the German Franchising Association, but obviously it is not mandatory for German courts.

ii South Africa

South Africa is also familiar with the cooling-off period, as it is included in the franchising sections of the Consumer Protection Act. The franchisee has a right to cancel the franchise agreement without cost or penalty within 10 business days of having signed the agreement by giving written notice to the franchisor.²¹ However, unlike in Germany, the law provides guidance for the franchisor on how to inform the franchisee about this right. The exact wording of the applicable section providing this right to the franchisee must be printed at the top of the first page of the franchise agreement, together with a reference to the section and the Act.²²

iii Australia

Australia is familiar with the right to withdraw too, but the franchisee’s right is not so extensive. On the other hand, provisions are applied widely to all franchisees, not only those to be regarded as consumers, which is similar to the German concept. The Australian Franchising Code of Conduct²³ provides that a prospective franchisee is entitled to a cooling-off period of seven days after entering into a new franchise agreement.

19 For Germany see, for example, Mörsdorf, in beckonline.GROSSKOMMENTAR Section 355 at paragraph 3 (Gsell, Krüger, Lorenz, Reymann, eds., August 2019).

20 German Civil Code, Section 355 paragraph 2.

21 Consumer Protection Act, Section 7(2).

22 Consumer Protection Act, Section 2(2)(a) Regulation 2.

23 Part 3, Division 5, Section 26.

VI JUDICIAL CONTROL OF CONTRACT TERMS

If no dedicated franchising legislation exists, the review of the contractual terms of the franchise agreements by the courts often depends on the application of the laws concerning unfair contract terms or standard terms respectively. More often than not, the application of the law (or at least the extent of the application) depends on whether it is a consumer contracting with an entrepreneur. In some jurisdictions, the application of the law depends on whether a standard form contract is used. In such cases, a franchisor's desire to use a consistent agreement pattern for his or her outlets comes at a price: the franchisor's terms will be reviewed by a judge for their fairness or reasonableness. The franchisee, on the other hand, can sit back and trust that terms to their (considerable) detriment will be softened or even removed by the courts.

i Germany

For standard form contracts,²⁴ the German Civil Code contains provisions governing, for example, the content of the contractual terms.²⁵ Even though the basis of the law is laid down in an EU directive that states that EU Member States have certain rules in common, German law on standard terms goes further than legislation in the rest of the world. German law is particularly strict on businesses. Contractual clauses are subject to an in-depth review by the courts and incomprehensible clauses are reversed to the franchisor's detriment. Clauses that are deemed to be contrary to statutory provisions are deemed invalid. Although core provisions regarding business-to-consumer transactions are similar in all EU Member States, one particular difference in Germany is that the courts tend to apply dedicated consumer provisions to business-to-business (B2B) transactions as well if the situation is 'comparable', and this position is often assumed by the courts. Furthermore, provisions identified as invalid by the courts are not reduced to a level at which they are legally valid, they are simply invalid as a whole. No reduction of invalid provisions to preserve validity is conducted.²⁶ Thus, even though a franchisee is not a consumer in terms of German law, his or her protection here comes close.

ii United Kingdom

In the United Kingdom, franchisees entering into a standard terms franchise agreement can invoke the Unfair Contract Terms Act 1977. However, as this Act seeks only to reduce the possibility of limiting one's own liability, the franchisee can only claim further protection if he or she actually falls within the definition of 'consumer', so the Consumer Rights Act applies. However, as this is highly unlikely, and because in the United Kingdom the principle of good faith is applied less to B2B contracts than it is in civil law jurisdictions, franchisees might have a hard time before UK courts, which (still) uphold the principle of 'freedom of contract' to a large extent. However, it is observed that the understanding of good faith with respect to commercial contracts is currently shifting in common law jurisdictions. Whereas before it

24 Exceptions apply.

25 Sections 305 et seq.

26 Settled case law since Federal Court of Justice NJW 1982, 2309.

was often said to apply only to non-business transactions, in common law jurisdictions there now appears to be a tendency²⁷ of easing the principle of freedom of contract and imposing a duty of good faith, or at least honesty and integrity, in commercial contracts as well.²⁸

iii South Africa

South Africa's Consumer Protection Act also offers the franchisee strong protection against unfair contract terms. Part G of the statute (the right to fair, just and reasonable terms and conditions) applies to franchisees too. According to Section 48 of the Consumer Protection Act, it is required, among other things, that pricing, terms of the contract, and marketing of the goods and services are fair, reasonable and just. Furthermore, the franchisor must draw the attention of the franchisee to important terms of the contract;²⁹ other terms are prohibited.³⁰

Interestingly enough, the law also seeks to regulate prices. According to Section 48(1)(a)(i) of the Consumer Protection Act, the supply of goods or services may not be offered for a price that is unfair, unreasonable or unjust. Hence, South Africa even intervenes in price-fixing. In contrast, as a rule, German law on general terms and conditions, despite being extremely comprehensive, never regulates the two core *essentialia negotii* of an agreement: pricing and performance description. The same can be found in UK law.³¹

iv Australia

The Australian Consumer Law, now for the first time in Australian history, regulates unfair terms in standard form contracts, yet it is limited to consumer contracts. There are some requirements that include franchisee as consumers, which means they can be protected against unfair contract terms. Nevertheless, franchise agreements have not been considered as consumer contracts so far. Also, as in Germany, the contract must not be negotiated. If a term is declared unfair, it will be deemed void, but the rest of the contract will continue, which is also similar to the practice in Germany.

The new Law, which entered into force on 12 November 2016, takes the approach of including franchisees under the Unfair Contract Terms provisions. The Law will protect small businesses from unfair terms in standard form contracts, granting the franchisee further protection as consumers. The small businesses are definitely protected if at the time of entering the contract at least one party to the franchise agreement is a business that employs fewer than 20 people; and either the price payable up front under the contract does not exceed A\$100,000 or the contract has a term of more than one year and the price payable up front does not exceed A\$250,000. Most franchise agreements are for a five- or 10-year term and the price payable up front to the franchisor is often less than A\$250,000, depending on the nature of the franchise system. It can be expected that many franchise agreements will fall within the definition of a small business contract.

Another issue that has a bearing on franchising arises in relation to the Australian Competition and Consumer Commission, as the Commission is empowered to issue

27 See, for example, 'Zhong Xing Tang, Keeping Faith with Good Faith?: The Evolving Trajectory Post-Ym Seng and Bhasin', *JBL* (2016), 420.

28 However, with regard to the United Kingdom, a general principle of good faith still does not exist; see *Chitty on Contracts*, at paragraph 1-1 (33rd edn, 2019).

29 Consumer Protection Act, Section 49.

30 Consumer Protection Act, Section 51.

31 Explanatory notes, Consumer Rights Act 2015, paragraph 18.

infringement notices if it determines a violation of the Competition and Consumer Act 2010 (e.g., by an unfair practices provision in the franchise agreement). The Commission can issue a fine and, probably with greater impact, will publish details of paid infringement notices in a publicly accessible³² register. Thus, knowledge of bad business behaviour will potentially be publicly disseminated.

VII SUMMARY

The question of whether to apply consumer protection laws to franchisees hinges on the issues of who should bear the risks and whether franchisees should be protected from their own decisions and conduct.

However, even if this question is to be answered in favour of the franchisee, what is the actual benefit to the franchisee? Inherent and hidden risks will become apparent to the franchisee no earlier than the point at which the franchisee deals with the franchise documentation that he or she seeks to sign; any real risk that the franchise system is faulty in some way will only emerge later. Nonetheless, the franchisee is protected by his or her right to rescind and by ordinary statutory law or franchising legislation requiring, for instance, a model franchise outlet to have been run by the franchisor (although this is rare). Thus, this already mitigates the need for that period of uncertainty, the cooling-off period. Furthermore, it is doubtful whether the availability of a short window in which to exercise the right to withdraw can protect a franchisee from being imperfectly informed (e.g., with respect to the possibility of withdrawing from the contract should a franchisee should sign a 'fly-by-night' contract). Any defects in the contractual object are likely to become apparent only much later.

However, where the franchisee relies on the advice, guidance and skills of the franchisor³³ – as is often the case – this structural weakness in the relation might bring the franchisee close to the position of a consumer and therefore justify the application of consumer protection legislation.

RESOLVING INTERNATIONAL FRANCHISE DISPUTES

*Victoria Hobbs*¹

I LIKELY CAUSES OF DISPUTE

The majority of disputes that arise fall into the following categories.

i A mismatch of expectations

This is one of the most common forms of dispute and will usually come to light within six to 18 months of the commencement of the agreement when the franchisee is not as successful as either party thought it would be and any failings in relation to how the franchise opportunity was presented by the franchisor are likely to come to light. A mismatch of expectations will range from a general disappointment, which falls short of giving the disappointed party any legal basis for claim, through to giving the innocent party the right to treat the agreement as effectively void and claim damages.

The concept of misrepresentation exists in many jurisdictions. The key elements that will need to be proved for an innocent party to succeed in a misrepresentation claim will vary between jurisdictions but are likely to include evidence that the franchisor (and misrepresentation is normally a claim against the franchisor) made an untrue statement of fact or law to the franchisee that induced the franchisee to enter into the agreement thereby causing the franchisee loss. The remedies available to the franchisee who is able to successfully prove a misrepresentation has been made will also vary from jurisdiction to jurisdiction but could include the right to set aside the agreement, recoup all monies paid under the agreement (minus an allowance for any profit made) and claim damages for loss of opportunity.

The risk of misrepresentation can be minimised by ensuring that all recruitment literature and any financials (in those jurisdictions where a franchisor is permitted to provide financial information) that are given are accurate and up to date; the parties carry out proper due diligence in relation to the other; both parties take proper professional advice; the franchise agreement is carefully drafted to ensure that the franchisor's liability for misrepresentation claims is limited or excluded (subject to local laws in relation to exclusion or limitation of liability); a carefully drafted and up-to-date disclosure document is given by the franchisor (the provision and content of which is mandatory in some jurisdictions); and the parties communicate openly and frankly with each other both before and after the agreement is signed to ensure that any mismatch of expectations is dealt with promptly to avoid escalation of issues.

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ii Inappropriate choice of franchise partner

When a franchisor decides to expand overseas, they often make the mistake of entering into an agreement with the first partner who shows an interest in their brand. It is vital that proper due diligence is completed and that the franchisor is confident that the choice of partner has experience of the local market (ideally in the particular industry sector in which the franchisor is operating); is properly funded; has experienced and capable staff who speak both the local language and that of the franchisor to ensure open and clear communication; and ideally a proven track record of growing other franchise brands.

In recent years, a number of large organisations have grown and been highly successful from buying up the master franchise rights to brands particularly in the Middle East and East Asia. Often these master franchisees are extremely experienced local operators and very well funded and own a whole stable of Western brands commonly in the food and beverage and retail sectors. The growth of such organisations has shifted the balance of power in the international franchisor–franchisee relationship and it is no longer necessarily the case that the franchisor is the larger or more experienced organisation. The growth of the large master franchisee organisations has resulted in much more sophisticated franchise partners who can make a phenomenal success in their local markets. However, these partners are also more likely to negotiate hard over the wording of the agreements with the result that agreements are a lot more balanced than they have been historically.

iii Failure to reach minimum performance requirements

It is common for agreements to have some sort of minimum performance requirements (MPRs) whether in relation to the number of stores opened, turnover achieved or products purchased. The current global financial crisis and nervousness caused by uncertainty over Brexit, the US–China trade wars and the delicate political situations in Russia and some Middle Eastern countries have had an impact on consumer spending and hit retailers and food and beverage companies hard. New technologies and customer buying habits have seriously impacted traditional bricks-and-mortar concepts. These sectors are highly competitive in Europe and North America and becoming increasingly so in the Middle East and East Asia. This has even resulted in a number of experienced and well-funded franchise partners being unable to reach the MPRs that are imposed. Failure to reach MPRs often entitles the franchisor to terminate the agreement or reduce the size of the franchisee's territory. However, in the current climate, provided that the master franchisee has had some success, it is common for the franchisor to agree to renegotiate the MPRs so that the relationship can continue, even though growth in the territory will be slower than the franchisor initially anticipated. MPRs should be reasonable and achievable, otherwise both parties will be disappointed.

iv Lack of franchisor support

Lack of support is a common complaint by franchisees. In domestic franchise systems, the express obligations on the franchisor in terms of support levels may be very limited. However, in an international context, they are likely to be more detailed and extensive. Lack of support allegations are often closely aligned with a mismatch of expectations as it may be that the franchisee is not contractually entitled to high levels of support but is not receiving what they expected or had been told they would receive.

v Failure to maintain brand standards

It is a common complaint by franchisors that master franchisees are failing to maintain the brand standards that the franchisor has set in its home country. This may be for genuine reasons such as a requirement for the brand and operating methods to be adapted to be successful in the franchise territory. There is sometimes a fine line between acceptable modifications to the system and undermining the valuable brand reputation that the franchisor has built up.

II FORMS OF DISPUTE RESOLUTION

In the event of a dispute between a franchisor and franchisee the main options open to the parties are (1) discussion, (2) mediation, (3) termination, (4) arbitration, and (5) litigation. Each of these options is considered in turn below.

i Discussion

Most international franchise agreements are long-term and complex arrangements. It is likely that neither of the parties will want the relationship to break down and the agreement to be terminated unless there really is no other option. The legal and commercial implications of termination are considered later in this chapter. Therefore, before taking any enforcement action or considering termination, the franchisor should contact the franchisee and try to discuss the issues involved to see whether an amicable settlement can be reached. There are often practical difficulties to overcome in arranging discussions as the franchisor and franchisee will inevitably be in different countries and potentially different continents but, if possible, a face-to-face meeting should be arranged as it is more likely to be conducive to settlement.

Many franchise agreements will contain a dispute escalation clause, which sets out how the parties must deal with any dispute that arises between them, or a reference to the operations manual, which sets out a detailed dispute escalation procedure. The first step in a dispute escalation clause is likely to be a face-to-face meeting between certain representatives of both parties. Some clauses will set out in detail the procedure and timings for such a meeting, including how much notice must be given, where the meeting will be held, who must be in attendance, what language will be used and the information that must be exchanged prior to the meeting. While such detail may, at the outset of a relationship, seem unnecessary, it can help when both parties are embroiled in a dispute for there to be a clear contractual mechanism for seeking to resolve it. While the legal enforceability of a dispute resolution clause will depend on the law of the agreement, the courts and arbitrators in many jurisdictions are increasingly likely to hold the parties to a contractually agreed dispute escalation process.

If initial discussions do not prove fruitful, the parties may wish to arrange for discussions to take place between their legal representatives, who will be able to assess the relative merits of each parties' case and may be able to negotiate a compromise. The involvement of legal representatives will not necessarily lead to litigation although it does inevitably have an impact on the relationship and can be taken negatively by a franchisee. However, the early involvement of legal representatives can often lead to a speedy settlement thereby avoiding the costs of the litigation and a complete breakdown in relations between the parties.

Discussions are more likely to be successful if the cause of the dispute is issues such as failure to reach MPRs, failure to maintain standards or allegations of lack of support as the parties should hopefully be able to work together to agree a process going forward that is

mutually acceptable. In some circumstances, discussions may be entirely inappropriate and the franchisor may need to move straight to litigation or arbitration. Such circumstances would include where there have been breaches of confidentiality or contractual provisions in relation to non-competition or misuse of the franchisor's trademarks or other intellectual property rights.

ii Mediation

If the parties agree to mediation, the dispute is submitted to a single impartial individual who will act as a referee in relatively informal settlement discussions. It is preferable, and nowadays fairly common, for there to be a contractual obligation for the parties to try to resolve their differences via mediation prior to resorting to litigation or arbitration, which will be an enforceable obligation in many jurisdictions. Mediation is a recognised form of alternative dispute resolution in almost all jurisdictions and is becoming increasingly popular because of the fact that the success rates are relatively high and it is a way for the parties to continue the relationship on agreed terms, which is ultimately what most parties wish to do.

As stated above in relation to informal discussions, it is preferable for the mediation clause in the agreement to set out precisely the mechanism for a mediation to avoid satellite arguments holding up the resolution of the main dispute. The clause should set out the mediation body (if any) that will be appointed or an arrangement for the parties to mutually agree the nomination of a mediator; the notice period that must be given; the location and language of the mediation; the length of the meeting (e.g., if it is limited to an eight-hour day or a two-day period); the representatives who must be in attendance (e.g., the CEO or managing director of each company); and how the costs of the mediator will be divided between the parties. In the absence of a mediation clause in the agreement the parties will not have a contractual obligation to mediate but instead must voluntarily and mutually agree to go to mediation.

Mediation is conducted in confidence and, as in arbitration, it should be possible for the parties to avoid any publicity, which can be a major advantage to the franchisor as the brand owner. The main advantages of mediation are as follows:

- a* it is private and flexible;
- b* a mutually acceptable trained professional is selected by the parties who acts as a referee;
- c* mediation is relatively low cost and, if litigation is avoided, is a cost-effective way of dealing with a dispute;
- d* an effective mediator should be able to dissuade a party from pursuing an unreasonable claim or an excessive amount of money;
- e* if there has been poor communication between the franchisor and the franchisee, mediation can bring the parties together to save the relationship;
- f* the parties are able to explore more innovative settlement options that are available to a judge or arbitrator; and
- g* subject to practicalities, a mediation meeting can be set up very quickly thereby saving costs and ultimately the relationship.

The main disadvantages of mediation include the following:

- a* the mediators available may have little experience of franchising and may not understand the key issues;

- b* quick and effective action may be needed to remedy the breach such as applying for an interim injunction (particularly if there has been a breach of confidentiality or intellectual property rights);
- c* mediation does not necessarily produce an enforceable and binding decision. The parties must mutually agree a settlement and time and effort could be wasted while the breach remains unremedied; and
- d* mediating too early in the lifespan of a dispute may mean that the parties are not ready to settle, which can render the mediation unsuccessful.

Mediation is becoming increasingly popular, particularly as a means of resolving international disputes, which can be incredibly expensive to litigate and potentially very damaging to a franchisor's brand reputation, and may have an impact on the rest of the franchise network.

iii Arbitration

The increase in international trade in recent decades has led to a huge upsurge in the use of arbitration as a method of resolving international commercial disputes. Arbitration is essentially a private form of litigation and all parties must agree to the use of arbitration as a means of resolving their dispute. The rights and obligations of the parties to arbitrate their disputes arise from the arbitration agreement that they have agreed. It is common to see an arbitration clause in an international franchise agreement that will form the basis of the agreement to arbitrate. An arbitration clause is a self-contained contract between the parties that is collateral to or ancillary to the main contract, which means that an agreement to arbitrate will not be regarded as invalid, non-existent or ineffective even if the main agreement is defective.

Arbitration has many advantages over litigation in an international franchise context as set out below:

- a* In many jurisdictions, arbitration proceedings are private and confidential, which means that the decision of the arbitrator will not be reported in the same way as a court judgment and the parties should therefore be able to avoid any adverse publicity that often follows litigation. However, this does not apply in all jurisdictions, so local law advice should be taken.
- b* The parties have the power to agree flexible procedures to ensure that the dispute is dealt with efficiently and cost-effectively.
- c* The parties can choose a neutral location for the arbitration hearing as opposed to opting for one of the parties' national courts. Jurisdictions such as Hong Kong, Singapore and Geneva have become very popular neutral locations for arbitrating international disputes.
- d* Parties can choose an arbitrator with expertise that is relevant to the franchise industry or to the particular issue in dispute. They can also ensure that the arbitrator is neutral and unbiased, which may be an issue in relation to the judges in some local courts.
- e* An arbitration award is generally final and binding and the options for challenging an award are very limited, whereas a court judgment is usually subject to rights of appeal to high appeal courts. The process should therefore give more certainty and finality for the parties.
- f* It is generally easier to enforce an arbitral award in another jurisdiction than it is a court judgment.

Because of the increase in the popularity of international arbitration and the fact that it encourages trade between continents, national legislators have responded by establishing improved and streamlined arbitration laws and procedures and the national courts of most jurisdictions demonstrate a willingness to provide a hospitable climate for arbitration and to require parties to comply with contractual obligations to resolve disputes by arbitration. In general, national courts will interpret arbitration clauses widely so that they cover all nature of disputes arising out of all in connection with the franchise relationship and will usually make it more difficult for parties to challenge arbitration awards in the courts.

Arbitration can be 'institutional' whereby the parties agree to use the laws of a particular established institution specialising in arbitration proceedings who will also have a list of recommended and approved arbitrators. Alternatively, the parties can choose ad hoc arbitration whereby the parties either set out their own rules for the conduct of the arbitration or rely on the rules of the law that govern the procedure of the arbitration. It is normally preferable to choose institutional arbitration to rely on the well-drafted rules administered by one of the international arbitral bodies and also benefit from the administrative assistance that they provide. In addition, institutional arbitration tends to be less expensive as, although the arbitral body will charge a fee, the body will fix the fees of the arbitrator or negotiate hourly rates for the parties, whereas there is no control of this type with ad hoc arbitration. Among the more well-known arbitral institutions are the CIETAC, the ICC, the ICDR, the HKIAC, the LCIA, the SIAC and the Arbitration Institute of the SCC.² The choice of arbitral body will usually be swayed by the location of each of the parties and the choice of the seat of arbitration.

The institutional rules usually contain the basic provisions for commencing arbitration, choosing the arbitrators and the procedures to be followed after the award has been given. In drafting an arbitration clause, parties should state where the arbitration is going to take place (the 'seat' of the arbitration); whether it will be administered by a particular arbitral body or be ad hoc; the language that will be used; the number of arbitrators (one or three); and the procedural and governing law.

An arbitration award is equivalent to a judgment in litigation in that it is final and binding. Enforcement of arbitration awards in countries other than the location of the arbitration hearing should, in theory, be relatively straightforward in view of the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention). As parties to arbitration normally choose a neutral forum for the hearing, it is unlikely that an arbitration award will be made in the defendant's place of residence or business and therefore it is very common for arbitration awards to be enforced in another jurisdiction in which the property and assets of the losing party are located.

The New York Convention requires the courts of contracting countries to give effect to an arbitration agreement and to recognise and enforce awards made in other member countries subject to only very limited exceptions. Countries that are signatories to the New York Convention are able to limit the applicability to awards made in other contracting countries only. Therefore, when seeking to enforce an award, it is important to check whether both the country where the award was made and the country where enforcement is intended

2 China International Economic and Trade Arbitration Commission, International Chamber of Commerce, International Centre for Dispute Resolution, Hong Kong International Arbitration Centre, London Court of International Arbitration, Singapore International Arbitration Centre, and Stockholm Chamber of Commerce.

are contracting countries. It is also open to countries to limit the applicability of the New York Convention to awards relating to commercial matters only but that should not present a hurdle in franchise relationships.

Despite being signatories to the New York Convention, the courts of some jurisdictions have remained resistant to enforcing foreign arbitral awards, instead choosing to look at the reasoning behind the award and effectively forcing the parties to relitigate the dispute. It is therefore always advisable to consider where the assets of the counterparty may be held, which will not necessarily be the same jurisdiction as its registered office address, and to take local law advice on the enforceability of foreign arbitral awards before deciding on the location of the arbitration.

The New York Convention provides for very limited grounds on which the enforcement of a convention award can be refused. These grounds include incapacity of the parties, invalidity of the arbitration agreement, denial of a fair hearing, lack of jurisdiction, invalid award, procedural irregularities and public policies. The party seeking to enforce an award should apply to the court of the country in which it seeks enforcement, and present the award and the agreement under which it was made. The court is then generally bound by local laws to enforce the award unless one of the grounds for refusal is satisfied. If a party is seeking to enforce an award that was made in a country that is not a signatory to the New York Convention, it will need to establish whether the country where enforcement is sought has entered into any other international treaty.

iv Litigation

The agreement will usually include either a binding arbitration clause or a jurisdiction clause that determines the jurisdiction of the courts that will deal with any litigation between the parties. The two main factors that parties normally take into account when deciding whether to opt for litigation or arbitration are whether there are any reciprocal arrangements between the countries in which both parties are based in relation to enforcement of court judgments and how important it will be to keep the dispute private.

Privacy

One of the major disadvantages of litigation is that it may be reported and can lead to adverse publicity for the franchisor. As explained above, arbitration proceedings are private and therefore are not reported although if there is satellite litigation surrounding an arbitration case that may be reported and it is often very difficult for a franchisee to keep the fact that it is in a dispute with one of its franchisees completely confidential from the rest of the network.

Location of the parties

If both parties are based within the EU, for example, the parties may opt for litigation in either party's home country as it is relatively straightforward to enforce a court judgment obtained in one EU Member State in another EU Member State by virtue of the Brussels Regulation No. 1215/2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (recast), which replaced the 2001 Brussels Regulation (Council Regulation (EC) No. 44/2001) for all legal proceedings instigated after 10 January 2015; and the 2011 Lugano Convention (the Lugano Convention on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters), which allow a party who has obtained a judgment from any EU Member State to enforce that judgment in all other Member States without issuing separate proceedings there. However, if one party is, for

example, based in the EU and the other is based in the United States, enforcement of a court judgment is far more complicated as there are no reciprocal enforcement arrangements between the United States and the EU. In those circumstances, the parties may be better advised to opt for arbitration and seek enforcement under the New York Convention.

v Dubai International Financial Centre

The UAE remains a desirable location for Western franchisors because of its wealth, the continued thirst within the region for Western brands and the barriers for entry resulting from the local shareholding restrictions for certain types of businesses (outside the free trade zones).

The Dubai International Financial Centre (DIFC) is a federal financial free zone, established in 2004 to promote growth and economic opportunities in the region. The DIFC has its own court system, separate from the local Dubai courts, which is a common law system based on English law and all proceedings are conducted in the English language. The judges are highly respected and experienced judges from not only within the UAE, but also the United Kingdom, Singapore, Australia and Malaysia. While the DIFC courts were originally restricted to cases relating to the DIFC, their success and reputation for quality decisions has led to an extension of their jurisdiction to any civil or commercial case where the parties opt for DIFC jurisdiction in a commercial contract or after the dispute has arisen.

The DIFC courts have become a popular choice of jurisdiction in international franchise agreements where one of the parties (most commonly the franchisee) is based in the UAE, as the courts are preferable to the local Dubai courts, and there have been cases where non-UAE entities have encountered difficulties enforcing an arbitral award obtained outside the UAE in the local courts, despite the fact that the UAE is a signatory to the New York Convention.

The DIFC also has an international arbitration and mediation centre that is run in partnership with the LCIA, the rules of which are closely modelled on those of the LCIA.

III CHOICE OF LAW AND JURISDICTION

In an international context it is preferable to choose the jurisdiction and the governing law (to the extent that the choice will be upheld by local laws) under which any disputes will be resolved to avoid time-consuming and expensive satellite litigation. While many jurisdictions will allow the parties to an agreement to choose a governing law and jurisdiction that is not that of the country in which the franchisee trades, some will not and will impose mandatory local law. The natural tendency is for franchisors to choose the jurisdiction and laws of their home country. However, it is imperative to check local laws in the country in which the franchisee is based and will be trading to determine whether these choices will be upheld. It is also important to check that there is a reciprocal enforcement of judgments structure in place between the relevant jurisdictions otherwise the franchisor could risk litigating in its home country and then effectively having to litigate the case again in the franchisee's home country where it could achieve a completely different result. The individual country chapters will deal with these issues in relation to each featured jurisdiction.

Choice of jurisdiction clauses can be exclusive or non-exclusive. The main advantage of an exclusive clause is that it gives certainty to the parties. The existence or otherwise of a reciprocal arrangement for enforcement of judgments is an important factor when deciding whether to choose an exclusive or non-exclusive jurisdiction clause. For example, if the franchisee is based in a country that has reciprocal arrangements with the franchisor's

country, the franchisor should be able to enforce a judgment obtained in its home state in the franchisee's jurisdiction and an exclusive clause may be preferable. However, if there is no such reciprocal arrangement, a non-exclusive clause may be preferable so that the franchisor has the option of suing the franchisee in the country in which the franchisee's assets are situated rather than attempting to enforce a foreign judgment in that country with all the difficulty that involves.

While a non-exclusive clause does provide flexibility, it also potentially exposes the franchisor to litigation in more than one country. While it may be possible to apply for a stay of proceedings, this will undoubtedly lead to increased costs and uncertainty for all parties. A non-exclusive jurisdiction clause or an exclusive foreign jurisdiction clause has the obvious disadvantage to the franchisor in that it has the cost and inconvenience of instructing foreign lawyers and the uncertainty of litigating abroad.

Even if the parties have opted for arbitration, it is relatively common for the franchisor to carve out a right to apply to the local courts where the franchisee is based or trading to apply for emergency injunctive or other relief (if such relief is available in that jurisdiction) to protect the franchisor's intellectual property rights, know-how and confidential information.

IV TERMINATION

Termination of an international franchise is one of the most difficult issues for a franchisor to face as it can be messy, expensive and commercially disastrous. Not only does the franchisor face often complex legal provisions and potentially risk being sued by the franchisee for compensation, it also faces the daunting task of deciding what should happen to the franchise in the territory following the termination. It is, of course, far preferable to avoid being presented with this problem by taking heed of the common causes of dispute discussed at the outset of this chapter. However, unexpected issues do arise and if a franchisor finds itself in a situation where it is seriously considering terminating an agreement, it is vital to ensure that it carefully considers the ramifications of such a termination, to carefully plan the legal and commercial procedures necessary and take good local legal advice before making a decision.

V COMMERCIAL ISSUES

The main decision facing the franchisor will be how to deal with the territory following termination. The answer will inevitably depend on the value of the market and the potential impact on the franchisor's brand reputation. If the territory already has a number of outlets up and running, the franchisor will usually want to allow them to continue. One way to achieve this is to terminate only the rights to open new outlets thereby allowing the franchisee to continue to operate any existing outlets and allowing the franchisor either itself or via a third party to exploit the rest of the territory (if the agreement permits the franchisor to do so); however, this can cause complications in that the franchisor and the franchisee are still in a relationship and it may be difficult to rebrand the territory given that existing relationship. It may be that the franchisee's breaches are so serious that the franchisor does not want to continue the relationship at all and therefore the only option is for termination of the entire agreement. In this situation the franchisor has three options: (1) appoint a new franchisee for the territory, (2) take over the franchisee's business and run it itself, or (3) discontinue trade in the territory.

i Appointing a new franchisee

This is likely to be the most attractive option for many franchisors, but it may be difficult to recruit a new franchisee if the former franchisee's actions have damaged the brand's reputation in the territory. Timing is also a big issue – unless the franchisor plans the process carefully, there may be a gap between termination of the old franchise and appointment of a new one. This can of course cause huge logistical problems in an international context. It is therefore more common for a franchisor to seek to appoint a new franchisee prior to terminating an agreement; however, the franchisor in that situation needs to take advice on the legal implications of being in discussions with a new franchisee while the old one is still trading, and of delaying a decision to terminate, which could lead to accusations that the franchisor has affirmed the contract and lost its right to terminate.

ii Taking over the franchisee's business and running it

If a franchisor needs to terminate immediately or is having difficulties finding a new franchisee, the franchisor may have no option but to step into the shoes of the former franchisee. It is highly likely that the franchisor will not have any staff on the ground in the territory and this can cause huge logistical problems and be highly time-consuming and very expensive – it is not a decision to be taken lightly. The franchisor also needs to take local advice in relation to the enforceability of any 'step-in' rights that it may have in the agreement and the legal implications of effectively taking over the franchisee's business, which could entail the franchisor also taking responsibility for certain debts, leases, employees, etc.

iii Discontinuing trade in the territory

This may be the most unattractive option but may be necessary to protect goodwill. This will also need to be carefully planned in relation to the sale of any assets and the sale of any existing stock. A well-managed winding down of the operations in the territory may give the franchisor an opportunity to reconsider its strategy for the territory and rebrand at a later stage when trading conditions are more favourable.

The situation may be complicated if the franchisor has granted master franchisee rights as opposed to developer rights. If there is a developer, then it is easier and cleaner for the developer's corporate outlets to be closed down or brought back with relative ease. It is, however, far more difficult to deal with the sub-franchisees left by a terminated master franchisee, with whom the franchisor is unlikely to have any contractual relationship. It can be very difficult for the franchisor to have any control over such sub-franchisees and could also result in negative publicity for the franchisor.

VI LEGAL ISSUES

Many countries have quite prescriptive legislation or regulations in relation to the parties' rights to terminate franchise agreements. If a franchisor terminates incorrectly, it could be faced with a substantial damages claim and, just as importantly, may face real issues in relation to controlling its intellectual property rights, in particular trademark rights in the territory. If the trademarks have been properly registered in the franchisor's name, the franchisor should be able to protect them following termination. However, in some jurisdictions, if the franchise agreement was registered with the relevant local agency, it can be more complicated to stop

the franchisee from continuing to use the trademarks following termination. These issues are addressed in more detail in the intellectual property rights chapter and the individual country chapters.

If a franchisor terminates for underperformance, it is quite likely that the franchisee will owe the franchisor money for management fees or for stock. If the franchisee company is a vehicle that has been set up specifically to run the franchise, then there is a real risk that it will have little or no assets against which the franchisor may obtain enforcement. Unless unpaid debts are fairly substantial and undisputed, the time, cost and effort involved in enforcing against the franchisee in a foreign jurisdiction may outweigh the benefits of doing so. While it is difficult to completely prevent this type of problem arising, the franchisor should try as far as possible to ensure that payments are carefully monitored on a regular basis and that any under payment or non-payment is dealt with swiftly. Particularly in the current climate, it is not uncommon for franchisors to agree payment plans and extended payment terms with franchisees to avoid the difficult question of termination; however, this can be a 'slippery slope' and when the franchisor does make a final decision to terminate, the franchisee may be in a situation where it owes the franchisor substantial sums that are going to be difficult to recover.

Another issue that the franchisor needs to consider is the question of existing stock and whether it should be returned to the franchisor or whether the franchisee can be permitted to sell it through other networks. The question is really a commercial one and will depend on which option the franchisor prefers. It may be that it is not commercially worthwhile for the franchisor to ship the goods back to its home country and it would prefer the stock to be sold on by the franchisee perhaps by way of an agreed method and within an agreed timescale. These types of issue should ideally be dealt with in the franchisor's standard terms and conditions of supply agreed at the outset of the relationship and annexed to the franchise agreement.

Any real estate or leases owned by the franchisee can also cause logistical problems. It may not be possible for the franchisor to take over any leases for local law reasons or the landlord may not wish to contract with a foreign franchisor.

VII NON-COMPETITION COVENANTS

Franchisors will commonly ask their franchisees to give certain contractual undertakings not to be involved in a competing business both during the term of the agreement and for a certain time period after termination. The enforceability of these in-term and post-term obligations will vary greatly depending on the jurisdiction and will be subject to the competition and antitrust laws of the franchisee's jurisdiction.

i In-term obligations

As a general rule, in-term non-compete obligations are more likely to be enforceable as local courts may agree that the franchisee should have an obligation not to compete with its franchisor during the term of the agreement. The franchisee will be party to a great deal of valuable confidential information that belongs to the franchisor during the term of the agreement, particularly in relation to pricing, costs of products and marketing strategy, and it is therefore unreasonable for the franchisee to be involved in a competing business while it is party to such information from the franchisor. In addition, it is also quite common for there to be a provision in the agreement entitling the franchisor to terminate if the franchisee

is involved in a competing business in the territory during the term of the agreement. If the franchisee is an existing operator, then it is quite likely that the parties will agree a carve-out for the franchisee's existing business interests when the agreement is negotiated.

ii Post-term obligations

These restrictions are more complicated both from a legal and commercial perspective. While the franchisee may be prepared to agree to an in-term restriction, many master franchisees are not prepared to agree to any post-termination restrictions, particularly if they are an existing operator in their jurisdiction. It is more common for post-termination restrictions to be widely used in the franchisor's domestic market in the event that it wants to ensure that a unit franchise operator does not go on to compete in its territory following expiration or termination of an agreement. With a more sophisticated international partner, it will be more difficult for the franchisor to impose post-termination restrictions and obligations. In addition, post-termination restrictions are more difficult to enforce as they are more likely to be anticompetitive and these issues are dealt with in more detail in each country chapter.

VIII CONFIDENTIAL INFORMATION

As mentioned above, a franchisee will be party to a considerable amount of confidential information that belongs to the franchisor during the term of the agreement. The agreement should contain an obligation to keep that information confidential, even following termination or expiration, for as long as the information remains truly confidential.

Therefore, even if the franchisee has not agreed to a post-termination restrictive covenant, it may be possible to prevent the franchisee from continuing to trade in the same line of business if it can only do so by using the franchisor's confidential information. In many franchise systems, however, while the franchisor does have valuable information in relation to operating procedures and systems, in most cases this information is not truly confidential and it will be very difficult for a franchisor to prevent a former franchisee from using fairly general operating methods and procedures. The information being misused must be genuinely secret and that information must be properly safeguarded and protected by the franchisor to benefit in turn from legal protection.

IX CONCLUSION

While international franchising can be a very successful way for a brand owner to expand its network with less costs and exposure than corporate expansion, it is not something to be entered into lightly and it is vital that the franchisor takes proper local law advice so that it can anticipate and prepare for potential problems and issues before granting the franchise rights. The country in which the franchisee is located is going to be a deciding factor in whether to use arbitration or litigation, and what the franchisor's rights and remedies will be if and when disputes do arise. Resolving international disputes can be expensive and therefore should ideally be avoided if at all possible. Franchisors should therefore consider the likely causes of disputes set out above before entering into the agreement and thereafter conduct the relationship in an open and transparent way to deal with issues before they escalate.

E-COMMERCE AND FRANCHISING

Ben Hughes and Francesca Longworth¹

I BACKGROUND

Whereas in the previous millennium e-commerce was something akin to science fiction, it is now a fundamental part of any franchise business and the franchise agreement must deal with the way in which it affects the franchisor–franchisee relationship in some detail. For nearly every multichannel retail operation, e-commerce is a key sales channel, and is increasingly the main sales channel. This transformation from science fiction to viable sales channel began with the dot-com boom of the mid to late 1990s when new and existing retailers began exploiting and developing internet-enabled technologies to market and sell their goods and services to consumers. The intervening years have witnessed correspondingly revolutionary changes in consumer behaviour and in the way that retail businesses operate. The current e-commerce retail market is also increasingly driven by the proliferation of mobile devices and their usage by consumers. Worldwide in 2019, there were over 8 billion smartphone subscriptions that could be used to carry out e-commerce activities and this is forecast to grow to almost 9 billion by 2025.²

Transactions completed on mobile devices accounted for 58.9 per cent of digital sales in 2017³ and this exponential growth has been underpinned by advances in wireless technologies. Analysts predict that there will be more than 13 million global 5G subscriptions by the end of 2019,⁴ giving consumers rapid, round-the-clock access to digital services.

The real challenge for franchisors, however, is that e-commerce continues to develop apace. With franchise agreements being granted for periods of up to 15 or 20 years it is essential that they are sufficiently flexible to accommodate the further changes that lie ahead. Although the past 25 years have seen a rapid development in internet-enabled technologies and an equally rapid increase in internet usage by consumers,⁵ the next 25 years are likely to see even more far-reaching changes.

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2 See ‘Mobile subscriptions Q3 2018’ in ‘Ericsson Mobility Report: November 2018’: <https://www.ericsson.com/assets/local/mobility-report/documents/2018/ericsson-mobility-report-november-2018.pdf>, p. 4.

3 See eMarketer’s report ‘Worldwide Retail and Ecommerce Sales’: <https://www.emarketer.com/Report/Worldwide-Retail-Ecommerce-Sales-eMarketers-Updated-Forecast-New-Mcommerce-Estimates-20162021/2002182>.

4 See ‘Ericsson Mobility Report: November 2018’, footnote 2.

5 For example, see the rapid growth in fixed (wired)-broadband subscriptions as published on the International Telecommunication Union’s website: www.itu.int/en/ITU-D/Statistics/Pages/stat/default.aspx.

The outlook is that internet-enabled marketing and selling of goods, services and digital content will be even more widespread in future. This means that all retailers – even retailers currently operating as traditional bricks-and-mortar businesses – need to understand e-commerce from a range of perspectives, including technological, operational, commercial and legal.

The purpose of this chapter is both to reflect on the key contracting issues that confront franchisors when they seek to agree the e-commerce components of franchising and development agreements and to help franchisors gain a broad overview of the general legal landscape that they will need to deal with when operating e-commerce businesses.

II WHAT IS E-COMMERCE?

The expression ‘e-commerce’ is used to refer to a wide range of commercial activities, which can involve different combinations of consumers, businesses and other organisations. The common link is that these activities are conducted over computer networks and, more usually, the internet.

In this chapter, e-commerce will refer to commercial activities between consumers and business retailers that take place over the internet and in which the retailers market or sell goods, services or digital content to consumers who are using networked devices – such as personal computers, tablets, smartphones and internet-enabled televisions.

In this sense, as previously indicated, e-commerce is a fast-moving territory. Retailers now routinely use social networks such as Facebook, Twitter and Instagram to market their products, and consumers are increasingly buying goods and services marketed to them on social networks. Retailers are also tending to optimise their operations so that consumers can learn about and buy goods and services through dedicated applications (apps) installed on their mobile devices (such as smartphones or tablets) rather than through more traditional websites. This allows retailers to learn more and more about their customers through location-based technologies and other marketing automation technologies.

Near-field technologies (and related security functions) now feature in most mobile devices and these are being leveraged to allow consumers to make payments directly through the devices themselves, a practice that looks likely to disrupt the credit and debit card industry. In future, consumers may also make more use of cryptocurrencies such as bitcoin to buy goods and services. For example, in 2019, e-commerce website Etsy began accepting purchases in bitcoin. If cryptocurrencies are adopted as a method of payment this will have profound implications for financial regulators and central banks.

III E-COMMERCE SOLUTIONS

Most owners of major international retail brands now operate a business strategy in which e-commerce activity forms one or more of several channels through which the goods or services associated with the brand are marketed and sold. This involves the brand owner operating a portfolio of e-commerce platforms that, at a minimum, generally include websites, mobile apps and social media platforms. Each channel generally forms an integral part of the brand owner’s business, with the objective of increasing brand exposure and, ultimately, revenue and profits. Responsibility for operating each e-commerce platform tends, to a greater or lesser extent, to be allocated among the brand owner itself, specialist digital media marketing agencies, e-commerce platform providers or third-party stakeholders (such as franchisees and

joint venture partners). Depending on their circumstances, brand owners and retailers are therefore able to outsource responsibility for parts of their overall e-commerce offerings to third-party providers.

The problem that brand owners face when operating this type of strategy is that e-commerce channels have an inherent tendency to conflict with other, more traditional channels, such as bricks-and-mortar channels operated by third parties. This conflict arises because of the borderless nature of the internet, which makes it difficult to impose territorial restrictions on the marketing and sale of goods, services and digitised content through e-commerce channels.

For example, an international UK fashion brand might have long-standing franchising agreements in place with a bricks-and-mortar franchisee in France. If, separately, the UK brand were to implement a website and mobile app that offer French consumers goods at cheaper prices or with better returns policies than those being offered by the franchisee's bricks-and-mortar shops, this would be problematic.

This type of scenario challenges the brand owner and the franchisee to find a way of operating their potentially competing and conflicting channels in harmony. Of course, in essence, this is a commercial challenge that will be resolved through a commercial agreement. Ultimately, however, the contractual documentation that underpins that agreement will have to show a full understanding of the different channels and how they interrelate. For example, the brand owner may wish to allow its franchisees or joint venture partners to take responsibility for operating some or all of the brand's local e-commerce platform or social media presence. If this is agreed, then the franchise agreement or joint venture documentation will have to specify what the franchisee or partner is permitted to do or is restricted from doing online. Current market practice is for either the contract itself or any handbook that is incorporated into the contract to address the following types of points:

- a* E-commerce platforms: franchisees and joint venture partners often want to control local landing pages and subdomains. To effect this, the contractual documentation will have to expressly set out the franchisee's or joint venture partner's rights and obligations in relation to the local landing pages and subdomains, as well as any controls to be retained by the brand owner.
- b* Social media: if a franchisee or joint venture partner is entitled to use its own social media accounts to promote the brand owner's products, the brand owner will usually want the contractual documentation to include obligations and restrictions that control such social media activity.
- c* Third parties: brand owners often also seek to control how the franchisee or joint venture partner contracts with third parties. This is aimed at helping the brand owner protect its brand or to help a franchisee or joint venture partner benefit from any potential economies of scale that the brand owner already enjoys. For example, the brand owner may wish to control how its brand is used in an online brand concession store or by third-party aggregators.

IV E-COMMERCE LEGAL LANDSCAPE

It is clearly very important for e-commerce platform operators to ensure they have a comprehensive understanding of the legal framework that applies to their activities in all jurisdictions in which they are using e-commerce to market and sell their products and services.

Broadly speaking, the types of legal issues that arise will be the same in all jurisdictions. In essence, they flow from the fact that the retailer needs to enter into contracts with consumers that it is marketing or selling to, but in a way that complies with local law. Of course, the overall commercial importance to the retailer of each contract that is generated by the retailer's e-commerce platforms can vary enormously, but such contracts tend to fall into two broad categories:

- a* contracts that govern the supply of the relevant goods, services or digital content; or
- b* contracts that govern the use by the consumer of the retailer's e-commerce platform (e.g., website and mobile apps), including contracts that incorporate acceptable use and privacy policies.

If a retailer operates internationally, it will often want to operate identical or near-identical e-commerce platforms across multiple jurisdictions. If so, then the retailer will need to design its platforms and supporting operations so that, when consumers' use of the platforms generates contracts, there is a high probability that those contracts are enforceable and on terms that the retailer can predict. This is important even if the retailer is seeking to specify that its e-commerce contracts have the same governing law irrespective of the country in which they are selling. The reason for this is that, notwithstanding the governing law chosen by the retailer, in many jurisdictions certain mandatory local law provisions will apply to contracts with consumers regardless of the governing law of the contract. In some jurisdictions, a consumer may even have grounds for arguing that the local law of the jurisdiction in which they reside should apply to the contract instead.

Depending on the law of the jurisdictions in which the retailer is seeking to operate and the nature of the goods, services or digital content being sold, creating e-commerce platforms that generate contracts that predictably comply in all respects with all local contract law can be a challenging (if not impossible) task. Nevertheless, it is often possible for retailers to create and operate platforms across a specific selection of jurisdictions with a reasonable level of confidence that the contracts generated by the retailer's e-commerce platforms will comply with local law in those jurisdictions.

The types of contractual issues that the retailer will need to consider in each jurisdiction are as follows:

- a* Contract formation rules: local rules on contract formation will apply to the retailer's various e-commerce platforms in each of the jurisdictions in which those platforms operate. The retailer will want to ensure that its platforms comply with these rules so that it has enforceable contracts in place with its retail customers.
- b* Contract terms: broadly speaking, there are two areas for retailers to consider. First, ensuring that key commercial terms are properly incorporated into its contracts. For example, terms and conditions relating to pricing, payment and delivery. Second, ensuring that terms and conditions that allocate legal liability between the retailer and the consumer are incorporated and enforceable. Many jurisdictions operate under laws that aim to be favourable to the consumer; for instance, by restricting the retailers' ability to enforce terms that seek to exclude or limit their liability. Given the risk that local law may apply to the contracts generated by a retailer's e-commerce platforms, it is generally sensible to get local legal advice on the enforceability of any contractual terms that seek to limit or exclude the retailer's liability in the context of consumer claims.
- c* Governing law and jurisdiction: a retailer may be located in a different country from the country in which the consumer is located. As indicated above, this triggers the rules

on choice of governing law and jurisdiction, including under the Rome I Regulation⁶ and the Brussels Regulation.⁷ This is a complicated area of law but, in general terms, it is usually prudent for retailers to include terms specifying which governing law and jurisdiction should apply to the contracts generated by their e-commerce platforms.

- d E-commerce and consumer legislation: it is likely that there will be specific local laws that will apply to consumers generally and more specifically in respect of e-commerce contracts with consumers. In the EU, there are a number of pieces of legislation that cover this area and apply across all Member States. Primarily, these relate to information provision by e-commerce operators and fairness of terms in consumer contracts. A number of EU Directives will impose obligations on the retailer in these areas, such as the Geo-Blocking Regulation,⁸ the Unfair Commercial Practices Directive,⁹ the Unfair Terms Directive,¹⁰ the E-Commerce Directive¹¹ and the Consumer Rights Directive.¹² The retailer will need to ensure not only that its e-commerce platform provides the information required by these Directives and that its contracts with consumers are compliant with these Directives but also, for the reasons discussed above, that it has complied with any specific local laws that apply in this area.
- e Data privacy: the retailer will, in almost all cases, be collecting personal data through the use of their e-commerce platform and is likely to be responsible for compliance with data protection laws in respect of that data. This will involve, *inter alia*, ensuring that they use personal data in a lawful manner, that personal data is appropriately secured and that individuals are informed and give consent to the use of their personal data. The key consideration for companies offering goods or services in the EU will be ensuring compliance with the General Data Protection Regulation¹³ (see Chapter 5 on data protection for a more detailed discussion on this).
- f Competition: the European Commission generally regards internet marketing and sales through websites as 'passive selling' for the purpose of the vertical restraints block exemption. Therefore, customers from outside a franchisee's exclusive territory who place an order with the franchisee as the operator of the website cannot be prevented from making a purchase from the franchisee, and must be free to make purchases over the internet in general.
- g Tax: local rules on sales tax are likely to apply to sales to consumers in other jurisdictions. Complying with these requirements may require a retailer to be registered with the tax authorities in the jurisdiction in which it is selling. In the course of running its e-commerce platform, the retailer may need to assess whether withholding tax will apply to any of its transactions (see Chapter 6 for a more detailed discussion on this).
- h E-money: payment over the internet is now ubiquitous. Many of these transactions use e-money (a digital cash equivalent) stored on an electronic device or remotely on a server in an e-wallet. E-money is usually funded from a credit or debit card or a bank account and allows money to be sent instantly and securely. Although these commonly

6 Regulation (EC) No. 593/2008.

7 Regulation (EC) No. 44/2001.

8 Regulation (EC) 2018/302.

9 Directive 2005/29/EC.

10 Directive 93/13/EEC.

11 Directive 2000/31/EC.

12 Directive 2011/83/EU.

13 Regulation (EU) 2016/679.

offer a cheaper and more efficient payment system for retailers, caution should be taken as these arrangements are likely to trigger the Electronic Money Directive¹⁴ and the Payment Services Directive.¹⁵ Depending upon the exact form of the arrangements, either the retailer or a third-party electronic money provider may be subject to these requirements.

- i* Virtual currencies: retailers may want to consider accepting virtual currencies such as bitcoin (distinct from e-money, as they are stand-alone currencies, rather than a digital version of fiat money) as a method of payment on their e-commerce platform. The recent emergence of virtual currencies in mainstream commerce (with large companies such as Microsoft and Expedia now accepting bitcoin for online payments) has left the law in this area playing catch-up. While some commentators have suggested that bitcoin should be governed by the Electronic Money Directive, others suggest it should fall under the Payment Services Directive. Despite much debate on the topic, the EU has not passed any specific legislation in relation to the status of bitcoin as a currency, and the European Banking Authority has highlighted the divergent approaches to regulating crypto assets that are emerging across EU Member States.¹⁶ Consequently, there is much uncertainty surrounding virtual currencies, and more significantly they are often unregulated, meaning retailers and consumers alike are not protected and may be at risk of losing their money should something go wrong.¹⁷ Some regulators, such as the Financial Conduct Authority in the United Kingdom, have released guidance¹⁸ warning that virtual currencies (or 'exchange tokens') such as bitcoin are currently unregulated in the United Kingdom (although consultations are ongoing on whether the regulatory perimeter should be expanded to regulate virtual currencies). Further, the introduction of EU legislation¹⁹ means that, from 10 January 2020, exchanges trading virtual currencies and providers of virtual currency wallets must perform anti-money laundering checks on customers. This could catch retailers looking to integrate virtual currency payments into their e-commerce channels.
- j* New payment methods: with the introduction of the Payment Services Directive, third parties are (upon becoming authorised in the relevant Member State) entitled to initiate payments from a consumer's bank account. These services, referred to as payment initiation services, allow retailers to accept payments directly from the consumer's bank account without requiring the consumer to supply debit or credit card details. While these payment methods are still under development, there are already a number of significant providers, particularly in EU Member States, where the use of card payments is lower.
- k* Open banking: retailers are making increasing use of open banking standards to provide consumers with more interactive experiences. Open banking allows third parties to access and retrieve data from a consumer's bank account (as long as the consumer has

¹⁴ Directive 2009/110/EC.

¹⁵ Directive (EU) 2015/2366.

¹⁶ In January 2019, the European Banking Authority issued a report on crypto assets; the report is available at: <https://eba.europa.eu/documents/10180/2545547/EBA+Report+on+crypto+assets.pdf>.

¹⁷ <https://eba.europa.eu/documents/10180/2139750/Joint+ESAs+Warning+on+Virtual+Currencies.pdf>.

¹⁸ See UK Financial Conduct Authority Policy Statement PS19/22, 'Guidance on Cryptoassets: Feedback and Final Guidance to CP 19/3'.

¹⁹ Directive (EU) 2018/843.

consented). Retailers are using this access to suggest new products to customers based on previous transactions and to allow consumers to see their balance before making a purchase.

- l* Merchant acquirers: to accept payments by card on their e-commerce platform retailers are likely to contract with a merchant acquirer, who acts as the link between the retailer, the card issuer and the card schemes. Since merchant acquirers take on the risk in each transaction, they commonly only contract on their standard terms, with little or no room for a retailer to negotiate (although this is of course subject to the specific commercial positions and negotiating power of the parties).
- m* Payment card industry data security standards (PCI DSS): since an e-commerce platform is likely to deal with credit and debit card data, the retailer must ensure that the platform complies with the requirements of PCI DSS. PCI DSS is a set of requirements on the storage and use of payment card data. Although PCI DSS does not have the force of law, it is a set of industry standards administered by significant payments stakeholders, including payment card schemes such as Visa and MasterCard, and non-compliance can result in significant fines.
- n* Deferred payment options: retailers seeking to increase sales may consider allowing consumers to purchase goods, services and digital content on finance. A recent trend has seen retailers offering 'buy-now-pay-later' services, whereby a retailer will partner with a funder to allow consumers to pay for goods in instalments (often on an interest-free basis). If the service is offered interest-free, the funder typically purchases the goods, services and digital content from the retailer at a discount but receives the full amount from the consumer in instalments – the amount of this discount will be a critical factor for the retailer as it eats into their profit margin. Retailers will also need to consider whether the funding amounts to providing credit which, in many Member States, is an activity requiring authorisation; although this is primarily an issue for the funder, the retailer could be subject to regulation as a credit broker.

V CONCLUSION

The internet-enabled technologies that have revolutionised the retail landscape over the past 25 years continue to develop at a rapid pace. Global brand owners, seeking to operate their multichannel businesses and exploit the commercial opportunities that these developments present, find themselves needing to overcome the significant commercial challenges that are created by the borderless nature of the internet. This is achieved through careful negotiations with their commercial partners, which can include third-party franchisees. E-commerce retailers also find themselves needing to navigate through a sometimes bafflingly complex multi-jurisdictional legal landscape, which requires them to adopt sophisticated legal risk-mitigation strategies. For both brand owners and retailers, if these issues are successfully surmounted, substantial rewards are available.

THE COMPETITION LAW OF THE EUROPEAN UNION

Mark Abell¹

I INTRODUCTION

Antitrust law has an uneasy relationship with franchising and there is no homogenous approach adopted by regulatory authorities around the world. Some, such as the United States, follow the view of the Organisation for Economic Co-operation and Development and adopt a ‘rule-of-reason’ approach, by which the practical impact of restrictions determines whether or not they are allowed or prohibited by antitrust law. Others, such as the European Union and its 28 Member States, take a less flexible, politically motivated per se approach and treat certain restrictions, such as retail price maintenance, as forbidden, regardless of their practical impact on competition. Article 101 of the Treaty on the Functioning of the European Union is the EU’s antitrust law and prohibits:

all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market

This means that franchisors are prohibited from directly or indirectly trying to fix prices, carve up markets or sources of supply and so on. A franchise agreement incorporating such provisions will be void, potentially leading both to the imposition of fines by the regulators and possible claims for damages from aggrieved parties.²

The definitive explanation of how EU antitrust law impacts franchising in the EU can be found in the seminal decision of the European Court of Justice in the case of *Pronuptia de Paris GmbH v. Pronuptia De Paris Irmgard Schilligallis*.³ This case, which concerned the German franchisee of a French bridal wear business, establishes the principle that a franchisor can impose restrictions on its franchisees if those restrictions are ‘indispensable’ to protect the franchisor’s know-how and to maintain the identity and reputation of the franchise network,⁴ but not those restrictions that carve up markets between the franchisor and its franchisees or fix retail prices.⁵

1 Mark Abell is a partner at Bird & Bird LLP.

2 Case C-453/99 *Courage Ltd v. Bernard Crehan* [2002] QB, [2001] All ER (EC) 886.

3 Case 161/84 *Pronuptia de Paris GmbH v. Pronuptia De Paris Irmgard Schilligallis* [1986] ECR 353, [1986] 1 CMLR 414.

4 *id.*, paragraphs 16, 17.

5 *id.*, paragraph 12(c).

In the wake of the *Pronuptia* decision by the ECJ, the European Commission gave further clarification as regards how competition law regulates franchising in the EU through its decisions in *Pronuptia*, *Yves Rocher*,⁶ *Computerland*,⁷ *Servicemaster*⁸ and *Charles Jourdan*.⁹

To encourage smaller businesses to participate in cross-border trade within the EU¹⁰ the Commission adopted a *de minimis* exemption,¹¹ which states that only those agreements that have an 'appreciable' effect on trade (i.e., those that have 15 per cent of the relevant market)¹² infringe Article 101(1). However, because of the difficulties in defining what amounts to a market, relying upon the *de minimis* exemption can be rather imprudent for a franchisor.

Recognising this, and in an attempt to further encourage trade between Member States, the Vertical Restraints Block Exemption¹³ was adopted. This Block Exemption disappplies Article 101(1) to franchise agreements, although franchising is not expressly referred to in the Regulation. The Exemption applies only to those franchisors with a market share of less than 30 per cent and means that franchisors may, inter alia, impose maximum price restrictions, but not minimum price restrictions. 'Hardcore' restrictions, such as exclusivity, price maintenance and restrictions on cross-supply are not permitted and mean that franchise agreements containing such provisions cannot take advantage of the Block Exemption. Non-compete clauses, although not allowed, can be blue-pencilled out of the agreement, so allowing it to take advantage of the Exemption.

The 28 EU Member States have all adopted competition laws that are exact copies of Article 101, and so there is complete homogeneity among them.

II THE EUROPEAN PARLIAMENT COMMITTEE ON INTERNAL MARKET AND CONSUMER PROTECTION REPORT ON THE 'LEGAL PERSPECTIVE OF THE REGULATORY FRAMEWORK AND CHALLENGES FOR FRANCHISING IN THE EU'

In September 2016, following a workshop held at the EU Parliament in Brussels, in which a spectrum of stakeholders offered a range of, in some cases rather polemical, ideas on how franchising should be regulated in the EU, the Directorate-General for Internal Policies of the Union issued a report about the way in which the regulation of franchising in the EU might be reconstructed.

The report is not a formal proposal by the Committee on Internal Market and Consumer Protection but is meant to stimulate further discussion among stakeholders. It offers a bold

6 Case C-126/91 *Schutzverband Gegen Unwesen in der Wirtschaft v. Yves Rocher GmbH* [1993] ECR-I-2361.

7 *Computerland Europe SA Franchise Agreements*, Re, Case IV/32.034, [1989] 4 CMLR 259.

8 *Servicemaster*, OJ [1988] L332/38, [1989] 4 CMLR 581.

9 *Charles Jourdan*, OJ [1989] L35/31, [1989] 4 CMLR 591.

10 The *de minimis* principle was first introduced by the ECJ in the case of *Völk v. Établissements Vervaecke Sprl*, Case 5/69 [1969] ECR 295.

11 Notice on agreements of minor importance that do not fall within the meaning of Article 85(1) of the Treaty establishing the European Community OJ [1997] C 372/13.

12 Commission Notice (EC) on agreements of minor importance that do not appreciably restrict competition under Article 81(1) of the Treaty Establishing the European Community (*de minimis*) OJ (2001/C 368/07).

13 Commission Regulation (EC) No. 330/2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices OJ L 102.23.4.2010 pp. 1–7.

vision of an entirely new supportive regulatory environment for franchising in the EU, from the one of the most creative academic and professional legal minds in international franchising. It is therefore important for those involved in franchising in the EU to be aware of the approach that it is advocating.

III THE ADVANTAGES DELIVERED BY FRANCHISING

The report observes that franchising is a specific, distinct and uniform type of commercial activity with a positive influence in the EU. It stimulates economic activity by improving distribution and increasing competition. It delivers economic advantages to all those involved and consumers, by inter alia, giving businesses increased access to other EU Member State markets. Arguably, with a looming Brexit, franchising has never been more important in terms of its ability to encourage cross-border EU trade.

IV THE DIFFERENT TYPES OF FRANCHISE REGULATION IN THE EU AND ITS DYSFUNCTIONALITY

The report observes that there are two distinct types of franchise regulation in the EU. Those concerned with macroeconomic issues and those concerned with both the way in which franchisors sell their franchises to potential franchisees and the rights of the two parties during the relationship.

Those regulations that focus on the macroeconomic issues are over-concerned with intra-brand issues and fail to appreciate the value that franchising can contribute to the single market, both by enabling small and medium-sized enterprises (SMEs) to expand effectively throughout the EU, and by unleashing entrepreneurship in individual franchisees throughout the EU.

The various EU Member State sales and relationship regulations lack any real uniformity, increasing cost and causing delays for franchisors seeking to roll out across the single market, thereby creating technical barriers to cross-border franchising within the EU.

To further exacerbate the difficulties, the macroeconomic and sales and relationship-focused regulations have been developed in an uncoordinated manner, in isolation from each other. This has contributed to the dysfunctionality of franchise regulation in the EU.

Self-regulation of franchising in the EU lacks both homogeneity and a clear, consistent and effective approach to enforcement, in addition to which there is a significant conflict of interest between the interests of individual franchisors and those of franchising as a way of doing business. In any event, nearly 80 per cent of franchise chains in the EU are not members of national franchise associations and therefore not subject to the self-regulatory regime.

The result of this dysfunctional regulation is that franchising is substantially underperforming in the EU. This is evidenced by the fact that 83.5 per cent of franchising's turnover in the EU is concentrated in only 25 per cent of the Member States and constitutes only 1.86 per cent of the EU's GDP, compared with 5.95 per cent of GDP in the United States and 10.83 per cent of GDP in Australia.

This failure of the regulatory environment to recognise the value that franchising can deliver to the EU and to support and promote it as a way of helping SMEs to grow across the EU can only be remedied by re-engineering the regulatory environment in the EU.

V HOW THE DYSFUNCTIONALITY OF EU REGULATION CAN BE RECTIFIED

Franchising could better fulfil its potential in the EU if the regulatory environment is re-engineered in a manner that:

- a* promotes franchising and market confidence, by underpinning and supporting the commercial advantages that franchising delivers to franchisors, franchisees and the single market;
- b* ensures pre-contractual hygiene in franchising;
- c* ensures a balance between the interests of franchisors and franchisees;
- d* reconciles the priorities and concerns of the two different types of franchise regulation in an appropriate way; and
- e* is harmonised throughout each EU Member State.

The report suggests that this could best be done by adopting a European legal act (ELA) containing provisions regulating specific issues that would increase market confidence in franchising, ensure pre-contractual hygiene and impose a mandatory taxonomy of rights and obligations. The following approach, using an ELA, is proposed:

- a* the ELA should be used to bring a homogenous approach to the regulation of franchising in the EU;
- b* the ELA should enable SMEs to use franchising to better compete with larger corporations through an ‘exchange of benefits’; and
- c* the ELA should promote market confidence in franchising as a way of doing business, ensuring pre-contractual hygiene and ensuring a fair ongoing relationship between franchisors and their franchisees by imposing appropriate rights and obligations on both parties.

VI WHAT LEGAL INSTRUMENT?

The current heterogeneous regulatory environment creates obstacles that prevent franchisors from taking full advantage of the single market. The same problem was encountered in relation to commercial agency and was overcome by the adoption of a directive.

The report suggests that the catalyst for harmonisation should be an ELA containing provisions regulating specific issues.

The report suggests provisions that the EU Commission could include in an ELA to implement these recommendations. The ELA would have the following three main areas of focus.

i Promoting confidence in franchising

The report proposes that franchising should be seen by business, especially SMEs, as offering legal as well as commercial advantages. They should be offered certain benefits in exchange for using franchising and so allowing third parties to operate their own businesses using the franchisor’s brand and know-how. Regulations should enable SMEs to use franchising to better compete with larger corporations. This can be achieved through an exchange of benefits.

This means that franchising must be clearly defined and be perceived as offering positive advantages to all involved in it. In other words, regulation should maintain and increase market confidence in franchising as a way of doing business, as it encourages entrepreneurship

not only in SMEs that become franchisors, but also in individuals who become franchisees. The following recommendations will achieve this. This is a positive contribution to the single market, franchisors, franchisees and consumers.

This can be achieved by enabling franchisors to require pre-contractual disclosure by franchisees; focusing regulation only where it is required (by excluding fractional franchisees, *de minimis* franchisees, sophisticated investors, large investors, large franchisees and insiders); and allowing franchisees to compete on a level playing field with corporate chains.

It should establish this by changes to antitrust law, namely allowing franchisors to set the prices their franchisees may charge and restricting franchisee sales over the internet.

These changes will increase market confidence in franchising in the EU and so encourage SMEs and other businesses to adopt it as part of their growth strategy.

Fraud and sharp practice should be regulated by criminal law and not by a franchise-focused ELA.

ii Ensuring pre-contractual hygiene

It is suggested by the report that regulation should also ensure pre-contractual hygiene. That is, it should help ensure that when franchisors and their franchisees enter into a relationship there is as little opportunity as possible for misunderstanding or a mismatch of expectations between them. To achieve this, franchisees should not only be strongly encouraged to take and follow expert advice, they should also understand exactly what they are buying – a blueprint for a business, not a guarantee of success, and an obligation to follow the franchisor's system.

To help ensure pre-contractual hygiene potential franchisees must be given access to appropriate information and equipped to interpret it in an appropriate manner. It is therefore proposed that advisers (particularly lawyers) are required to take short online franchise education courses if they are to advise potential franchisees, and potential franchisees investing more than €20,000 must produce a certificate from their advisers to prove that they have taken such advice.

National franchise associations can play an important part in educating potential franchisees that they have to work hard, follow the format, risk failure and take and follow expert advice from appropriately experienced professionals. They should receive financial support from central government to help ensure their independence.

Pre-contractual disclosure should:

- a* be given in a set form 15 working days before execution or payment;
- b* cover details of the identity and experience of the franchisor, the franchise network, the terms of the franchise agreement and any earnings claims;
- c* be in plain language;
- d* contain an appropriate risk statement;
- e* be accompanied by a copy of the franchise agreement in the form in which it is to be executed;
- f* include a five-day cooling-off period after execution;
- g* if not complied with, lead to the right for the franchisee to terminate or claim damages within 12 months of the franchisee becoming aware of the non-compliance or 24 months of the date of execution, whichever is the later, if it resulted in defective consent having been given;
- h* enable the appropriate regulatory authority to rescind the franchise and related agreements, or claim damages;
- i* allow the regulatory authorities to impose penalties, including disqualification;

- j* be allowed electronically;
- k* give rise to personal liability for any individual responsible for the disclosure document being inaccurate; and
- l* apply to foreign franchisors with no presence in the relevant Member State, who should be under an obligation to disclose relevant information about analogous markets.

To ensure that the legal requirement is always in step with market practice, there should be a regular review of the disclosure law every five years.

Misleading and deceptive behaviour (failing to comply with the pre-contractual disclosure obligations and making any statement that, although literally true, misleads or deceives or is likely to mislead or deceive) should be prohibited.

Registration of documentation on a public register creates a catalogue of problems in those jurisdictions where it is required both in the EU and elsewhere. Indeed, it has been wrongly viewed by some potential franchisees as an endorsement by the regulator of franchise systems – some of which have later proved to be unsuccessful. It is therefore inappropriate, not only because of the practical difficulties it would give rise to in EU Member States, but also because of its lack of cost-effectiveness and lack of impact.

iii Ensuring a fair relationship

The report goes on to state that the ELA should ensure that both franchisor and franchisee act fairly towards each other, reflecting the bargain that they have struck with each other. This can best be done by imposing mandatory terms onto the franchisor–franchisee relationship through the franchise agreement.

The report observes that discussion of these issues are often polemical and driven by the vested interests of individuals rather than higher-level balance. For example, the suggestion that franchisees should be free of any post-term restriction on using the franchisor's know-how is nothing less than theft of the franchisor's property and, if adopted, would constitute 'free-riding', dealing a potentially near-mortal body blow to franchising and the benefits that it delivers to all involved in it.

It is proposed that there must be a quality-based restriction on franchisors that can take advantage of the benefits offered by the regulation. A franchise that has not operated the business format for at least 12 months or that is operating fewer than four outlets will not have to comply with the regulation and cannot enjoy the exchange of benefits.

Consideration of the realities of the franchise relationship and the risks that both franchisor and franchisee accept lead to the following recommendation.

Franchisees must:

- a* not challenge the franchisor's intellectual property;
- b* implement the business format;
- c* not compete with the franchisor during the term and for a reasonable period thereafter;
- d* allow the franchisor the right to purchase the franchisee's business on termination;
- e* allow termination for cause without compensation;
- f* allow the franchisor a pre-emptive right of purchase;
- g* impose a duty of confidentiality; and
- h* purchase core goods and services from the franchisor or its nominated suppliers.

The franchisor must:

- a* be the owner of or have the right to license the intellectual property rights on which the franchise is based;
- b* provide a reasonable level of training;
- c* refrain from encroachment;
- d* allow the franchisee the right to sell its business (subject to the franchisor's pre-emptive right); and
- e* not supply goods or services to the franchisee at overinflated prices or that are unfit for purpose.

Each of these can be justified in their own right, the report states, but would require more space than is available in this chapter.

To take account of the franchise agreement's long-term and changing nature, unconscionable behaviour by both parties must be prohibited.

VII CONCLUSION

This report written by Dr Mark Abell on behalf of the Committee on Internal Market and Consumer Protection breaks new ground and proposes that to actively support and encourage franchising within the EU, an ELA should be adopted that aims to:

- a* define franchising;
- b* require disclosure by both franchisors and franchisees;
- c* disapply other duties of care and consumer rights;
- d* allow franchisors to set retail prices and control use of the internet;
- e* prohibit unconscionable behaviour;
- f* impose a specific and exclusive duty of good faith;
- g* support, and establish a clear role for, national franchise associations; and
- h* periodically review the terms of the ELA.

These proposals as to how regulation can be used to promote the interests of franchisors, franchisees and consumers in the European Community in a harmonised and constructive manner amount to a step change in the regulation of franchising in the EU and will no doubt receive serious consideration from all those with an interest in franchising within the EU and beyond.

THE IMPACT OF BREXIT ON FRANCHISING

*Mark Abell*¹

The decision of the United Kingdom on 23 June 2016 to leave the European Union will have a very real, but at present not fully known, impact upon all those franchisors around the world that have a presence in the United Kingdom, and possibly upon many of those that have a presence in the rest of the EU. This will present challenges for franchise lawyers, who will need to understand the potential implications as these change and develop over the coming years, and consequently they will have to advise their franchise clients how best to deal with the developments.

Although the decision in the referendum was a close one, with 51.9 per cent of the voters in favour of leaving and 48.1 per cent in favour of remaining in the EU, then Prime Minister Theresa May made it clear that there would be no second referendum and that 'Brexit means Brexit'.

This unexpected result has caught almost all franchisors on the hop and left them potentially exposed in respect of their business in the United Kingdom and, perhaps, in the rest of the EU.

There is still a body of sentiment in Scotland in favour of remaining in the EU and speculation that this could lead to another referendum on Scotland leaving the United Kingdom in favour of staying within the EU.

At the time of writing, the date on which the United Kingdom will leave the EU has been fixed as 31 January 2020, following MPs' approval for Prime Minister Boris Johnson's Brexit deal. However, to ratify Brexit, it will also be necessary to pass an agreement with the EU into law. This entire process continues to present considerable political challenges (it should be recalled that the unpopularity of the Withdrawal Agreement bill sank Mrs Theresa May's premiership) as, following the withdrawal, further complex negotiations will attend the transition period, which runs until 31 December 2020.

Wherever the Brexit process leads the United Kingdom and the rest of the EU in terms of both the process itself and the ongoing relationship between the EU and the United Kingdom, the withdrawal agreement must be passed by a qualified majority of the Council, with the consent of the European Parliament.

When Brexit does take effect, EU treaties will cease to apply to the withdrawing state from the date the withdrawal agreement comes into force or, failing the conclusion of an agreement, two years after the Council is notified of the withdrawal (unless the Council unanimously agrees to extend this period).

¹ Mark Abell is a partner at Bird & Bird LLP.

Although no one, including franchisors and their lawyers, has a crystal ball enabling them to predict exactly what will happen as a result of the Brexit decision, it is clear that when the United Kingdom leaves the EU certain things will happen that will have an impact upon franchisors in the United Kingdom and, potentially, franchisors throughout the EU.

Regardless of how the English legal system adapts to the change, Brexit may provide grounds for the termination of franchise agreements, depending on the specific facts and drafted terms (e.g., material adverse change or force majeure clauses) in contracts. This is particularly relevant in the case of franchise agreements that have the EU as their territorial scope. Parties might argue that a contract has become frustrated as a result of Brexit. This is of great relevance to any US franchisors that have granted master franchises for the EU rather than for specifically named countries.

Although 'Brexit will mean Brexit', it does not mean that all the laws impacting upon franchisors in the United Kingdom will change overnight.

When the United Kingdom leaves the EU, all directly applicable EU law (including treaty provisions and regulations) will cease to have legal force in the United Kingdom, unless Parliament passes equivalent domestic legislation. Directives (which are only effective once transposed into domestic UK legislation) will continue to operate, but the UK statute will no longer be required to comply with the Directive from which it derives: the UK Parliament will be free to amend the legislation as it sees fit.

Secondary legislation introduced under the powers set out in European Communities Act 1972 (ECA 1972) to implement EU law will lapse when the ECA 1972 is repealed, subject to the enactment of saving provisions. Where ambiguities arise, directives are likely to continue to be relevant to the interpretation of UK statutes that derive from them.

It is likely that, even after Brexit, the decisions of the Court of Justice of the European Union (CJEU) will continue to be persuasive in UK courts, particularly with respect to UK law derived from or harmonised with EU law. This influence will diminish over time as UK law diverges. Some UK statutes contain a requirement to interpret the legislation consistently with CJEU rulings: this requirement will continue to be effective after Brexit unless and until the UK statute is amended. Depending on the United Kingdom's new status in relation to the EU (which is to be negotiated), the United Kingdom may join the European Free Trade Association (EFTA) (and then also the Lugano Convention on Jurisdiction and Judgments) and possibly the European Economic Area (EEA).

If the United Kingdom joins EFTA, and through it joins the EEA, the position in relation to many aspects of legal practice will remain unchanged. This must be a real possibility and, if it is the outcome, there is likely to be less upheaval from a legal point of view.

If the more Eurosceptic view prevails, it is likely that the United Kingdom will negotiate a looser arrangement with the EU via a series of bilateral and multilateral trade agreements, or through reliance on the rules of the World Trade Association, Organisation for Economic Co-operation and Development, and G20, of which it will remain a member.

One thing that is clear is that should the EU's Directorate-General for Internal Policies of the Union consider there to be a need for further franchise regulation, resulting in some form of new franchise regulation in the EU, this would most probably not take effect in the United Kingdom.

EU competition rules will continue to apply to franchising post-Brexit, although the Commission will have reduced powers. However, new block exemption measures will be needed at UK level, as the UK Competition Act currently relies on the EU block exemption regulations (which will no longer apply following Brexit).

Disputes where the franchisor or franchisee is based in the United Kingdom and the other party is based in an EU Member State are likely to be affected by Brexit. However, there may be an even wider impact. A dispute between a franchisor and franchisee, even if both are based outside the EU and the United Kingdom, may nevertheless be affected by Brexit if the subject matter of the dispute is in the United Kingdom.

The Brussels Regulation currently governs jurisdiction and the enforcement of judgments within the EU. The Lugano Convention sets out very similar rules, so if, post-Brexit, the United Kingdom becomes a signatory to this convention, little will change. Otherwise, the position will depend on negotiated bilateral and multilateral agreements with other countries, or the possible ratification by the United Kingdom, in its own right, of the Hague Convention on Choice of Court Agreements (which the EU has ratified).

It is likely that EU rights, such as registered and unregistered community designs and EU trademarks (EUTMs) (formerly referred to as Community trademarks or CTMs), will no longer have effect in the United Kingdom and there will be questions about what will happen to the 'UK portion' of such rights obtained before Brexit. If existing rights automatically reduce in geographical scope to exclude the United Kingdom, their value will diminish, which will have a commercial impact on the rights holder. This is something that US franchisors with EUTMs have to keep an eye on, as it may mean having to reapply for some of their trademarks in the United Kingdom at some point.

Furthermore, some US franchisors have EUTM registrations but only use their marks in the United Kingdom. Once the United Kingdom no longer forms part of the EU, these EUTM registrations could be vulnerable to attack for non-use. US franchisors in this situation would have to consider expanding their use in the EU to defend their EUTM registrations or consider filing independent national UK applications that would survive any possible future demise of their EUTM as a result of non-use.

Franchisors with a presence in the United Kingdom should audit the immigration status of their workforce, consider applications that could be made now (e.g., for permanent residency and communicate with concerned employees. In the longer term, if and when the government proposes that laws be amended or repealed, employers should also review employment contracts (with a view to addressing any enforceability risks that might arise), policies, procedures and benefit schemes, and check any European Works Council arrangements.

Changes to immigration laws in relation to EU citizens currently living and working in the United Kingdom could have a substantial impact on your franchisee's employees, particularly in the food and beverage and hospitality industries.

Various EU provisions have entered into force in the United Kingdom since the Brexit vote. These include the General Data Protection Regulation (GDPR), which entered into force on 25 May 2018, the Network and Information Security (NIS) Directive, enacted in UK law as the Network and Information Systems Regulations 2018 in May 2018 (and often referred to simply as the NIS Regulations) and, for the police and criminal justice sector, the Police Data Protection Directive, which had to be transposed by Member States by 6 May 2018.

Post-Brexit, any US franchisor that processes or monitors EU citizens' personal data in connection with its offer of goods, services or monitoring activities, or has a group company or staff operating within the EU, will still have to comply with the GDPR. The extent to which the GDPR will be adopted in the United Kingdom will depend heavily on the type of relationship with the EU that the United Kingdom adopts. However, it seems likely that

either the GDPR or a law that looks very like it will be required in the United Kingdom, given that the current UK law is in need of refreshment (it is nearly 20 years old) and given the way that EU data transfer laws operate.

The United Kingdom will wish to continue to trade with the EU post-Brexit, therefore closely comparable data protection and cybersecurity laws in many areas will be necessary to avoid barriers to trade.

US franchisors with franchisees in other EU Member States will have to be very careful to ensure they comply with EU data protection and cybersecurity laws even after Brexit.

Franchisors with a large number of commercial contracts, particularly with entities within the EU, should consider auditing these contracts in due course to determine the effect Brexit will have on rights and obligations under these agreements.

The commercial impact of the cost of increased trade barriers between the EU and the United Kingdom could have an adverse impact on franchisors with networks based in the United Kingdom and covering other EU Member States because of, for example, the impact of the restriction of free movement of persons and monitoring of currency fluctuations.

The one thing that is certain about Brexit and its impact on franchisors at the moment is that nothing is certain. However, franchisors must keep a watching brief as various areas of law develop in response to the political changes that look likely to take place over the coming year. Bird & Bird will be providing an ongoing review of the impact of Brexit on franchising as matters develop.

EDITOR'S GLOBAL OVERVIEW

Mark Abell¹

AFRICA OVERVIEW

Chapter written by Nick Green

The past 12 months have seen a great deal of franchise investment into the African continent, North, South, East, West and Central Africa are all attracting a great deal of attention from franchisors. The regulatory regimes can be challenging and procedures time-consuming and expensive. Accessing knowledgeable legal advice on franchising can be a challenge.

GCC OVERVIEW

Chapter written by Melissa Murray

The Gulf Cooperation Council (GCC) countries comprise six distinct nations, each with similar but distinct legal systems. For example, while Dubai (part of the UAE) has a legal system that has many similarities with Western nations, Saudi Arabia has a legal system firmly based on shariah law. However, there is such a degree of commonality in the way these jurisdictions approach franchising that they can sensibly be dealt with together.

Until recently there had been no specific franchise legislation in any of the GCC countries, but a new Saudi Arabian Franchise Law was approved by the Saudi Council of Ministers in October 2019 and is due to enter into effect in April 2020.

While, in general, direct foreign investment is restricted in GCC countries, the recently passed UAE Foreign Direct Investment Law allows foreign investors to own 100 per cent of onshore companies on UAE mainland, although the extent to which this might impact the sectors in which franchising is traditionally widely used is not clear yet. Notwithstanding these developments, the region is often granted by foreign franchisors as a single territory, this has an obvious impact upon the way in which franchisors and their developers or master franchisees structure their approach to the region.

All of the GCC countries have commercial agency laws that can apply to foreign franchises entering the market, with substantial negative consequences from the franchisor's point of view.

¹ Mark Abell is a partner at Bird & Bird LLP.

AUSTRIA

Chapter written by Eckhard Flohr and Alfons Umschaden

Austrian law closely resembles that of Germany in respect of its impact upon franchising and so good faith is of great importance.

CANADA

Chapter written by Paul Jones and Katya Logunov (Stepanishcheva)

Canada does not have national franchise legislation. Many Canadian provinces have adopted franchise-specific laws. Unfortunately each province has adopted slightly differing laws, introducing additional red tape and uncertainty for franchisors entering Canada.

CHILE

Chapter written by Cristóbal Porzio

Chile is seeing an increasing amount of growth in the franchise sector but does not have a franchise-specific law. The concept of duty of good faith is used to impose both a degree of pre-contractual disclosure and a restraint upon how franchisors exercise their contractual rights.

CHINA

Chapter written by Sven-Michael Werner

China's franchising law was adopted in a hurry to satisfy the conditions imposed upon China as regards its accession to the World Trade Organization. As a result, it was not as well considered as it might have been, and has since been amended several times.

The law imposes pre-contractual disclosure, registration and mandatory terms, and the registration process can be challenging and time-consuming. Chinese law also imposes a duty of good faith upon franchise relationships.

As China is a signatory to the New York Convention, foreign arbitration in international franchise agreements tends to be the norm. There is a growing body of Chinese jurisprudence about franchising, but there is yet to be any real evidence of consistency between the various courts.

CZECH REPUBLIC

Chapter written by Vojtěch Chloupek

The Czech Republic does not have any franchise-specific regulations and instead relies upon its Commercial Code to deal with issues such as pre-contractual misrepresentations and the like.

DENMARK

Chapter written by Jacob Ørskov Rasmussen

Like the other Nordic members of the EU, Denmark has a civil legal system that is markedly less interventionist than the German-influenced systems.

It does not have a franchise-specific law.

FRANCE

Chapter written by Raphaël Mellerio

The Napoleonic Code has had a substantial impact upon the law of other EU Member States.

France was the first European country to adopt a franchise-specific law – the Doubin Law – although paradoxically, it does not actually use the word franchising. Although its requirement for pre-contractual disclosure has many similarities to the United States' franchise laws, it is distinct from them.

Concepts such as good faith impact upon the franchisor–franchisee relationship especially as the French judiciary has over recent years taken a more interventionist approach to commercial relationships.

Article 101 of the TFEU shapes French antitrust law.

GERMANY

Chapter written by Stefan Münch, Alexander Duisberg, Markus Körner and Michael Gaßner

Although Germany does not have any franchise-specific laws, it is probably one of the most heavily regulated franchise markets in the world. The application of the doctrine of good faith on both pre-contractual negotiations (*culpa in contrahendo*) and the franchise relationship itself can have a severe impact upon the franchisor's ability to exercise its contractual rights against franchisees. Added to this is a tendency of the German courts to treat franchisees as consumers and a willingness in some circumstances to view individual franchisees as 'hidden employees', who are able to take advantage of employment rights.

HONG KONG

Chapter written by Michelle Chan

Although a part of China, Hong Kong is a Special Administrative Region and has its own distinct legal system, which still has its roots in English common law. It has no franchise-specific law and, like the English legal system, puts great store in the concept of *caveat emptor* while being reluctant to imply any duty of good faith into the franchise relationship.

HUNGARY

Chapter written by Péter Rippel-Szabó, Bettina Kövecses and Péter Sziládi

Unlike many former Soviet Bloc EU Member States, Hungary has resisted the temptation to specifically regulate franchising.

Its civil system still retains some vestiges of its Soviet past, but generally reflects EU directives and regulations. An overriding duty of good faith is imposed by the Hungarian Civil Code on franchising, but the courts do not look to jurisprudence on agency and distribution cases for guidance by analogy, as is the case in some civil jurisdictions.

INDIA

Chapter written by Nipun Gupta and Divya Sharma

Indian law is heavily based upon English law and exhibits the traditional English doctrine of *caveat emptor* in its approach to pre-contractual dealings between franchisors and other franchisees. Likewise, it is loath to imply a duty of good faith on to the franchise relationship.

However, the Indian legal system is exceptionally slow and franchisors are often sceptical as regards the courts' impartiality. As a result foreign law and jurisdiction is the norm in international franchise agreements with arbitration being preferred to litigation because of India being a signatory to the New York Convention and the difficulty in enforcing foreign court judgments. However, there was some uncertainty about the status of foreign arbitration until the 2012 *Balco* decision.

There are some restrictions upon the ability of foreign parties to acquire more than 49 per cent equity interest of Indian companies and although royalties can now be paid without limit and approval, certain other payments still require the approval of the Reserve Bank of India.

IRAN

Chapter written by Shelley Nadler and Farid Kani

Iran has no franchise law and the legal environment is fairly benign for franchisors. However, despite having been partially lifted for non-US companies, the international sanctions have a significant impact upon the way franchisors must structure their market entry.

ITALY

Chapter written by Claudia Ricciardi

Italy adopted its franchise law in 2004 after some 15 years of toing and froing within the legislature. It imposes mandatory pre-contractual disclosure and various mandatory clauses.

The law had originally required that all foreign franchisors operate a pilot in Italy before they could franchise their concept there. However, this was received badly by franchisors and it was soon changed so that it did not become a barrier to foreign franchisors establishing their brand in Italy. As a Member State of the EU, Italy's approach to vertical restraints reflects Article 101 of the TFEU.

KAZAKHSTAN

Chapter written by Nick Green and Saule Akhmetova

Kazakhstan has a sophisticated and in parts complex franchise law, which needs to be carefully considered before executing a franchise agreement in the country.

MALAYSIA

Chapter written by Lee Lin Li and Chong Kah Yee

The Malaysian franchise law is somewhat complicated and regulates not only franchisors, but also franchise brokers.

MEXICO

Chapter written by Eduardo Kleinberg

Although there is no franchise-specific law in Mexico, franchises are regulated by the Industrial Property Law. This imposes a duty of pre-contractual disclosure upon franchisors and requires certain mandatory provisions included in the franchise agreement.

Franchise agreements are also generally registered with the Mexican Institute of Industrial Property to enable the franchisor to protect its trademarks.

There is also a limited duty of good faith imposed upon parties to a franchise agreement.

NEW ZEALAND

Chapter written by Stewart Germann

After considering whether it should adopt franchise-specific regulations, New Zealand decided that it would not follow the example of its Australian neighbour and that its common law was sufficiently adaptable to deal with the legal issues that arise as a result of franchising.

POLAND

Chapter written by Kuba Ruiz

Poland has no franchise-specific law and applies a relatively light touch to its regulation.

RUSSIA

Chapter written by Sergey Medvedev

Russia has a specific trademark-based franchise law, which requires registration of franchise agreements with the Federal Service for Intellectual Property (Rospatent). This can cause some difficulties in practice for franchisors.

SAUDI ARABIA

Chapter written by Melissa Murray

The impact of shariah law on franchising is very marked, and standard agreements usually need substantial amendment before they are suitable for use in the country.

SINGAPORE

Chapter written by Lorraine Anne Tay and Just Wang

The origin of Singapore's commercial success lies in its geographical position and its entrepôt trade. It has a legal system with its roots firmly planted in both English common law and its international outlook. As a trading nation its laws promote international trade and the concept of *caveat emptor* is a fundamental part of its approach to common law.

There is no franchise-specific law in Singapore and it does not generally imply a duty of good faith into contractual relationships.

SOUTH KOREA

Chapter written by Jason Sangoh Jeon, Jin Woo Hwang and Seung Hyeon Sung

South Korea has a challenging franchise law that delivers an unusually high level of protection for franchisees.

TAIWAN

Chapter written by Wen-Yueh Chung, Jane Wang and Charles Chen

There are no franchise-specific laws in Taiwan, but the validity and the enforcement of franchise agreements is governed by the Fair Trade Commission Disposal Directions on the Business Practices of Franchisers (amended in 2009) and the Fair Trade Act 2010, which both deal with competition matters.

UKRAINE

Chapter written by Volodymyr Yakubovskyy and Graeme Payne

Ukraine does not have a franchise-specific law and it falls to the Civil Code and Commercial Code to regulate it. Legal uncertainty about registration of franchises has been settled by the passing of new procedural rules on registration of concession agreements, which came into effect in April 2015.

UNITED KINGDOM

Chapter written by Graeme Payne

The United Kingdom is the cradle of common law and yet it is also a Member State of the EU, which has a legal system dominated by civil law concepts such as good faith.

As a result, the law in the United Kingdom is undergoing constant change as the influence of civil law concepts becomes more and more marked. Its competition law is based on Article 101 of the TFEU.

Scotland has its own legal system, which, although very similar to that of England and Wales as regards corporate and commercial matters, is very different in respect of real estate.

There is no franchise-specific law in the United Kingdom and it is generally one of the more 'pro-franchisor' jurisdictions. Because of its colonial past and mercantilist traditions, English law is highly developed as regards international trade. As a result, English law is often adopted as the governing law in the international agreements of non-UK franchisors.

UNITED STATES

Steven Feirman, Daniel Deane, Andrew Loewinger, Keri McWilliams, Arthur Pressman and Kendal Tyre

The United States is the birthplace of franchise regulation, the first such law being passed in California in the early 1970s. A complex network of both state and federal laws that imposes a cocktail of pre-contractual disclosure, registration and mandatory term requirements has led to many foreign franchisors believing that the law has become a near insuperable barrier to market entry. It is certainly a complex and ever-changing jurisdiction as regards franchise law, but with appropriate legal support it is far from impenetrable.

AFRICA OVERVIEW

Nick Green¹

I INTRODUCTION

The year 2019 has presented a mixed picture for the African continent. The collapse of crude oil prices a few years ago, which in Nigeria triggered the worst recession in a quarter of a century, has abated, with prices rising steadily over the past two years.² While this undoubtedly benefits oil-rich countries such as Nigeria, Algeria and Sudan, recovery has been slow. In Angola, another oil-producing nation, the slow pace of political reform and continuing problems with corruption meant that, as predicted, it slipped back into recession in 2018.³ On the other hand, some mid-sized economies such as Tanzania and Kenya are continuing to see solid growth rates of around 5 per cent, with the spread of technology such as mobile banking and spending on large infrastructure projects among the driving factors.⁴ Growth in sub-Saharan Africa is forecast to average out at around 3.6 per cent in 2019–2020, although the World Bank notes that the picture remains uneven.⁵ The continent boasts the largest number of countries with the most notable economic improvement in the World Bank's 'Doing Business 2019' report – with Djibouti, Togo, Kenya, Côte d'Ivoire and Rwanda all included. The report draws particular attention to reforms in areas such as starting a business, obtaining credit and paying taxes.⁶

Africa therefore still provides plenty of potential opportunities for franchisors looking to expand their brand internationally. Many African countries are focusing on harnessing the potential for growth from advancements in technology, in particular mobile payment networks, allowing poorer individuals living in both cities and rural areas to have greater access to the wired, global financial economy, and providing faster and more secure payment

1 Nick Green is an associate at Bird & Bird LLP. The information in this chapter was accurate as at January 2019.

2 Dave Pilling, 'Nigeria's recovery tethered to oil's fortune', *The Financial Times* (21 November 2018), available at: <https://www.ft.com/content/27f17114-c700-11e8-86e6-19f5b7134d1c>.

3 Joseph Cotterill, 'Angola's IMG request highlights financial strain', *The Financial Times* (22 August 2018), available at: <https://www.ft.com/content/2d6dd9ec-a613-11e8-926a-7342fe5e173f>.

4 'Africa's economies are turning a corner', *The Economist* (12 May 2018), available at: <https://www.economist.com/middle-east-and-africa/2018/05/12/africas-economies-are-turning-a-corner>.

5 'The World Bank in Africa', The World Bank (Last Updated: 14 May 2018), available at: <http://www.worldbank.org/en/region/afr/overview>.

6 'Doing Business 2019 – Training for Reform', The World Bank Group (16th Edition), available at: http://www.doingbusiness.org/content/dam/doingBusiness/media/Annual-Reports/english/DB2019-report_web-version.pdf.

and money transfer systems.⁷ Other countries, such as Côte d'Ivoire and Senegal, supported by infrastructure spending, are expected to continue growing robustly,⁸ ensuring that they are attractive prospects for foreign brands looking to invest in the region. Legislative and economic reforms have also been introduced in several countries to ensure local laws – particularly those relating to repatriation of funds and the protection of trademarks – do not deter foreign brands. The number of countries that have ratified the African Tripartite Free Trade Area agreement (TFTA) now stands at four, with South Africa the most recent to do so in October 2018.⁹ Once 10 further countries ratify the agreement it will enter into force, and there is optimism that this could happen within the next year.¹⁰ The past year also saw the signing of the African Continental Free Trade agreement (AfCFTA), which aims to create a continent-wide free trade area. The AfCFTA has rapidly reached 13 ratifications, fuelling optimism of reaching the 22 ratifications required to bring the AfCFTA into force.¹¹ It is hoped that measures such as these will increase regional stability and facilitate economic integration, providing increased harmonisation in the areas of rules of origin, customs cooperation, non-tariff barriers and dispute settlement.

Franchising continues to be recognised by governments in the region as a fast and effective way to increase employment among local populations. Relatively high growth rates across the region continues to support a developing urban middle class, with a consequential increase in the demand for western brands and potential opportunities particularly for those operating in the retail and consumer space.¹² The World Economic Forum also highlights the 'fast-growing youth population' and the urbanisation of the region, which is expected to result in over 50 per cent of Africans living in cities by 2050,¹³ as key reasons to keep Africa in mind with regard to expansion and investment. Continued improvement in infrastructure and policy across the region will undoubtedly strengthen this growth and ensure brands, both foreign and domestic, remain focused on Africa and its vast potential.

II FRANCHISE LAW

i Legislation

As in Europe and the United States, there is no unified or consistent approach to franchising in the African region. South Africa and Tunisia have enacted franchise-specific legislation, although each differs in its application. Nigeria, Angola, Kenya, Sudan and Uganda regulate technology transfer and commercial agency agreements, which may impact on franchise

7 Tarek Sultan Al Essa, '6 reasons to invest in Africa', The World Economic Forum (6 May 2016), available at: www.weforum.org/agenda/2016/05/6-reasons-to-invest-in-africa/.

8 *ibid.* No. 5.

9 'Comesa welcomes SA's ratification of the tripartite FTA', COMESA (9 October 2018), available at: <https://www.comesa.int/comesa-welcomes-sas-ratification-of-the-tripartite-fta/>.

10 Shaimaa Al-Aees, 'TFTA is unique integration initiative: COMESA Secretary General', Daily News Egypt (12 December 2018), available at: <https://dailynewsegypt.com/2018/12/12/tfta-is-unique-integration-initiative-comesa-secretary-general/>.

11 'Africa Trade Ministers discuss progress of free trade area', Ghana News Agency (13 December 2018), available at: <https://www.ghanaweb.com/GhanaHomePage/business/Intra-African-trade-fair-targets-25billion-in-trade-deals-708407>.

12 Hendrik van Blerk, 'Ipsos Views – African Lions: Who are Africa's rising middle class?', Ipsos Views #15 (February 2018), available at: https://www.ipsos.com/sites/default/files/2018-04/african_lions.pdf.

13 *ibid.* No. 7.

agreements depending on how the franchise is structured and the sector it operates in. Other countries rely on their civil codes, foreign investment laws or consumer protection regimes to regulate franchise arrangements. In Namibia, the competition commission (NCC) proposed a new franchising law in 2017, stating that it would contribute to its creation. In its announcement, the NCC recognised the economic importance of franchising, while highlighting potentially anticompetitive effects of franchise agreements that require resolution.¹⁴

ii Pre-contractual disclosure

Few African countries require franchisors to provide franchisees with pre-contractual disclosure. Franchisors entering into agreements in Tunisia and South Africa, however, should be aware that these countries are the two exceptions, requiring a minimum amount of information to be provided a set number of days prior to signing (20 days in Tunisia, and 14 in South Africa). A general duty to act in good faith both prior to signing and during any commercial – including franchise – agreement may be understood to require disclosure in certain countries such as Morocco, Algeria, Angola, Cape Verde, Congo, Equatorial Guinea and Mozambique, although the extent to which this is enforced is unclear.

iii Registration

It is not common practice to require registration of franchise agreements specifically, although many countries – such as Democratic Republic of Congo – require a trademark licence to be registered, and it is recommended (but not mandatory) in Angola, Cape Verde and Malawi. In Nigeria, there is a requirement to register franchise agreements as a sub-category of technology transfer agreement.¹⁵ In Egypt, a trademark licence may be registered, but it is recommended not to do so because of the difficulty involved in deregistering a licence.¹⁶ In August 2016, the Ethiopian Parliament adopted the Commercial Registration and Business Licensing Proclamation No. 980/2016 (CRBLP), which introduced, for the first time, a definition of a franchise agreement.¹⁷ The CRBLP was implemented by Commercial Registration and Licensing Council of Ministers Regulation No. 392/2016, which states that applicants for a special registration certificate of franchising must provide documents including a copy of the franchising contract.¹⁸

14 Mihe Gaomab II, 'Necessity of Franchising Law in Namibia' (2017), Namibian Competition Commission, available at: http://www.nacc.com.na/cms_documents/4d6_necessity_of_franchising_law_in_namibia.pdf.

15 Updated Requirements for the Registration of Technology Transfer Agreements, Notab.gov.ng (accessed 14 December 2018), available at: <http://notap.gov.ng/content/updated-requirements-registration-technology-transfer-agreements>.

16 Kendal H Tyre Jr, ed., *Franchising in Africa 2014: Legal and Business Considerations* (LexNoir Foundation, 2014), p. 26.

17 'Proclamation No. 980/2016 Commercial Registration and Business Licensing Proclamation', Federal Negarit Gazette of the Federal Democratic Republic of Ethiopia (5 August 2016), Part 1, Article 2(33), available at: http://www.mot.gov.et/by-category/-/asset_publisher/jzCt7vgBnStr/content/-980-2008-?inheritRedirect=false.

18 'Commercial Registration and Licensing Council of Minister Regulation No. 392/2016', Federal Negarit Gazette of the Federal Democratic Republic of Ethiopia (28 October 2016), Part 4, Article 48(1), available at: http://www.mot.gov.et/-/reg-392-2016-commercial-registration-and-licensing?inheritRedirect=true&redirect=%2Fby-category%2F-%2Fasset_publisher%2FjzCt7vgBnStr%2Fcontent%2F-980-2008-%3FinheritRedirect%3Dfalse.

Any agreement that may result in the payment of money outside Zimbabwe by a business entity operating in Zimbabwe must be registered with and approved by the Zimbabwe Exchange Control Authority. South Africa, Cape Verde and Mozambique impose similar registration requirements in relation to agreements containing foreign payment provisions. While not strictly a registration requirement, central bank approval may be necessary for the remittance of payments abroad in a number of African states, including Angola, Congo, the Democratic Republic of Congo, Ghana, Gabon, Burundi, Rwanda, Cape Verde and Egypt.

Franchisors should also be conscious of any post-signing requirements that exist under local law. For those countries where agreements or trademark licences must be registered, or documents must be provided to central banks for remittance approval, this documentation will generally require some form of notarisation or legalisation, and may need to be provided in the local language. While it is rare for this to be an overly onerous requirement, these formalities can be expensive and cause delays if not planned and provided for in advance.

iv Mandatory clauses

The absence of franchise-specific legislation across the region means that there are few mandatory clauses that must be included in a franchise agreement, beyond those requirements that exist in countries' general contract law or civil codes. South Africa does, however, stipulate a number of specific provisions that franchise agreements must contain, including express wording providing the franchisee with a 10-day cooling-off period.¹⁹ Additionally, foreign franchisors should be aware of particular restrictions that regulatory or national bodies impose on doing business more generally. In Nigeria, for instance, all foreign technology agreements must be registered with the National Office for Technology Acquisition and Promotion (NOTAP), and a broad range of obligations may be imposed on the agreement before NOTAP will approve its registration. Of particular importance to franchisors, NOTAP may limit royalty payments at 0.5 to 2 per cent of net sales or profit²⁰ and prohibit any agreement having a term greater than 10 years.

Franchisors should also be aware of additional tax or foreign exchange restrictions that may apply to franchise agreements deemed to be 'service agreements' on that basis that at least part of the agreement relates to 'services' (such as initial training, guidance on the use of trademarks, etc.) being provided by a franchisor to a franchisee in exchange for a 'service fee' (howsoever named). In Angola, if a franchise agreement contains such service agreements, it is likely to be classified as a technical assistance and management agreement, which must satisfy certain criteria (including the requirement that the services cannot be obtained within Angola, and that the provision of the services will bring significant benefits to the 'franchisee' and the Angolan economy), must be licensed by the Ministry of Economy, and any fees paid thereunder will be subject to a higher tax burden. Similarly, in 2017, the lack of foreign currency and struggling domestic economy in Zimbabwe led to the Reserve Bank of

19 No. 68 of 2008: Consumer Protection Act, 2008, Republic of South Africa, Government Gazette No. 32186, Article 7(2), available at: https://www.gov.za/sites/default/files/gcis_document/201409/321864670.pdf; Consumer Protection Act, 2008 (Act No. 68 of 2008) Regulations, Republic of South Africa, Government Gazette No. 34180 (1 April 2011), Article 2, available at: <http://extwprlegs1.fao.org/docs/pdf/saf107945.pdf>.

20 'Updated Requirements for the Registration of Technology Transfer Agreements', National Office for Technology Acquisition and Promotion (NOTAP) (as accessed on 18 December 2018), available at <http://notap.gov.ng/content/updated-requirements-registration-technology-transfer-agreements>.

Zimbabwe imposing a restriction on the level of any service fee being greater than 3 per cent of gross annual revenue.²¹ Recent legislative changes announced in October 2018²² require all foreign currency receipts to be kept separate in a separate bank account from local currency receipts, to reduce the dilution of local currency and make payments to foreign creditors easier to process. However, the 3 per cent cap on service fees remains in place, so the real impact of these changes remains to be seen.

Franchisors considering African markets will, therefore, have to consider how best to structure their arrangements with their franchisees to ensure they are compliant with all local laws, while also ensuring they receive the full benefits of the anticipated deal.

GCC OVERVIEW

*Melissa Murray*¹

I INTRODUCTION

Franchising within the Gulf Cooperation Council countries of Bahrain, Kuwait, Qatar, Oman, Saudi Arabia and the United Arab Emirates (collectively, the GCC) is a well-known and established method for international franchisors to enter the GCC markets. The local shareholding restrictions for certain types of businesses, discussed further below, have led to franchising being one of the most popular methods for international brands entering these local markets.

The United Arab Emirates (UAE) is often looked upon as being the first market for a franchisee to open in when franchisors grant rights to the GCC and wider Middle East and North Africa region. For this reason, this chapter will focus on the UAE, as well as looking at various factors common to franchising in the GCC.

Although historically the franchising market has been dominated by international franchisors granting master franchises to wealthy individuals or family groups who directly open multiple locations, local brands are now beginning to emerge and franchise to multiple individuals. Although these local brands are typically looking for franchisees within the GCC market, some brands are beginning to expand outside the UAE into international markets. Just Falafel, a UAE-based falafel retail brand is one example of such a local brand that has expanded into many countries outside the GCC. The emergence of local brands franchising within the GCC has led to the introduction of various franchising consultancies, brokerages and related businesses also entering the GCC markets.

At this stage there is no national franchise association within each country, but local chamber of commerce departments within each country are taking a keen interest in franchising, along with the commercial departments of various embassies, such as the American Embassy office of the US Commercial Service of the Department of Commerce's International Trade Administration.

Given the private nature of company and individual's information within the GCC, there are limited market reports on franchising within each country, but various news reporting agencies and consultancies release independent estimated market intelligence at varying intervals.

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II MARKET ENTRY

i Restrictions

Generally speaking, there are no approvals or restrictions on franchisors granting master development rights to local entities.

For most businesses in which franchising has predominantly been used in the GCC, such as retail, a company incorporated with local majority shareholding is required to obtain the appropriate trade licence. For example, in the UAE (but outside the various free zone areas) only a company that has 51 per cent UAE national shareholding or 100 per cent GCC shareholding can obtain a retail trade licence for the sale of clothing. Other types of business – for example, real estate agencies – require a 100 per cent UAE national shareholding.

The new, recently passed, Federal Decree-Law No. 19/2018 on Foreign Direct Investment (the Foreign Direct Investment Law) allows foreign investors to own 100 per cent of onshore companies on UAE mainland. There is currently available in the public domain a list of 122 activities that purportedly constitute the ‘positive list’, for which full ownership is permitted. However, no formal resolution has been published in the official gazette in this regard and therefore there may yet be changes to the final list. The approval process for establishing 100 per cent company ownership has also not yet been formalised. We are aware of certain food manufacturers who have been successful in obtaining 100 per cent ownership of their outlets. As yet, we are unaware of any franchisors attempting to restructure and obtain the exemption in relation to onshore retail outlets.

Notwithstanding the shareholder ownership restrictions, the company’s constitution can be drafted such that the economic benefit of the company is allocated in percentages different from the share ownership. In addition, practice has developed to overcome restrictions on foreign ownership of UAE companies whereby side agreements are entered into between the UAE national shareholder and the foreign shareholder pursuant to which the UAE national shareholder assigns its profits to the foreign shareholder.

Although it is common practice to enter into such side agreements in the UAE, their enforceability is not certain and the prudent view is that a UAE court may consider such agreements as an attempt to circumvent UAE restrictions on corporate ownership by non-UAE nationals and as a breach of UAE Federal Law No. 17 of 2004 on the Combating of Commercial Concealment, as amended (the Anti-Concealment Law).² The Anti-Concealment Law aims to criminalise the practice of enabling a non-UAE national to conduct an economic or professional activity that is prohibited by UAE laws and regulations. In reality, these practices are followed widely in the UAE and more recently have led to the emergence of specific businesses offering to be the ‘silent’ 51 per cent shareholder (for a fee). Although this is general market practice, as there is no other way around the strict interpretation of the law, the commercial risk of the UAE law courts should be taken into consideration. For these reasons most international brands enter the GCC markets through franchising rather than through incorporating a local company with potentially unenforceable side agreements.

In most areas (except specific designated ‘freehold for foreigner’ areas), foreign nationals cannot be registered as the freehold owner of real property, although again side arrangements similar to the foregoing have been used to circumvent the legislation. Further, when taking a lease on property, the owner or manager of the property will usually wish to see a valid trade

2 Entered into force on 31 December 2009.

licence (or residency visa for individuals), which means many clauses in standard franchise agreements, such as those that discuss the franchisor taking possession of a franchisee's premises upon default, are not practical or easily enforced.

ii Foreign exchange and tax

All GCC states, except Kuwait, are pegged to the US dollar. Generally, no GCC state has any foreign exchange controls or restrictions on the remittance of funds, and foreign investors can freely transfer funds. Withholding tax considerations are relevant in Saudi Arabia, Oman, Qatar and Kuwait, and are discussed further below. Neither the UAE nor Bahrain imposes withholding tax.

III INTELLECTUAL PROPERTY

i Brand search

Throughout the GCC, searching for protected trademarks and other intellectual property (such as copyright, patents and design rights) is conducted through registered trademark agents and law firms, who directly approach the relevant trademarks office in each country. In addition to this, some trademark agents have developed their own internal database based on published gazettes and trademark journals, which can provide further details on potential conflicting trademarks. As it is not possible to perform GCC-wide trademark searches, trademark applications, or multi-class searches, the process for searching and registering trademarks can be comparatively very costly. Further consideration should be given to issues with English and Arabic symbols and translations, which can increase the searches and registrations required. The Supreme Council of the Gulf Cooperation Council prepared a GCC Trademarks Law many years ago; however, there are currently no implementing regulations and the law is not yet in force in any of the GCC countries. It is, however, expected that the implementing regulations of the GCC Trademarks Law will not offer a unified filing system (as is the case with the GCC Patent Law) and trademark applications will continue to be filed separately in each GCC Member State for protection.

All GCC countries follow a 'first to file' trademark protection system, as opposed to the US system of 'first to use'. Historically, many franchisees have registered in their own names the franchisor's trademarks and use the trademarks in their registered business or company names. Franchisees often quote the time it takes for trademark registration to complete (which can be up to several years in some countries) along with the costs of registration as reasons why they should be responsible for the trademark registration; however, opposing such a registration or having the registration assigned at a later date can be difficult, time-consuming and costly. Business, trade and company names pose a different challenge as each province or emirate has local municipalities or chambers of commerce responsible for business names, which are often not directly linked to trademark registries. In addition to this, independent free zones within the various GCC countries also maintain company and business name registries. Further issues with translation between Arabic and English usually mean there are many competing trade names that often cannot be challenged.

ii Brand protection

To register a trademark, a legalised and notarised power of attorney (prepared by the trademark agent) needs to be provided by the applicant, although some countries within the GCC have differing requirements as to whether the power of attorney needs to be both

legalised and notarised. This power of attorney allows the trademark agent to represent the applicant in registering intellectual property rights with the relevant trademarks office in each country. The trademark agent also requires:

- a* an electronic copy of the mark (usually in black and white unless specific colours are sought to be protected);
- b* a list of goods and services to be protected by the mark;
- c* a certified copy of any previous trademark registrations if priority is being sought; and
- d* a certificate of incorporation, certificate of good standing, or extract of the commercial register or trade licence evidencing the name, address, date of incorporation and objectives of the company.

iii Enforcement

Enforcement of franchise-related intellectual property rights can present a number of challenges within the GCC markets. The courts of each of the GCC countries do not readily allow for injunctions or other discretionary remedies, meaning that it can be extremely difficult to prevent a terminated franchisee from continued use of a franchisor's intellectual property. As arbitration is often chosen as the dispute resolution method for international franchise agreements, the arbitration clause can also be raised in any court proceeding to challenge the jurisdiction of the court in some intellectual property disputes.

Criminal offences for fraud, counterfeiting or imitating a registered trademark can be possible in certain circumstances. Also where a local court has jurisdiction to hear intellectual property disputes, a number of other remedies such as attachment orders, confiscation orders, fines, damages, destruction orders and compensation may be available depending on the nature of the dispute.

The Dubai International Finance Centre (DIFC) introduced a new intellectual property law in November 2019. Although the law is still in the initial stages of implementation, it could be the future of intellectual property rights enforcement in the UAE.

iv Data protection, cybercrime, social media and e-commerce

There is currently no GCC-wide data protection law. Qatar and Bahrain have both recently implemented data protection laws. We are also aware that UAE regulators at the federal level are working on a draft federal data privacy law. Some free zones, such as the DIFC, Abu Dhabi Global Market and the Qatar Financial Centre, have enacted data protection legislation in relation to the collection, use and transfer of data within the relevant free zone. In June 2019, the DIFC launched a public consultation into its proposed new Data Protection Law (the New DIFC DP Law). This new Law is expected to bring DIFC data protection legislation into line with the EU's General Data Protection Regulation by introducing additional obligations related to consent, processing responsibilities, appointment of data protection officers, data breach notifications, joint controllers, data export and other issues. It is our understanding that the New DIFC DP Law is at the final stage of approval and should be enacted in January 2020.

Data protection is covered generally in various parts of the legislation such as in criminal, civil and commercial codes, electronic transactions laws, and industry-specific legislation such as covering protection of patient data in medical contexts. Shariah principles also protect an individual's right to privacy and protection from disclosure of secrets. Sanctions associated with processing personal data outside the scope permitted by the various laws are therefore relatively severe compared with those found in Western jurisdictions. For example, in the

UAE there are criminal sanctions associated with disclosing 'secret' information (such as personal data). Generally speaking, however, specific consent to the processing of personal data can help mitigate or avoid potential penalties.

Many GCC countries have enacted updated cybercrime laws in line with the model Cybercrime Law recently drafted by the Gulf Cooperation Council and agreed between all members of the GCC. These updated laws cover internet fraud, hacking, illegal access, system interference and distribution of viruses, and include specific provisions covering state security and political stability. These laws are drafted broadly and cover any publication of information over the internet, including blogging and use of social media. Penalties include imprisonment, fines and deportation. Furthermore, as most GCC states have enacted specific electronic transactions law (that allow for execution of contracts through electronic means and that govern the legal effect of electronic records) most of these laws contain some data protection considerations.

IV FRANCHISE LAW

i Legislation

With the sole exception of the new Saudi Arabian Franchise Law, approved by the Saudi Council of Ministers on 8 October 2019 (the Saudi Franchise Law) and due to enter into effect in April 2020, there is no franchise-specific legislation in the GCC countries, although commercial agency laws (as discussed further below) often cover franchise relationships with, in some cases, serious consequences for franchisors. General civil and commercial codes can also apply together with general intellectual property laws, penal codes, cybercrime laws and more specific legislation such as consumer protection laws and food safety laws.

ii Pre-contractual disclosure

As until recently there had been no specific franchise legislation in any of the GCC countries, neither are there any specific pre-contractual disclosure requirements. Misrepresentation for pre-contractual statements are, however, covered under provisions contained in the various civil codes but in a much more narrow way than in some Western jurisdictions. For example, under Article 185 of the UAE Civil Code, misrepresentation occurs when one of the parties 'deceives the other by fraudulent means by word or act which leads the other to consent to what he would not otherwise have consented to'. It is important to note that it does not include statements made innocently or negligently; there must be an intention, through deliberate action or inaction, to deceive by fraudulent means. Article 187 of the UAE Civil Code allows the person misled to cancel the contract if it can be shown one of the parties made a misrepresentation to the other and that the contract 'was concluded with gross unfairness'. It is important to note that both misrepresentation and 'gross unfairness' must be proven and therefore a case for misrepresentation can be difficult to prove. Further, a party may be prevented from claiming for misrepresentation if the party continued to act in accordance with the contract, as Article 192 of the UAE Civil Code provides 'the right to cancel for misrepresentation and gross unfairness shall lapse on the death of the person having the right to apply for the cancellation or upon a dealing made in the subject matter of the contract in whole or in part in such a way that implies consent'.

iii Registration

As there is no franchise-specific legislation, there are no registration requirements for franchise agreements (outside those to register 'agency' agreements discussed further below).

iv Mandatory clauses

As there is no specific franchise legislation in any GCC state, the usual elements to provide for a binding contract must be met. As an example, Article 129 of the UAE Civil Code provides that for a contract to be formed:

- a* the two parties to the contract should agree upon the essential elements;
- b* the subject matter of the contract must be something that is possible and defined or capable of being defined and permissible to be dealt in; and
- c* there must be a lawful purpose for the obligations arising out of the contract.

Note that consideration is not a required element for a contract to be binding between the parties.

v Guarantees and protection

Guarantees are provided for under various parts of legislation in each of the GCC states. Most Western drafted forms of guarantee require tailoring for the region to be enforceable and there are provisions and practices that can make enforcement of such guarantees difficult. For example, Article 1092 of the UAE Civil Code provides that 'if a debt is due, the creditor must claim for it within six months from the date on which it fell due, otherwise the surety shall be deemed to have been discharged'. Further, it can be especially important to undertake the usual due diligence to ensure the proposed company is authorised to provide the guarantee under its memorandum and articles of association, any board or shareholders' meetings passing relevant resolutions are undertaken, etc., and translation into Arabic and signing in front of a notary public can also be necessary.

V TAX

i Franchisor tax liabilities

The UAE and Bahrain do not impose any company or individual taxes and therefore there is no withholding tax.

Further, there is no withholding tax in Kuwait, but in respect of business entities there are a number of laws that provide for a retention-type tax, where every business operating in Kuwait should retain 5 per cent from all invoices paid to contractors or service providers. These amounts are retained until the Kuwait Tax Authority authorises release. Further, the Department of Income Tax (DIT) seeks to tax any entity 'doing business in Kuwait'. This historically did not cover franchisors, but more recently the DIT has focused on franchise relationships that could in some situations create a tax liability for franchisors. Specific Kuwait tax and legal advice should be sought in this respect.

Saudi Arabia's withholding tax applies at different rates depending on the services and depending on payments made to related and unrelated parties. Saudi Arabia generally imposes a 15 per cent withholding tax on royalties and a 20 per cent withholding tax on management fees.

Oman does not levy withholding tax on technical services fees, interest or dividends. As for royalties, foreign companies without a permanent establishment in Oman that derive Omani-sourced royalties are subject to a 10 per cent withholding tax on the gross royalty, withheld by the Omani payer and remitted to the tax authorities. The definition of royalties includes, among other payments, those for the use of intellectual property rights, patents and trademarks.

In Qatar, withholding tax on payments to non-residents is charged at 5 per cent on royalties and technical fees and 7 per cent on interest, commissions, brokerage fees, directors' fees and any other payments for services conducted wholly or partly in Qatar. Withholding tax is levied on amounts paid to non-residents in relation to activities not associated with a permanent establishment in Qatar. As a consequence, withholding tax requirements apply to service providers in Qatar who are unable to produce a tax card as evidence of having a tax file in Qatar.

ii Franchisee tax liabilities

At present, there is no withholding, capital gains, personal or individual income tax imposed in the UAE (however, individuals are charged some taxes, albeit indirectly, such as municipality tax imposed on certain hotel services, as well as business and residential property rentals). *Zakat*, a religious wealth tax levied pursuant to shariah law in many Islamic countries, is also not presently levied in the UAE. Individual emirates in the UAE have issued tax decrees concerning corporate taxes (some decrees dating as far back as the 1960s) but have not implemented their respective decrees, except that oil and gas-producing companies and foreign banks are taxed.

All GCC states impose custom duties payable for the import and export of goods that may be applicable if any goods are supplied. In addition, value added tax (VAT) is payable in Saudi Arabia, Bahrain and the United Arab Emirates (see Section V.iii).

In Kuwait, income tax is imposed on non-Kuwaiti and non-GCC owned companies. Corporate bodies incorporated within the GCC and owned by the citizens of those countries are granted the same treatment as Kuwaiti companies and are therefore not subject to income tax at present. As discussed above, income tax is imposed on those 'carrying on business in Kuwait', which is currently interpreted widely by the taxation authorities and can expose some franchisors to Kuwait tax.

In Saudi Arabia, individuals can, in some circumstances, be subject to *zakat* and a non-Saudi's share of companies is subject to income tax. Capital gains tax can also be applicable. In Oman, taxes are levied on income earned by a permanent establishment located in Oman. In Qatar, profits of business establishments that are wholly owned by Qatari individuals are not taxed and income tax applies only to businesses. The Qatari tax law states that taxable income arising from sources in Qatar in excess of 100,000 Qatari riyals in any taxable year is taxed at a flat rate of 10 per cent.

iii VAT

VAT is in the process of being implemented in all GCC countries at a rate of 5 per cent, with a limited number of items related to food, healthcare and education being exempt. It was introduced in Saudi Arabia and the UAE on 1 January 2018, and Bahrain implemented it on 1 January 2019. Oman, Qatar and Kuwait have yet to set definitive implementation dates.

VI IMPACT OF GENERAL LAW

i Good faith and guarantees

As the laws of the GCC are based on shariah law, which provides for fairness and good faith in contractual arrangements, the principle of 'good faith' is specifically recognised and is an important part of the legal system in each jurisdiction.

The UAE Civil Code³ specifically provides at Article 246 an obligation on contracting parties to perform their obligations in accordance with the agreement 'in a manner consistent with the requirements of good faith'. Furthermore, Article 243(2) provides 'with regard to the rights (obligations) arising out of the contract, each of the contracting parties must perform that which he is obliged to do under the contract'. Article 129 of the Bahrain Civil Code also provides that a 'contract must be performed in accordance with its contents and in compliance with the requirements of good faith and honesty'. There are similar provisions in the Qatar, Kuwait and Oman Civil Codes.

ii Agency distributor model

Each of the GCC states has a commercial agency law that can apply to franchise relationships. Where the relevant agency law does not apply, agency considerations under general law (e.g., the civil and commercial codes in the relevant countries) can be relevant as franchising often falls within the ambit of the agency provisions in such laws. In each state, the agency provisions under the agency law and general laws encompass broadly similar principles. As a full discussion of the agency provisions are outside the scope of this chapter, obtaining specific legal advice as to the structure of the proposed arrangements, current arrangements and careful drafting of the franchise agreements can be important given the consequences when the agency laws apply. Dealing with a foreign national (or company owned in the amount of a specific percentage (100 per cent or 51 per cent) by nationals of the relevant country), registration (through providing a legalised and notarised version) and exclusivity (but not in all GCC countries) are the predominant requirements for finding a commercial agency under the specific agency laws in each country. Under both the agency laws and general commercial laws of each jurisdiction, termination of an agent can be difficult and compensation (often in substantial amounts) can be payable upon termination. Registration is therefore often avoided by the specific drafting of clauses within the franchise agreements and through taking procedural steps to mitigate the risk of registration by the agent. Also selecting arbitration and a foreign governing law can help; although most commercial agency laws (where they apply) provide that the sole jurisdiction of the local courts apply, local law applies to the dispute and any arbitration provision is void.

In July 2014, Oman amended its Law of Commercial Agencies⁴ to remove the requirement for a material contractual breach to take place before an agreement could be terminated or not renewed (despite what may be provided in the agreement between the parties). The UAE in 2006 made similar amendments, but, after lobbying by various agents, distributors and franchisees, changed the law back in 2010 to require 'material justified reasons' before an agency agreement could be amended. It will, therefore, be interesting to see how these changes will play out in practice and whether, as a consequence of this amendment, franchisors with Omani-registered agents will now look to terminate (or not

3 Federal Law 5 of 1985.

4 Sultani Decree 26 of 1977 as amended.

renew) underperforming franchisees. In 2016, Kuwait and Qatar updated their respective Agency Laws. Of particular note, Kuwait replaced its Agency Law to clarify that franchisees and licensees are specifically covered by the Law, and has removed the requirement of exclusivity for agency agreements. The new Saudi Franchise Law specifically excludes commercial agency agreements.

iii Employment law

To date we are not aware of any cases whereby a court has held franchisees to be employees of the franchisor. The various rules and regulations in each country regarding employment and procedural requirements such as visas and labour contracts would make a claim to this effect difficult.

iv Consumer protection

The various consumer protection laws throughout the GCC focus on the protection of individuals in purchasing day-to-day items. For example, the UAE Consumer Protection Law⁵ defines ‘consumer’ as ‘an individual who purchases goods and/or services with or without consideration for personal use or the use of others’. We are not aware of any situations where a franchisee has been or could be treated as a consumer, and the relevant government authorities in each country are focused on protection of individual consumers’ rights, such as safety of products, product recalls, clear pricing, protection against unreasonable price increases, refunds and product labelling.

v Competition law

Historically, most GCC countries addressed anticompetitive behaviour through their civil and commercial codes or trademark laws, or both, by means of broad and general provisions that prohibit forms of anticompetitive behaviour. More recently the UAE, Saudi Arabia, Qatar, Oman and Bahrain have enacted specific competition law legislation. Kuwait to date does not have a specific anti-competition regime; however, there is discussion at GCC level regarding the preparation of a unified GCC competition law.

The competition legislation for the UAE, Saudi Arabia, Qatar, Oman and Bahrain is drafted in broad terms focusing on anticompetitive practices (restrictive agreements and abuse of a dominant position) and economic concentrations. A wide range of common commercial practices could therefore be construed as being non-compliant with the legislation; however, there are a number of exemptions and exclusions. For example, in the UAE, the telecommunications, financial and transport sectors are specifically excluded, as are exclusive distribution agreements governed by the Commercial Agencies Law. The UAE Competition Law now has the required implementing regulations; however, most provisions of standard franchise agreements, such as price controls and mandatory purchasing of products from authorised suppliers, are unlikely to require the approval of the competition regulation committee.

⁵ Law 24 of 2006.

vi Restrictive covenants

Non-compete and restrictive covenants are generally difficult to enforce in each of the GCC states. The courts will assess what is reasonable to protect a legitimate business interest and this is determined on a case-by-case basis. Additionally, even if considered reasonable, there can be enforcement challenges as the courts lack injunctive power in most situations. Furthermore, as generally only direct, proven and actual losses are recoverable, proving actual loss arising from breach of the relevant clauses can be difficult.

vii Termination

As discussed above, given the difficulties in enforcing post-term restrictive covenants, and the inability of the franchisor to take over directly the franchisee's business (because of restrictions in local shareholding and on taking local leases), most franchise disputes are resolved through negotiation or mediation between the parties.

viii Anti-corruption and anti-terrorism regulation

Fraud, anti-corruption and anti-terrorism are covered in both general provisions of civil and commercial codes in each jurisdiction and in specific legislation such as the UAE's Anti-Money Laundering Law,⁶ Fraud and Deception Law and the UAE's updated Cybercrime Law.

As an example, the Anti-Money Laundering Law criminalises money laundering in the UAE and provides supporting mechanisms and structures to enforce the prohibition. In addition to the Anti-Money Laundering Law, the recently updated Cybercrime Law provides further penalties of imprisonment and fines for those who use any computer network, electronic information system or information technology to illegally transfer funds with the intent to conceal or disguise either the source of the funds, the origin, ownership and movement of the funds or illegally attain possession of the funds.

ix Dispute resolution

All GCC states are signatories to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention) and most franchise agreements entered into between international franchisors and franchisees within the GCC provide for arbitration as the dispute resolution method. Arbitration, together with a foreign governing law provision, is often the recommended method of proceeding where the franchisor is outside the GCC to attempt to mitigate the risk of the various agency protections provided to franchisees in each jurisdiction. The exemption to this is Saudi Arabia, where the enforcement of foreign arbitral awards has traditionally been challenging and, depending on the circumstances, referral of the dispute to arbitration within one of the GCC states or to a Saudi court may be preferable. In 2012, a new arbitration law was introduced in Saudi Arabia; however, it is yet to be seen how or if this will facilitate the enforcement of foreign arbitral awards in Saudi Arabia. The UAE became a signatory to the New York Convention in 2006, and at this stage there are only a few instances of local courts enforcing an arbitration award from another Convention country and to the best of our knowledge no foreign award has yet been enforced in Oman.

All GCC countries allow for contracting parties to choose a foreign law, although this is not always upheld in practice where disputes are brought to the local courts. Where the contract provides for arbitration and the arbitration clause is raised (sometimes for tactical

6 UAE Federal Law No. 4 of 2004.

reasons it may be preferable not to raise the arbitration clause), the courts will usually refuse jurisdiction to hear a matter. Where the relevant commercial agency law applies to a dispute, there are set procedures for the dispute contained within the relevant law, such as referral first to an agency committee prior to the courts.

Specific performance and injunctions are discretionary remedies and are not commonly granted in the GCC states; however, attachment orders are common (and often used to seize assets that are the subject of the claim). As a general note, only direct, proven and actual losses are recoverable, and consequential losses are generally not recoverable.

VII CURRENT DEVELOPMENTS

Because of the popularity of franchising in the GCC and wider Middle East region, there have been a large number of conferences and expos held by franchise consultants, brokers and chambers of commerce of relevant emirates and provinces within each of the GCC states. The success of these conferences, expos and similar events is yet to be seen, as, historically, the most successful brands have entered the market without advertising at such events. Franchising of local brands within the GCC is on the rise and we are seeing the beginning of local brands franchising internationally. Although brands franchising to one company or family, who open all stores directly (or through related entities), is still the most commonly seen method of international brands coming to the region, some brands are allowing sub-franchising of non-exclusive individual locations. In particular with local brands, there is growth in franchising to individual (non-corporate) non-exclusive franchisees.

On the legislation front, there have been calls by some interested parties for the development of a franchising law, but at this stage drafts for such a law have not progressed given the need for other laws, such as that on intellectual property (trademarks, patents, copyrights), to be updated to keep pace with the advancements in technology and e-commerce. With the increase of franchising of local brands to individuals within the GCC, the number of disputes relating to quality and assistance by franchisors is beginning to rise, which may in due course lead to increased regulation in this area.

The recently introduced Saudi Franchise Law creates a clear regulatory framework for the relationship between the franchisor and the franchisee on a basis that promotes transparency. This new franchising regime is expected to come into force in April 2020.

As noted in Section II, the UAE's new Foreign Direct Investment Law will permit 100 per cent foreign ownership of companies on the UAE mainland (as opposed to within the free zones, which already allow 100 per cent foreign ownership). The new Law introduced a negative list of those sectors excluded from 100 per cent foreign ownership (and therefore still requiring 51 per cent company ownership by Emirati nationals). While the Law also introduced a positive list, this has yet to be released officially so it is currently unclear whether retail, consumer goods or the hospitality sectors will appear on this list. It is, however, expected that the sectors in which franchising is traditionally widely used (such as restaurants and apparel) will not be on the positive list, so trade licences for these sectors will still require an onshore UAE company, with 51 per cent ownership by a UAE national. This means, therefore, that franchising is likely to continue as the preferred model for businesses entering the UAE, given that most brands are uncomfortable with the UAE national ownership requirements that would apply were they to decide to open company-owned outlets in the UAE.

AUSTRIA

Eckhard Flohr and Alfons Umschaden¹

I INTRODUCTION

Just as in Germany, franchise systems have developed very slowly in Austria, but Austria now has a flourishing franchise industry. In particular, international franchise systems such as Burger King and McDonald's are very successful in Austria.

Most German franchise systems are likely to move into to Austria as the first step of the international development of their franchise system, so that virtually all the German franchise systems are also present in Austria, such as Fressnapf, Zoo & Co, Studienkreis, Schülerhilfe, ISOTEC or hagebaumarkt.

Austria has not yet enacted a franchise act of its own, so the principle of contractual freedom exists. It must, however, be borne in mind that Commission Regulation (EU) No. 330/2010 on the application of Article 101 of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices (vertical agreements) also directly applies in Austria, and is national law; however – just as in Germany – the provisions of general civil law, commercial law, corporate law, competition law, antitrust law, consumer protection law, employment law and data-protection law (the General Data Protection Regulation),² as well as the corresponding decisions of the Austrian Supreme Court (OGH) and the European Supreme Court (EuGH), must be complied with when franchising agreements are drawn up. Finally, the general contractual provisions, as well as the provisions relating to industrial and intellectual property rights and, in certain circumstances, aspects pertaining to tenancy law or fiscal law, must also be observed.

II MARKET ENTRY

In Austria there are no restrictions on foreign franchisors. Master franchise contracts can be closed directly between a foreign franchisor and the Austrian master franchisee or the Austrian franchisor running the franchise outlet (direct franchising).

No franchise regulation nor any disclosure requirement exists in law in Austria, other than in decisions of the OGH.

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2 Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation).

III INTELLECTUAL PROPERTY

Through a franchising agreement, the franchisor grants the franchisee the right of use of its trademark rights. An informal agreement is sufficient to validly grant the licence. It can also be agreed that the franchisee's entitlement to use the trademark is recorded in the trademark register.³ A registration of the trademark register is, however, not a necessary prerequisite for the franchisee to be entitled to use the trademark. It may be stipulated in the franchise agreement that certain types of use of the mark, for example, in advertising, require the franchisor's consent.

Signage has major economic significance in the success of a franchise system, and the franchisor must vouch for the fact that its rights are being validly maintained. Such signage is a 'property usually required in commerce' within the meaning of Section 922 of the Austrian Civil Code (ABGB), so that if it is lacking, the franchisee may be entitled to assert warranty claims. A complete exclusion of any such claims is generally considered unethical under Section 879 of the ABGB. The franchisor is required to protect the intellectual property rights accordingly. In addition, the franchisee is also entitled to assert the right to pursue infringements of intellectual property rights, as the mark ranks among the trademarks protected under Section 9 of the Austrian Act on Unfair Competition.

The 'trade dress' plays an important role if the franchise system is operated in the form of a retail outlet (e.g., a special interior, choice of colour, staff uniform and packaging). The protection of trade dress is not dependent upon registration; it must, however, have gained public recognition.

The protection of the company or its name begins with its registration in the commercial register.

IV FRANCHISE LAW

i Legislation

As previously mentioned, Austria has no special law on franchising or a disclosure requirement law. Franchise contracts and even master franchise contracts have to be drafted according to the rules of the ABGB, the Antitrust Law, the Enterprise Law (UGB), the rules of the labour and consumer protection regulations, the Austrian Act on Unfair Competition (UWG) and the rules of the EU block exemption on vertical restraints.⁴

Of interest in relation to the drafting of franchise agreements are two booklets published by the Austrian Federal Competition Authority: the first one covers franchise systems and price policy, and the second deals with compliance regulations. Both booklets are relevant for franchisees, as well as for franchisors, and in relation to the structure of a master franchise agreement and the franchise agreement with local franchisees.⁵

3 Section 25(1) of the Austrian Trademark Protection Act (MaSchG).

4 EU VO 330/2010.

5 www.bwb.gv.at.

ii Pre-contractual disclosure

There are no disclosure requirements with which a master franchisee is obliged to comply by law. The main points are set by the jurisdiction of the OGH.⁶ A franchisee or master franchisee has to be informed about all points that are relevant to the decision of the franchisee or master franchisee to close the franchise or master franchise contract. This may refer to information concerning:

- a* the local market situation;
- b* the expected turnover of the franchise outlet;
- c* a business plan for building up the franchise system in Austria (optional);
- d* the competitors;
- e* the importance of the franchise system in Austria;
- f* number of franchisees (local or international);
- g* franchisees leaving the franchise system, especially for what reason during the final year for closing the franchise contract;
- h* intellectual property rights of the franchise systems;
- i* information about the master or local franchisee franchise contract; and
- j* the know-how of the franchise system.⁷

The type of information that has to be disclosed depends on the franchise contract. Normally, franchisors in Austria have a disclosure requirement document giving the potential franchisee all such relevant information.

Foreign franchisors should look to the guidelines of pre-contractual information by the Austrian Franchise Association (ÖFV), but these guidelines are not binding on the courts in Austria.

Most franchise contracts concluded by a German master franchisor with an Austrian master franchisor, or local franchisees directly with the German franchise headquarters, have a choice of German law. Therefore the most recent decisions of German courts of appeal⁸ are also important in relation to pre-contractual disclosure in Austria and the information to be delivered to potential master franchisees when concluding a master franchise agreement, and to local franchisees concluding a direct franchise contract.

iii Registration

There are no registration requirements for foreign franchisees or Austrian franchisees, and no rule is expected in the future. Membership of the ÖFV is not mandatory but may be useful for recruiting franchisees in Austria.

⁶ OGH 19.01.1989 WBl. 131.

⁷ See Directive (EU) 2016/943 of the European Parliament and of the Council of 8 June 2016 on the protection of undisclosed know-how and business information (trade secrets) against their unlawful acquisition, use and disclosure – EU RL 2016, 943 ABl. EU Nr. L 157 – in force since 5 December 2018.

⁸ OLG Düsseldorf, ZVertriebsR 2014, 46; OLG Hamburg, ZVertriebsR 2015, 78 – Tom Taylor; OLG Dresden, ZVertriebsR 2016, 320 – Krankendienst; OLG Frankfurt, ZVertriebsR 2016, 313 – Haarentfernung.

iv Mandatory clauses

Franchise contracts

A franchise agreement is characterised as a *sui generis* agreement, which incorporates elements of a licence agreement, as well as the types of agreement regulated by national law, such as commercial agency agreements, sales contracts, urban and usufruct leases, loan agreements, and memoranda and articles of association. The main purpose of a franchise agreement is the transfer of expertise developed by the franchisor.

Franchise agreements give rise to ongoing obligations, as they are concluded for a particular period and not just for a one-off performance on the part of the franchisee. This leads to a permanent mutual duty of care, and thus also increased significance is given to good faith.

The conclusion of a franchise agreement is, in principle, not subject to any condition regarding form, and, in certain circumstances, may be assumed through conduct that may imply consent to the terms and conditions suggested. The written form is therefore not a legal prerequisite for the franchise agreement to be considered valid. It is, however, advisable, for reasons relating to evidence, to conclude a franchise agreement in writing.

Franchisor

The franchisor is to be introduced in the recitals of the franchise agreement. In particular, a brief outline of the history and development of the franchise must be given, as well as a summary of the key elements characterising the particular franchise.

Franchisee

Detailed provisions in regard to the franchisee's legal personality must be included in the franchise agreement. The question of legal personality entails particularly that it has to be checked whether the franchisee is a natural or legal person (partnership or company). A supplementary agreement to the franchise agreement may also be concluded concerning the franchisee's company, if necessary.

The franchisee is not a representative of the franchisor, and also has no authority to transact business on behalf of any third party. For this reason, it should be explicitly regulated in the franchise agreement that the franchisee does not represent the franchisor, and that the franchisor is freed by the franchisee from responsibility for any third-party claims made because of the actions of the franchisee.

Recitals

It is always advisable to precede a franchise agreement with recitals, in which the history of the emergence and basis for the franchise system are explained. Recitals are of legal significance for establishing the inherent purpose of the provisions set out in the agreement (the commercial basis). They may therefore also serve the purpose of examining the question of whether it is possible to adjust the franchise agreement, or even terminate it in accordance with the principles of the commercial basis lapsing.

Franchise systems fees

Most franchise agreements provide for the payment of an initiation fee, a franchise fee and an advertising fee.

The initiation fee is not a fee for ongoing services provided by the franchisor, but a consideration in return for the expertise developed by the franchisor and passed on to the franchisee. It should therefore be laid down in the franchise agreement that, should the agreement be dissolved for any reason, the latter is not returned to the franchisee.

Franchise fees are paid to the franchisor by the franchisee, usually on a monthly basis. They are, in the vast majority of cases, calculated based on the total net sales generated by the franchisee. Since total net sales are usually taken as a basis, spin-off products that the franchisee sells may also be included in the calculation when establishing the figure, unless anything has been agreed in the franchise agreement to the contrary.

The average fee of this type in Austria in 2006 was 5.37 per cent of the corresponding total net sales achieved. In some systems, however, these may as well be significantly above that figure. It is also possible to agree that a fixed monthly amount be paid. Furthermore, it may be laid down in the franchise agreement that, in the event of certain total net sales not being achieved, the franchisee still has to pay a minimum franchise fee.

The obligation to pay fees should be differentiated from the obligation to contribute towards advertising expenses. This entails franchisees making a certain contribution, usually calculated as a percentage of the total net sales, towards the national or regional advertising to be carried out. Such contributions are earmarked for a specific purpose, and should be used by the franchisor in accordance with the established purpose.

Transfer of expertise (know-how)

The transfer of the relevant expertise is an essential component of the franchise agreement, as the franchisor hands over to the franchisee complete instructions for operations.

In accordance with the guidelines of the EU Commission on vertical agreements, Directive (EU) 2016/943 on the protection of undisclosed know-how and, *de lege ferenda*, the German law of protection of know-how by way of a choice of German law in the franchise contract, or the Austrian know-how protection legislation based on the above-mentioned EU Directive 2016/943, the expertise being imparted to the franchisee is a necessary prerequisite for the agreement to qualify as a franchise agreement. Should no expertise be transferred, it will be considered only a licensing agreement.

The ÖFV Code of Ethics defines 'expertise' as a package of non-patented practical information based on experience of and trials conducted by the franchisor, which is secret, substantial and identifiable. According to the statements contained in the ÖFV Code of Ethics, 'secret' means that the substance, structure or precise composition of the components of the expertise is not generally known or not easily accessible, in regard to which the word 'not' is to be understood in the narrow sense, so that each individual part of the expertise ought to be entirely unknown or unavailable outside the franchisor's business. According to the ÖFV Code of Ethics, the expertise is deemed 'material' if it covers knowledge that is indispensable for the franchisee concerning the use, sale or resale of the contractual goods or the provision of the contractually agreed services. The expertise is in particular indispensable for presenting the goods intended for sale, processing products in the context of the provision of services, the manner in which customers are served, and conducting business from an administrative and financial perspective. The expertise moreover has to be useful to the franchisee. A further prerequisite is that the expertise needs to be identified. This means that the expertise must in any case be described in sufficient detail for it to be possible to check whether the features of secrecy and materiality are being fulfilled.

The description of the expertise may be included in either the franchise agreement, the handbook or the guidelines, which usually form part of the agreement.

The expertise should be documented in the franchise handbook, which accompanies the franchise agreement. Both are connected by means of dynamic references (i.e., it is laid down in the franchise agreement that the franchisee is required to use the applicable version of the franchise handbook).

As regards future law, the know-how of a franchise-system is only protected by EU and national law if it is both documented in written form (or, for example, within the franchise system intranet) and also permanently developed by the franchisor, with the franchisee contractually obliged (whether by the franchise contract or the master franchise contract) to keep the franchise system know-how secret, even after the termination of the franchise contract.

Legal succession

In the event of the franchise agreement not containing any provisions on legal succession, it will end upon the death of the franchisee. Just as in the case of an agency agreement or commercial agency agreement, the activity undertaken by the franchisee based on the franchise agreement is personal, and thus relates to an individual. The franchise agreement is concluded based on the personal qualifications of the franchisee, which is why the franchisor has an interest in the franchisee personally fulfilling the obligations arising from the agreement.

Usually a legal succession clause is agreed in franchise agreements, to give the franchisee's heirs the opportunity to continue to carry on the franchise operations. The case may be different, however, if a franchise agreement is concluded with an Austrian private company limited by shares. Should the majority shareholder of the franchisee's company die, the franchise agreement will only lapse if, pursuant to the memorandum and articles of association, the death leads to the dissolution of the franchisee's company, and thus its liquidation. Notwithstanding the latter, the provision that the death of the majority shareholder is a reason for terminating the franchise agreement can, of course, also be included in the franchise agreement.

Contractual period

Certain limitations in regard to the contractual period in particular arise from Sections 864a and 879 of the ABGB), Section 6(1)(1) of the Austrian Consumer Protection Act (KSchG), and the Commission Regulation (EU) No. 330/2010.

A long contractual period in conjunction with an exclusive obligation to purchase from the franchisor may, in certain circumstances, be deemed unethical gagging. Drawing upon the case law on the beer supply contracts, a contractual period of 20 years appears to come very close to being the upper limit that can be tolerated. Classing an excessive contractual period as gagging is based on the restriction of the economic independence of the purchaser contained therein. According to the requirements of the ÖFV Code of Ethics, the contractual period should be limited in such a way that the franchisee can amortise his or her initial investments. Depending on the circumstances of the case, a contractual period exceeding 20 years may also be justified in franchising. This is particularly the case with investment franchise agreements or master franchise agreements.

Subsidiary provisions

It should be agreed in franchise agreements – in the final or subsidiary provisions – that any amendments and additions or supplementary provisions to the agreement need to be laid down in writing to be legally valid, which is also supposed to apply to setting out a provision dispensing with the requirement for the written form. In addition, there should be no subsidiary verbal agreements supplementing an agreement, to prevent problems to obtain the necessary evidence from occurring should a lawsuit be initiated.

Usually, in the final provisions a severability clause is also agreed upon, which, in the event of any provisions of the agreement being or becoming invalid, should stipulate that the validity of the remaining provisions of the agreement should not be affected, and that the latter will therefore remain valid. It is consequently usually agreed in the agreement that a void or invalid provision be reinterpreted or supplemented in such a way that the economic purpose intended with the void or invalid provision is achieved as precisely as possible, and that the latter is also supposed to apply to any loopholes in the agreement.

V TAX

i Franchisor tax liabilities

The corporate income tax system in Austria is nearly same as the system in Germany, but the rates to be paid by franchisors in the legal form of a corporation differ in Austria. At the moment those rates are under political discussion, and a tax reform is to be expected next year.

The franchisor is not liable for any taxes to be paid by the franchisee. On the entrance fee and the royalties, 20 per cent VAT has to be paid.

For income tax purpose, the entrance fee is usually recognised over the term of the franchise. The part of the fee that represents payment for initial services can be recognised as a business expense in the first year. Franchise fees and royalties are subject to withholding if the franchise agreement does not expressly stipulate which portion of the franchise fee is a royalty payment and which part is paid for service; the tax authorities will assess the portions according to their experience. Austria has double-taxation treaties with a large number of countries, which often allow exemptions to be applied for.

ii Franchisee tax liabilities

The franchisee is liable for corporate income tax if it is a corporation. If the franchisee is a natural person or a partnership, he or she is liable for income tax.

Franchisees often pay themselves a salary as CEO of the franchisee company to pay income tax rather than corporate income tax. Such a salary needs to reflect the market and the salaries normally paid. If the salary substantially strips out all profits or is otherwise unusual, this can lead to a challenge by the tax authorities.

VI IMPACT OF GENERAL LAW

i Good faith and guarantees

Good faith and fair dealing is central to Austrian contract law,⁹ similar to the German contract law. As the franchisor and the franchisee are working together on a long-term franchise contract, there is an implied obligation of good faith that applies to both parties. As a result, the franchisor needs to consider the impact on the franchisee before exercising a remedy or imposing a new system standard. The main practical example of how good faith affects franchising is the requirement that changes to the manual are subject to the requirement of good faith: the franchisor may only impose changes while taking into account the reasonable interests of the franchisee – this is the loyalty to which the franchisor is entitled.

ii Agency distributor model

The UGB came into force in Austria on 1 January 2007. According to the provisions of the UGB, ‘enterprise-related transactions’ refers to all transactions of an entrepreneur that form part to the operations of his or her company. Transactions that a natural person concludes before taking up the operations of his or her company to create the prerequisites for the latter do not yet count as enterprise-related transactions.

What is significant when applying the UGB is Section 454 is that when the franchise agreement is terminated a franchisee is entitled to assert a claim to compensation for investment for any investments not amortised as at the agreement being terminated, as long as the latter have been initiated by the franchisor.

iii Employment law

The franchisee has to work as an independent salesman, running the franchise outlet at his or her own risk. Therefore the franchisee must have his or her own:

- a* price policy;
- b* running of the franchise outlet; and
- c* staffing decisions.

If franchisees do not have these rights, they are not independent – they are employees of the franchisors. The guiding decisions in Germany of the Labour Supreme Court and the Civil Supreme Court are also the leading decisions in Austria.

iv Consumer protection

In the past, franchisees were supposed to be briefed, if necessary, about their right of withdrawal in accordance with the provisions of the Austrian Consumer Protection Act. On 13 June 2014, the Implementing Act on the EU Directive on Consumer Rights came into force. With this law a uniform right of revocation was introduced in all EU Member States, and thus also in Austria.

In other words, when concluding a franchise agreement the founder of a new business must be briefed on the 14-day right of revocation available to him or her, in Austria as well. Should the information on revocation not be provided or not be in line with the legal requirements, the franchisee may revoke his or her declaration of intent given with a view to

⁹ Sections 863 II and 914 of the ABGB.

concluding the franchise agreement, even after 14 days have expired; however, in the interests of legal certainty, this right of revocation will lapse one year and 14 days after the franchise agreement has been closed.

Following a recent judgment by the OGH,¹⁰ if the franchise agreement has been concluded by a consumer franchisee and certain franchise-agreement regulations are thus rendered invalid because they are in conflict with consumer protection law, the franchisee and the franchisor have to conclude an amendment stipulating that the required regulations are obligatory as the franchisee has now become an entrepreneur.

v Competition law

Austria is one of the 28 EU Member States and as such European competition law principles apply. There are some local issues around the interpretation of the Vertical Restraints Block Exemption and its impact on franchise agreements. Generally, it is thought that a purchase tie in a franchise system should not exceed the 80 per cent threshold set out in the Vertical Restraints Block Exemption.

Price-fixing is, according to the Vertical Restraints Block Exemption, not allowed and normally franchise contracts last for five years if the franchisee is obliged to sell only products of the franchise system to customers and the purchase and sale of other products is not allowed.

The Austrian antitrust authorities have recently published guidelines for the pricing policy of franchise systems as well as other distribution contracts, but they are not binding on the Austrian courts.

For example, the following are not allowed:

- a* verbal or written agreements fixing prices or minimum prices;
- b* agreements for paying provisions to franchisees if they agree that the recommended prices are fixed prices;
- c* obligations for franchisees to pay penalties if they do not agree that the recommended prices are fixed prices; and
- d* agreements monitoring the pricing policy of a franchise.

Example clauses are allowed concerning:

- a* recommended prices;
- b* fixed maximum prices; and
- c* price monitoring of franchise competitors.

If a franchisor commits a breach of competition law (e.g., price-fixing in relation to the franchisees), the OGH¹¹ has fixed new principles for the determination of the penalties to be paid to the Austrian Competition Authority.

Following the *Coty* judgment of 5 December 2017 by the EuGH,¹² the franchisor is allowed to forbid the selling of franchise-system 'luxury products' by the franchisee through

10 OGH 21 January 2015 – 3 Ob 186/14w ZVertriebsR 2015, 389.

11 OGH 8 October 2015 – 16 Ok 2/15b ZVertriebsR 2015, 391.

12 C-230/16 ZVertriebsR 2018, 52 A; see additional: Metzlaß/Schöper ZVertriebsR 2018, 1; Rohrßen DB 2018, 300; Rohrßen ZVertriebsR 2018, 277; Wolf-Posch/Samek ZVertriebsR 2018, 302; and the recently published decisions: OLG Frankfurt ZVertriebsR 2018, 321.

Amazon or other online platforms. In future, therefore, the question will arise as to whether a franchise-system product is a beauty product (online sale allowed) or a luxury product (online sale not allowed).

vi Restrictive covenants

Non-compete clauses may only be agreed within the scope of antitrust provisions, and should be restricted by the limit of unconscionability in accordance with Section 879 of the ABGB. Accordingly, a geographically unlimited competition clause would inherently cause concern during the currency of a contractual relationship.

Because of the existing interest in maintaining and extending the franchise system, a geographically unlimited non-compete obligation will also be permitted during the period in which the franchise agreement is being maintained. According to Commission Regulation (EU) No. 330/2010, and the Commission Guidelines, the latter is permissible, subject to certain prerequisites, under antitrust law.

In accordance with the provisions of Commission Regulation (EU) No. 330/2010, if the percentage of goods sold being purchased from the franchisor amounts to over 80 per cent of the amount spent on purchases, non-compete clauses may only be agreed for a maximum of five years, unless the exemption clause of Article 5 of Commission Regulation (EU) No. 330/2010 comes into force. According to this, the five-year limitation does not apply if the contractual goods or services are sold by the franchisee on the premises and in grounds that are the property of the franchisor, or are rented by the latter on either a usufructuary or an urban basis, from third parties not connected with the franchisee, and the non-compete obligation does not extend beyond the period in which the franchisor uses the premises and grounds.

From the sixth year onwards, the franchisee is entitled to sell competing products, at least to the extent of 20 per cent of the initial purchase value. This regulation has led to a situation in which only an initial contractual period of five years may be agreed in the case of a franchise agreement with 100 per cent of the goods sold being purchased from the franchisor, and then the parties subsequently conclude another franchise agreement that is, in turn, of five years' duration.

Furthermore, according to Commission Regulation (EU) No. 330/2010, post-contractual non-compete obligations are only permissible for a maximum period of one year following termination of the franchise agreement, as long as the non-compete obligation refers to goods and services that are in competition with the contractual goods or services, relates to premises and grounds from which the franchisee has operated its business during the contractual period, and is vital to protecting the expertise transferred by the franchisor to the franchisee. In all other cases, post-contractual non-compete obligations under Commission Regulation (EU) No. 330/2010 are not legal.

Limitations on the legality of non-compete obligations may also arise from Section 879 of the ABGB. Accordingly, non-compete obligations are generally only permitted to a very limited extent. This is mainly justified by the aim of protecting the free and unimpaired exercise of a profession. To assess the legitimacy of a non-compete obligation, initially the valid interests of both parties need to be determined. The technical, geographical and time limits of the legitimacy of the non-compete obligation will emerge upon weighing up the considerations in this way. These depend substantially on the product and features of the market in question.

vii Termination

Termination of the agreement

Like any agreement, the franchise agreement can be amicably dissolved by agreement between the parties. Franchise agreements are often concluded for a certain period, so that the franchise agreement ends upon the expiry of the agreed period. The parties are essentially free in determining the length of the period.

Even in the event that the application of the KSchG is in principle assumed, the right of termination in accordance with Section 15 does not apply. Section 15 of the KSchG covers sales contracts and comparable agreements. Within a franchise system, the franchisor provides recurring services, in particular consultancy and support services concerning marketing or organisational activities.

In accordance with Section 21(1) of the Commercial Agents' Act (HVertrG), if the agreement has been concluded for an indefinite period it may be dissolved by either party in the first contractual year by giving one month's notice. After the second contractual year has commenced, however, the notice period will be at least two months, and after the commencement of the third contractual year at least three months and so on until the sixth and following contractual years, when the notice period will be six months. When calculating the duration of the notice period, in the case of agreements entered into for a specific period but then extended for an indefinite period in accordance with Section 20 of the HVertrG, the contractual period of the defined-term agreement entered into must be included in the calculation. These legal concepts also apply to the termination of franchise agreements.

The basic concept of not permitting termination out of season may, however, be taken into consideration when making analogies in law concerning the termination of ongoing commitments.

Ongoing commitments of indefinite duration may also be ended by giving notice of termination in the absence of contractual arrangements. This right may generally not be entirely excluded through contractual provisions. This right of termination does not, however, exist if it would conflict with the purpose of the agreement. Whereas it does actually follow on from the legal nature of the franchise agreement that long-term cooperation between the contracting parties is intended, it does, however, not follow on that the latter should only end in cases of extraordinary dissolution.

In principle, parties are at liberty to agree termination dates and deadlines for dissolving a franchise agreement. Essentially, a waiver of termination may also effectively be submitted for a specific period. The limit for the legitimacy of termination agreements is formed, *inter alia*, by immorality. For instance, it may, in certain circumstances, be immoral for the franchise agreement to stipulate that the franchisor has a right of termination in the event of unsatisfactory sales if the same is not also conceded to the franchisee.

The analogue application of commercial agency law to franchise agreements is also affirmed by the OGH, where typical causes concern both the termination of the agreement and the claim to compensation. Section 22 of the HVertrG provides for the dissolution of commercial agency agreements for a significant reason.

According to Section 22 of the HVertrG, the following circumstances are in particular deemed to be important reasons entitling the principal to dissolve the contractual relationship prematurely:

- a* the commercial agent becomes incapable of carrying out his or her activities;
- b* the commercial agent is guilty of an act that makes him or her appear unworthy of the principal's trust, particularly if, contrary to the provision of Section 7 of the HVertrG,

he or she accepts a reward when he or she transmits orders to the principal that have not been placed or if he or she otherwise engages in deception in regard to essential business matters;

- c* the commercial agent, after a period deemed considerable according to the circumstances, ceases to work for the principal, or refuses to do so, or if he or she infringes any other essential contractual provisions;
- d* the agent is guilty of violence against or substantial defamation of the principal; and
- e* insolvency proceedings are instituted against the assets of the commercial agent.

The commercial agent in turn is entitled to dissolve the contractual relationship prematurely, if:

- a* he or she is unable to carry out his or her work; or
- b* the principal:
 - unduly curtails or retains commission due to the commercial agent or infringes other essential contractual provisions;
 - is guilty of violence against or substantial defamation of the commercial agent; or
 - gives up carrying on the operations in the line of business in which the commercial agent is primarily involved.

Pursuant to Section 21 of the Austrian Insolvency Code (KO), in the event of mutual agreements not having been entirely fulfilled by both parties, the insolvency administrator will be entitled either to fulfil the contract and demand the consideration or to withdraw from it. In the second case, the other contracting party will actually be entitled to assert a claim for compensation for damages, this may only be filed as a claim against the insolvency estate.

In the event of insolvency, the insolvency administrator is entitled to assert a statutory right of continuation for 90 days from the insolvency proceedings being instituted during which its claims to segregate items from the assets involved in the insolvency proceedings (e.g., to require the handing over of trademarks or machinery of the franchisor) cannot be asserted¹³ and the contractual agreement of a right of withdrawal or the dissolution of the agreement in the event of composition proceedings being instituted is usually inadmissible.¹⁴

Should the franchisee die, the franchise agreement will, in the event of doubt in the matter, lapse upon his or her death, since he or she is usually obliged to be personally involved in the day-to-day operations. The case may be different if a franchise agreement is concluded with an Austrian private company limited by shares. Should the majority shareholder of the franchisee's company die, the franchise agreement will lapse only if, pursuant to the memorandum and articles of association, death leads to the dissolution of the franchisee's company and its liquidation. Notwithstanding the latter, the provision that the death of the majority shareholder is a reason for terminating the franchise agreement can, of course, also be included in the franchise agreement.

Legal consequences of termination of the agreement

Upon termination of the franchise agreement, the franchisee will lose its right to use the trademarks, business designations, logos and other promotional or business symbols of the franchisor. Any operating resources owned by the franchisor are likewise to be returned.

¹³ Section 11(2) of the KO.

¹⁴ Section 20e(2) of the Code on the Austrian Insolvency and Composition Proceedings.

In the event of any doubt, the franchise handbook, as well as any additions, will cover the matter. The franchisee may not continue to use the items once the franchise agreement has been terminated.

According to the case law of the OGH, the provisions on the obligation to disclose customer data laid down within the scope of the franchise agreement are also deemed 'justified interests' of the franchisor within the meaning of Section 8 of the Austrian Data Protection Act.

An obligation on the part of the franchisee to cease and desist from selling goods or providing services for payment of the franchisor once the agreement has been terminated may arise from a direct contractual provision, for example, from a post-contractual prohibition of competition,

Abuse of signage under Section 9 of the UWG is usually not seen in post-contractual sales, insofar as original products are concerned, since no likelihood of confusion regarding the origin of the goods exists in that case. It should, however, be set out in the franchise agreement that such products are bought back by the franchisor when the franchise agreement is terminated, if applicable applying a mode of calculation for the purchase price already set out in the franchise agreement (cost price minus X per cent).

Should the former franchisee give the impression that he or she is still the franchisee in his or her sales activities, or at least an authorised dealer or contractual partner of the franchisor, this conduct may, in certain circumstances, be deemed an anticompetitive 'exploitation of third-party reputation' under Section 1 of the UWG.

Any claims to compensation for damage will be governed by the general regulations under the Austrian law of obligations.

An unauthorised termination by the franchisee may lead to claims for compensation on the part of the franchisor. The franchisor will, however, be obliged to keep its losses to a minimum by engaging in an appropriate protective transaction; for example, by concluding a new franchise agreement with a third party. The case law states that, in consideration of the mutual interests of the parties as well as when assessing the question of whether there is a reason for early dissolution, the assessment of the legislator regarding the premature dissolution of an agency agreement is to be taken as the basis of reasoning.

From the perspective of contract law, the question arises whether the franchisor is in a position to relieve itself of liability. In this respect, the limitations of Section 879(3) of the ABGB are to be observed. Liability exemption will always be inadmissible and void if it puts the other party – in this case, the franchisee – severely at a disadvantage.

According to the case law, excluding liability for harm deliberately caused is unethical, and therefore irrelevant, but it is legitimate to exclude liability for slight negligence. The explicit or tacit agreement of the exclusion of liability for gross negligence is admissible insofar as it is not unethical. Conduct being unethical should be assumed in the event that the negligence taking place is so blatant that, in light of the experience gained from daily life and based on honest commercial practice, the conduct cannot be condoned.

Following termination of the agreement, the former franchisee is required to refrain from disclosing the franchisor's expertise, even without express provision having been laid down. The parties may agree that the prohibition on the disclosure of expertise should apply for an indefinite period, and thus not be subject to any limitations.

Compensation claims

Commercial agency

For the franchisee, there is no separate legal provision regarding the question of whether he or she is entitled to assert a claim for compensation once the franchise agreement has been terminated. Such claims are only regulated for commercial agents in Section 24 of the HVertrG. According to this provision, a commercial agent is entitled to assert a claim to compensation if and to the extent that:

- a* it supplies the principal with new customers or has considerably extended already existing business relationships;
- b* it is to be expected that the principal or his or her successors in right can also draw benefits from these business relationships, even after the contractual relations have been dissolved; and
- c* the payment of compensation, taking into account all the circumstances – in particular the commission payments due to the commercial agent arising from business transacted with the customers concerned – is equitable.

In a decision in April 1991,¹⁵ the OGH affirmed the application of Section 24 of the HVertrG to franchisees for the first time. The OGH linked to its previous decisions on the analogous application of Section 24 of the HVertrG to licensed dealers and on the comparability of the tasks of the licensed dealer with those of the franchisee.

In the opinion of the OGH, the legal status of a franchisee can certainly be compared with that of a licensed dealer. In the case of a franchise relationship, the integration into the distribution system could even be closer than between manufacturers or intermediate distributors and their licensed dealers. This is allegedly the case if the franchisee's dependence upon the franchisor extends to virtually all matters of business management, wherein the entire management activities are largely geared towards the instructions of the franchisor, which also has extensive monitoring rights.

Compensation for investment

Section 454 of the UGB determines that, when the contractual relationship with the franchisor is terminated, a franchisee has a claim to compensation for investments that, according to the distribution undertaking (franchise agreement), it was obliged to make to ensure uniform distribution, as long as the latter are neither amortised nor reasonably utilisable once the agreement comes to an end. Both material and staffing expenditure are covered.

Section 454 of the UGB covers both investments and expenditure. Both material and staffing expenditure fall under the latter. The following can be compensated:

- a* marketing expenses;
- b* advertising expenditure;
- c* expenses for trade fair presentations;
- d* expenses for maintaining the sales organisation;
- e* expenses for setting up the sales premises;
- f* expenses for developing a warehouse for spare parts;
- g* costs of providing the business with the appropriate special tools;

15 OGH, 10 April 1991 – 9 Ob A 8.9 /81 *Commercial Law Review* 1991, 332; see also the recent judgment: OGH, 1 March 2017 – 5 Ob 72/16y *ZVertriebsR* 2017, 397.

- h* expenses for designing and redesigning the headquarters;
- i* specific personnel costs (equipping the staff employees); and
- j* the costs of CPD and vocational training.

It is to be borne in mind that investments that exceed the contractual obligation are not covered by the claim to compensation for investments.

A claim to compensation for investment will, in accordance with Section 454(2) of the UGB, not arise in the event that:

- a* the franchisee has terminated the contractual relationship or dissolved it prematurely ('self-termination'), unless there was a significant reason for the latter, attributable to the franchisor;
- b* the franchisor has terminated the contractual relationship or dissolved it prematurely based on a significant reason attributable to the franchisee ('termination without notice for a significant reason'); or
- c* in accordance with an agreement with the franchisor, the franchisee has imposed the rights and obligations to which he or she is subject in accordance with the franchise agreement upon a third party ('transfer of contract' or 'sale of business').

It is, moreover, explicitly regulated in Section 454(5) of the UGB that the claim to compensation under Section 24 of the HVertrG is not affected, since the latter is in fact oriented towards a service that is different from the claim to compensation for investment, and pursues a different aim.

viii Anti-corruption and anti-terrorism regulation

Bribery and corruption are criminal offences in Austria, but there is no requirement for Austrian franchisors to carry out any background checks on potential franchisees.

Anti-terrorism regulation in Austria has no impact on franchise systems or the drafting of franchise contracts.

ix Dispute resolution

The franchise agreement has to set out which court has jurisdiction to decide on any legal dispute, should one arise, so including an agreement conferring jurisdiction is imperative for a franchise agreement. Since franchise agreements with foreign franchisors are also often concluded in Austria, it has to be established in the scope of the agreement that in the event of any dispute the law of the Austria will apply. Although international franchise agreements usually stipulate that the law of the franchisor's jurisdiction applies, this practice tends to be rejected by Austrians; Austrian franchisees are usually only prepared to sign a franchise agreement – even with foreign franchisors – if the application of Austrian law is agreed.¹⁶

In franchise agreements, however, and particularly with foreign franchisors, resolving disputes through an arbitration court is generally preferable to pursuing a case through the ordinary courts, so the franchise agreement should be supplemented by an arbitration agreement.

¹⁶ The exception to this is that franchise contracts concluded directly with German franchisors are generally governed by German law.

Use of the regulations of recognised arbitration institutions is generally recommended.¹⁷ Whether taking the route to such an arbitration institution or court is expedient has to be decided on a case-by-case basis.

In many cases, it is also laid down in franchise agreements in Austria that resolution of legal disputes should be attempted with the aid of a mediator prior to initiation of a judicial dispute (before the state or arbitration courts). To that extent, it has to be established in the franchise agreement that such mediation is to be undertaken, and that the failure of mediation is a procedural prerequisite to any kind of action being filed. The failure of the mediation, therefore, has to be made explicit by the mediator.

Furthermore, it must also be set out within the franchise agreement that measures of provisional legal protection are excluded from the scope of application of the mediation process, or of the arbitration court, and only the courts of the state court system are competent to deal with such measures.

VII CURRENT DEVELOPMENTS

Currently, no general franchising or special disclosure requirement law is expected.

CANADA

*Paul Jones and Katya Logunov (Stepanishcheva)*¹

I INTRODUCTION

The Canadian franchise industry is fairly well developed, generating approximately C\$100 billion every year. According to the Canadian Franchise Association (CFA), there are an estimated 1,300 franchise brands operating in Canada² in most sectors of the economy, including restaurant, automotive, hospitality, real estate, professional services industries and many others, with 60 per cent of franchises operating in non-food sectors.³

CFA is a national trade association that represents both franchisors and franchisees. CFA publishes an annual Accomplishments Report, which includes an overview of the franchise market in Canada.⁴

The Province of Quebec has a unique legal environment, a mix of civil law and common law systems. Quebec is also predominantly francophone and has laws mandating the use of French in some aspects of business. It is also culturally distinct from other Canadian provinces. The Quebec Franchise Council is a provincial association representing the franchise industry in Quebec.

II MARKET ENTRY

i Restrictions

Generally, there are no restrictions on a foreign franchisor entering the Canadian market. Because of many similarities in business environment, culture, legal system and consumer preferences, franchisors from the United States often start their international expansion into Canada by unit franchising. Master franchising and area development arrangements are also common, particularly when expanding into Quebec.

It is not necessary for a foreign franchisor to establish a Canadian entity or branch. If a foreign franchisor decides to establish a local entity or acquire equity interest in a master franchisee or area developer, a notification to Innovation, Science and Economic Development Canada under the Investment Canada Act will be required. Significant foreign investment into a Canadian business may be subject to review and approval by the federal government; however, investments on this scale are not common in the franchise industry.

1 Paul Jones is a principal and founder and Katya Logunov (Stepanishcheva) is an associate at Jones & Co.

2 Canadian Franchise Association, 2019 Accomplishments Report, available at: <https://www.cfa.ca/our-services/education-information/research>, at page 37.

3 2019 Accomplishments Report, note 2.

4 2019 Accomplishments Report, note 2.

Franchisors in the food and restaurant industry may face unexpected restrictions with respect to the supply of some foods and beverages. Imports of milk, cheese, eggs and poultry to Canada are subject to high tariffs. The sale of alcohol is also subject to regulations that are more restrictive than regulations in most of Europe.

Franchisors and franchisees usually do not face restrictions on holding or leasing land, as restrictions mostly concern agricultural and cultural land. However, because of low vacancy rates in large urban centres, it may be challenging to secure a good location for a franchised unit. Canadian franchisors often try to lease the desired property and then sublet it to franchisees.

For franchisors who do not already operate in French, the cost of translating disclosure and marketing materials and the operations manual into French may be a barrier to entry to the Quebec market. There are also significant French-speaking populations in New Brunswick and the eastern part of Ontario.

ii Foreign exchange and tax

There are no foreign exchange restrictions in Canada.

The Canadian dollar trades freely and fluctuates against other currencies. Franchisors, depending on the complexity of their supply systems, may want to consider introducing protections against currency fluctuation, and warn potential franchisees of currency fluctuation risks. Franchisors may also want to consider discounts and other measures to remain competitive to Canadian consumers while the Canadian dollar is weak.

Initial franchise fees and royalties paid by a Canadian franchisee to a non-resident franchisor are subject to a 25 per cent withholding tax. The tax rate is reduced under some tax treaties. For example, the withholding tax rate under the tax treaties with the United States, Australia and the United Kingdom is 10 per cent.

III INTELLECTUAL PROPERTY

i Brand search

Canada is a first-to-use as opposed to first-to-file jurisdiction: trademark rights can be acquired through use, as well as through registration. Therefore, a search in the trademarks database alone is not sufficient; a broader search, including business names, corporate register and domain names, is recommended.

Given that Canada has two official languages, French and English, an English language trademark may be confused with a trademark in French and vice versa. Canadian courts held that the likelihood of a trademark being confused with another mark must be assessed through the eyes of an average francophone consumer, an average anglophone consumer or, in some instances, an average bilingual consumer.⁵ A trademark that is likely to be confused with another trademark in English or French will not be registered by the Canadian Intellectual Property Office.⁶

⁵ *Médicament v. Smithkline Beecham Corp.*, 2004 FC 811.

⁶ Trademarks Act, RSC 1985, c T-13, section 12(1)(d); *Rose v. Fraternité Interprovinciale des Ouvriers en Électricité* (1977), 32 CPR (2d) 42 (FC).

ii Brand protection

Even though common law rights in unregistered trademarks can be enforced in Canada, registration of a trademark significantly strengthens the level of protection and the value of the mark. Registration provides nationwide protection regardless of whether the mark is actually used in all parts of Canada.

Applicants from a World Trade Organization or a Paris Convention country can claim as a priority filing date the filing date of a foreign application if it was filed within six months prior to the Canadian application.

In June 2019, Canada acceded to the Madrid Protocol, the Nice Agreement and the Singapore Treaty. Franchisors from other Madrid Protocol countries are now able to file Canadian applications using the Madrid system. Foreign applicants are required to appoint a local agent to communicate with the Canadian Intellectual Property Office. The term of trademark registrations has been reduced from 15 to 10 years and colours, sounds, scents and textures are now registrable as trademarks if the applicant can show their distinctiveness. Canada no longer requires use of the trademark as a prerequisite to registration.

The process of registering a trademark can take approximately one year to 24 months if no oppositions are filed and the examiner does not raise significant objections. Oppositions and examiner's objections may delay registration significantly. It is therefore recommended to file trademark applications in advance of entering the Canadian market.

As Canada has two official languages, French and English, the registration or use of a mark in one language will to some extent protect the equivalent in the other language. However, translations may vary considerably according to a variety of factors. Where protection of the mark in the other language is clearly desired, it is prudent to apply for and register the mark in both official languages.

Starting from June 2019, when the 2014 amendments to the Trade-marks Act will enter into force, Canadian law will be harmonised with the Madrid Protocol, the Nice Agreement and the Singapore Treaty. Franchisors from other Madrid Protocol countries will be able to file Canadian applications using the Madrid system. Filing fees will be charged per class; therefore, franchisors with goods or services spanning a number of classes should take advantage of the current flat-fee structure. Among other significant changes, the term of trademark registrations will be reduced from 15 to 10 years and colours, sounds, scents and textures will be registrable as trademarks. The new law will eliminate the requirement that the trademark must have been used in Canada or abroad before registration.

On 5 November 2018, Canada acceded to the Hague Agreement Concerning the International Registration of Industrial Designs (also known as the Hague System) and harmonised its industrial design law with other jurisdictions.

Canada is a party to all major international treaties on copyright. Copyright can be registered, although it is not required. Registration of copyright will serve as evidence of ownership and will preclude an infringer from relying on a defence of 'innocent infringement' in court.

Canadian residents and corporations may register a '.ca' top-level domain. Non-resident owners of Canadian registered trademarks may also register a .ca domain name that represents or includes the exact word component of their Canadian registered trademark.⁷

⁷ Canadian Internet Registration Authority, Canadian Presence Requirements for Registrants, Version 1.3, available at: <https://cira.ca/policy/rules-and-procedures/canadian-presence-requirements-registrants>.

iii Enforcement

Trademark rights can be enforced against an infringer by filing a lawsuit in the Federal Court or a provincial superior court. Common law rights in an unregistered trademark can be enforced by a common law claim of passing off, as codified by Section 7(b) of the Trademarks Act. Preliminary injunctions can be applied for, but are rarely granted. A successful party in the lawsuit may be awarded a permanent injunction, damages or an accounting of the infringer's profits from the infringement, the delivering up or destruction of infringing goods and litigation costs (to a certain extent).

The downside of trademark enforcement in Canada is that the judicial process is slow and expensive. The World Bank Group's Enforcing Contracts⁸ ranking puts Canada in 100th place, well behind Australia, China, the United States and the United Kingdom. In Quebec, the rules of civil procedure codified in the Code of Civil Procedure are different from those in common law provinces but generally would be more familiar to a common law practitioner than a civil lawyer, because of availability of discovery and other rules of common law civil procedure.

The Trademarks Act also establishes criminal liability for knowingly infringing a trademark on a commercial scale, punishable by a fine of up to C\$1 million and imprisonment for up to five years.

Similarly, claims of copyright infringement can be filed with the Federal Court or, in some instances, a provincial superior court. It is not necessary to register copyright before filing a lawsuit. It is a criminal offence to knowingly infringe copyright, including by making copies, selling or distributing infringing copies, etc.

Know-how and confidential information should be protected by a contract between the parties.

iv Data protection, cybercrime, social media and e-commerce

Canada was an early adopter of privacy legislation that meets standards similar to those of the European Union. The Federal Personal Information Protection and Electronic Documents Act and provincial privacy statutes in Alberta, British Columbia and Quebec regulate the collection, use and disclosure of personal information in Canada. The EU Commission has determined that Canada meets the 'adequate level of protection' standard for cross-border transfer of personal data between Canada and the EU.

Generally, non-governmental organisations in Canada are not required to store personal information within the country. The transfer of personal information abroad for data management or processing purposes is permissible if the transferring organisation retains control of personal data. In Alberta, the transfer of personal information abroad for processing requires prior notification to the individual; the federal Office of the Privacy Commissioner recommends that organisations advise their customers that their personal information can be processed in another jurisdiction.

In 2010, Canada adopted a federal anti-spam law (CASL)⁹ that requires organisations that send 'commercial electronic messages' within, from or to Canada to obtain a prior

8 Available at <http://www.doingbusiness.org/data/exploretopics/enforcing-contracts>.

9 An act to promote the efficiency and adaptability of the Canadian economy by regulating certain activities that discourage reliance on electronic means of carrying out commercial activities, and to amend the Canadian Radio-television and Telecommunications Commission Act, the Competition Act, the Personal Information Protection and Electronic Documents Act and the Telecommunications Act, S.C. 2010, c. 23.

consent from a recipient. CASL also prohibits false or misleading online promotions and the installation of computer programs without consent. CASL establishes sanctions for non-compliance, including a charge of criminal offence for obstructing an investigation, administrative penalties of up to C\$10 million and personal liability for an organisation's officers and directors. CASL's right of private action has been temporarily delayed.

Every province in Canada has adopted electronic commerce legislation that regulates transactions that occur in electronic form. Provided that certain requirements are met, online transactions and contracts concluded electronically are enforceable.

IV FRANCHISE LAW

i Legislation

The regulation of franchising falls within the provincial jurisdiction. To date, six Canadian provinces have enacted franchise statutes: Alberta, British Columbia, Manitoba, New Brunswick, Ontario and Prince Edward Island (the Disclosure Provinces). The respective franchise acts (collectively, the Franchises Acts) of the Disclosure Provinces are fairly harmonised, but not identical.

Provincial franchise statutes focus on pre-contractual disclosure obligations and exemptions, the duty of fair dealing, the franchisees' right to associate, statutory right of damages, rescission rights and the jurisdiction of provincial laws and courts.

The Province of Quebec decided not to adopt franchise-specific legislation. Franchises in Quebec are governed by the Civil Code of Quebec, which imposes rules on many aspects of the franchise relationship, including in relation to pre-contractual disclosure, duty of good faith, franchise agreements, securities interests, leases, etc.

Quebec courts recognised that franchisors are subject to certain implicit obligations that flow from the franchise agreements, including an obligation to use reasonable efforts to 'protect and enhance the brand' (*Dunkin' Brands Canada Ltd v. Bertico Inc*, 2015 QCCA 624 (*Dunkin' Donuts*)). The *Dunkin' Donuts* ruling may also have implications for franchising beyond Quebec's borders.

ii Pre-contractual disclosure

In the Disclosure Provinces, a franchisor must provide a disclosure document to a prospective franchisee at least 14 days prior to entering into a franchise agreement or payment of a franchise fee. Although provincial franchise statutes in the Disclosure Provinces were based in part on franchise rules developed in the United States by the Federal Trade Commission and the states, Canadian franchise laws differ from the United States in one significant aspect. In the Disclosure Provinces, in addition to the prescribed information, franchisors must disclose all material facts that can impact the decision to buy a franchise.

Initially, franchisors often overlooked the requirement to disclose material facts. However, courts tend to give considerable weight to this requirement. As a result, failure to disclose material facts may have grave consequences for a franchisor, including rescission of the franchise agreement, refund of franchise fees, compensation of franchisees' losses or damages. This is particularly true in Ontario, where the Arthur Wishart Act (Franchise Disclosure) 2000 does not contain a 'substantial compliance' provision that may excuse a technical or minor non-compliance.

Information disclosed must be complete and accurate as of the date of the disclosure document (except for certain information, such as financial statements, which must be current as of the end of the most recent completed fiscal year).

Failure to provide disclosure, or delivery of incomplete or inaccurate disclosure gives the franchisee the right to rescind the franchise agreement, demand the return of its investment and claim damages. The rescission period for incomplete disclosure is 60 days, and two years from the date of the franchise agreement if no disclosure was provided or the disclosure was so deficient as to amount to no disclosure at all.

The Civil Code of Quebec imposes a duty of good faith on contracting parties.¹⁰ Courts have established that the duty of good faith under the Code requires a franchisor to inform the franchisee of any relevant information that might have a decisive impact on the prospective franchisee's decision to buy in.¹¹ Failure to provide information to a prospect in Quebec may result in the reduction of certain obligations, rescission of the franchise agreement and a damages award.

iii Registration

There is no requirement to register the franchisor or the disclosure document in any province. Provincial corporate statutes require out-of-province corporations to register in the province when the foreign corporation starts to 'carry on business' in the province.

iv Mandatory clauses

There are no prescribed clauses that must be included in the franchise agreements.

v Guarantees and protection

Franchisors in Canada routinely require shareholders and directors or officers of the franchisee entity to personally guarantee the obligations of the franchisee under the franchise agreement.

Alberta's Guarantees Acknowledgement Act renders personal guarantees unenforceable unless the individual guarantor signs the guarantee before a lawyer.

The Civil Code of Quebec contains certain unique provisions applicable to guarantees, which will require revision of a common law standard guarantee agreement for use in Quebec.

V TAX

i Franchisor tax liabilities

Taxes in Canada are levied at the federal, provincial and local levels. Federally, the imposition of tax is governed by the Income Tax Act and is administered by the Canada Revenue Agency (CRA). As a general rule, Canadian residents pay taxes based on their worldwide income and non-residents may be subject to Canadian taxes on income earned in Canada. Provincial and municipal governments have powers to levy local taxes, including provincial income tax, liquor and tobacco taxes and municipal property taxes. Taxation is a complex topic in Canada and professional tax advice must be sought before commencing franchise sales.

10 Code civil du Québec, CQLR c CCQ-1991, article 1375.

11 *Bank of Montreal v. Bail Ltée*, [1992] 2 SCR 554; 9150-0595 *Quebec Inc v. Cora Franchises Inc*, 2013 QCCA 531 at para. 18.

The tax liabilities of the franchisor depend on several factors, including whether the franchisor has or is deemed to have established a permanent presence in Canada. As noted above, it is not necessary for a foreign franchisor to establish presence in Canada to sell franchises, although having ‘boots on the ground’ may be beneficial for some franchisors. In very general terms, a ‘permanent establishment’ consists in having a Canadian branch, subsidiary, place of business or an agent with authority to sign agreements on behalf of the franchisor in Canada.

If the franchisor grants franchises in Canada without having presence in the country, and is not otherwise carrying on business in Canada, generally there will be no tax liability except for withholding taxes on the franchisor’s royalty income, management fees and interest payments, payable by the franchisee (see Section II.ii).

A 15 per cent withholding tax is payable on service fees for services rendered in Canada and an additional 9 per cent if the services are rendered in Quebec. In certain circumstances, a waiver from the CRA may be obtained in respect of the service fee withholding tax. Some service payments may be considered royalties and be taxed accordingly if the payment is made for the use of trademarks or other intellectual property rights.

A non-resident franchisor may be liable to pay Canadian income taxes on income earned in Canada if the franchisor carries on business in Canada. The definition of ‘carrying on business’ is fairly broad and includes, among other things, packing or improving anything in Canada, whether or not for export, and offering anything for sale in Canada through an agent.

If the franchisor has presence in Canada that qualifies as a ‘permanent establishment’, the franchisor will be responsible for payment of the federal and provincial income taxes on income attributable to the Canadian business.

A Canadian subsidiary of a foreign franchisor is a Canadian resident and as such is responsible for payment of Canadian federal and provincial taxes.

ii Franchisee tax liabilities

The franchisee will be required to register with the CRA and obtain a business number, which will be used to open one or more accounts to remit sales taxes, payroll taxes, corporate income tax, etc.

The Canadian federal government collects a 5 per cent Goods and Services Tax (GST) on sales of goods and provision of services in Canada. In addition to the GST, other provinces (except Alberta) levy a provincial sales tax (PST) on the retail price of most goods. Businesses that sell taxable goods or services are responsible for collecting and remitting the tax. Some provinces have harmonised the PST with the GST, and the combined Harmonised Sales Tax (HST) is collected by the CRA. British Columbia, Manitoba, Quebec and Saskatchewan collect the PST separately.

Franchisees are also responsible for remitting withholding taxes (see Section II.ii and Section V.i).

iii Tax-efficient structures

There are a number of ways to structure franchising in Canada and the most tax-efficient option will depend on the franchisor’s specific needs and circumstances.

For an international franchisor without presence and business operations in Canada, unit or master franchising may be the most tax efficient option. Tax liability of the franchisor will be limited to withholding taxes, which sometimes may be wholly or partially passed on to franchisees.

If a presence in Canada is desirable, franchisors may choose between operating as a branch or establishing a subsidiary in Canada.

Using a branch in Canada may allow the franchisor to deduct losses incurred by the branch from its home taxes. However, a non-resident franchisor will be subject to a branch tax at the same rate as the income tax rate for a foreign-controlled corporation. Branch tax is reduced under some tax treaties. Also, branch operation will not shield the parent entity from the debts and liabilities incurred by the Canadian operation.

The use of a local subsidiary corporation will limit a foreign parent's exposure to liability for debts and liabilities incurred by local operations. The subsidiary will be taxed on its net worldwide income, at a combined federal and provincial or territorial rate, which varies between 26 and 31 per cent. Dividends to the non-resident parent entity are subject to the withholding tax, subject to relief provided in some tax treaties.

VI IMPACT OF GENERAL LAW

i Good faith and guarantees

Historically, Canadian common law did not recognise an overarching duty of good faith in contractual relationships. However, the Supreme Court of Canada in 2014 recognised¹² that parties owe each other a duty to perform the contract 'honestly and reasonably and not capriciously or arbitrarily' and that the duty of good faith is a 'general organising principle' of contract law.

Unlike the duty of good faith embodied in the Civil Code of Quebec, *Bhasin v. Hrynew* does not create an obligation of franchise disclosure in common law non-Disclosure Provinces.

Disclosure Provinces impose a duty of fair dealing in the performance and enforcement of the franchise agreement. Failure to act in good faith will give rise to a right to claim damages against the breaching party.

ii Agency distributor model

The definition of a 'franchise' in the Disclosure Provinces may include product distribution franchises in addition to business format franchises. Certain agency and distribution arrangements (particularly automotive dealerships) fall under the definition of a 'franchise' in the Disclosure Provinces and therefore are subject to disclosure and other obligations imposed by the Franchises Acts. Alberta's Franchises Act specifically excludes purchase of a 'reasonable amount of goods at a reasonable bona fide wholesale price' from the definition of a franchise fee; wholesale purchases are also excluded in British Columbia, Manitoba, New Brunswick and Prince Edward Island, but not in Ontario.

Distribution agreements can generally be terminated upon reasonable notice. Canadian law does not require a manufacturer to provide compensation for goodwill to its distributor upon termination.

12 *Bhasin v. Hrynew*, 2014 SCC 71.

iii Employment law

Under provincial labour and employment laws, two or more companies may be treated as one employer if they are engaged in related business and are commonly controlled or directed. In some circumstances, franchisor may be deemed a 'related' employer of its franchisee's employees, giving rise to liability for employees' claims for wrongful dismissal, wage and overtime payments, collective agreements claims and even human rights complaints.

If the franchisor's operational control ties franchisees' business to the extent that they become economically dependent on the franchisor, including with respect to pricing for goods and services and ability to market to new customers, franchisees can be deemed franchisor's employees.¹³ Janitorial service franchisors can be particularly vulnerable to the risk of being recognised as employers of their franchisees because of their business model, in which the franchisor contracts with and collects payments directly from customers, remitting money to the franchisees after deducting franchisor's fees.

iv Consumer protection

Franchisees are not recognised as consumers under the provincial consumer protection laws. However, the Franchises Acts in the Disclosure Provinces are remedial legislation, intended to protect franchisees from the perceived imbalance of power in a franchise relationship; as such, the Franchises Acts are often interpreted and enforced in favour of franchisees.

Consumer protection in Quebec is governed by the Civil Code of Quebec and the Consumer Protection Act. To our knowledge, Quebec courts have not yet extended provisions of the Consumer Protection Act to franchisees; however, certain consumer protection provisions of the Civil Code of Quebec, such as rules applicable to contracts of adhesion, apply to franchisees.

v Competition law

The Federal Competition Act regulates restraints on trade such as price-fixing, exclusive dealing and refusal to deal. Serious anticompetitive activities, such as price-fixing between competitors and bid-rigging, are criminal offences. Vertical market constraints, such as territorial restrictions, resale price maintenance and exclusive dealing, are reviewable by the Competition Tribunal if they negatively affect competition, which is rare in the franchise industry as a negative effect on competition would require a significant market share.

vi Restrictive covenants

Both in-term and post-term non-competition restrictions are common in Canadian franchise agreements. Canadian courts held that, to be enforceable, non-compete restrictions must be reasonable, specific in terms of geographic boundaries, duration and scope of restrictive activities, and should not constitute an undue restriction on trade.

It is important to draft non-competition covenants carefully, as courts generally will not rewrite the clause to make it enforceable.

Non-solicitation clauses are viewed as a lesser restraint on a person's ability to make a living and may be easier to enforce than a non-competition clause.

13 *International Brotherhood of Teamsters v. Canada Bread Company Limited*, 2017 CanLII 62172 (ON LRB).

vii Termination

Termination of a franchise agreement is governed by the contract's provisions, subject to the duty of fair dealing under the Franchises Acts, common law duty of good faith and duty of good faith under the Civil Code of Quebec.

A well-drafted franchise agreement should contain detailed provisions on the events that give rise to a right of termination. The takeover right of the franchisor in the event of abandonment of the franchise by the franchisee should also be reserved in the agreement.

The Civil Code of Quebec contains unique provisions on taking over security and leases.

viii Anti-corruption and anti-terrorism regulation

The Proceeds of Crime (Money Laundering) and Terrorist Financing Act establishes record-keeping and client identification requirements for certain businesses that are susceptible to being used for money laundering and the financing of terrorist activities (money services businesses, accountants, real estate brokers, dealers in precious metals and stones, etc.), and requires reporting of suspicious financial transactions.

The Corruption of Foreign Public Officials Act (CFPOA) creates a criminal offence of bribing a foreign public official. CFPOA may apply to non-Canadian persons if there is a 'real and substantial link' between the offence and Canadian territory; for example, where the offending organisation is registered in Canada.

ix Dispute resolution

Franchise disputes in Canada fall under the jurisdiction of provincial courts, unless the dispute involves purely a matter of federal jurisdiction (such as a trademark).

Generally, Canadian courts will extend comity and recognise a final foreign judgment rendered by a foreign court that had jurisdiction over the dispute. Canadian courts will recognise jurisdiction of a foreign court if it had 'real and substantial connection' to the dispute.

The Franchises Acts of the Disclosure Provinces do not allow the parties to restrict the application of the respective Franchises Acts or jurisdiction of provincial courts by agreement. Jury trials are not used in franchise disputes.

Recognising that judicial process in Canada is relatively slow and expensive, the Supreme Court of Canada encouraged the use of summary judgment proceedings and these are used, to a certain extent, in franchise disputes.

Damages awards in Canadian courts are generally less generous than in the United States. Punitive damages are rare. Damages in a contractual dispute will generally be awarded to place the non-breaching party in the position he or she would have been in had the contract been performed. The winning party may be awarded part of its legal costs.

Canada is a party to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. Foreign and domestic arbitral awards will be recognised and enforced upon an application to the relevant provincial court. The Supreme Court of Canada in *Sattva Capital Corp v. Creston Moly Corp*, 2014 SCC 53 ruled that courts should show deference to arbitrators' decisions and apply the standard of reasonableness rather than a stricter standard of correctness when reviewing arbitral awards, except for matters of a 'pure question of law'. Mediation is also recognised and some franchise agreements require the

parties to attempt to resolve the dispute by mediation before commencing arbitration or litigation. In New Brunswick, mediation is mandatory if one of the parties to the franchise agreement requests it.

Arbitration in Quebec is governed by the Code of Civil Procedure.

VII CURRENT DEVELOPMENTS

In October 2019, the Supreme Court of Canada heard an appeal from the decision of the Court of Appeal for Ontario *1688782 Ontario Inc v. Maple Leaf Foods Inc, et al.*, 2018 ONCA 407. The Supreme Court's decision is expected to clarify whether an exclusive approved food supplier of a franchise system is liable to franchisees in tort for economic and reputational harm caused by product recall.

In 2018, the Court of Appeal for Ontario issued further guidance on distinguishing an imperfect disclosure from a disclosure so deficient as to amount to no disclosure at all (*Raibex Canada Ltd v. ASWR Franchising Corp.*).¹⁴ This is particularly important because the courts have extended the two-year rescission remedy, available under provincial franchise statutes to franchisees who have not been provided with a disclosure document, to circumstances where disclosure was provided but is deemed materially deficient. The Court of Appeal clarified that imperfect disclosure should not automatically be considered to be 'no disclosure at all', as long as the deficiency did not deprive the franchisee of the possibility of making an informed decision. Still, franchisors should carefully review their agreements and disclosure documents to make sure that franchisees are informed about the uncertainties associated with each franchise offering so that the franchisee has an opportunity to make an informed investment decision.

Legalisation of cannabis nationwide on 17 October 2018¹⁵ created an opportunity for cannabis producers and retailers to engage in franchising. Distribution and sale of cannabis is regulated provincially.

In November 2017, Ontario passed amendments to the Arthur Wishart Act; some of the amendments are not yet in force, pending adoption of the revised regulations. However, further amendments to the Act were recently recommended by the Business Law Modernization and Burden Reduction Council, including clarification on the acceptable accounting standards for financial statements included in disclosure documents, pre-disclosure deposits and disclosure exemptions.

The Court of Appeal for Ontario decisions in the *Trillium Motor* cases¹⁶ dealt with several issues arising in the franchising class action context, including whether out-of-province claimants are covered by the Ontario franchise statute, whether releases signed by franchisees are enforceable and whether a franchisor has a duty to facilitate the franchisees' right of association. The Court also held that a law firm that initially acted for the franchisees breached its duty of loyalty and conflict-of-interest obligations to them by simultaneously acting for another of the restructuring transaction parties.

CHILE

*Cristóbal Porzio*¹

I INTRODUCTION

The Chilean franchise market has been growing at a steady pace over the past few years. This growth has been strongly linked to the positive and consistent economic results shown by the national economic figures. The slowdown of the Chilean economy that began in the second half of 2014 and has continued up to the present has apparently yet to affect the growth of franchising figures in Chile, certainly in terms of the number of brands present and entering the Chilean market. It is still difficult to anticipate at this stage what will happen in the medium and long term. In addition to the difficulties presented by the international economy – with the slowdown in China and its direct consequences for those countries in which commodities are very economically important, as with Chile and copper – there is also the prospect of how important legal reforms, including fiscal and labour reforms, that have already been approved, and are gradually entering into force, will impact the Chilean economy. It is difficult, therefore, to anticipate the direct impact these changes will have on franchising. In fact, a significant impact is already being felt in some sectors, such as mining and construction. Furthermore, although commerce has slowed down – and as sales have slowed the owners of the stores also complain – as yet unemployment in the sector has not increased, and new franchises continue to appear in the market and are visible in Chile's various cities. Furthermore, while the commerce sector's complaint regarding the slowdown in sales is also heard from franchisees, new malls continue to open their doors, with many hosting new brands.

In spite of the economic slowdown, there still appears to be an active interest in franchising in the Chilean market and articles on the subject continue to appear in local newspapers and magazines. Some of these articles have dealt with particular brands (local and foreign) that have chosen to use the franchising system to grow their business. While other articles have been about the franchising industry in general, some have simply announced or confirmed rumours that certain companies are exploring the Chilean market or are ready to enter the local market.

The interest of the Chilean market in the franchising model is only confirmed by the fact that the International Franchise Fair (FIF) took place once again in 2017, for the fourth consecutive year. The stands were numerous and attendance figures were correspondingly

1 Cristóbal Porzio is a partner at Porzio, Ríos, García. The information in this chapter was accurate as at January 2018.

high. The interest of the public was very clear, not only during the fair, but also especially during the conferences, as was evident at the extremely well-attended conference on the legal aspects of franchising, which the author led.

In terms of the figures concerned, according to an investigation conducted by the Faculty of Economics and Business of the University of Chile² – one of the of the country's main universities – the statistics from 2016 concerning the franchise market are still quite impressive. In fact, the franchise market has generated sales of approximately US\$1,957 million per year, which corresponds to a growth of 31 per cent between 2012 and 2016. This figure is three times the amount it was eight years ago. From a social and employment point of view it is estimated that the franchise market currently employs approximately 53,500 people. This investigation remains probably the most recent and most extensive study made locally on this subject as, at the time of writing, no updates to this report have been published.

The number of brands operated by franchising is over 200.

The services and food sectors remain the most important as far as franchising is concerned. In fact, franchises in those sectors comprise over 78 per cent of existing franchised brands. In addition, while a very large number of foreign brands are present in the Chilean market by means of franchising systems, domestic brands also constitute a significant market presence.

The Chilean franchise market features important international players such as 5àSec, GNC Live Well, Applebee's, Alamo Rent A Car, Sixt Rent a Car, Best Western, Starwood Hotels, Burger King Domino's Pizza, Dunkin' Donuts, Holiday Inn Express, Kentucky Fried Chicken, McDonald's, Movistar, the Wall Street Institute, engel & Völkers (real estate), Fast Fitness, Fruzco, Papa John's and Johnny Rockets, among others.

Among the most important local franchises operating in Chile are International Center (education services), Fuenzalida Propiedades (real estate agencies), Doggis (restaurants serving mainly hot dogs), Emporio La Rosa (restaurants and ice cream producers), Copec (fuel distribution and petrol stations), Juan Maestro (fast-food restaurants, serving mainly sandwiches), Pedro, Juan y Diego (fast food) and Soquimich Comercial (producer and seller of speciality fertilisers, iodine and derivatives, lithium and derivatives, industrial chemicals and potassium).

Although the franchise market plays an important role in the current economy, there is no official government agency in charge of this matter, nor a public report concerning franchising activity in Chile.

II MARKET ENTRY

i Restrictions

The Chilean Political Constitution provides in Article 19 No. 21 for the right of any person to develop any economic activity, provided the activity is not immoral or contrary to public policy or national security. The Constitution does not differentiate between foreign nationals and Chilean nationals – all of them being equal in the law. In view of this, foreign nationals and foreign companies are entitled to deal with Chilean people (individuals and corporations) and to enter into the Chilean market directly.

2 Pinaud Verde-Ramo, Nicole, 'Mercado de las Franquicias en Chile 2016', Departamento de Administración, Facultad de Economía y Negocios, Universidad de Chile, 2016.

The Chilean legal system does not provide for a franchise law. Having said that, at the time of entering the Chilean market, a foreign investor or foreign franchisor will not be required to obtain special permission or prior approval but will be required to comply with the Chilean laws that regulate commercial activity, the declaration and payment of taxes, labour relationships, the treatment of foreign investments, etc.

As far as the grant of a master franchise or the grant of development rights to a local entity is concerned, no special restrictions will apply. As mentioned, however, a foreign entity wishing to do business in Chile through a franchise system will have to comply with the applicable Chilean laws.

Depending on the field of activity where the foreign entity will do business in Chile, specific or particular rules may apply, in addition to the normal commercial, labour and tax laws indicated above. This is the case, for instance, in the food industry, for which specific rules will apply, and in the telecommunications sector, among others. With regard to the food industry, 2014 was a year of heated debate following the enactment of the 'Super 8 Law' (a law aimed at limiting children's access to junk food while at school), the enactment of its regulations and the withdrawal of the same from Congress. This debate continued during 2015. A local discussion on plain packaging also started to develop slowly and a draft bill is currently before Congress.

Notwithstanding rules and concerns such as those noted above, which may affect its chosen field of activity, a foreign company is free at the time of deciding to enter into the Chilean market to elect the best route for its project, in accordance with the 'principle of the autonomy of the will', established in the Chilean Civil Code.³ As a result, practice indicates that the solutions chosen are very different from one case to another. Some may consist in the franchisor simply granting a master franchise for the Chilean territory to a Chilean entity, while others may consist in the entry into the Chilean market and incorporation of a local entity that will interact with franchisees, or that will incorporate a joint venture with a local entity, etc. Basically, 'all legal solutions' can at least be explored

ii Foreign exchange and tax

Business entities are, for the most part, legally structured, and in different ways, using the main types of company or corporation provided for by Chilean law. At the time of making a decision to enter the Chilean market, the franchisor will have to decide whether a legal entity is to be incorporated in Chile. If the decision is affirmative, it will then have to determine what kind of legal entity will have to be considered. For that decision, the franchisor will take into account the limitations on responsibility, the tax consequences, the needs of the local entity, the power of leverage with a possible local partner, the possibility of amending the structure quickly, the possibility of withdrawing from the business, etc.

In this regard, Chilean law provides for several types of corporation, such as limited liability companies, stock corporations and corporations, among others. The choice of one of the foregoing alternatives will depend on what the foreign franchisor is looking for in its business (e.g., free transfer of shares, number of partners, administration and tax considerations).

Whatever the solution or model chosen, the foreign investor will consider on the one hand that money can be obtained locally at competitive rates, or brought into Chile easily

3 Article 1545.

without major obstacles, and on the other hand that money can be changed at a market exchange rate with no major limitations or boundaries. Finally, and from a strict tax point of view, the foreign investor will know or will have to know from the beginning that a withholding tax will apply to most of the amounts of money that are to be exported from Chile to the country of origin of the foreign investor.

As the franchising model is not currently regulated as such in Chile, the franchisor and franchisee will be liable to pay Chilean taxes for activity carried on in Chile using this model. There could be an exception in the case of an international franchising contract in which one company (franchisor or franchisee) is Chilean and the other company (franchisor or franchisee) is foreign, if Chile and the country concerned have a treaty to avoid double taxation.

It is important to bear in mind that every time a franchisor who has no domicile in Chile, or has not incorporated a company in Chile, is to export to its country of origin the sums of money consisting in rents or payments made to it by the franchisee, this will be subject to payment of a withholding tax, on the terms mentioned above. The responsible entity for the withholding tax will be the person or company responsible for its payment, such as the franchisee. Said tax will have to be paid by means of a formal deposit of money in the official account of the state of Chile.

III INTELLECTUAL PROPERTY

i Brand search

The Chilean Patent and Trademark Office (INAPI) has an online system that provides most of the information regarding trademark registrations and pending applications. The same information can be obtained in the case of patent applications.

In the case of trademarks, the search engine allows the user to search for phonetical and graphical coincidences, and also to check the classes and goods or services descriptions. All this information is public and can be accessed through INAPI's website. However, although the system is undergoing constant improvements, the information may not be completely accurate and might need completion by means of a material review of some files.

In addition, there are private services that perform more detailed searches and that are in a position to prepare and draft thorough reports on the registrability of a trademark.

ii Brand protection

In Chile, it is possible to obtain trademark protection for goods and services. Applications will need to designate classes (using the Nice Classification) and to contain a description of the products or services that are to be covered by the trademark.

Protection can be sought for word marks and for figurative marks. The same can be done for slogans and for sound marks. Three-dimensional trademarks cannot be registered.

To obtain trademark rights in Chile, a trademark application must be filed with INAPI and prosecuted according to the rules established in the Chilean Intellectual Property Law (the IP Law) and its implementing regulations. Some basics that can be highlighted are as follows:

- a* trademark applications can be filed by individuals or by corporations;
- b* trademark applications can be filed by Chilean persons or entities, or by foreign persons or entities;
- c* trademark applications are the subject of a formal examination and examination as to substance;

- d* trademark applications are published in the Chilean Official Gazette, for third parties to file their possible opposition in writing;
- e* the final decision, independently of whether the application has been the subject of opposition, can be appealed before the Court of Industrial Property; and
- f* the final decision of the Court of Appeals can be the subject of an annulment recourse filed before the Supreme Court of Chile.

Trademark registrations are granted for 10 years. This term can be renewed for further periods of 10 years provided a trademark renewal application is properly filed.

Currently, the IP Law does not provide for mandatory trademark registrations. In other words, the registration of a trademark is not mandatory for its use as a trademark in Chile, provided, of course, it does not interfere with the legally superior rights of third parties. In addition, if a person decides to file an application for the registration of its trademark, and finally a registration is granted by the Chilean authority, said registration will not be subject to cancellation on the grounds of non-use. In fact, the use of a trademark is not mandatory to maintain a trademark registration in force. In this respect, a bill for a new IP law is still being discussed by the Chilean Congress, and this draft contains a provision concerning the mandatory use of trademark registrations.

The IP Law also provides for the application, prosecution and granting of other IP rights, such as patents, industrial designs (3D), industrial drawings (2D) utility models, geographical indications and integrated circuits.

As far as franchising contracts are concerned, it would be advisable, although not mandatory, for the owner of a trademark and owner of a franchising programme to file for a trademark application for its trademarks before entering the Chilean market and, in some cases, before offering franchises locally or even before starting a search for potential franchisees or a master franchisee.

While it may seem expedient to forego this process, as it is not mandatory, the use of a trademark alone will not give significant rights to its user. Trademark property or ownership is acquired in Chile through filing a trademark application, the prosecution of this application and the final granting of trademark rights by the Chilean authority, INAPI.

iii Enforcement

According to Chilean practice, all franchising agreements contain a trademark licence agreement. In some cases, the licence agreement is part of the main body of the franchise agreement while in other cases it is drafted in an annex or exhibit of the franchising agreement.

On the assumption that the trademark will be registered in the name of the owner of the trademark or the franchisor, for a licence agreement to be enforceable against third parties, it will be necessary to register it with INAPI. Although, according to Chilean law, a licence agreement will be valid between the signatory parties because of the sole fact of their having a valid executed agreement, granted in good faith and with a clear intention to enter into the agreement, for the agreement to be valid or enforceable against third parties, it is necessary to register the contract with INAPI.

iv Data protection, cybercrime, social media and e-commerce

Chilean legislation does not provide for a data protection law as such. Nevertheless the Industrial Property Law⁴ contains provisions regarding protection of ‘industrial secrets’.

In addition, Chilean legislation provides for a Law on Protection of Consumer’s Rights,⁵ a Law on Electronic Documents and Electronic Signature⁶ and for a Law on Privacy Protection.⁷ The latter regulates the ‘adhesion contracts’ usually found on internet websites under the title of ‘general terms and conditions of use’.

In Chile, the sole visit to a website that offers access to certain services does not impose any obligation on the user, unless the user has unequivocally previously accepted the conditions offered by the provider. Typical clauses such as ‘by accessing this website you acknowledge that you have read, understood and accepted these terms and conditions of use’ do not obligate users in Chile.

To comply with the legal requirements for the ‘electronic formation of consent’, users must accept the terms and conditions of a website in writing. This can be achieved by clicking the relevant box to indicate acceptance of the terms and conditions. Once the contract is agreed, the provider must send written confirmation to the consumer.

Law No. 19,799 on Electronic Documents and Electronic Signature and its Certification recognises the validity of the acts and contracts agreed electronically, and gives them the same value as a written document.

Regarding personal data, Law No. 19,628 on Privacy Protection states that the user must authorise in writing the use of its personal information. This written agreement can be replaced by an electronic registration process if the identification of the user can be determined and a record of the authorisation can be kept.

IV FRANCHISE LAW

i Legislation

Chile does not have a law on franchising. Therefore, the main applicable law is the contract, which is considered to be law for the parties, according to the provisions of Article 1545 of the Chilean Civil Code. In addition to that, civil and commercial codes will apply, together with the general rules of law and the existing case law on franchising. However, case law will not be binding for a court.

The parties are free to determine both the structure and content of the franchise agreement. In other words, a franchise agreement contract should be subject to general contract rules and certain limitations provided by local law, just as with any other contract.

Practice indicates that most franchising agreements are drafted on the basis of ‘international models’ and ‘current international practice’.

4 Law No. 19,039.

5 Law No. 19,496.

6 Law No. 19,799.

7 Law No. 19,628.

ii Pre-contractual disclosure

Generally speaking, Chilean law considers the parties that enter into a contract to be equals. In consequence, it does not impose more pre-contractual obligations than those that are the result of the application of the principle of good faith. The Chilean Civil Code states that 'the contracts must be executed in good faith'.

Under normal conditions, the parties to a contract only have to comply with the requirements of pre-contractual disclosures that are necessary to credit that both parties are in good faith; in other words, to be in a position to prove that the information granted to the other party is the information necessary to execute the contract in its natural meaning.

The obligations of the parties at the time of negotiating the agreement are not specifically established, and therefore franchise contracts are treated as any other contract. Therefore, what was discussed at the time of the negotiations in principle has no value unless it is possible to prove by means of strong evidence that the discussion was not a simple discussion but an agreement that was made before the execution of the document, and that is to be considered the contract.

In this respect, the Chilean Civil Code, Article 1554, states that:

The promise to enter into a contract does not produce any obligation unless the following conditions are met:

- 1) *That the promise is in writing;*
- 2) *That the contract promised is not one of those that the law declares ineffective;*
- 3) *That the promise contains a term or condition that sets the time of the conclusion of the contract;*
- 4) *That the promised contract is specified therein in such a manner that to be perfect the only thing missing is the tradition of the thing or the solemnities prescribed by law.*

Finally, the Civil Code contains rules for the interpretation of contracts (Articles 1560 to 1566), of which the following are examples: 'if the intention of the parties is known, it should be given greater consideration than the literal wording of the contract'; 'the terms of the contract, even if they are general, will be applied only for the contract'; 'the interpretation of a clause that produces effects will be preferred over an interpretation that does not'; 'unless there is a clear intention of the parties against it, the contract should be interpreted in the way that best suits its nature'; 'the clauses of common use are considered part of the contract even when they are not expressly included'; and 'the clauses should be interpreted in a way that favours the whole execution of the contract'.

The local practice indicates that in the case of franchises, memoranda of understanding (MOU) are common. A document of this sort will be useful to channel the discussions and negotiations of the contract. However, in most cases, practice indicates that they will have little weight from a legal point of view. In any case, such a document will in all probability include clauses regulating points such as confidentiality, transfer of information, ownership of information, a possible non-compete clause in case of not reaching an agreement, etc. While such clauses are normally considered an enforceable contract, the MOU or letter of intention is not sufficient for the prospective franchisee to force the franchisor to enter into the final agreement.

iii Registration

As mentioned above, Chilean law does not prescribe any formalities regarding the execution of franchise agreements.

Nevertheless, to facilitate the enforcement of franchise contracts, it is very common for these contracts to be executed before a notary public, the involvement of which provides certainty regarding the date of execution and the parties to the contract.

iv Guarantees and protection

Guarantees are valid and often used in Chilean contracts. According to local law, there are the following three guarantees:

- a* mortgage: guarantees involving real estate;
- b* pledge: guarantees involving different kinds of movable property; and
- c* personal guarantee: guarantee involving the goods of a person, in case the principal debtor does not pay its commitments.

The following formalities are required by law in respect of these different kinds of guarantee:

- a* mortgages: Chilean law requires a public deed, and the registration of this deed in the Registry of Mortgages and Encumbrances of the competent real estate registrar. There are some special cases that require other formalities (i.e., mortgage on certain ships), though these are not common;
- b* pledges: pursuant to local law, there are several kinds of pledge for which the law requires different formalities. The most common pledges are the pledges on shares, credits and the non-possessory pledge, among others. Each of these has its own specific formalities (notarisation, registration, among others); and
- c* personal guarantee: Law No. 18,092 provides that this guarantee shall consist of a written document, signed by the person who grants the guarantee, clearly identifying this document as a 'personal guarantee' to ensure the fulfilment of a specific obligation. This guarantee can be limited to a specific amount. Its notarisation is recommended.

V TAX

i Franchisor tax liabilities

As briefly mentioned above, pursuant to Article 58 et seq. of the Chilean Income Tax Law, foreign nationals with no residence or domicile in Chile, or foreign legal entities incorporated abroad, shall pay a withholding tax on any income produced by a Chilean source before they export that income from Chile.

In addition, franchisor and franchisees will pay tax on profits made in Chile through the franchising activity. In the case of international or cross-border franchising contracts, treaties to avoid double taxation may apply.

ii Franchisee tax liabilities

The local franchisee must collect the withholding tax and pay it to the Treasury. Therefore at the time of negotiating a contract of this nature and at the time of its execution, it is very important for the franchisor and franchisee to be clear on the exact amounts to be paid from one party to the other, and to the state (tax). In other words, at the risk of having a longer clause (which may even repeat that the burden of the withholding tax will be on the

franchisee), it may be wise to go into some detail to establish clearly how the calculations will take place, the exact amount to be paid ultimately by the franchisee to the franchisor, and when it should finally be received by the franchisor.

According to Chilean law, there are no currency restrictions that may affect a franchise relationship between a US franchisor and a Chilean franchisee.

Notwithstanding the aforementioned, any operation in which the local franchisee receives payment of an amount exceeding 10,000 Chilean pesos shall be notified to the Central Bank of Chile. (This obligation, however, is generally fulfilled by the corresponding Chilean commercial bank that receives the payment.)

iii Tax-efficient structures

Practice indicates that in the case of franchisors domiciled abroad, it is common to establish in the contract the exact amount to be received abroad by the franchisor. Any deduction or payment to be made is the responsibility of the franchisee and does not affect the final amount received by the franchisor. Therefore, the cost to the franchisee is the total sum due for payment plus the withholding tax.

VI IMPACT OF GENERAL LAW

i Good faith and guarantees

As indicated above, the Chilean Civil Code imposes a duty of good faith that applies to all contracts, including franchising.

Furthermore, there are some general provisions that should always be taken into consideration in an agreement subject to local law, such as the rules of the interpretation of contracts already mentioned above.

ii Agency distributor model

As indicated above, Chilean law does not provide for a law on franchising. The same can be said for distribution. Therefore the law of the contract will be the main applicable law for the parties.

iii Employment law

The franchisee will not normally be considered an employee of the franchisor. In addition, practice indicates that most local franchising agreements contain a special clause by means of which the parties establish that the relationship they have is not a labour-law relationship but a commercial relationship.

On the other hand, franchisees are considered employers of the employees they hire to run the business. As a consequence, the franchisees must comply with all Chilean labour legislation, which always regulates the relationship between employer and employees in the country.

Jurisprudence has determined that if a franchisee who is an employer breaches Chilean labour law, the affected worker could pursue the fulfilment of the relevant legal obligations against the franchisor, which is considered to have subsidiary liability.⁸

8 Chilean Supreme Court, *Ortiz Huaiquil Claudia v. Comercial Proventa S.A.*, No. 4012-2008, decision of 25 September 2008.

Discussion on the reform of the Labour Code is ongoing, and even if the current situation does not change, it cannot be assessed at present.

iv Consumer protection

Unlike in other countries where the jurisprudence and doctrine have developed a criterion that establishes that under special circumstances franchisees could be treated as consumers (for example, in pre-contractual disclosures), this is not the case in Chile.

v Competition law

Franchise agreements are not subject to special treatment under Chile's competition law. Therefore general rules apply. Particularly relevant among these are the Chilean Antitrust Law⁹ and the Unfair Competition Law.¹⁰ In these matters, and in contrast to what was indicated in Section VI.iv, the Chilean legal system that regulates antitrust and unfair competition gives a very special role to case law, which is examined, studied and applied in court decisions.

Some parts of the legal provisions concerned 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 to be, among other things, actions, acts or conventions that impede, restrict or hinder competition or which 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.¹¹*

In general, an act of unfair competition is any act against good faith or good custom which, by illegitimate means, is carried out with the purpose of diverting the clientele of a market agent.¹²

The Unfair Competition Law contains a, merely illustrative, list of acts considered 'acts of unfair competition'. These include, among others:

- a 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;*
- b the use of signs or diffusion of facts or assertions, incorrect or false, that lead to misinformation about the nature, provenance, components, characteristics, price,*

⁹ DL No. 211 of 1973.

¹⁰ Law No. 20,169 of 2010.

¹¹ Article 3, Law No. 20,169.

¹² id.

production process, brand, appropriateness to fulfil the objectives, quality or quantity, and, in general, about the advantages that are really provided by the offered goods or services; and

- c* 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 a person without any objective basis.¹³

In principle, the parties to the franchise agreement are free to determine its contents.

Practice indicates that most franchising contracts are drafted in a such a manner as not to impose final prices for the end consumer but instead propose a range in which the price should move, to maintain the international standards and position of the product and brand; not to force the franchisee to buy necessarily very specific amounts of goods but, on the contrary, to try to reach some agreement concerning annual sales, and to give bonuses when the goals are reached; and to establish certain rules on 'how to sell' and 'how to make discounts' without jeopardising the position of the brand in the local market and at international level, etc.

vi Restrictive covenants

In Chile, competition and confidentiality covenants are often agreed by the parties. Pursuant to Chilean law, these are valid and fully enforceable. These covenants are usually either contained within the contracts (specific clauses) or agreed in a specific and separate document (non-competition agreement or non-disclosure agreement). However, case law and practice indicate in a rather consistent manner that non-compete clauses are acceptable and enforceable as they are limited in time and provide that the one benefiting from the clause will somehow compensate the one who bears the burden of not competing.

vii Termination

Once again, and as indicated above, the contract will be the law of the parties. In addition, in practice there is a consistent use of rather detailed termination clauses, since if nothing is said, general rules of commercial and civil law will apply, and in most cases those laws will have to be applied by a court. Also in this context, in cases of termination local franchising contracts are repeatedly seen to be used to regulate the following areas:

- a* protection of trademarks;
- b* pending payments between parties;
- c* the possibility of having the franchisor continue with the business, with the aim of protecting the brand, the employees of the franchisee, the location, etc.;
- d* payment of stock and destination of stocks;
- e* rights of the parties during the time of termination and possible legal actions and waivers within determined conditions; and
- f* confidentiality, etc.

As indicated above, non-competition agreements are usually enforceable. In most cases, specific terms and conditions are agreed upon.

13 id.

Chilean law does permit placement of restrictions regarding transfers of equity interest in franchisees, to the extent that the parties agree to it. Where the parties have provided for a prohibition on the franchisee assigning the contract, a breach of such a provision will be a cause for the franchisor to terminate, in principle, with no doubt. If the parties have not agreed to a clause of this nature, and given that the franchising contract is a contract *intuitu personae*, it is understood that the franchisee will not be entitled to assign its contract or rights without the prior consent of the franchisor.

viii Anti-corruption and anti-terrorism regulation

Prior to joining the Organisation for Economic Co-operation and Development,¹⁴ Chile enacted Law No. 20,393 of 2009 introducing criminal liability for legal entities in cases of money laundering, financing of terrorism and bribery.

The law states that:

Legal entities will be responsible for the crimes that were committed directly and immediately in their interest or to their advantage, by its owners, drivers, managers, executives, representatives or those engaged in administration and supervision, provided that the commission of the offence is the result of the failure by the latter of the management and supervisory duties.

The most relevant consequence for franchising is the obligation for the franchisor and franchisee, to different degrees, to exercise strict control to prevent the situations mentioned above.

ix Dispute resolution

Practice indicates that there is no uniform option chosen by the parties as far as applicable law and forum are concerned. Foreign laws and Chilean law (in spite of the lack of franchise law) are common. The same can be said regarding forum; some parties choose court proceedings while others prefer alternative dispute resolution methods such as arbitration (national or international).

Chilean laws permit the parties to reach an agreement to choose from all these options. In fact, there are no restrictions upon the choice of a foreign law or a venue outside Chile for dispute resolution purposes. However, this choice and, in consequence, foreign law, will be applicable only to the extent that there is no conflict with Chilean public policy. Taking into consideration the foregoing, there are some topics in which the applicable law will necessarily be Chilean law, even if the signing parties have agreed something different. For example, Chilean law will apply to the sale or rent and other transactions made in relation to real estate located in Chile, to employment matters, to tax issues, etc.

Commonly, franchising agreements give a mandate to the Arbitration and Mediation Centre of the Santiago Chamber of Commerce as it has gained a favourable reputation in recent years.

Mediation in these cases is recognised, but it is not mandatory unless the parties to the franchise contract have so agreed.

¹⁴ 7 May 2010.

Both judgments and awards are usually enforceable without many issues. Chile has been a party to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards since 3 December 1975.

Equitable remedies are available in Chile. The Civil Procedure Code provides several remedies, and specific requirements for each of them. The Industrial Property Law provides for the possibility of obtaining an interim or permanent injunction to prevent someone – and, therefore, a former franchisee – from continuing to trade in breach of a non-compete provision or from using the franchisor's trademarks and other IP rights duly registered in the name of the franchisor.

As far as damages are concerned, liquidated damages are contemplated in the Chilean Civil Code.¹⁵ These clauses are used often in civil and commercial contracts, and they are fully enforceable. Notwithstanding the aforementioned, their amounts are generally reasonable, and therefore they are not understood as punitive. The Civil Procedure Code and the Industrial Property Code contain rules for the calculation of damages, under specific circumstances.

VII CURRENT DEVELOPMENTS

The Chilean economy has been growing consistently for many years. The slowdown that began in 2014 and continues today does not seem to have affected franchise development yet or, at least, does not seem to have affected franchise sales in a different manner from commerce sales in general, if these are compared as distinct areas of economic activity. That said, franchise-specific case law is still rather limited at the moment and it could be argued that we have yet to obtain a clear indication of how the continuing economic slowdown and the tax law reforms will ultimately impact on the franchising business.

Despite franchising being discussed and studied today in some Chilean law schools, we have not yet seen a discussion concerning the need for a specific law on the matter. Current commercial, civil and competition laws seem to provide a good framework for franchising businesses in Chile.

It is hoped that, in the short term, both jurisprudence and doctrine development will give more definitive positions and practical answers regarding those topics that have still not been treated in a detailed or consistent manner.

The success of the franchise model in Chile and the still-growing economy have seen several international brands featured in Chilean newspaper and magazine articles as candidates for entry into the Chilean market by means of a franchise system. Finally, in 2017, the FIF organised by the Chamber of Commerce of Santiago took place successfully once again in Chile, with a significant number of participants, and the 2018 FIF event is already being planned.

15 Article 1535 et seq.

CHINA

*Sven-Michael Werner*¹

I INTRODUCTION

Retail and franchising in China developed very fast in the decade from 2001 to 2012, during which the sales volume of the top 100 chain-store retailers in China increased by 10 times. The total sales of the top 100 franchisors in China reached 428 billion yuan in 2016. In 2014, the franchising growth rates varied from sector to sector; for instance, the automobile sector doubled its sales whereas catering and retail experienced a negative year. Still, 90 per cent of franchisors had forecast a sales growth for the following year, 2015, and of those, 43 per cent expected 2015 to show a higher rise compared with 2014.

There have been two remarkable trends. First, with the increasing costs on franchising (particularly premises and workforce in the first-tier and the second-tier cities) and the overwhelming competition from the rise of online retail, as of 2015 many franchisors tended to develop franchises in the fourth-tier cities, particularly in sectors such as supermarkets, laundry, fast food, accessories and the automotive sector. Second, both online and offline purchasing and sales have increased rapidly in recent years in China, forcing global franchisors to seek suitable approaches and strategies to address this.

Franchising in China covers a wide range of industries and sectors, such as food and beverages, retail, catering, education and other services. Franchisors encompass Chinese local retailers and international brands such as KFC and FamilyMart with legal entities in China, most of which are members of the China Chain Store & Franchise Association (CCFA).

CCFA, incorporated as a civil association under the Ministry of Civil Affairs in 1997, is the official industry association for the retail and franchise industry in China. Currently it has over 1,000 enterprise members with more than 356,000 outlets, including domestic and overseas retailers, franchisors, suppliers and relevant organisations. By 22 October 2018, 1,032 foreign franchisors had registered their franchises with the Ministry of Commerce (MOFCOM), the highest governmental body in charge of franchising in China.

II MARKET ENTRY

i Restrictions

As part of its World Trade Organization commitments, China agreed to eliminate legal restrictions on foreign investment in the area of franchising by 11 December 2004. This commitment was implemented with the enactment of Administrative Measures on

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Commercial Franchise Businesses on 30 December 2004 with effect from 1 February 2005.² However, foreign franchisors are still obligated to comply with the restrictions on foreign investment set out in the Special Administrative Measures for Access of Foreign Investment (Negative List) and the various laws and regulations applicable to foreign investment in the distribution sector. For example, foreign companies are not permitted to engage directly in distribution activities (which generally covers retail, wholesale, commission agency and franchising operations) but must engage in such activities by setting up a wholly foreign-owned commercial enterprise (FICE). The types of products or services provided by the FICE must be specified in the statement of its business scope.

There are certain restrictions on granting a master franchise or development rights to a local entity (e.g., registration and other requirements) that apply to all master franchisors, foreign or domestic. Such franchises generally fall into two categories: the first is a two-level franchise, or sub-franchise, whereby the franchisor grants a franchisee the franchise rights to a specific sales region, allowing the franchisee to grant sub-franchises to others. In this instance, the franchisee would have a dual role as a franchisor as well as a franchisee. The master franchisor in this model may be either a foreign or a domestic company. The second model is an agent franchise, whereby the franchisor grants a franchisee the right to recruit other franchisees. In this instance, the franchisee would essentially act as an agent of the franchisor in handling the recruiting and would provide these sub-franchisees with guidance, training, consulting, supervision and support. In the second model, the franchisor would have to be a foreign-invested enterprise rather than a foreign company as it would essentially be conducting franchising activities in China.

Subject to obtaining the relevant governmental approvals, a foreign franchisor can own equity in a local business so long as the local business does not fall within an industry sector where foreign investment is restricted or prohibited.

Owning real property is restricted under Chinese law. A foreign-invested enterprise that does not specialise in real estate may only purchase real estate in China for its own use. If the franchisor's overall strategy includes provision of premises to franchisees, one solution may be for the franchisor (or an affiliate) to set up a foreign-invested real estate company in China (which would trigger conditional approvals by several Chinese governmental bodies) to make the relevant real estate purchases and to provide premises for franchises to the franchisees. This, however, is subject to another set of relatively restrictive procedures that the investor must complete prior to any applications made for these approvals.

ii Foreign exchange and tax

The yuan, China's official currency, is not a freely convertible currency; offshore remittances are generally subject to the regulation of the State Administration for Foreign Exchange (SAFE). From the perspective of a foreign master licensor, it would be prudent to insist that the master franchise contract provide for payments to be made in a foreign currency and into an offshore bank account so that the responsibility for making offshore remittances rests with the domestic master franchisee. Transactions involving remittances of current account payments can usually be handled at banks designated by SAFE to handle such transactions upon presentation of the contract and shipping documents. Since 2016, reports have confirmed that SAFE is again tightening the supervision of outbound payments for both capital and current account items.

2 The Franchise Measures are no longer valid; they have essentially been replaced by the Administration Rules on Commercial Franchise Businesses enacted on 6 February 2007 with effect from 1 May 2007.

It will mean, therefore, that SAFE may require the submission of an application for approval. In addition to what would normally be presented to a bank, the application submitted to SAFE shall contain additional documents and information, including without limitation the detailed reasons for the parties' agreement to the terms. Payments may therefore be rejected repeatedly. In the (unlikely) event that the payment cannot be remitted offshore, the parties may consider adding a provision setting out an alternative arrangement for payment of yuan to an onshore bank account or agent. It would also be prudent to stipulate that failure to pay for any reason (including those relating to government actions) cannot be excused under force majeure. However, on 23 October 2019, SAFE issued the Circular on Further Promoting the Facilitation of Cross-border Trade and Investment (Hui Fa [2019] No. 28) (Circular 28). Circular 28 aims to further liberalise and streamline foreign exchange control over cross-border investments and trades through measures such as (1) simplification of the documentary and reporting requirements in relation to payments made in cross-border trade; and (2) relaxation of the domestic equity investment restriction imposed on foreign-invested enterprises. Notwithstanding these aims, the implementation of the Circular 28 has yet to be tested in practice.

III INTELLECTUAL PROPERTY

i Brand search

Brands of foreign franchisors would usually enjoy protection by operation of their respective trademark registrations in the relevant countries. Such registrations are generally made in the brand's original language and writing. To market products under such a brand to consumers in China, the franchisor would need to create a recognisable Chinese brand based on Chinese language characters and protect the brand locally in China. The selection of Chinese characters for each transliteration is very important as the choice of characters may flatter or detract from the brand image. To avoid future disputes, the franchisor should conduct all necessary trademark searches to ascertain that the selected Chinese name is not already being used by another entity, or if it is being used, that its use can easily be discontinued; for example, by having an intermediary purchase any existing rights on behalf of the franchisor. It is essential, as mentioned, to conduct the requisite market research to ensure that the name appeals to the Chinese general public, taking into account the visual effect of the Chinese characters in both simplified and classical format as well as its auditory effect in various major Chinese dialects. Once the franchisor determines the Chinese name under which it wishes to be officially known to the Chinese public, if it chooses to do so trademark applications to register the Chinese mark in all relevant trademark classes may be filed with the Chinese Trademark Office.³

Once the franchisor has determined what marks it plans to use to identify the goods or services that are intended to be offered under the franchise, it should conduct a search of the official database of the Chinese Trademark Office to ensure that there are no records of trademark registrations or pending applications for marks identical or similar to its own in the trademark classes covering the goods or services to be offered. If there are registered trademarks or pending applications for marks similar or identical to the marks that the

3 Trademark Office of the State Administration for Industry and Commerce of the People's Republic of China.

franchisor intends to use in the Chinese market, the franchisor will need to decide whether to try to acquire the relevant rights from the prior rights holders, or to identify alternative marks for use in the Chinese market.

The Chinese brand name may then be used for Chinese domain names and also as part of the name of any entity to be established in China. For the registration of China domain names, searches should also be conducted to determine whether the desired domain names in the relevant domains (.cn, .com.cn, .net.cn, etc.) are available. The same applies for company names, as regards company name searches with the relevant Administration of Industry and Commerce to ensure that these names are available for use as part of a company name in the jurisdictions where the franchisor intends to establish its affiliates.

If franchisors are to be allowed to use this name in China, the granting of the relevant use rights would need to be made part of the legal franchise documentation. Franchisors, however, are advised not to license the brand to the franchisee for use as part of the franchisee's company name as it will be difficult to reclaim the rights for its use in the event that the franchise relationship terminates.

ii Brand protection

A franchisor that wishes to do business in the domestic Chinese market is strongly advised to register its key marks in China. The Chinese registrations can be done as part of an international application under the Madrid Convention or by filing separate applications with the Chinese Trademark Office. Although filing applications under the Madrid system is a simpler process, in-country applications filed with the Chinese Trademark Office will provide the applicant with greater flexibility as it will be able to craft its own specification of goods and services, tailored to accommodate local requirements, and to the needs of the domestic market.

China is a first-to-file jurisdiction and trademarks are protected in China upon registration with the Chinese Trademark Office in accordance with the procedures set out by relevant laws and regulations. That is to say, even though a trademark has been registered in the home country, it is not protected in China until the registration application is approved. Therefore, it is very important for foreign companies to ascertain whether its specific mark is still available in China as it makes plans to enter the Chinese market.

In respect of what can be registered as a trademark, Chinese law recognises three-dimensional symbols and combinations of colours as well as any visual sign if it can be used to distinguish the goods or service of a natural person, legal entity or any other organisation from that of others, including any word, design, letters of an alphabet, numerals, etc. Under the Trademark Law, non-visual trademarks such as sound trademarks are registrable in China.

A trademark registration is valid for 10 years, starting from the date the registration receives approval, and may be renewed for subsequent 10-year terms. Renewal applications should generally be made 12 months prior to the expiration date, although, subject to a related application, the application may still be accepted up to six months before the expiry date.

In China, trademarks are not only categorised in the international trademark classes but are further categorised into subclasses. It is possible that the Chinese Trademark Office may allow a registration for the same mark from another applicant if it covers goods or services that are not in the same subclass as the goods and services listed in the franchisor's registrations.

Therefore, as a defensive measure to prevent others from registering a certain mark for other related goods, the franchisor may also consider whether it wishes to include additional

goods or services in each subclass or register its mark in other classes. As a matter of first priority, the franchisor should register any and all marks in the relevant classes of goods and services that it will be using in China or to promote its products to Chinese customers.

iii Enforcement

The franchisor should monitor, whether on its own or through a designated intermediary, the domestic market on an ongoing basis so that possible problems may be addressed as they arise or as early as possible; for example, any unauthorised use of its trademarks and trade dress in China. This may entail working with law firms, investigation firms and agents as necessary to monitor use of any intellectual property (IP) of the franchisor, identify infringers and collect evidence. If the franchisor is considering sending cease-and-desist letters to infringers, it must be prepared to follow through on any threats made therein, if only to maintain its credibility as a company that is serious about protecting and enforcing its intellectual property. Pursuit of an aggressive enforcement strategy is key to discouraging potential infringers.

In addition to IP litigation in Chinese courts, companies may also file for administrative protection with the State Administration for Industry and Commerce (SAIC) or its local counterparts for trademark infringement matters. However, the SAIC's authority is limited: it can issue an order to halt the infringement, impose fines, conduct raids or seize counterfeit goods, materials or equipment, but it cannot award compensation.

iv Data protection, cybercrime, social media and e-commerce

The laws and regulations relating to cybercrime, e-commerce and other internet-related activities that are applicable to general commercial transactions under Chinese law would also apply to franchising activities in China. Though there are no e-commerce provisions specifically applicable to franchising, the increasing regulatory trend to protect personal data is noteworthy. In particular, the Chinese Consumer Protection Law, amended in October 2013 and effective from 15 March 2014, newly included provisions on personal data protection with a specific focus on consumer rights; the State Council and the Ministry of Industry and Information Technology, one by one, enacted new rules between 2012 and 2013 protecting online personal data or personal data related to other means of telecommunication. The revised Chinese Consumer Protection Law came into effect in March 2014, provisions of which re-emphasised the protection of consumers' personal data, online and offline. The Cybersecurity Law, issued by the Standing Committee of the National People's Congress (SCNPC), entered into effect on 1 June 2017 and has had a profound influence on personal data protection. This new Law regulates, for the first time at national level, how information is collected, stored, transmitted, exchanged and processed. 'Operators' will bear additional security protection responsibilities, such as formulating internal security management systems, adopting technological measures to prevent computer viruses, and monitoring and recording the operational status of networks. However, whether these obligations will apply to all enterprises, or only to e-commerce companies, is not clearly stipulated.

The Chinese E-Commerce Law, effective as of 1 January 2019, is the first fundamental law addressing e-commerce in China, and it is likely to have a significant impact on prevailing e-commerce practice. The E-Commerce Law stipulates specific requirements for platform operators' liability, the protection of intellectual property rights, and data protection. Following the rules for protection of personal information mentioned above, the E-Commerce Law provides clear details about the use, collection and processing of customer information, enquiry, correction and requests. The Law also covers rules on how to disclose information

about goods or services in a comprehensive, truthful and accurate manner. As regards the protection of intellectual property rights, the E-Commerce Law stipulates that the platform operator should bear joint and several liability with the online retailer if it fails to adopt necessary measures when the platform operator knows or should have known that the online retailer is infringing a third party's intellectual property rights. The platform operator should adopt appropriate measures for deleting, screening, disconnecting and ending transactions and services in cases where there is a potential intellectual property claim.

v Advertising Law

The most recent influential amendment to the Advertising Law, issued by the Standing Committee of the National People's Congress, entered into effect on 1 September 2015, and the Interim Measures for the Administration of Internet Advertising issued by the State Administration of Industry and Commerce entered into effect on 1 September 2016. Changes introduced by these amendments included: (1) more restrictions on advertising-related matters, with explicit penalties for non-compliance; (2) claims containing superlative words or the advertising of off-limits products or services are generally restricted; (3) the use of 'technical/digital methods' to fabricate or 'improve' the real effect of the product or service in advertisements is punishable as false advertising; (4) further regulation of electronic advertising by defining internet advertising; (5) tighter regulation of endorsements; and (6) changes regarding the advertising of specific products and services. On 26 October 2019, the Standing Committee of the National People's Congress promulgated the latest amendment to the Advertising Law, although without any significant changes to the 2015 amendment. The franchisors, by making advertisements to promote their brands, are subject to the amended Advertising Law.

IV FRANCHISE LAW

i Legislation

Under Chinese law, there are specific commercial franchising regulations that stipulate among other items, franchise-specific pre-contractual disclosure and franchise requirements. These regulations apply to both foreign-invested and local Chinese franchisors.

Commercial franchising operations are generally defined under Chinese law as:

arrangements whereby a franchisor, by contract, authorises a franchisee to use its relevant operational resources, such as its trademark, trade name, logo, patent, proprietary know-how and the franchisee conducts the business in accordance with the franchisor's standardised business model (i.e., uniform visual image, business concept, management model, etc.) and pays fees for participating in the franchise in accordance with the franchise agreement.

However, simply not charging fees does not automatically mean that an entity is not running a franchising operation, as other factors will also be taken into consideration.

The two types of franchising arrangements most commonly seen in the Chinese market are arrangements whereby the franchisor authorises the relevant franchisees to (1) open and operate stores in a specific territory, without any right to grant further sub-franchises; or (2) act as the master franchisor for a specific territory, with the right to grant further sub-franchises to other downstream sub-franchisees as well as directly operate its own

franchises as a franchisee. However, the relevant laws and regulations address only franchising as a direct relationship between two parties, and do not distinguish between the different types of franchising arrangements.

An entity must satisfy the following requirements to be eligible to conduct a franchising business in China:

- a* it must be an enterprise;
- b* it must own or have the right to use the relevant operational resources, such as the relevant trademark, trade name, logo or well-established operational model, etc.;
- c* it is capable of providing long-term operational guidance and training support to franchisees;
- d* it (or any of its subsidiaries or its controlling shareholder) must have established at least two directly operated stores and have operated those stores for a period of no less than one year;
- e* it must have established a stable supply system that can ensure sound product quality and render relevant services where the franchising arrangement requires the franchisor to supply the relevant goods; and
- f* it must be of good repute and does not have any record of fraudulent operational activities.

ii Pre-contractual disclosure

A franchisor should positively disclose in writing to the franchisee, at least 30 days before signing the franchising contract, certain information about itself:

- a* basic information on the franchisor and franchise activities (e.g., full name, registered address, registered capital, business scope);
- b* basic information on the business resources of the franchisor (e.g., trademarks, proprietary technologies, business models);
- c* basic information on the franchising expenditures (e.g., franchising fees, deposit, payment, refund);
- d* information on prices and conditions of the products, services and equipment provided to the franchisee;
- e* plans on continued provision of support or training services to the franchisee;
- f* the methods and content of guidance or supervision over the franchise activities of the franchisee;
- g* investment budget for the network of franchises;
- h* information on the franchisees within the territory of China (e.g., number, regional distribution, operational status);
- i* abstracts of the franchisor's financial and accounting reports and audit reports for the past two years audited by accounting firms or auditing firms;
- j* information on major litigation and arbitrations concerning franchises of the franchisor in the past five years, including the cause of action, litigation and arbitration claims, jurisdiction and results;
- k* information on the records of gross violations (i.e., above a certain threshold of fines or amounting to criminal offences) of the franchisor and its legal representative; and
- l* the franchise contract:
 - a sample franchise contract; and
 - a sample of other contracts relating to the franchise if the franchisor requires the franchisee to sign any with the franchisor (or its affiliate).

A franchisor is obligated to provide its franchisees with authentic, accurate and complete information, and keep the franchisees informed of updated information in a timely manner. If a franchisor hides any related information or provides false information to a franchisee, the franchisee will be entitled to terminate the franchise contract and the franchisor may also be ordered to rectify the matter and be punished by a fine of up to 100,000 yuan, with a public announcement if the responsible governmental body (MOFCOM) thinks the franchisor's violation is severe.

Pursuant to the Beijing Appellate Court's Interpretation on Several Issues regarding Adjudication on Franchise Agreement Disputes (effective as of 23 February 2011), the franchise agreement may be invalid when undisclosed false information is material to the operation of the franchise and the franchisee entered into the franchise agreement on the basis of that information. The courts shall also consider the adverse impact of undisclosed or false information in relation to the performance and purpose of a franchise agreement so as to adjudicate whether the franchise agreement is valid. This interpretation suggests that violation of the disclosure obligation does not necessarily render the contract invalid in every instance.

If any of the information provided constitutes trade secrets, the franchisor may ask the franchisee to enter into a non-disclosure agreement.

iii Registration

Within 15 days of entering into a first franchising contract in China, the franchisor is required to make a filing with the Ministry of Commerce. The franchise contract template, operational manual, business plan for the proposed franchising arrangement and the documents evidencing that it has satisfied the relevant requirements to serve as a franchisor must be submitted as part of the filing.

Regulations are not clear on what constitutes a 'first franchise agreement'. It may be interpreted that the franchisor should only file the franchise agreement concluded with their first franchisee but not every franchise agreement it enters into. According to informal enquiries to the Ministry of Commerce, the franchisor should record as a template the franchise agreement entered into with its first franchisee. After this filing, the franchisor is required to make an online renewal of this filing at the MOFCOM website each year in March to be able to register any new franchisees. This confirms that the franchisor does not need to record every franchise agreement entered into with new franchisees.

iv Mandatory clauses

The franchisor and the franchisee must enter into a written franchise contract; and the main content of the franchise contract shall include the following:

- a* basic information in respect of the franchisor and the franchisee;
- b* content and term of the franchise;
- c* type, amount and payment method for the franchising fees;
- d* specific content and methods for providing business guidance, technical support, business training and other services;
- e* quality requirements and standards for the product or service and methods for assurance thereof;
- f* sales promotion, advertising and publicity in respect of the product or service;
- g* protection of consumers' rights and interests and the assumption of compensation liabilities in the franchise;

- h* alteration, annulment and termination of the franchise contract;
- i* liabilities for breach of the contract; and
- j* methods for dispute resolution.

The franchisor and the franchisee may stipulate in the contract any other matters as they like.

The qualification and validity of a franchise agreement would depend upon the nature of the actual commercial arrangement as set out in the relevant agreement among the parties, even if the agreement itself was not identified as a franchise agreement. This question has been confirmed by the Supreme People's Court recently. The Supreme People's Court also decided on whether a franchise agreement should be invalidated where the franchisor does not comply with the above franchise-related requirements. The question of the non-compliance of the franchisor appears to depend upon whether the non-compliance is remediable; for example, failure on the part of the franchisor to comply with the requirement of directly operating at least two stores will not affect the validity of its agreements with franchisees, whereas franchise agreements entered into by any non-enterprise entity or individual (which by law is not permitted to enter into franchise agreements) will be deemed as invalid.

v Guarantees and protection

The laws and regulations relating to guarantees and protection under Chinese law that are applicable to general commercial transactions would also apply to franchising activities in China, but there are no provisions specifically applicable to franchising.

V TAX

i Franchisor tax liabilities

There are no specific tax duties for franchise operations. Any company incorporated in China shall pay corporate income tax on its profits. Unlike most business operators, franchisors as such do not have to file consolidated tax returns covering consumption tax, corporate income tax, etc. However, franchisors must pay taxes on fees received under the franchise agreement, which are generally all subject to value added tax.

ii Franchisee tax liabilities

As business operators, franchisees would have to file consolidated tax returns covering value added tax, consumption tax, corporate income tax, surcharges, etc.

iii Tax-efficient structures

Whether a structure is tax efficient will depend on specific aspects of the franchise.

VI IMPACT OF GENERAL LAW

i Good faith and guarantees

The duty of good faith is one of the key principles set out in Chinese contract law. A party that breaches its duty of good faith may find itself liable for the damages incurred by the other party as a result of the breach.

ii Employment law

The courts are unlikely to treat the franchisees as employees of the franchisor, but the franchisor should provide clear statements with respect to the independent nature of the relationship between the contracting parties stated in the relevant franchise agreements, and make clear that the franchisee is responsible for bearing the responsibility as an employer of the individuals employed in the franchise, and that those individuals are not employees of the franchisor.

iii Consumer protection

In the event of consumer claims in relation to franchise operations, Chinese law gives consumers the choice of claiming against either the franchisee or the franchisor. A franchisor may consider indemnifications by franchisees individually in the franchise agreements. In addition, MOFCOM requires franchisors and franchisees to clarify and disclose to MOFCOM in advance each party's responsibilities for consumers in the franchise agreement.

We are not aware of any specific circumstances under Chinese law whereby franchisees would be treated as consumers.

iv Competition law

The laws and regulations relating to competition and antitrust under Chinese law that are applicable to general commercial transactions would also apply to franchising activities in China, although there are no antitrust cases currently involving franchising. It is permissible for a franchisor to exercise control over the franchisee business. Given the increasing enforcement activities by the Chinese competition law authorities, however, it is important to bear in mind that restrictions imposed on the franchisee should not go beyond what is necessary and proportionate to the aims of protecting know-how, brand unity and licensed IP rights. Specific attention has been paid in recent years to fixed-price clauses in retail and distribution agreements; such clauses are prohibited under Chinese competition law since it is difficult to justify them in relation to franchise networks.

v Restrictive covenants

There should be no problem with imposing non-compete or other restrictive covenants so long as they do not violate any competition rules or obviously break the principle of fairness. Any non-compete or other restrictive covenants should be set out in the franchise agreement or other agreement to be enforceable. The Chinese laws and regulations applicable to general commercial transactions would also apply to franchising activities in China.

vi Termination

Chinese laws and regulations that are applicable to general commercial transactions, including termination and transfer of businesses, would also apply to franchising activities in China.

Regarding post-contractual obligations of franchisees, some are stipulated by laws. For instance, a franchisee has contractual and post-contractual obligations to keep the franchisor's trade secrets confidential, whether or not this is agreed by the franchising parties in writing. As to any other post-contractual obligations, franchisors may impose them on franchisees by contractual agreement.

vii Anti-corruption and anti-terrorism regulation

The laws and regulations relating to fraud, anti-corruption and money laundering under Chinese law that are applicable to general commercial transactions would also apply to franchising activities in China, but there are no provisions specifically applicable to franchising. Corrupt and fraudulent behaviour in retail operations are generally widespread, however, so franchisors should implement protective measures against related legal non-compliance and financial risks.

viii Dispute resolution

Contracting parties may elect to settle disputes by arbitration or litigation, and with respect to contracts with a foreign element (i.e., involving one or more foreign parties), arbitration or litigation may take place offshore. At this time, mediation is still not commonly used as a dispute resolution mechanism in China.

Parties that choose to settle disputes by litigation may stipulate that disputes be settled in a Chinese or foreign court with jurisdiction (e.g., located where the contract is signed or performed). However, because it is difficult to enforce a foreign court judgment in China, a foreign party to an agreement should not choose to resolve disputes by means of litigation in a foreign court unless the Chinese party has assets under the jurisdiction of that foreign court. In the absence of these circumstances, it would be prudent to stipulate that disputes be settled by binding arbitration in a neutral location. The arbitration clause must be drafted to expressly provide final and binding arbitration as the sole and exclusive means for resolving any and all disputes arising under or in connection with the agreement, and the arbitration tribunal designated for this purpose should be named in a clearly identifiable manner. Any ambiguity or other flaws in the arbitration clause may result in invalidation of the clause itself, which would allow a party to refuse to submit to arbitration and leave litigation in a Chinese court as the only viable alternative, or render an award obtained by arbitration under that arbitration clause unenforceable.

The parties may elect to submit their dispute to arbitration before any internationally recognised arbitration commission. As a signatory to the New York Convention, China's courts are obligated to recognise and enforce arbitral awards issued by arbitration tribunals in the country of other signatories to the Convention.

Notwithstanding the above, it may be prudent to carve out an exception so as to give a party the right to seek injunctive relief from any competent court with jurisdiction over the subject matter. This may be useful in cases involving infringement where damage control is necessary, as it is faster to obtain and enforce injunctive relief from a court where the activity at issue takes place. While a case is pending, injunctive relief (preservation of property or evidence and other specific injunctions) may also be sought in urgent circumstances (e.g., instances involving IP infringement), and China's IP laws provide an efficient mechanism for seeking these interim remedies. An applicant that submits an application for injunctive relief must post a bond or provide another form of guarantee. Within 48 hours of an application for injunctive relief, the court must respond with a written decision and must notify the applicant of its decision within five days. Within 15 days of the order for injunctive relief being issued, the applicant must file a complaint with the court, otherwise the injunctive order will be vacated. However, Chinese courts are not bound to follow the agreement of the parties with respect to a party's right to injunctive relief, notwithstanding the fact that it is expressly set out in the agreement. The court is at liberty to review the circumstances to determine whether to order specific performance, or to grant injunctive or equitable

relief, and may still require the party seeking relief to prove damages and post a bond or other security. But notwithstanding the above, the provision should not be deleted from the agreement as its inclusion in the agreement may have a persuasive effect on the judge and a deterrent effect on the other party.

There have been various cases involving franchise arrangements in the courts over the years, some of which have been identified by the Supreme People's Court as being noteworthy cases. One of those cases, decided in 2012 by Shandong Province High Court, addressed the issue of an implied obligation on the part of franchisors to avoid competing with their franchisees in the same geographical territory. In that particular case, the franchisor opened a branch company within 200 metres of its franchisee, and both were offering similar real estate agency services. The court held that because of the nature of a franchise arrangement and based on the principle of good faith, a franchisor should reasonably avoid operating in the business territory of its franchisee so as not to threaten or affect the normal operation of the franchisee. The franchisor was ordered to immediately cease the business operations of its branch company.

VII CURRENT DEVELOPMENTS

Since the amended Commercial Franchise Operations Registration Administrative Measures took effect on 1 February 2012, the government has made a significant effort to regulate and monitor franchising activities in China. However, the barriers to market entry in the franchising business have risen with the increasing costs of real estate, equipment, goods and labour, and made it more challenging to make sustainable profits in these businesses. As an example, to cut down on costs, fast-food outlets have sought to reduce their labour costs by trying to automate many of their work processes and by centralising goods production.

Franchising in China has long focused on many industries relating to retail, food and beverages, and services. The education sector has been booming with high growth rates since around 2005, but reports in late 2013 suggested that certain subsectors in the Chinese education market have become saturated and appear to have slowed down. In particular, the Chinese Private Education Promotion Law, which was passed in 2003 to encourage private funding of non-profit schools, was amended on 7 November 2016 by the SCNPC and became effective as of 1 September 2017. The new law provides that dual-curriculum schools may only be organised as non-profit entities for the nine-year compulsory education phase of the curriculum. Additionally, it reiterates that a core Chinese curriculum should be taught in the compulsory years, which may make it more difficult for dual-curriculum schools to cooperate with overseas schools, by franchising or other means. When the Ministry of Justice published a circular seeking public comments on the Implementing Regulations of the Law of the People's Republic of China on the Promotion of Private Education (Revised Draft) (Draft for Review) (the Draft) on 10 August 2018, concerns were substantial that the rules may be further tightened for the education business and its foreign investors. The Draft proposes a number of amendments to the prevailing version of the Implementing Regulations of the Law of the People's Republic of China on the Promotion of Private Education. In short the proposed changes are yet again trying to prevent operators in the educational sector avoiding the need to comply with existing regulations. In particular, they are seeking to re-enforce the separation of for-profit and not-for-profit schools in China and prevent foreign companies

indirectly controlling schools in China. Without clarification of the changes, the exact impact of these new rules is difficult to predict, but it is clear that the Draft constitutes a further tightening of the regulatory landscape for education businesses and their investors in China.

One of the fast-growing and promising market areas is currently the baby-and-mother market. However, the traditional franchising models in this market have suffered largely from e-commerce and parallel import competition, but, on the other hand, the e-commerce model has itself suffered from a crackdown by the customs authorities at the time of writing. Another area showing optimistic signs is the technology sector, while some other industries have been suffering slow or even negative growth. The government is working through a 10-year plan called 'Made in China 2025', to accelerate the development of high-tech industries and aiming to spearhead in telecommunications, robotics, new-energy vehicles and high-end automation research and development.

CZECH REPUBLIC

Vojtěch Chloupek¹

I INTRODUCTION

The concept of franchising made its way to the then Czechoslovakia soon after 1989 when the fall of communism brought about the necessary political and economic changes. The opening of the Czech market to both domestic and international businesses led to the establishment of the first franchises, including the fast-food chain McDonald's (1991), the cosmetics shop Yves Rocher (1991) and the DIY retailer OBI (1995).

In 1993 the Czech Franchise Association (CFA), a non-profit professional organisation whose approximately 60 members include franchisors and various franchising specialists, lawyers and advisers, was established. The CFA is a member of the European Franchise Federation and the World Franchise Council.

Widespread expansion of the franchising model was, however, rather slow during the 1990s because of a variety of factors, including difficulty of access to external funding for small entrepreneurs, an underdeveloped legal system and foreign franchisors or investors' limited knowledge of the Central and Eastern Europe (CEE) markets, as well as Czech small to medium-sized businesses' lack of experience of international trade. This started changing around the time of the Czech Republic's accession to the European Union, in 2004, and after. This political development at the EU level contributed to the creation of a favourable environment for franchising, which has since progressed rapidly. Today, franchising is seen as a common business model with approximately 260 franchises being present on the Czech market. In 2017 there were 8,103 franchisees in the Czech Republic operating 6,262 own branches and 8,476 franchise outlets, which represents almost a doubling of the situation in 2012.² While in the past there was a clear predominance of imported foreign concepts entering the Czech market through franchising, since 2011 franchising concepts originating in the Czech Republic have been in the majority. Among the most successful Czech brands are Husky and Bushman (both outdoor clothes), Benu and Teta (pharmacy and retail) and Fruitissimo and Bageterie Boulevard (both food).

The community of franchising professionals has also been growing. In 2006, the Czech Franchise Institute (which runs the Franchise Club) was established and, three years later, joined the International Franchise Association. The membership currently numbers around 100, making it the largest local franchising body. Other notable developments in the country include the publishing of an annual franchising report, since 2010, and since 2012 a dedicated quarterly magazine, *Vlastní firma FRANCHISING*.

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2 Franchising Report Czech Republic 2017. PROFIT system. Prague 2017.

II MARKET ENTRY

i Restrictions

In general, there are no restrictions or approvals required in connection with foreign franchisors entering the local market. Obviously, there are some highly regulated sectors, such as defence, telecoms and gambling, but there are no limitations imposed specifically in connection with franchising.

Foreign entities that carry out business activities in the Czech Republic on a regular basis might need to set up a local establishment, whether in the form of a local subsidiary or a branch of the foreign entity, and must comply with the same rules that are applicable to domestic entities, such as acquiring the relevant trade licence and registering in the Commercial Register (although with respect to EU-based entities the latter requirement is disputed among legal commentators). Assessment of this requirement and ensuing obligations should ideally be made on a case-by-case basis and reflect the particular franchising model in question.

There are no general restrictions on a foreign entity granting a master franchise or development rights to a local entity. The terms of the respective agreements must, however, comply with the provisions of competition law.

There are no restrictions on foreign franchisors owning equity in a local business either.

ii Foreign exchange and tax

As far as foreign exchange is concerned, foreign persons (non-residents) can hold bank accounts in any currency and there are no restrictions placed on the import or export of capital. Repatriation payments can be made in any currency.

In general, the Czech tax system has been rather infamous for its complexity and for being rather burdensome for businesses. That said, most aspects of the local tax systems (including mutual assistance and administrative cooperation) stem from EU law. The main taxes include income tax, value added tax, real property tax, road tax (imposed on entities that use vehicles), excise duties and social security. The Czech Republic is party to over 90 double-taxation treaties. As far as withholding tax on royalties paid to non-residents is concerned, the standard rate is 15 per cent but can be 35 per cent if income is paid to a 'tax haven'. These rates can, however, be reduced under either a tax treaty or an exemption granted under the applicable EU legislation. Taxpayers from other EU or EEA countries may file a tax return at year end and deduct expenses related to royalty payments. From 2014, the Czech Republic and the United States cooperate on enforcement of tax duties under the terms of the US Foreign Account Tax Compliance Act.

III INTELLECTUAL PROPERTY

i Brand search

The Czech Industrial Property Office (IPO CZ) keeps a database of trademarks and other intellectual property rights valid on the territory of the Czech Republic, whether national trademarks, European Union trademarks or international registrations. The database is available online (at www.upv.cz) and is a very useful tool for searching protected trademarks, similar brands and other intellectual property rights that may be relevant for franchises. The IPO CZ conducts research as part of its paid services, but it is perhaps more common to use the services of specialised law firms or trademark attorneys. The main reason for this is that

searches should not be limited to the databases maintained by the IPO CZ. For unregistered brands, business names and the like, it is usually necessary to search in the relevant databases of legal entities (especially the Commercial Register), search among registered domain names, or simply carry out research on the internet. For some rights that may also be relevant, such as image rights, no research can be conclusive because copyright is an unregistered right in the Czech Republic. The results of searches should always be discussed with specialists who can carry out a risk assessment and provide advice on the best way forward.

ii Brand protection

Brand protection is typically obtained via registration of the relevant brand as a trademark by the IPO CZ or as a European Union trademark by the European Union Intellectual Property Office. Although Czech law contains tools to achieve protection of non-registered signs, it is always a good idea to rely on registered rights. Trademarks are protected by the recently amended Trademark Act No. 441/2003 (the Trademark Act), which now defines trademarks as any sign, in particular words, colours, drawings, letters, numbers or the shape of a product or its packaging, or sounds, provided that the sign can distinguish the goods and services of one entrepreneur from those of another and that it is represented in a manner that enables the authorities as well as the public to determine the clear and precise subject matter of the protection. Upon receipt of the application, the IPO CZ carries out a formal search to ascertain that the application meets all the requirements prescribed by law, as well as a substantive search to find out whether the sign concerned is eligible for registration as a trademark. In the event that the IPO CZ finds no legal obstacles to registration of the trademark, it publishes the application in its regular Bulletin; third parties can oppose the registration within three months of publication. From 1 January 2019, brand owners must monitor more actively what third parties are trying to register because the IPO CZ can no longer stop the registration of an identical mark for identical goods and services unless an opposition is filed by the owner of earlier trademark. Also, the IPO CZ can no longer prevent various speculative registrations that could previously have been considered to be in bad faith.

When a trademark is successfully registered, it is protected for 10 years from the priority date, which is usually the date when the application was submitted. This period can be repeatedly extended by an additional 10 years, subject to payment of an administrative fee.

Protection is also granted to designs provided they are new and have an individual character. Applications for registration of Czech national industrial designs must be submitted to the IPO CZ and they are then subject to substantive examination (in contrast to the registration procedure applicable to registered Community Designs, where there is only formal review of the application). When a design is registered, the protection lasts for five years but can be repeatedly renewed up to a total of 25 years.

iii Enforcement

According to the Trademark Act, the owner of a trademark has the exclusive right to use the trademark in connection with goods or services for which the trademark is registered. The term 'use' is defined in a rather broad manner and includes: (1) use of the trademark on the goods or on their packaging; (2) offering goods under the trademark, putting them on the market or storing them for such a purpose or offering or providing services under the trademark; (3) exporting or importing goods under the trademark; and (4) using the trademark in business correspondence and advertising.

According to the Industrial Designs Act,³ the registration of an industrial design gives its owner the exclusive right to use the industrial design, to prevent third persons from using it without his or her consent, to grant consent to use the industrial design to third parties or to transfer the right to the industrial design.

Intellectual property rights are typically enforced via courts. The relevant rights and claims available in cases of intellectual property rights infringement are (with the exception of copyright, which is regulated separately) all concentrated in Act No. 221/2006 on the Enforcement of Industrial Property Rights (the IP Enforcement Act). The IP Enforcement Act gives the IP owner the right to request that the infringer refrains from the activity that infringes or endangers the rights concerned, and that the consequences of the endangering or infringement be removed, namely by recalling or permanently removing goods and by recalling, permanently removing, or destroying tools or devices determined or used in connection with the activities that infringe or endanger this right. The IP owner can also request information about the origins of the infringing goods and their distribution channels. Regarding monetary claims, the rights holders can claim damages (they can choose whether to claim actual damages and lost profits, if applicable, or the amount calculated as double the standard market licence fee), surrender of unjust enrichment or, in cases of non-monetary harm, reasonable satisfaction, which can take the form of anything from an apology to financial compensation.

Simultaneously with enforcement of intellectual property rights, it is also fairly common in practice to make unfair competition claims. Examples of the activities that are explicitly listed among the types of unfair competition behaviour include misleading advertising, misleading marking of goods and services, and causing risk of confusion and parasitism on reputation, all of which can be especially relevant for franchising. This can be particularly useful for protection against various lookalikes and imitations, where the traditional intellectual property rights may not, for various reasons, provide sufficient protection.

iv Data protection, cybercrime, social media and e-commerce

The Czech Republic has a relatively long tradition of protection of personal data. The first data protection law had already been adopted in 1992 and this was later harmonised with EU law by Data Protection Act No. 101/2000, prior to the accession of the Czech Republic to the EU. On 25 May 2018, the Data Protection Act was replaced by the EU General Data Protection Regulation No. 2016/697 (GDPR), which is now valid and effective law throughout the whole EU. The GDPR further tightens the rules for the processing of personal data, as well as imposing severe sanctions for non-compliance. Conversely, some previous obligations were lifted and data controllers, for example, are now no longer required to notify the processing of personal data to the Czech Office for Protection of Personal Data. For more information about data protection law aspects of franchising, see the dedicated chapter of this *Law Review* on data protection.

With effect from 24 April 2019, local data protection legislation was introduced to implement some of the GDPR provisions – the new Act No. 110/2019 on the Processing of Personal Data (the Personal Data Processing Act). The most relevant aspect of the new Personal Data Processing Act is the specification of the age of consent for online services, which will have an impact on e-commerce. Under the GDPR, the age of consent in the

3 Act No. 207/2000 Coll. on the Protection of Industrial Designs and the Amendment to Act No. 527/1990 Coll., on Inventions, Industrial Designs and Rationalisation Proposals, as amended.

online world is 16, but Member States can choose to lower this to 13. From this age range of 13 to 16 years, Czech legislators took the view that 15 years of age is sufficient for valid consent to data processing in the online world.

Cybercrime is explicitly addressed by the Czech Criminal Code,⁴ which provides modern criminal law protection for IT systems and data. The criminal offences include unauthorised access to IT systems and information media (hacking), unauthorised use of data and obtaining technology to violate the secrecy of messages, etc. Furthermore, the Czech Republic was one of the first European countries to take the measure of adopting a Cybersecurity Act.⁵ The Cybersecurity Act imposes duties on telecommunication providers or providers of critical infrastructure (e.g., in banking and the defence sector), consequently it is not likely to burden typical franchise businesses. Its purpose is to make the online environment safer. This may serve primarily to benefit digital franchises. The Czech Republic has adopted the EU Directive on Security of Network and Information Systems, known as the NIS Directive, which will slightly extend the number of subjects affected, and will harmonise the rules with the rest of the EU.

Legal regulation of e-commerce is rather complex and spreads across various laws, including the Civil Code,⁶ the Electronic Communications Act,⁷ the Consumer Protection Act,⁸ the Personal Data Processing Act, the Criminal Code and the Information Society Services Act.⁹ The latter is especially relevant not only because it contains rules on the liability of internet service providers, but also for its regulation of email marketing (and spam). Similarly, a wide range of rules apply to social media. Franchises must cope with many individual laws governing personal data protection, personality and privacy rights, intellectual property, consumer protection and advertising regulations. Rather than focusing on social media, these laws are technology-neutral and regulate on a general level.

IV FRANCHISE LAW

i Legislation

In the Czech Republic, there is no legislation dedicated specifically to franchising. However, this absence of franchising legislation is perhaps not unusual, and definitely not a barrier to the development of franchise systems. Franchise arrangements are typically governed by civil law (as far as the actual contract or establishment of the business is concerned) but other areas, including public law (e.g., competition regulation, employment, trade licences and tax), can play an important role. Therefore, it is really a mixture of laws that are relevant in connection with the franchising industry.

A franchise agreement as such would be considered an innominate agreement (meaning a type of contract not specifically provided for in law) pursuant to Section 1746(2) of the Civil Code. The Civil Code is one of the most important pillars of Czech private law. Several years ago, the Civil Code was fully recodified, focusing on, among other things, the extension of contractual flexibility and freedom. Even though the current Civil Code has now been

⁴ Act No. 40/2009 Coll. Criminal Code.

⁵ Act No. 181/2014 Coll. on Cyber Security and Amending Certain Related Acts.

⁶ Act No. 89/2012 Coll. Civil Code.

⁷ Act No. 127/2005 Coll. on Electronic Communications and Amending Certain Related Acts.

⁸ Act No. 634/1992 Coll. on Consumer Protection.

⁹ Act No. 480/2004 Coll. on certain Information Society Services and Amending Certain Related Acts.

in effect for six years, it will still take time before the courts establish the necessary case law to bridge a few interpretation gaps and provide sufficient guidance to parties affected. A typical franchise contract would include elements of a sale contract, lease contract, licensing agreement, consignment contract and trade secrets, etc., which are all expressly regulated by the Civil Code. That, in turn, needs to be reflected when drafting a franchising agreement.

The European Code of Ethics for Franchising is not binding legislation in the Czech Republic; however, it seems to have certain persuasive power and tends to be relied on by entities involved in the cross-border franchising business.

ii Pre-contractual disclosure

The Civil Code brought into Czech law the concept of pre-contractual liability (*culpa in contrahendo*), which involves an element of disclosure obligation. Sections 1728 and 1729 of the Civil Code set out the following general rules:

- a* parties are entitled to hold talks freely and they are not liable when the contract is not concluded unless the other party starts or continues negotiations without the intention of concluding the contract;
- b* during the contract negotiations, parties should inform each other about all factual and legal circumstances to allow the other party to determine the possibility of concluding a valid agreement, and be clear about the other party's interest in making the contract;
- c* if during the negotiations the parties reach the point where the conclusion of the agreement appears to be highly likely, the party who, despite the other party's reasonable expectations, terminates the negotiations without justified reason is deemed to have acted unfairly; and
- d* the party that acts unfairly is liable for damages up to the maximum amount corresponding to the loss from non-concluded contracts in similar cases.

Other than this, there are no pre-contractual disclosure obligations specifically relating to franchising under Czech law. Also, the above rules are fairly general, broad and new, hence no proper judicial guidance is available yet. There are no special provisions regarding formal requirements for pre-contractual information concerning franchise agreements.

iii Registration

There are no specific registration requirements for franchises and no franchise register exists in the Czech Republic. Nevertheless, some general registration requirements apply; for example, relating to the setting up of a business in the Czech Republic (e.g., the trade licences register, registration of a legal entity in the Commercial Register and tax-related obligations).

As of 1 January 2018, a new central register of beneficial owners was established in the Czech Republic in line with the obligations imposed on EU Member States under the Fourth Anti-Money Laundering Directive. Czech companies had until 1 January 2019 to register their beneficial owners. Although currently there is no direct penalty stipulated by law for non-compliance, failure to register the beneficial owner may lead to negative consequences in, for instance, public procurement proceedings. Nevertheless, the Czech Ministry of Justice is currently working on a new Act on the Registration of Beneficial Owners, which should adopt a broad and comprehensive perspective on this matter. The proposed date of entry into effect of this Act is 1 December 2020. The first draft of the Act expressly provides penalties for non-compliance with registration obligations, such as a ban on the exercise of voting rights in a company or a fine of up to 50,000 crowns.

iv Mandatory clauses

There are no mandatory clauses applicable to franchise contracts. In principle, parties can determine the terms and conditions of their contract freely provided that their contract does not infringe good morals (*bonos mores*), public order or protection of personality status or rights.

Despite the fact that the European Code of Ethics for Franchising is not legally binding, members of national associations and federations of the European Franchise Federation (like CFA) undertake to respect the Code's principles and often incorporate these principles into provisions of franchise agreements or attach their national annex to an agreement.

v Guarantees and protection

A franchisor may request guarantees and protection under civil law. According to the Civil Code there are several options for guarantees, such as suretyship, financial guarantees, collateral transfer of rights, liens, bank guarantees and contractual penalties. Guarantees that are in compliance with the law are enforceable.

V TAX

i Franchisor tax liabilities

Regarding Czech tax non-residents, a withholding tax of 15 per cent applies to licence fees paid by Czech tax residents to Czech tax non-residents. Double-taxation treaties may reduce the statutory withholding tax rates to 5 to 12.5 per cent. Under certain conditions the licence fees paid to related party recipients in the EU, Switzerland, Norway, Liechtenstein or Iceland may be exempt.

Legal entities with their registered office or place of effective management in the Czech Republic are considered to be Czech tax residents. Income from the worldwide operations of Czech tax-resident legal entities is subject to general corporate income tax. The corporate income tax rate applicable in 2019 was 19 per cent.

The licence fees received shall be subject to general corporate income tax and, on the principle described above, can be also subject to taxation in the country of the licence fee payer, depending on the relevant double-taxation treaty and national tax legislation of the payer. The franchisor may avoid double taxation by setting off the tax paid (withheld) in the foreign country against its tax liability in the Czech Republic.

Besides corporate income tax and withholding tax, general value added tax (VAT) rules apply to franchise business. As a member of the EU, the Czech Republic adopted the EU common system of VAT. VAT applies to most goods and services sold for use or consumption in the Czech Republic regardless of their origin (i.e., VAT applies to imports as well as to goods consumed or services provided in the Czech Republic). On the other hand, exported goods or services that are consumed outside the Czech Republic are usually not subject to Czech VAT. In 2019, the standard rate was 21 per cent and there are two reduced rates, of 15 and 10 per cent. Reduced rates apply primarily to essential goods and services such as food, medical supplies or goods for persons with disabilities or children. From December 2016, the 15 per cent reduced rate also applies to catering services, potentially including restaurants and fast food services. This benefit was introduced primarily as compensation for the new obligation to maintain electronic records of sales (called EET), which was implemented in the Czech Republic in 2016.

ii Franchisee tax liabilities

A Czech franchisee that pays a Czech tax resident for the licence fee has no tax liability, except for VAT, if applicable.

As a rule, licence fees paid to Czech tax non-residents are subject to withholding tax of 15 per cent. Double-taxation treaties may reduce the statutory withholding tax rates to 5 to 12.5 per cent and under certain conditions the licence fees paid to related party recipients in the EU, Switzerland, Norway, Liechtenstein or Iceland may be exempt. The tax is withheld by the Czech franchisee when making a payment to the foreign franchisor. The withheld amount must be transferred to the relevant Czech tax administration office by the end of the month after the month in which the money was actually withheld or in which the Czech franchisee had to record this liability (whichever occurred first).

iii Tax-efficient structures

There is not a generally applicable, one-size-fits-all best practice for tax-efficient franchising in the Czech Republic. It is always a good idea to analyse each particular situation and obtain specific tax advice on any franchising structure before its implementation.

VI IMPACT OF GENERAL LAW

i Good faith and guarantees

It is a general principle of civil law that everybody must act fairly in their legal relationships. Nobody should obtain benefit from the performance of an unfair or illegal act, and nobody should obtain benefit by causing or controlling illegal conditions. In civil law disputes, good faith is presumed, whereas a lack of good faith is subject to a burden of proof. Another related principle is that of good morals (*bonos mores*) – a legal act (such as a contract) can be null and void if it is in obvious conflict with good morals.

ii Agency distributor model

Under Czech law, a business agent is an independent entrepreneur who undertakes to work towards long-term goals and carries out activities that aim at the conclusion of contracts of a certain kind. The represented person undertakes to pay a commission (agent's fee). An agency is therefore not a suitable model for franchising. In practice, franchisees typically proceed under their own name and at their own risk, whereas agents act on behalf of a principal and at his or her risk.

iii Employment law

It is highly unlikely, bordering on impossible, that courts would treat franchisees as employees. According to Czech labour law, an employee is a natural person who undertakes to provide dependant work in a basic employment relation. Therefore, relationships between franchisors and franchisees are not treated as employment relations.

iv Consumer protection

Under Czech law, a consumer is defined as any natural person who acts outside the scope of his or her business activities or outside the scope of his or her performance of a profession during the conclusion of an agreement with an entrepreneur (business undertaking). Because

franchisees themselves act in their capacity as entrepreneurs or business entities, they cannot be treated as consumers. On the contrary, most franchise operators must make sure they comply with relevant consumer protection regulations in relation to their customers.

With respect to both entrepreneurs and consumers, Czech law recognises protection against abuses of expertise or economic position that aim to create or take advantage of the dependence of the weaker party and create a clear and unjustified imbalance in the parties' mutual rights and obligations.

v Competition law

In the Czech Republic, competition law is mainly included in (1) the Civil Code, which contains a brief general overview of the topic, rules about unfair competition and non-compete arrangements; and (2) the dedicated Competition Act.¹⁰ Czech competition law is harmonised with EU law, and the activities and views of the Czech Antitrust Office seem generally to be aligned with those of the European Commission. Obviously, it is always a good idea to review franchise contracts, especially from the perspective of any potential vertical restraints, which may include any exclusivity arrangements, resale price maintenance, product ties, etc., while checking whether an EU block exemption regulation applies. For more information about competition law aspects of franchising see the dedicated chapter of this *Law Review* on the competition law of the EU.

vi Restrictive covenants

During the term of the agreement, non-compete and other restrictive covenants can be enforced through the courts. In practice, and depending on the circumstances, the most efficient tool can be a request for a preliminary injunction. The court must decide within seven days of receipt of the request for a preliminary injunction, so it can be rather quick. The downside is that the claimant risks being liable for damages to the counterparty in the event that the main action is not successful.

Needless to say, the enforceability of restrictive covenants is subject to their being in line with the aforementioned competition law regulations. The Civil Code now includes a new concept of 'forbidden non-compete clause', according to which non-compete clauses must specify the territory, scope of activity or group of persons to which the restriction applies. A non-compete clause for an indefinite term or for a term longer than five years is forbidden, as is a clause that restricts the other party more than is necessary for adequate protection of the first party. The court may limit such a non-compete clause, revoke it or declare it invalid.

vii Termination

Franchise agreements can be terminated for reasons set out in law or agreed in a contract. Franchise agreements may be typically terminated by mutual consent of the parties or by one of the parties giving notice of termination.

Withdrawal from a contract is possible if it is negotiated by the parties to the contract or on the basis of law. If one party breaches a contract in a substantial manner, the other party can withdraw from the contract without unreasonable delay. Breach of a contractual obligation is substantial if the breaching party knew or should have known that the other party would not have concluded the contract if such a breach had been anticipated.

¹⁰ Act No. 143/2001 on the Protection of Competition and Amending Certain Related Acts.

If a debtor is in default, a creditor can withdraw from a contract on the terms given by the contract or by law. If the default is substantial, one party can withdraw from the contract if it gives withdrawal notice to the other party without unreasonable delay. If the default is not substantial, the party can withdraw from the contract if the other party does not meet its obligation in adequate additional time. The rights to contractual penalties, payment interest, liquidated damages and also all provisions that should remain valid following a withdrawal are not affected by withdrawal from a contract.

The franchisee and franchisor can also terminate a contract if the parties negotiate a cancellation fee. If one party pays the cancellation fee, the agreement is cancelled in the same manner as if the party had withdrawn from the contract.

Revocation of a contract is possible if allowed by law or specifically agreed upon by the parties.

viii Anti-corruption and anti-terrorism regulation

The Criminal Code affects natural persons and their offences, and the Act on Legal Entities' Criminal Liability¹¹ sets down offences of legal entities, such as corruption, money laundering or fraud. However, there is not any special regulation applicable to franchise agreements. The Czech Republic is also a member of various anti-terrorism and anti-corruption international treaties and agreements.

ix Dispute resolution

Disputes can be settled in courts or through arbitration. Franchise agreements typically include a dispute resolution clause that points either to a court or to arbitration. In the Czech Republic, arbitration is regulated by the Arbitration Act.¹² This Act is applicable to all relations, without regard to their character. Disputes before courts are governed by the Civil Procedure Code.¹³ Another supportive procedure was introduced under the Mediation Act;¹⁴ if it is useful and suitable, the court can order the parties in dispute to attend meetings with a mediator for at least three hours and can interrupt the proceedings (for a maximum of three months). Nevertheless mediation is still not used very often, especially not for commercial disputes.

There is no specific procedure or industry practice for franchising disputes; we are not aware of any of the existing franchising associations in the Czech Republic offering mediation or arbitration services.

Ordinary court proceedings, including first and second instances, may last for several years, depending on the difficulty of the particular case, whereas arbitration proceedings are usually shorter.

Local courts recognise a foreign choice of law. Czech judges are obligated *ex officio* in matters that have international elements to follow conflict of law rules, and cases may use foreign law. Local courts also recognise jurisdiction clauses.

According to the Civil Procedure Code there is an option to obtain a preliminary injunction if it is necessary to arrange rights and obligations between participants to the

11 Act No. 418/2011 Coll. on Criminal Liability of Legal Persons and Proceedings against Them

12 Act No. 216/1994 on Arbitral Proceedings and on Execution of Arbitral Awards, as amended.

13 Act No. 99/1963 on the Civil Procedure Code.

14 Act No. 202/2012 on Mediation and Amending Certain Related Acts.

proceedings. Jurisdiction is the same as in the main action. A security deposit of 50,000 Czech crowns must be paid by the applicant for such a measure to cover any potential damages (but the amount may be raised by the court).

Costs of litigation are allocated according to the principle of success in the dispute and costs are not capped according to law, but court fees are capped and the costs of representation are limited by secondary legislation, so it is usually impossible to obtain meaningful recovery of legal costs.

Enforcement of judgments and awards follows the common rules of enforcement under Czech law. Czech courts readily recognise foreign arbitral awards from other countries that are party to the New York Convention.

VII CURRENT DEVELOPMENTS

In the recent past, we have seen a lot of activity in the area of franchising. The Czech franchise market is approaching maturity. The annual increment of new concepts and outlets is lower than in the market's development phase and customers are more demanding and prefer original concepts. That said, the number of franchises in the Czech market is still increasing, although modestly. Among the franchises with the highest increase in the number of outlets in 2017 were Century 21 (real estate agency), Naturhouse (diet consultancy), OK Point (financial consulting) and Ice'N'Go (food). Besides some well-established food and beverages franchises, the new popular areas seem to be lifestyle, fitness and education. Franchisees tend to seek lower entry fees and a higher return of investment rather than the costly licences and know-how of the world's most famous franchises. That said, market expansion strategies remain significant, both inbound and outbound, with foreign brands and franchise systems still eyeing the Czech Republic and considering entry, while some Czech franchisors have been successful in going to other countries (or are at least planning such expansion) – particularly to the bordering countries in the CEE region but also beyond. Local franchisors had a market share of 63 per cent in 2017. Among the most popular foreign franchisors are brands from the United States, and also from Germany and Poland. On the other hand, the countries where Czech brands most often expand are Slovakia, Poland and Germany. Czech franchises that have started international expansion in the past three years include BubbleMania (beverages), Carun (cannabis cosmetics), Quickwash (self-service laundry) and Svět zdraví (diet consultancy).

From a purely legal perspective, there have been no significant shake-ups attributable to the adoption of the new Civil Code in 2014. While professional practitioners are still eager for judicial interpretation of some parts of this new Code by civil courts, so far the transition has gone smoothly, without any substantial increase in risks for franchise businesses.

DENMARK

Jacob Ørskov Rasmussen¹

I INTRODUCTION

Most of the franchise systems in Denmark are found in the retail sector, but there are also franchise systems in the restaurant and hotel sector, as well as in the car rental and service sector, and the education sector.

Franchising has experienced rapid growth in Denmark over the past decade, which is attributable to both foreign franchise systems establishing in Denmark and Danish companies expanding through the use of franchise systems.

Among the biggest foreign franchise brands in Denmark are McDonald's, Burger King, Domino's Pizza, Subway, 7-Eleven, Avis Rent a Car and Sixt Rent a Car. Some of the latest newcomers are TGI Fridays, KellyDeli (Sushi Daily), Pret A Manger, Dunkin' Donuts, Starbucks, Carl's Jr. Restaurants and Pizza Hut.

Several of the domestic franchise brands are small or medium-sized companies that have chosen franchising as a way to expand their business in Denmark. Some of the domestic franchise brands have also expanded their business internationally, such as Bang & Olufsen, Jysk, Vero Moda, Jack & Jones, Bianco and BoConcept.

Franchise Danmark is an interest group for Danish companies involved in franchising, established in 2013 following the dissolution of the former Danish franchise organisation Dansk Franchise Forening (DFF). DFF was established in 1984, at a time when franchising was almost unknown in Denmark. Franchise Danmark has issued a code of ethics, which is based on the European Code of Ethics for Franchising adopted by the European Franchise Federation. Franchise Danmark works towards ensuring that franchising in Denmark is conducted in accordance with the Code of Ethics. Franchisors with Franchise Danmark membership are required to operate a franchise system that is compliant with Danish law and the Code of Ethics. Membership of Franchise Danmark is not required but may be commercially advisable for franchisors, franchisees and consultancies providing counselling and other services to franchisors and franchisees.

There are no current governmental activities or other official campaigns focusing on franchising as a business model in Denmark.

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II MARKET ENTRY

i Restrictions

As a member of the European Union, Denmark is committed to observe the principle of free movement of goods, persons, services and capital, and the general prohibition against discrimination on grounds of nationality. Consequently, there are no market entry restrictions or other approval requirements that apply to foreign franchisors in Denmark. This also applies to foreign franchisors from outside the EU.

However, persons who are not residents of Denmark and who have not previously been resident in Denmark for a total period of five years may only acquire title to real property in Denmark after having obtained permission from the Ministry of Justice. This also applies to companies that do not have their registered office in Denmark, such as foreign franchisors.

EU or EEA nationals may acquire an all-year dwelling in Denmark without obtaining permission from the Ministry of Justice on certain conditions. The same applies to companies established in accordance with the law of an EU or EEA Member State that have established branches or agencies in Denmark or intend to do so or plan to deliver services in Denmark. It is a requirement that the property will serve as a necessary all-year dwelling for the acquirer or that the acquisition is a precondition for engaging in self-employed activities or providing services.

ii Foreign exchange and tax

Payments to and from Denmark are fully liberalised. This means that there are no restrictions on taking banknotes and coins out of or into Denmark, nor are there restrictions on other external transactions, including loans from and deposits with foreign banks, or portfolio investments and direct investments. However, anyone who enters or leaves the Danish customs area carrying money exceeding €10,000 in value shall on their own initiative go through a customs check and shall declare all money to the customs and tax authorities.

There is no tax regulation that relates specifically to franchising in Denmark (see Section V.i).

III INTELLECTUAL PROPERTY

i Brand search

To a large extent the Trademarks Act² has been harmonised with the EU Trademark Directive,³ but there are still differences. The most notable difference is that a Danish trademark can be acquired through use. Further, the Trademarks Act is to some extent supplemented by the Marketing Practices Act,⁴ which is a statutory law of unfair competition.

Protected registered trademarks can be searched on <https://euipo.europa.eu/eSearch/#advanced> (EU trademarks) and www.dkpto.dk (Danish trademarks). These websites can also be used for searching EU- and Danish-registered design rights. Unregistered Danish trademarks would have to be found through general knowledge of the market and internet searches.

2 Consolidated Act No. 88/2019 on Trademarks.

3 Directive 2015/2436/EU of the European Parliament and of the Council of 16 December 2015 to approximate the laws of the Member States relating to trade marks.

4 Consolidated Act No. 426/2017 on Marketing Practices.

Copyrighted works, image rights and business processes are not registered, and a search for these would therefore have to be conducted using the internet and through general knowledge of the market.

The process for ascertaining whether there is a conflict follows the normal process of determining whether there is an intellectual property infringement.

ii Brand protection

There are four ways in which a trademark can be obtained in Denmark:

- a* registration with the Danish Patent and Trademark Office (DKPTO);
- b* use in Denmark;
- c* international World Intellectual Property Organization registration designating Denmark; and
- d* EU trademark registration with the European Union Intellectual Property Office.

The Danish relative and absolute grounds for refusal are similar to those for EU trademarks. The DKPTO will provide a search report of its findings. An application for trademark registration will not be refused based on relative grounds for refusal.

The Trademarks Act contains a rule about ‘trademark theft’. It follows from this provision that registration cannot be obtained for trademarks that are identical or very similar to trademarks that are being used in a foreign country for the same goods or services, if the applicant knew or should have known of this older, foreign mark.

Design rights may also be registered via DKPTO. To be registered a design has to be new and have individual character.

iii Enforcement

A trademark proprietor is entitled to start proceedings based on its trademark rights. A franchisee can be a licensee, and a licensee is also entitled to start proceedings in relation to infringements of the trademark right, unless otherwise agreed upon between the licensee and the trademark proprietor. This will, however, change once the new Trademark Directive comes into force, no later than 2019. The licensee shall duly notify the trademark proprietor of such proceedings.

In general the remedies are the following:

- a* imposition of a court injunction, including a preliminary injunction, on the defendant (i.e., an order to refrain from any – continued – trademark infringement in the future);
- b* the securing of evidence (similar to an *Anton Piller* order);
- c* receiving compensation, in cash or in another form;
- d* imposition of a court order on the defendant (i.e., an order to do something so as to prevent any threatening – continued – trademark infringement);
- e* on conviction, having the defendant publish the judgment in whole or in part;
- f* imposition of a fine on the defendant; and
- g* surrender of the profit enjoyed as a result of the infringement.

The remedies apply regardless of whether the trademark right has been granted by registration or has been obtained by use.

The enforcement of design rights and copyright also follows the enforcement procedures listed in the EU Enforcement Directive.⁵

iv Data protection, cybercrime, social media and e-commerce

The General Data Protection Regulation (GDPR)⁶ and the Act on Protection of Personal Data (the Danish Act)⁷ apply to the processing of personal data, with the Danish Act providing the supplements and the derogations of the GDPR. The GDPR and the Danish Act entered into force on 25 May 2018 and replaced the former Danish Data Protection Act⁸ and the underlying Directive.⁹ The GDPR and the Danish Act provide a framework within which the processing of personal data may take place; for example, the principles relating to the processing of personal data, and the legal basis for the processing. By way of example, certain requirements must be met when a data controller (e.g., a franchisee) transfers personal data on customers or employees to a franchisor outside the EU or EEA. Hence, such transfers must be subject to appropriate safeguards as set out in the GDPR. In many respects, the new legislation that entered into force on 25 May 2018 carried on the former requirements for the processing of personal data. However, and by way of example, a principle of accountability was introduced, according to which the aforementioned franchisee must be responsible for, and be able to demonstrate, compliance with the principles applicable to the processing of personal data – an obligation that goes hand in hand with the franchisee's obligation, under certain requirements, to maintain a record of the processing activities that fall within its responsibilities. The GDPR introduces a basis for significant fines, which has raised awareness concerning the processing of personal data and the attendant obligations to be met in this respect.

So far, special rules regarding cybercrime and notification of government authorities in relation to data breaches have only been adopted for the telecommunications sector.

The E-Commerce Act¹⁰ contains certain requirements in relation to identification of the trader and a duty to provide information on relevant aspects when purchasing goods or services online, for instance the name of the trader, its physical address and business registration number. In relation to distance sales, a trader must also provide a consumer with a right of cancellation according to the Consumer Contracts Act.¹¹

Finally and more generally, a trader, whether a franchisor or a franchisee or other, must comply with the Marketing Practices Act when performing marketing directed towards the

5 Directive 2014/67/EU of the European Parliament and of the Council of 15 May 2014 on the enforcement of Directive 96/71/EC concerning the posting of workers in the framework of the provision of services and amending Regulation (EU) No. 1024/2012 on administrative cooperation through the Internal Market Information System.

6 Regulation 2016/679 of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation).

7 Consolidated Act No. 502/2018 on the Protection of Personal Data.

8 Consolidated Act No. 429/2000 on the Processing of Personal Data.

9 Directive 95/46/EC of the European Parliament and of the Council of 24 October 1995 on the protection of individuals with regard to the processing of personal data and on the free movement of such data.

10 Consolidated Act No. 227/2002 on Services in the Information Society, etc.

11 Consolidated Act No. 1457/2013 on Certain Consumer Contracts.

Danish market. The Act requires adherence to the principles of good marketing practices, no use of misleading or undue indications or omission of material information if this is designed to significantly distort consumers' or other traders' economic market behaviour. The Act also applies to advertisements on social media such as the internet if directed towards the Danish market. Furthermore, with respect to advertisements on social media, a main principle of the E-Commerce Act stipulates that traders within the EU or EEA offering information society services – meaning commercial services delivered online – are subject to domestic control, thus a trader in a country within the EU or EEA has to comply with the requirements regarding digital marketing in said country, even though the marketing is targeted at other countries within the EU or EEA.

IV FRANCHISE LAW

i Legislation

There is no legislation that makes express provisions for franchising in Denmark. This means that every aspect of franchising is regulated by the general rules of law.

The Contracts Act¹² and general principles of contract law apply to franchise agreements. The overall principle in Danish contract law is the principle of freedom of contract (i.e., the parties are free to decide the contents of their agreement). However, the drafting (or carrying out) of a franchise agreement may be regulated by various mandatory rules. In particular, certain statutory rules such as the Competition Act,¹³ the Marketing Practices Act, the Business Lease Act,¹⁴ the Product Liability Act¹⁵ and the Act on Interest on Overdue Payments¹⁶ may restrict the parties' room for manoeuvre.

Among the rules to be considered in the Contracts Act when drafting (or carrying out) a franchise agreement, the general clause in Section 36 is of particular relevance. Section 36 stipulates: 'An agreement may be amended or set aside, in whole or in part, if its enforcement would be unreasonable or contrary to principles of fair conduct. The same applies to other legal transactions.'

Danish courts are reluctant to apply Section 36 on commercial agreements, but it may be applied where there is an evident discrepancy between the parties' bargaining positions.

Where the franchise agreement is silent, the parties' relationship may be regulated by general principles applicable to commercial relationships. Such principles may be found in the Sale of Goods Act¹⁷ as well as in the Commission Act¹⁸ and the Commercial Agents Act.¹⁹ However, the principle regarding payment of compensation for goodwill at termination in the Commercial Agents Act will only apply by analogy in very exceptional cases (see also Section VI.ii).

Case law is also a relevant source of law in relation to franchising, especially where an earlier decision has been made in the superior courts. Possible precedents may be found

12 Consolidated Act No. 193/2016 on Contracts and other Juristic Acts pertaining to Property.

13 Consolidated Act No. 155/2018 on Competition.

14 Consolidated Act No. 1218/2018 on Lease of Business Premises.

15 Consolidated Act No. 261/2007 on Product Liability.

16 Consolidated Act No. 459/2014 on Interest etc. on Overdue Payments.

17 Consolidated Act No. 140/2014 on Sale of Goods.

18 Consolidated Act No. 332/2014 on Commission.

19 Consolidated Act No. 272/1990 on Commercial Agents and Commercial Travellers.

primarily in various law reports. However, not many precedents relating to franchising have been published. This may be because many franchise agreements refer disputes to be settled by arbitration and not by the ordinary courts.

ii Pre-contractual disclosure

There are no specific pre-contractual disclosure requirements in Danish law. Consequently, there are no legal requirements to disclose certain information relating to the franchise prior to entering into the franchise agreement. However, as a general principle, a duty of disclosure arises when reasonable commercial standards of fair dealing require that particular circumstances should be disclosed when entering into an agreement. A misrepresentation prior to entering into a franchise agreement may therefore give rise to an action for breach of the agreement. In a commercial relationship, the parties are also obliged to give information voluntarily if they know or ought to have known that the information is material to the other party.

The basis of liability for contractual damages on account of breach of an agreement is the concept of fault (*culpa*). In addition, liability requires that the non-breaching party has suffered a loss and that there is an adequate causal connection between the breach and the loss. Damages are computed on an expectation basis (i.e., the non-breaching party shall be put in the same position as if the agreement had been performed).

Danish courts are reluctant to award damages for pre-contractual behaviour when no agreement has been entered into. However, the doctrine of *culpa in contrahendo* is recognised as a general principle but only as an exception. As a starting point, pre-contractual liability requires a clear breach of the law in the form of an unfair behaviour or a clear breach of the rules applicable to the contractual process.

Furthermore, the general conditions of liability in terms of loss and adequate causal connection must be fulfilled to impose a pre-contractual liability. Since no agreement has been entered into, damages will be computed based on reliance damages.

iii Registration

There are no registration requirements for franchising in Denmark.

iv Mandatory clauses

There are no mandatory clauses in franchise agreements according to Danish law.

v Guarantees and protection

There is no legislation relating to guarantees made by a franchisee under a franchise agreement, regardless of whether it is provided by a person or a company. A guarantee promise is subject to the rules in the Contracts Act. A guarantee promise is thus binding on the promisor when it has been communicated to the promisee, and it does not require any acceptance from the promisee to be binding. The guarantee commitment as such is subject to the general rule of contractual freedom. Where the guarantee is silent, the reality of the guarantor's obligation must be determined by reference to case law and legal tradition.

Whether the guarantee is enforceable must be evaluated under the general rules on invalid declarations of intent in the Contracts Act. In particular, the general clause in Section 36 may be of relevance (see Section IV.i).

V TAX

i Franchisor tax liabilities

The tax system in general

There is no Danish tax code applicable specifically to franchising structures. Hence, the taxation of a franchise in Denmark depends on whether the franchise is subject to personal or corporation tax.

Furthermore, the Danish tax system distinguishes between tax payers domiciled in Denmark and abroad.

Individuals and companies domiciled outside Denmark can be subject to a limited tax liability to Denmark regarding a number of specified income types.

Foreign persons and companies are, however, obviously often subject to tax liability in another jurisdiction as well. To avoid double taxation for limited liable taxpayers, Denmark has entered into a large number of double-taxation treaties. Further, Denmark has implemented various EU directives seeking to eliminate double taxation.

Corporation tax

A company is domiciled and subject to full tax liability in Denmark if the company is registered with the Danish Business Authority or if the management of the company has its principle place of business in Denmark.

Companies are subject to 22 per cent tax (2019) on income, capital gains, interests, etc.

Companies can deduct from taxable income expenses incurred when obtaining, ensuring or maintaining the taxable income, though with certain limitations. Additionally, companies can obtain a deduction from amortisation of assets. Finally – with some limitations – losses realised on tax relevant assets, such as debt and real estate, are deductible.

For non-domiciled companies withholding taxes on income from Denmark is particularly relevant. Most importantly Danish withholding taxes may apply to royalties, dividends and interests.

Royalties received from a Danish source are subject to limited tax liability. Thus, Denmark will withhold tax on royalty (e.g., from a Danish franchisee to a foreign franchisor). The withholding tax rate on royalties is 22 per cent (2019).

However, for royalties paid to recipients domiciled in a jurisdiction with which Denmark has entered into a double-taxation treaty, the state in which the beneficial owner of the royalty is domiciled has the exclusive right to tax the royalty payment. Additionally, Danish tax on royalties between group-related companies in the EU is normally waived pursuant to the EU Interest and Royalties Directive.²⁰

Non-domiciled companies are subject to limited tax liability on dividends at a 22 per cent tax rate (2019). The tax rate for non-domiciled companies was reduced from 27 per cent to 22 per cent on 1 July 2016, but the withholding rate for the Danish dividend-paying company remains at 27 per cent (equivalent to the rate applicable for domiciled companies). Subsequently, the foreign receiving entity can reclaim the excess withholding tax.

20 Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States. (Latest consolidated version: 01/07/2013).

Dividends received by non-domiciled companies from Danish subsidiaries are tax exempt if the receiving company would not be taxable pursuant to the EU Parent–Subsidiary Directive²¹ or the tax should have been exempt pursuant to a double-taxation treaty.

Similarly, dividends received by non-domiciled companies from related Danish companies are exempt if the recipient is domiciled within the EU or EEA and would be tax exempt pursuant to the EU Parent–Subsidiary Directive or the tax should have been (fully or partially) exempt pursuant to a double-taxation treaty.

If the dividends are not exempt from withholding taxes, but the receiving entity is resident in a state with which Denmark has concluded a double-taxation treaty that calls for a lower rate of withholding taxes, tax at the rate of 27 per cent (2019) must generally be withheld, and the receiving entity may subsequently reclaim the excess withholding tax.

Personal tax

An individual is subject to personal tax on employment income. Furthermore, income derived from self-employment is subject to personal tax.

An individual is fully liable to tax in Denmark, if the individual is domiciled in Denmark or has been present in Denmark for a continuous period of at least six months (including short stays abroad in the form of vacations).

An individual is subject to tax on salary, profits from self-employment, capital gains, interests, dividends, pensions, etc.

For employed individuals the expenses qualifying for a deduction are very limited; hence, for example, certain work-related transport and interest expenses on debt are deductible.

A personal business tax regime is applicable to self-employed individuals to allow for a harmonised taxation of personal businesses and companies. The tax rate applicable to self-employment income under this regime is 22 per cent (2019). Operating costs, such as salary, rent, travel expenses, insurance, training, etc., are deductible from self-employment income (such deductions may also be obtained outside the tax regime for self-employed individuals).

When self-employment income is extracted from the franchise business by the franchisee for personal use it will be subject to ordinary salary tax with a progressive net tax rate of up to 56.5 per cent, including labour market contribution and optional church tax (2019). The tax already paid on the self-employment income will be credited in the personal tax for the individual.

ii Franchisee tax liabilities

See Section V.i.

iii Tax-efficient structures

The structuring of a franchise business in Denmark is generally not driven by tax considerations. Hence, there is no general best practice used specifically for franchising.

21 Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States. (Latest consolidated version: 17/02/2015).

Instead the structuring – from a tax point of view – is typically dependent on the specific business drivers for the franchisee, such as the nature of the business, the place of residence, whether the franchise is conducted as an individual concern or partnership or in a corporate form.

VI IMPACT OF GENERAL LAW

i Good faith and guarantees

Danish contract law recognises the principle of good faith. This means that the parties to an agreement are obliged to care for each other's interests and to give each other information that is necessary to mitigate losses, as well as to avoid acting contrary to previous behaviour and to avoid an abuse of rights.

The principle of good faith has not been expressed in any statutory provision, but its existence is presupposed in some statutes, for example in Section 36 of the Contracts Act (see Section IV.i).

Unfair actions and omissions as well as actions and omissions carried out in bad faith by a contracting party may give rise to an action for breach of the agreement (see Section IV.ii).

ii Agency distributor model

According to Danish law, franchisees are normally treated as independent distributors purchasing and selling goods in their own name and for their own account, and the franchisors are thus acting as suppliers. There are no specific Danish rules on either distribution or franchise agreements.

It is possible to include in the franchise agreement provisions providing for the franchisee to act as a commission agent. It would also be possible to include provisions providing for the franchisee to act as a commercial agent. This would not modify the nature of the franchise agreement as such, but it would constitute an 'agreement within the agreement', which would be governed by the Commission Act or the Commercial Agents Act, as the case may be. It should be emphasised that the Commercial Agents Act is based on an EU Directive²² that embodies a number of mandatory provisions serving to safeguard the interests of the agent by ensuring certain minimum rights.

In particular, the provisions in the Commercial Agents Act relating to goodwill at termination and minimum notice of termination may not be deviated from to the detriment of the agent through an agreement stipulating that foreign law shall apply, if the legal relationship would otherwise be governed by the Act. Therefore, if the franchisee acting as an agent has its place of business in Denmark, these provisions will apply regardless of any choice of law clause contained in the franchise agreement (see Section VI.ix).

According to published Danish case law, a distributor is only entitled to compensation at termination under very special circumstances. This could be the case if the distributor or dealer, despite fixing its own resale prices and otherwise being responsible for the commercial risks, has not been duly compensated for its investments, etc. at termination; for example, if the duration of the agreement was very short, and if the distributor or dealer also actively transfers the customer records, etc. to the supplier at termination, provided that

22 Council Directive 86/653/EEC of 18 December 1986 on the coordination of the laws of the Member States relating to self-employed commercial agents.

the identity of the customers is not generally known. In a case before the Danish Supreme Court on 25 April 2000, a terminated dealer was, under very special circumstances, awarded compensation in the amount of 200,000 Danish kroner. In the ruling the Supreme Court clearly stated that under normal circumstances an independent distributor or dealer will not be entitled to any compensation upon termination of the distributorship or dealership. However, in this specific case the Supreme Court awarded the terminated dealer the compensation mentioned with reference to the fact that the termination of the dealership had taken place with no reasonable explanation and without taking the dealer's interests into consideration (very disloyal behaviour towards the terminated dealer), and with reference to the fact that the terminating supplier in question had taken over the customer base built up by the dealer, thereby preventing the dealer from being duly compensated for its investments in marketing, etc.

iii Employment law

According to Danish law, a franchisee is generally considered as a separate and independent business partner to the franchisor. However, depending on the intensity of the parties' cooperation and provided that the franchisee is a natural person, the franchise relationship may be qualified as a camouflaged employment relationship governed by general principles of employment law, whereby the franchisee is considered similar to an employee, as the weaker party in need of protection. There is also a risk that mandatory rules such as the Salaried Employees Act²³ will apply, as well as statutory tax law relating to employment relationships.

Whether the franchise relationship is to be considered as a camouflaged employment relationship depends on an overall assessment of the circumstances of the case, including the wording of the franchise agreement and the parties' execution thereof. Among the factors to be considered is the extent to which the franchisee may manage its own hours, the extent to which the franchisee is taking on a financial risk by paying for the business premises and any employees, whether the remuneration to the franchisee is determined by the franchisee's performance or the time spent, etc.

iv Consumer protection

When entering into a franchise agreement, the franchisee is considered to act in the course of business, and the franchisee will therefore not be treated as a consumer in accordance with any of the Danish laws concerning consumer protection.

However, the parties' position of strength may be of relevance in relation to Section 36 in the Contracts Act (see Section IV.i).

v Competition law

The Danish competition rules, which are found in the Competition Act and executive orders issued on the basis of the Act, are in all relevant aspects identical to the EU competition rules. In particular, the European Commission's Block Exemption Regulation for vertical agreements²⁴ has been incorporated into Danish law.

23 Consolidated Act No. 1002/2017 on the Legal Relationship between Employers and Salaried Employees.

24 Commission Regulation No. 330/2010/EU of 20 April 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices. (Latest consolidated version: 01/06/2010).

This means that issues of exclusivity, pricing, product ties, e-commerce and full-line forcing are treated in the same way under Danish law as under EU competition law.

vi Restrictive covenants

The Danish competition rules are in all relevant aspects identical to the EU competition rules, and non-compete obligations are therefore treated in the same way under Danish law as under EU competition law.

Accordingly, a non-compete obligation relating to the products or services purchased by a franchisee is permitted for the duration of the franchise agreement, provided that the obligation is necessary to maintain the common identity and reputation of the franchised network.

vii Termination

Danish law does not require a minimum period of notice for the parties to terminate a franchise agreement made for an indefinite term and the parties are free to agree the period of notice. If a short period of notice has been agreed, the courts may in rare circumstances establish a reasonable period of notice by applying Section 36 in the Contracts Act (see Section IV.i).

If no period of notice has been agreed, a franchise agreement made for an indefinite term may be terminated with a reasonable period of notice taking all circumstances into consideration, including the duration of the franchise relationship. A period of notice of six months is normally considered reasonable, including in situations in which the parties' relationship has lasted for several years (also, according to case law, if it has lasted over 20 years).

It is the starting point under Danish law that a franchisee is not entitled to compensation for goodwill at termination following an adequate term of notice. However, Danish courts have in some cases allowed a distributor such compensation but only in cases offering very special circumstances (see Section VI.ii).

The Danish competition rules are in all relevant aspects identical to the EU competition rules, and post-term non-compete obligations are therefore treated in the same way under Danish law as under EU competition law. Accordingly, post-contractual non-compete obligations in franchise agreements related to products or services that compete with the products and services covered by the franchise agreement are permissible for a maximum period of one year after termination of the agreement, provided that the non-compete obligation is indispensable to protect know-how transferred by the franchisor to the franchisee and is limited to the point of sale from which the franchisee has operated during the contract period.

The right for the franchisor to take over the franchisee's business upon termination should be regulated in the franchise agreement. If nothing has been agreed, Danish law predicts that neither party has a right or a duty to take over the other party's rights and obligations under the agreement.

viii Anti-corruption and anti-terrorism regulation

Fraud

The Criminal Code²⁵ deals with different types of fraudulent behaviour and actions, including embezzlement, deceit, fraud against creditors, breach of fiduciary duties, breach of trust, including providing the authorities with false or misleading information concerning a company's accounts.

There is no strict liability under the Criminal Code. As a general rule, criminal liability requires the intention to commit a criminal fraudulent act for the purpose of gain that causes a corresponding loss to the victim.

Furthermore, negligent and fraudulent accounting under the Bookkeeping Act²⁶ and the Annual Report Act²⁷ are punishable by a fine with no statutory limit. Wrongful bookkeeping made with fraudulent intent may also be covered by the provisions on fraud in the Criminal Code.

Bribery

The Criminal Code distinguishes between and prohibits public active bribery, public passive bribery and private bribery (both active and passive).

Public active bribery means any person who unduly gives, promises or offers to someone performing a public function or office with a Danish, foreign or international public organisation a gift or another benefit to make the relevant person perform or fail to perform that function or office.

Public passive bribery means any person who unduly receives, demands or agrees to receive a gift or another benefit in the exercise of a Danish, foreign or international public function or office. Facilitation payments are generally considered bribes falling within the scope of public active bribery and public passive bribery.

Private bribery means any person who receives, demands or agrees to receive another benefit for himself, herself or others in a manner contrary to his or her duty of managing the property entrusted to him or her by another person, and any person who grants, promises or offers such a gift or other benefit, including in the form of kickbacks.

Violations of the Criminal Code's provisions on bribery may be sanctioned with criminal fines, imprisonment (only individuals) and forfeiture. Further, violations may be sanctioned with exclusion from public procurement contracts. Directors and employees of a company may under certain circumstances be found personally liable for acts on behalf of a company.

25 Consolidated Act No. 976/2019 on Criminal Law.

26 Consolidated Act No. 648/2006 on Bookkeeping.

27 Consolidated Act No. 838/2019 on Annual Reports.

Money laundering

The Act on Anti-Money Laundering²⁸ is based on the Fifth EU Anti-Money Laundering Directive,²⁹ which was transposed into Danish law on 2 May 2019, with effect from 10 January 2020. The Act on Anti-Money Laundering is to a great extent aligned with the Fifth EU Anti-Money Laundering Directive, although there are a number of deviations from the Directive, the scope of which is increasing.

Money laundering is defined as any of the following:

- a* unlawfully accepting or acquiring for oneself or others a share in economic profits or funds that are obtained by a punishable violation of the law;
- b* unlawfully concealing, keeping, transporting, assisting in the disposal of or in a similar manner subsequently serving to ensure profits or funds are obtained by a punishable violation of the law; and
- c* attempting or participating in actions of this nature.

A franchisor acting and contracting in its own name is responsible for complying with the Act on Anti-Money Laundering (assuming it carries out activities subjecting it to the Act). However, a company may under certain circumstances be found liable for acts committed by a third party, if that third party is in some way connected to or is representing the company. Consequently, although this risk is unlikely to materialise, a franchisor may be found liable for money laundering committed by a franchisee or the employees of the franchisee or for lack of compliance with the Act on Anti-Money Laundering by the franchisee.

For this reason it is recommended that the franchisee agrees to comply with the franchisor's internal guidelines, code of conduct, etc., subject to such adjustments as may be necessary to ensure compliance with the Act on Anti-Money Laundering; such proper adequate procedures can be used as a defence for the franchisor against liability for acts committed by the franchisee or the employees of the franchisee.

ix Dispute resolution

With regard to issues relating to jurisdiction, the 1968 Brussels Convention,³⁰ the 2007 Lugano Convention³¹ and EU Regulation 1215/2012³² apply in Denmark. This means that when entering into an agreement the parties are free to agree on the choice of forum. Many franchise agreements refer disputes to be settled by arbitration and not by the ordinary courts. It is also possible to agree on mediation as a form of dispute resolution. With regard

28 Consolidated Act No. 930/2019 on Measures to Prevent Money Laundering and Financing of Terrorism, as amended by Act No. 553 of 7 May 2019 (transposing the Fifth EU Anti-Money Laundering Directive).

29 Directive (EU) 2018/843 of the European Parliament and of the Council of 30 May 2018 amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, and amending Directives 2009/138/EC and 2013/36/EU.

30 The Brussels Convention of 27 September 1968 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters.

31 The Lugano Convention of 2007 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters.

32 Regulation No. 1215/2012/EU of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters. (Latest consolidated version: 26/02/2015).

to jurisdiction outside the ambit of these rules, international jurisdiction of Danish courts is based on a number of provisions in the Administration of Justice Act³³ and the starting point is that the defendant must have home court in Denmark.

Regarding choice of law, the 1980 Rome Convention³⁴ applies in Denmark (not the Rome I Regulation³⁵ because of Denmark's opt-out from the EU cooperation as regards justice and home affairs). Consequently, the parties are free to agree on the law that shall govern their agreement. To the extent that no valid choice of law has been made by the parties, the starting point is that the agreement shall be governed by the law of the country with which it is 'most closely connected'. According to the basic presumption, the closest connection is to be found in the country where the party who is to effect the performance that is 'characteristic of the agreement' has his or her habitual residence or, in the case of a company, its central administration.

It is generally considered in relation to franchise agreements that the franchisor is to effect the performance that is characteristic of the agreement, consisting of the franchise concept, the right to use the franchisor's business names, trademarks and know-how and in some cases also patent rights, which shall be provided to the franchisee against payment of remuneration. Nevertheless, there are many indications that the franchise agreement shall be considered to have its closest connection to the country in which the franchisee is to make use of these rights. There is, however, no relevant Danish case law dealing with these issues.

It is possible to obtain a court injunction, including a preliminary injunction, ordering a former franchisee to refrain from trading in breach of a non-compete provision, or from using the franchisor's trademarks or other intellectual property rights (see also Section III.iii).

As a starting point, damages for breach of contract (and misrepresentation) are calculated on an expectation basis (i.e., the non-breaching party shall be put in the same position as if the agreement had been performed).

The party 'losing' the case will normally be ordered to effect reimbursement to the other party of the costs incurred by the latter in connection with the case (court fees, legal fees, etc.). In principle, the fees of legal professionals are not regulated. However, the Supreme Court has laid down publicly accessible guidance rates for some fees, which are usually followed by the court. The amount to be reimbursed by the losing party according to these guidance rates will normally not cover the actual legal fees for conducting the case.

Foreign judgments against Danish citizens may be enforced in accordance with the rules in the 1968 Brussels Convention and the 2007 Lugano Convention, as well as EU Regulation 1215/2012. If neither of these rules is applicable, the starting point is that foreign judgments are not recognised and that they cannot be enforced in Denmark. With respect to arbitration awards, Denmark has acceded to the 1958 New York Convention³⁶ and, according to the Arbitration Act,³⁷ Danish courts recognise foreign arbitral awards, irrespective of the country in which they were made. Recognition and enforcement may, however, be rejected on grounds of public policy.

33 Consolidated Act No. 938/2019 on Administration of Justice.

34 Convention on the Law Applicable To Contractual Obligations opened for signature in Rome on 19 June 1980 (80/934/EEC).

35 Regulation No. 593/2008/EC of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I).

36 The Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958).

37 Consolidated Act No. 553/2005 on Arbitration.

FRANCE

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I INTRODUCTION

Franchising is a well-established marketing system in France, and has constantly developed since the 1960s. Today, it is perceived as one of the few sectors creating jobs, despite recurring difficult economic conditions. The French press regularly contains recruitment advertisements for new franchisees (in particular through the French Observatoire de la Franchise) and certain trade fairs (such as Franchise Expo Paris) take place at least once a year.

Based on recent statistics from the French Franchising Federation,² franchising accounts for a total turnover in France of €62 billion, covering 75,193 franchised outlets within 2,004 networks and employing directly and indirectly 700,000 people. France is the biggest market for franchising in Europe by the number of networks. International franchisors (for the greatest part of US origin) account for about 10 per cent of the total. Six business sectors represent about 70 per cent of the franchising turnover in France: personal and household equipment, food retail, hotels, fast food restaurants and hairdressing. Most of the networks are mixed, which means they combine the franchisor's own outlets and the franchisees'.

While there are no dedicated government organisations, the French Ministry of the Economy keeps a close eye on the development of distribution networks (including franchising), in particular when it comes to food retail distribution, which is highly concentrated in France.³

Approximately 180 significant franchisors are members of the French Franchising Federation, which represents approximately 45 per cent of the franchised outlets in France. Its role is to promote and support franchised networks in their development in France and abroad. The services offered to its members include documentation, training, legal assistance, mediation, etc. The French Franchising Federation founded the European Franchise Federation in 1972.

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2 Source: www.franchise-fff.com/franchise/chiffres-cles/les-chiffres-cles-en-france.html (figures for 2018).

3 Six retailers (operating through four central purchasing organisations) account for about 85 per cent of the market in France: Carrefour, Auchan, Casino, Leclerc, Intermarché and Système U.

II MARKET ENTRY

i Restrictions

Because of the absence of specific regulations on franchising in France, there are no restrictions on the development of a foreign franchisor's network in the French market, including by way of master franchising, which is often used in practice. Similarly, there is no impediment to the foreign franchisor taking a stake in the capital of the franchisee and obtaining veto rights in relation to certain decisions affecting the management of the franchised business. If the franchisor intends to develop the franchised network only from its home country, it will make sure not to create a permanent establishment in France (arising from a branch, offices, employees or the appointment of an agent acting on behalf of the franchisor). Franchisees and master franchisees are considered by French courts as the owners of their clientele (at least at local level), which allows them to enter into lease agreements giving them security of tenure.

ii Foreign exchange and tax

Foreign exchange control disappeared a long time ago in France and the French legislation on foreign investments (applicable to certain protected activities such as defence) is of no relevance in the context of franchising. As regards taxation, corporate franchisees located in France are subject to corporate income tax and all other applicable taxes.

III INTELLECTUAL PROPERTY

i Brand search

To be effective against third parties, trademarks need to be registered at the appropriate intellectual property (IP) offices: nationally at the National Institute of Industrial Property in France (INPI), at EC level with the European Union Intellectual Property Office (EUIPO), or worldwide with the World Intellectual Property Organization. Trademark clearance searches can easily be performed using the online trademark databases, updated by the IP offices, to assess the availability of trademarks and prevent infringement of third parties' rights. These databases also allow verification of the status of registration of trademarks, their ownership, the existence of registered licences and sometimes oppositions made by third parties. Company names may also be included in clearance searches thanks to the online commercial registry database. As concerns designs, even though online databases are also available, clearance searches require dedicated tools. Certain forms or fittings may not be protected by registered trademarks or designs, in which case French rules on copyright may apply. As copyrights are not registered in France, searching third parties' rights is far more complicated.

ii Brand protection

Whatever the IP office involved, the registration process follows the same main steps, namely (1) filing and payment of the fee, (2) publication by the relevant IP office of the trademark or design on a special bulletin, (3) examination of the filing request and possible oppositions by third parties and (4) provided the oppositions are rejected by the relevant office and the filing complies with the examination requirements, formal registration of the filed trademark or design. The process takes at least five months at the INPI and 26 weeks at the EUIPO (provided no oppositions are filed).

iii Enforcement

Franchise agreements typically let the franchisor take any action that it deems necessary to protect its distinctive signs, whether through court actions or interim measures. This derives from applicable Association Française de Normalisation (known as AFNOR) norms in France and from the European Code of Ethics for Franchising, whereby the franchisor must allow the franchisee to peacefully enjoy the right to use the relevant distinctive signs. If the franchisor does not take appropriate steps to protect this right, despite an official written request by the franchisee, the franchisee may sue third parties on grounds of trademark infringement (and may also request the seizure of counterfeit products). Furthermore, any franchisee is entitled to start legal proceedings on grounds of unfair competition.

iv Data protection, cybercrime, social media and e-commerce

French data protection legislation applies to any 'data controllers'⁴ that are (1) either located in France, (2) or located in a country that is not a Member State of the European Union but use processing means on French territory.

Pursuant to this legislation, franchisors or franchisees have to comply with numerous obligations, such as providing the data subjects (e.g., consumers) with specific information and filing declarations with the French data protection authority, the Commission Nationale de l'Informatique et des Libertés (CNIL). Some specific uses of personal data may be subject to prior authorisation by the CNIL. This is particularly the case where data is transferred to an entity located outside the European Union. Since May 2018, the EU General Data Protection Regulation has been in force in France.

Failure to comply with this legislation may lead to sanctions by both the CNIL and French criminal courts.

Cybercrime, social media and e-commerce are subject to general laws, such as criminal law, contract law, data protection law, consumer law, etc. Some specific provisions related to e-commerce have been implemented into French law by the EU Directive on electronic commerce dated 8 June 2000.

IV FRANCHISE LAW

i Legislation

Although franchising is a well-established distribution system in France, there is no specific legislation governing franchising. This is strange for a country that is used to producing numerous laws on many different business subjects. As stated by a minister over 30 years ago, this is because legislating on franchising would risk 'weakening its dynamic and evolving features'.⁵

Consequently, franchising is subject to general EU and French laws governing distribution, including competition laws (in particular EC Regulation No. 330/2010 of 20 April 2010 on vertical restraints).

An area in which French legislators have dealt with franchising is in relation to pre-contractual disclosure, which is described below (known as the Doubin Law of 1989, the

⁴ Article 3 of the French Data Protection Law (No. 78-17 of 6 January 1978) defines a data controller as the legal person who decides on the purpose and means of the processing.

⁵ Ministerial response No. 8419, JO Débats, December 1986, p. 5032.

provisions of which are set out in Article L330-3 of the French Commercial Code). Franchising is not mentioned as such in the Law (which may apply to other distribution methods as well) but it is at the centre of this Law. More recently, the French parliament adopted the law on growth and business (known as the Macron Law), which contains certain provisions regarding cross-termination in the context of franchising, as well as non-compete clauses.

ii Pre-contractual disclosure

Article L330-3 of the French Commercial Code requires any party who makes available to another person a trade name, trademark or trade sign in consideration of an exclusivity or quasi-exclusivity commitment by the other party, to provide to that other party at least 20 days before the execution of a contract a document giving accurate information allowing the other party to make an informed commitment. Because a franchisor will in most cases require the franchisee to trade under its distinctive signs on an exclusive basis and sometimes by procuring most of its products or services from the franchisor or parties designated by the franchisor, this provision applies almost systematically to franchising transactions.

The franchisor's pre-contractual information obligation is the subject of extensive case law in France, in circumstances where the franchisee's business is unsuccessful and the franchisee alleges that he or she has been misled by the franchisor on the financial prospects of the franchised business. According to the Doubin Law, the franchisor is required to give a presentation on the state and development perspectives of the relevant market. In cases where the franchisee complains about the lack of forecast figures, French courts tend to adopt the following approach: the law does not require the franchisor to provide a local market survey and a forecast income statement to the franchisee. However, if the franchisor does provide a market survey and forecast figures to the franchisee to allow it to build its business plan, the information must be fair and accurate.

Where a court considers that the lack of (or inaccuracy of) information has deceived the franchisee (which will often be the case where the actual turnover is significantly below the forecast figures, for example by more than 30 per cent), it may hold the franchise agreement as null and void and in some cases find the franchisor liable for damages, if the latter has committed misrepresentation. If the misrepresentation of the franchisor or the error of the franchisee cannot be demonstrated, a judge may nonetheless grant damages to the franchisee for the loss suffered (covering the costs and investments incurred by the franchisee but not the profit he or she was expecting to make on the basis of the figures provided by the franchisor). This will be the case particularly where the franchisee has become bankrupt because of a structurally loss-making business.

iii Registration

No specific registration requirement applies to companies solely on the basis that they are franchisees. However, depending on the business they are involved in, they may be subject to certain regulatory constraints (such as special permits to be obtained in certain professions, e.g., restaurants and travel agencies). It is for the franchisee to apply for such permits, with the assistance of the franchisor if necessary.

iv Mandatory clauses

To constitute a franchise agreement under French law, the agreement needs to provide for three essential obligations on the part of the franchisor, namely (1) the licensing of intellectual property rights to the franchisee, (2) the provision of substantial know-how, and

(3) the supply of commercial and technical assistance by the franchisor. The franchisee's obligations may be more or less detailed (bearing in mind agreements subject to French law are traditionally shorter than English ones) but should include at a minimum the financial conditions, including the entry fee and the franchise royalty payable by the franchisee.

v Guarantees and protection

There are various ways in which a franchisor may secure the payments due by the franchisee. The French Civil Code provides for various kinds of personal guarantees, such as letter of comfort, surety and first demand guarantee. Such guarantees may be issued by the parent company of the franchisee or by a financial institution. From a protection point of view, the franchisor is much better off with a first demand bank guarantee, which can be enforced by the franchisor subject to the conditions set out in the guarantee itself, and the guarantor may not raise objections in relation to the underlying franchising agreement. It is obviously preferable that the guarantor be located in a country where the enforcement of a foreign judgment can realistically be obtained in a timely manner.

V TAX

i Franchisor tax liabilities

If established in France, franchisors are liable to all taxes applicable to businesses in France (including corporate income tax at a standard rate of 28–31 per cent).⁶ All revenues generated from the licensing of trademarks and know-how and the provision of training services will constitute taxable income. As already mentioned, franchisors wishing to remain outside France must avoid creating a permanent establishment in France.

ii Franchisee tax liabilities

Save in exceptional circumstances (see Section VI.iii), a franchisee is deemed for tax purposes to be an independent party having title to its clientele. Accordingly, it is subject to applicable taxes in France. All amounts paid to the franchisor (including the entry fee, the franchise royalty and payments for the supply of goods) are normally tax deductible. However, in some circumstances, a master franchisee may have to account for licensed IP rights as an asset and consequently may not be entitled to deduct royalties paid to the franchisor for tax purposes.

iii Tax-efficient structures

To the extent franchisors are generally part of large groups of companies, certain tax-efficient structures generally involve lodging IP rights (trademarks in particular) in countries where tax amortisation of such rights is possible (e.g., in the Netherlands or Switzerland). The know-how, the commercial and technical assistance, and the goods or services that are required for the performance of the franchised business may be made available by other companies of the group. Where the franchisor and the franchisee are located in different

⁶ The 2020 Finance Bill submitted by the current government confirms the continuing reduction of the corporate income tax rate. For companies generating a turnover lower than €250 million, the standard corporate income tax (CIT) rate was reduced to 28 per cent from 1 January 2020, and will be reduced to 26.5 per cent from 1 January 2021 and 25 per cent from 1 January 2022. For all companies irrespective of their size and turnover, the standard rate of CIT will be 25 per cent from 1 January 2022.

countries, close attention must be given to the provisions of the applicable tax treaty between those countries, if any. Generally, franchising agreements include 'gross-up' clauses to allow the franchisor to receive the exact net amount, as if no withholding tax in the franchisee's country applied.

VI IMPACT OF GENERAL LAW

i Good faith and guarantees

The law of contracts in France (which has been subject to a wide-ranging reform, effective as from 1 October 2016) is based on some general but essential principles, such as the binding force of contracts and the duty of good faith. According to Article 1103 of the French Civil Code, legally formed agreements are as binding as law between the parties. Article 1104 adds that, as a matter of public policy, contracts must be negotiated, formed and performed in good faith. Article 1194 adds that agreements commit the parties not only to what is stated in them, but also to all consequences derived from equity, custom and the law. In most contractual disputes, these texts are often referred to by the parties (among others), and French courts have on the basis of these principles built up a set of rules for the performance of contracts (e.g., the duty of information and the obligation to warn the other party of certain risks). This is why franchising agreements (like other distribution agreements governed by French law) are often shorter than contracts governed by English or US law, as the parties may rely on implied obligations, beyond what is stated precisely in the agreement. With the recent reform of contract law, good faith gives rise to the right of a party to request the revision of an agreement in the event of an unforeseen change of circumstances (Article 1195 of the Civil Code). In such a case, the judge may not only terminate the agreement, but also revise it, which provides for a potentially high level of judicial interference. However, as the new Article 1195 is not a public policy provision, the parties may expressly derogate from it.

Finally, the new Article 1171 of the Civil Code provides that 'in a preformulated standard agreement, any non-negotiable clause which is defined in advance by one of the parties and creates a significant imbalance between the rights and obligations of the parties to an agreement is deemed null and void. The determination of the significant imbalance does not relate to the main object of the agreement or the adequacy of the price to the performance.' As franchise agreements will most probably be viewed as preformulated standard agreements because of the traditionally limited scope of negotiation on the contract terms, it remains to be seen whether judges will use this text to set aside or restrict the application of, for example, exclusion of liability, exclusivity and non-compete clauses.

ii Agency distributor model

Based on EU legislation, a person can be considered as an agent if it is entitled to negotiate and, as the case may be, conclude agreements in the name and on behalf of its principal. Since the agent is not the owner of the clientele, who purchase products or services from the principal, it is entitled to a termination indemnity or compensation upon the expiry or the termination of the agency agreement. If the franchisee (like any other distributor) buys products from the franchisor (or an affiliate of the franchisor) and resells them in its shops or outlets, it may not qualify as an agent. It is therefore rare to see cases where the franchisee has successfully been requalified as an agent, with the consequence that, for the time being, under French law the franchisee is not entitled to any indemnity upon expiry or termination of the agreement (see Section VI.vii).

A closer model to franchising is distribution (including selective distribution) that does not require the licensing of intellectual property rights or the provision of know-how (simply the sale of products and marketing support by the supplier to the distributor). However, the distinction between franchisee and distributor has little impact when it comes to the termination of the agreement and the consequences arising therefrom.

iii Employment law

The application of French employment law to franchisees is another issue highly debated in the courts, with numerous decisions on the subject. There are two ways a franchisee may benefit from protective employment laws in France: one is to demonstrate that despite being called a 'franchisee', he or she is in fact an employee working under the constant authority of the franchisor, who has the power to give orders and instructions, control performance and impose sanctions on the franchisee;⁷ another way, that does not require the demonstration of the existence of the employee's subordination to the employer, is by fulfilling the conditions set out in Article L7321-2 of the French Labour Code, namely (1) the franchisee sells products that are supplied exclusively or quasi-exclusively by the same company, (2) it conducts its activity in premises that are provided or approved by such a company, and (3) at prices and conditions imposed by the same company.

Finally, the franchisor may be held liable to the employees of its franchisees if it behaves as the *de facto* manager of the franchised business, interfering in such a way as to leave no real autonomy to the franchisee.⁸

The application of French labour law to a franchising agreement has serious implications as the franchisor, who in such circumstances will be deemed to be the employer, will be liable to the 'franchisee' for past wages, paid holiday and, in the event of termination, may have to pay indemnities for redundancy and paid holiday, not to mention the repayment of the entry fee and training costs. In addition, all such sums being subject to social security contributions, the franchisor could be requested by social security bodies to pay the related employer's contributions.

iv Consumer protection

To our knowledge, there is no example in French case law of a franchisee being held to be a consumer. This is because the criterion that is widely used by French courts to consider someone as a consumer is that he or she acts for the satisfaction of his or her personal needs (and not those of a business). Consequently, franchisees do not benefit from the protective provisions of French consumer law (covering all sorts of issues, such as the extent of the duty of information owed to the consumer, the extent of the statutory warranties in relation to products, the absence of automatic renewal of contracts, etc.).

In the interests of consumer protection, pursuant to Article A441-1 of the French Commercial Code, the franchisee is required to inform consumers that it acts as an independent undertaking. This information must appear on all information documents (including advertising) as well as both inside and outside the franchised outlet.

7 Court of Cassation, Labour Section, 18 January 2012, No. 10-16342.

8 Court of Cassation, Commercial Section, 9 November 1993, No. 91-18351.

v Competition law

One of the laws that has the greatest impact on franchising contracts is certainly competition law. This is because franchising networks (and the inherent vertical restraints, such as exclusivity and non-compete) are sometimes critical in the organisation of the sale of products or services in some sectors of the French economy. In that respect, the French Competition Authority and French courts apply consistently the EU rules derived from EU Regulation No. 330/2010 and its Guidelines. While price-fixing and restrictions on passive sales are *per se* prohibited practices, non-compete clauses are assessed on a case-by-case basis depending on the relevant economic sector and the ability of the franchisee to develop a business independently of the franchisor. Competition law has also led the French Competition Authority⁹ to identify distinctive features for food retail distribution, including for franchised hypermarkets and supermarkets, where some contractual clauses may be forbidden while they are admitted in other sectors.

vi Restrictive covenants

Restrictive covenants applicable throughout the duration of the agreement give rise to little debate before French courts. Decisions are generally in line with the provisions of EU Regulation No. 330/2010, in particular in relation to purchasing exclusivity and non-compete obligations, which are viewed as essential to preserve the identity and reputation of the franchise network. A recent survey indicates that most franchising agreements have a duration of five years (aligned with the duration of the non-compete obligation as provided for in the Block Exemption Regulation), and some go to seven years.¹⁰

vii Termination

Although the termination of franchise agreements is often a hot topic for practitioners and legal commentators, the case law of the French Court of Cassation is at present stable, based on general principles of contract law: while a fixed-term contract may not be terminated prior to its term (unless one of the parties has committed a material breach of its obligations), an indefinite term agreement may be terminated at any time by either party, provided a reasonable notice is granted by the terminating party and that termination is not abusive. Despite numerous arguments raised by franchisees based on their situation of economic dependency in relation to the franchisors upon the expiry of the franchise agreement, the franchisee is not entitled to any compensation or indemnity for loss of business, provided termination is neither abusive nor sudden.

After a lengthy parliamentary debate, the above-mentioned Macron Law of 6 August 2015 has introduced the principle whereby a franchise agreement and its related agreements 'whose common purpose is the operation of one or several retail outlets and include clauses that are likely to limit the freedom of the outlet's operator to carry on its business' must all have the same expiry date. Therefore, if one of the agreements terminates, this shall cause the termination of all other agreements on the same date. The parliamentary debates do not shed much light on what is meant by 'related' or 'ancillary' agreements in this context. The general intention is to avoid franchisees remaining bound by multiple

⁹ Opinion No. 10-A-26 of 7 December 2010 of the French Competition Authority.

¹⁰ Annual Franchise Survey: Summary of Results 2015 (conducted by CSA for Banque Populaire and the French Franchising Federation).

agreements relating to the operation of the sale outlets if their franchise has terminated, for instance under supply agreements for goods or equipment with the franchisor or some of its affiliates.

Except in the specific sector of food retail distribution (see Section VII), French courts will generally enforce these principles, as well as franchisees' post-term obligations, despite the fact that the franchisee may find itself in a difficult economic situation upon leaving the franchise network. This position is derived from the well-established principle whereby the franchisee owns its clientele (at least at local level, because of the investments and risks it has taken) and is therefore to be clearly distinguished from an agent, who has no goodwill.

As far as post-term non-compete clauses are concerned, one generally looks at the criteria for block exemption as set out in Article 5, Paragraph 3 of EU Regulation No. 330/2010 (including the one-year limitation). If these conditions are not fulfilled, a French court will apply the general conditions required for the validity of a non-compete clause under French law, namely it must be limited in time and geographic scope, it must be justified to protect the interests of the franchisor and proportionate to those interests (however, please refer to Section VII in relation to the Macron Law). Despite some franchisees' attempts to include another condition that applies to employment contracts (i.e., the need for the non-compete clause to include financial compensation), French courts have so far resisted making this addition. In practice, this means that non-compete clauses are often enforced in France as long as they meet the above requirements. Moreover, French courts tend to differentiate traditional non-compete clauses (the object of which is to prohibit the conduct of a business similar to that of the franchise network) from non-reaffiliation clauses (which simply restrict the freedom of the franchisee to join a competing franchise network).¹¹ As the latter is less restrictive on the franchisee than a non-compete clause, it is more widely admitted in court, except in sectors where belonging to a network is decisive given the structure of the market (for example, in the food retail or car rental businesses).¹²

Furthermore, under the Macron Law, post-term non-compete clauses in franchising agreements are void unless they meet the four conditions contained in the Block Exemption Regulation (including the one-year limitation). Therefore, the Macron Law may in the future limit the scope of some court decisions, which until now have been keen on accepting longer post-term non-compete clauses in franchise agreements, if they were proportionate to the interests to be protected and deemed necessary for the integrity of the franchisor's network.

Finally, the franchisor is also generally granted a pre-emption right over the shares of the franchisee or its business, subject to paying the price that a third party offers or may offer (on the basis of a willing seller and a willing buyer), and is generally entitled to take over the business and assets of the franchisee (including the lease). Again, subject to specific constraints applicable to the food retail distribution sector (see Section VII), such clauses are perfectly legitimate and it is common for shareholders of the franchisee and the franchisor to enter into a shareholders' agreement setting out certain veto rights for the franchisor. Likewise, if the franchisee is a master franchisee, the takeover by the franchisor of the contracts with the sub-franchisees (in the event of termination of the master franchise agreement) is generally provided for in the sub-franchise agreements and is normally enforceable.

11 Court of Cassation, Commercial Section, 28 September 2010, No. 09-13.888, Bull. Civ. IV, No. 145 – Commercial Section, 31 January 2012, No. 11-11.071.

12 Court of Cassation, Commercial Section, 18 December 2012, No. 11-27.068.

viii Anti-corruption and anti-terrorism regulation

Anti-corruption and anti-terrorism legislation is contained in the French Criminal Code. The anti-corruption provisions, which have recently been strengthened in line with the US Foreign Corrupt Practices Act and the UK Bribery Act,¹³ apply to both the public and the private sector and they do not raise specific issues in relation to franchising.

ix Dispute resolution

Disputes in relation to franchise agreements do not give rise to significant differences from the settlement of disputes in relation to other types of distribution agreements.

However, because the relationships between the parties are generally governed by a set of agreements, including not only the franchise agreement, but also a supply agreement, a services agreement, sometimes a shareholders' agreement, etc., and the fact that these agreements are very much intertwined, it is generally recommended to provide for an amicable mediation or conciliation mechanism to avoid long and often inconclusive litigation. Following the recommendations of various professional organisations, including the International Chamber of Commerce (ICC) and the Paris Chamber of Commerce, there is now in France growing awareness of and interest in alternative dispute resolution (ADR) systems. Where an agreement provides for mediation or conciliation (prior to litigation), French courts now reject any judicial claim if the parties have not previously exhausted the mediation or conciliation process.

Recent statistics indicate that among the ADR systems, mediation is the most common in franchising disputes; various organisations (including the French Franchising Federation and the ICC) offer a forum for mediation that gives rise to a quick outcome (approximately two to three months to reach a positive or negative conclusion), ensures the confidentiality of the discussions and costs little.

Franchisors have an interest in opting for a unified way of dealing with disputes with their franchisees, either through arbitration or via litigation before a designated local court (often those of Paris or the local court of the head office of the franchisor). Apart from the benefit of confidentiality, arbitration will give rise to quicker decisions than in French courts; normal judicial proceedings in front of first instance courts in France tend to last approximately 18 months.

Pending any lawsuit on the merits of a case, it is possible to refer to French courts for interim measures, even if the parties have incorporated an arbitration clause in their agreement. However, as recent decisions indicate, this presupposes that the case has not already been referred to the arbitration tribunal by either party. Interim measures may be granted by the President of the Commercial Court in situations of urgency or to prevent an imminent peril. Interim measures may include an interim payment to the damaged party if the existence of the underlying obligation is not seriously challenged, or even the mandatory performance of the relevant obligation.

Finally, French courts will give effect to a choice of law clause designating a foreign law. This is, however, subject to the application of mandatory provisions of public interest under French law (for instance, where the franchisee is subject to insolvency proceedings).

13 Law No. 2016-1691 of 9 December 2016 relating to transparency, the fight against corruption and economic modernisation, known as the Sapin II Law.

VII CURRENT DEVELOPMENTS

Several decisions rendered by the Court of Cassation and the Paris Court of Appeal in 2012 and 2013 show the importance given to antitrust considerations when deciding on the legality of certain clauses or mechanisms included in franchise agreements: in the food retail sector, courts have ruled out the application of veto rights of a major retailer in the franchisee's decisions, the obligation of the franchisee to source food products (other than private-label products) exclusively from the franchisor (or companies in its group) and a post-term non-compete commitment by the franchisee.¹⁴

Although these decisions are very specific to the organisation of food retail distribution in France, they remind us that any contractual clauses or shareholder mechanisms included in franchise agreements and ancillary agreements are always subject to an analysis of their impact on the affected market of goods and services, and may be set aside if they breach applicable competition laws.

GERMANY

Stefan Münch, Alexander Duisberg, Markus Körner and Michael Gaßner¹

I INTRODUCTION

Germany is a mature franchising market, with a good number of indigenous franchises ranging across more than 42 different sectors, from retail and fast food through hotels, education, car rental and domestic services to energy, health care and telecommunications. The three biggest sectors are services (40 per cent), hotels and gastronomy (24 per cent) and retail (24 per cent).

There are currently more than 990 active franchise systems and 167,961 franchise businesses in Germany, employing more than 715,362 employees, according to the German Franchising Association. The current annual turnover of the German franchise sector is estimated at about €122.8 billion.²

Domestic franchise chains, such as Apollo-Optik, Arko Kaffee und Confiserie and BabyOne sit side by side with the likes of McDonald's, Hertz, Intercontinental Hotels and Mail Boxes Etc. The average franchise business operating in Germany is active in 17 different countries at the same time. Over 55 per cent of all franchise systems in Germany are still expanding, while only 14 percent are already fully developed.

The German Franchise Association and the German Franchisee Association are both active, and the German Franchise Association is a member of the European Franchise Federation and of the World Franchise Council.

II MARKET ENTRY

i Restrictions

Although the General Trade Act imposes some sector-specific regulations, Germany is a market economy, which typically imposes no restrictions on foreign franchisors as regards the granting of master franchise or development rights.

1 Stefan Münch, Alexander Duisberg and Markus Körner are partners and Michael Gaßner is a counsel at Bird & Bird LLP. This chapter was originally drafted by Stefan Engels and Bahne Sievers, formerly lawyers at Bird & Bird LLP.

2 Figures as at 2018 by the German Franchise Association (Deutscher Franchise-Verband e.V.).

ii Foreign exchange and tax

There are no foreign exchange controls or restrictions on foreign currency payments applicable to cross-border franchising in Germany. It is prudent to ensure that franchise documentation states the currency in which payments should be made and the rate and time of currency conversion. Likewise, it is preferable to describe ongoing fees as service fees rather than royalties, as these can be more advantageously dealt with tax-wise.

Germany has double-taxation treaties in place with most countries and the terms of the relevant treaty should always be taken into account when structuring international payment flows.

III INTELLECTUAL PROPERTY

i Brand protection and search

The key intellectual property rights involved are trademarks, designs, domain names, copyright, database and know-how rights (patent rights are usually not relevant). Although copyright is not registrable in Germany, trademarks are, and franchisors can choose whether to register them as domestic German or European Union trademarks (EUTM) or international registrations. The registration fee for an application for a German registration is €300 with a discount of €10 should the registration be made online. A fast-tracked examination is available for an additional fee of €200. If more than three classes of goods and services are requested, a fee of €100 for each additional class will be charged. Before application, the applicant is expected to make an availability search (at least briefly) in respect of the trademark, which is usually carried out by specialised service providers, to avoid a conflict with a prior rights holder.

Not surprisingly, however, most franchisors opt for EUTM registrations rather than German domestic registrations, although domestic registration is more common if it is a German-language mark used solely for a domestic German business. Franchisors can extend their trademarks to Germany as part of an international registration or subsequent designation, as Germany is a party to the Madrid Protocol.

Germany is a first-to-file jurisdiction, although unregistered marks can be acquired by way of usage if they have acquired a reputation in Germany, and Article 6 of the Paris Protocol also ensures that 'well-known marks' can be protected even if there is no evidence of use in Germany. The German Unfair Competition Act provides relevant supplementary protection to trademarks.

In addition to pure trademark protection, the German Trademark Act also grants special protection for trade designations, which could be business names or titles of works. Their protection does not require a registration, but rather a certain level of usage of the trade designation by the proprietor.

As trade designations are not contained within the trademark register, special search tools are required to identify existing prior third-party rights.

Just recently know-how protection has been modified by the new German Trade Secrets Protection Act (based on the EU Trade Secrets Directive³), which has been implemented to improve protection for companies' technical and commercial trade secrets, and which provides additional stipulations to concretise existing protections for companies.

ii Enforcement

Trademark proprietors are entitled to commence enforcement proceedings based upon their trademark rights. It is possible to obtain a preliminary injunction (*ex parte*) in Germany, even without an oral hearing, within a very short time ('urgency period'), but any delay in issuing proceedings can mean that this right may fall away. Both parties must be represented before the court by a lawyer admitted to the German Bar.

German litigation lawyers usually work on an hourly fee arrangement – conditional fees are generally not compliant with German Bar rules. In German litigation, the English rule applies, so attorneys' fees are usually paid by the losing party to the winning party. The amount to be refunded is, however, limited by the Attorney's Remuneration Act and, as a result, the winning party may end up bearing part of its own attorney's fees.

iii Data protection, social media and e-commerce

The rules of data protection law play an important role in any dealings with the personal data of end users (and employees); these rules have a significant impact, for example, when franchisors run loyalty programmes and promotional campaigns. The former German Federal Data Protection Act (GDPA), which was based on the EU Data Protection Directive 95/46/EC, has been replaced by the General Data Protection Regulation (Regulation (EU) 2016/779 (GDPR) since 25 May 2018, and it must be read in conjunction with national derogations laid down in the new GDPA. Any processing of personal data by the franchisee (and franchisor) must be based on the consent of the data subject or legal justification under law. Wherever a data controller transfers data outside the EU or EEA, for example, into the United States, measures to ensure an adequate level of data protection compliance must be met by suitable means, such as data subject consent, the EU Model Contract Clauses, Binding Corporate Rules (for transfers within corporate organisations) or the EU-US Privacy Shield Framework (the Privacy Shield).⁴ Where a data controller instructs a data processor to process data on its behalf and subject to its instructions within the EU, the parties have to enter into a commissioned data processing agreement. Under the GDPR (Article 28), the data processor assumes a higher level of liability towards the data subject and the authorities for complying with data protection law, whereas under the former GDPA only the data controller was responsible towards the data subject and the authorities. Data protection authorities have issued further guidance on the requirements regarding processor obligations and liability.⁵ Franchisors and franchisees must, however, also consider whether they could be tied into joint controllership, namely where they jointly determine the means and purposes

3 Directive (EU) 2016/943 of the European Parliament and of the Council of 8 June 2016 on the protection of undisclosed know-how and business information (trade secrets) against their unlawful acquisition, use and disclosure.

4 Certain civil rights organisations have challenged the Privacy Shield; proceedings are pending before the court of first instance, Case T-670/16, Digital Rights Ireland.

5 DSK (16 January 2018): Kurzpapier Nr. 13, Auftragsverarbeitung, Art. 28 DS-GVO, available at https://www.datenschutzkonferenz-online.de/media/kp/dsk_kpnr_13.pdf (last accessed 26 November 2019).

of processing personal data (Article 26 GDPR). Depending on the circumstances, this can well be the case; for example, where a franchisor provides infrastructure or a platform, or both of these, for the franchisees to jointly process end customer data.⁶ As a result, both parties will have to define their joint controllership in a relevant agreement, or in an annex to their franchise agreement, pursuant to Article 26 GDPR, as well as having to be aware of their joint and several liability towards the data subjects and authorities (Article 82(4) GDPR).⁷ Subsequent to the statement by the EU Commission on 21 October 2019 that an investigation had revealed serious concerns over the role of Microsoft as a processor for EU institutions using its products and services, Microsoft recently admitted its role as processor and joint controller and announced an update to the privacy provisions in its contractual services terms.⁸ For guidance on this matter, consideration should be given to the guidelines on joint controllership recently published by the European Data Protection Supervisor.⁹

As regards online tracking and profiling, use of cookies and personal data collected in the context of electronic communications, parties should be aware of the discussion on the ePrivacy Regulation. Currently, the Council's position on the draft ePrivacy Regulation has been rejected by the Permanent Representatives Committee of the Council of the European Union. The Commission may either withdraw the entire proposal or the Council may prepare a new draft. Until then, German data protection authorities have made it clear that the use of cookies is subject to consent or opt-in requirements under the GDPR, and the data protection provisions of the German Telemedia Act shall no longer apply.¹⁰ This position has been reaffirmed by the recent cookie decision of the European Court of Justice (ECJ), according to which technically non-essential cookies are subject to consent. The ECJ ruled that users must actively consent to the retention of cookies (i.e., they must opt in), whereas consent by default is not permitted.¹¹ The German data protection authorities announced fines and restrictions on website tracking. As a precaution, it is therefore highly advisable to switch to an opt-in implementation of non-essential cookies.

Notably, each regional state in Germany has its own data protection authority, which can take slightly different views on interpreting and enforcing the law. However, under the GDPR, the possible scope of interpretation has now narrowed down, given the GDPR's universal application throughout the EU and EEA; additionally the European Data Protection

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- 6 A similar case was decided by the European Court of Justice (ECJ): the ECJ ruled that Facebook and the administrators of Facebook 'fan pages' are to be considered joint controllers (ECJ ruling from 5 June 2018 (Case No. C-210/16, paragraph 39).
 - 7 See also DSK (19 March 2018): Kurzpapier Nr. 16, Gemeinsam für die Verarbeitung Verantwortliche, Art. 26 DS-GVO, available at https://www.datenschutzkonferenz-online.de/media/kp/dsk_kpnr_16.pdf (last accessed 26 November 2019).
 - 8 Julie Brill (18 November 2019): Introducing more privacy transparency for our commercial cloud customers, available at <https://blogs.microsoft.com/eupolicy/2019/11/18/introducing-privacy-transparency-commercial-cloud-customers/> (last accessed 26 November 2019).
 - 9 European Data Protection Supervisor (7 November 2019): EDPS Guidelines on the concepts of controller, processor and joint controllership under Regulation (EU) 2018/1725, available at https://edps.europa.eu/sites/edp/files/publication/19-11-07_edps_guidelines_on_controller_processor_and_jc_reg_2018_1725_en.pdf (last accessed 26 November 2019).
 - 10 DSK position paper (26 April 2018): Zur Anwendbarkeit des TMG für nicht-öffentliche Stellen ab dem 25 May 2018, available at https://www.ldi.nrw.de/mainmenu_Datenschutz/submenu_Technik/Inhalt/TechnikundOrganisation/Inhalt/Zur-Anwendbarkeit-des-TMG-fuer-nicht-oeffentliche-Stellen-ab-dem-25-Mai-2018/Positionsbestimmung-TMG.pdf (last accessed 26 November 2019).
 - 11 ECJ ruling from 1 October 2019 (Case No. C-673/17).

Board plays an important role in providing further guidance; the GDPR also makes provision for other forms of secondary law that may take consideration of particular industry and sector practices, such as codes of conduct (Articles 40 and 41 GDPR) and certifications (Articles 42 and 43 GDPR).

Further to that, there are also various sector-specific regulations, such as those that apply to providers of telemedia services under the German Telemedia Act, which is relevant for online marketing and user-tracking activities, or to internet service providers. Lack of compliance with data protection laws and those of the Telemedia Act can lead to serious consequences, including monetary fines and cease-and-desist orders, as well as reputational issues and negative publicity in Germany. To date, there has been no harmonised framework for determining monetary fines under the GDPR. The German group of national and regional data protection authorities, the Data Protection Conference (DSK), recently published a concept document¹² providing guidance on the imposition of fines against companies in proceedings within the scope of the GDPR, and introduced this at European level to harmonise it with existing frameworks of other Member States. In the past, the German data protection authorities had imposed only rather moderate fines and had not advanced into the range of millions. However, this changed recently with the imposition by the Berlin data protection authority of a fine of around €14.5 million on a real estate company for not maintaining a proper deletion process for customer data.¹³

Social media monitoring, as well as active marketing through social media, raises a considerable number of issues under the GDPR – as was previously the case under German privacy rules, which is why use of these channels is typically less developed than in other European jurisdictions. Accordingly, taking proper legal advice on a case-by-case basis is required for activities in this field.

German regulations on e-commerce mainly derive from EU legislation, such as the directives on distance selling¹⁴ and on consumer rights.¹⁵ E-commerce providers need to observe a variety of information obligations; failure to comply with these obligations can trigger extended rights of withdrawal for consumers, as well as possible competitor actions.

On the basis of unfair competition law, competitors as well as competition associations, qualified consumer protection associations and chambers of industry and commerce, or craft chambers, can launch cease-and-desist actions against market players that do not ‘play by the rules’ with regard to compliance with requirements on electronic contracting, information obligations, unlawful advertising or even, in certain circumstances, presenting clauses in standard terms of business that are partially or entirely unenforceable. Given the quick reaction times and the speed of courts in granting injunctions (including *ex parte* injunctions), businesses need to pay particular attention to the potential pitfalls in the area of unfair competition law.

12 DSK concept (14 October 2019): Konzept der unabhängigen Datenschutzaufsichtsbehörden des Bundes und der Länder zur Bußgeldzumessung in Verfahren gegen Unternehmen, available at https://www.datenschutzkonferenz-online.de/media/ah/20191016_bu%C3%9Fgeldkonzept.pdf (last accessed 26 November 2019).

13 Berlin Data Protection Commissioner press release (5 November 2019): Berliner Datenschutzbeauftragte verhängt Bußgeld gegen Immobiliengesellschaft, available at https://www.datenschutz-berlin.de/fileadmin/user_upload/pdf/pressemitteilungen/2019/20191105-PM-Bussgeld_DW.pdf (last accessed 26 November 2019).

14 Directive 97/7/EC.

15 Directive 2011/83/EU.

IV FRANCHISE LAW

i Legislation

There is no franchise law as such in Germany; provisions concerning franchising can instead be found in the general codes of law such as the Civil and Commercial Codes. These provisions, inter alia, impose pre-contractual disclosure obligations and a heavy expectation of good faith on all parties, making claims of profit to potential franchisees particularly risky.

ii Pre-contractual disclosure

Pre-contractual disclosure obligations are imposed on the principle of *culpa in contrahendo*, which is codified in Section 311(2) of the Civil Code. In addition, the law concerning misrepresentation is also relevant.

During the negotiations, both parties – not just the franchisor – must tell the truth, make no false promises and disclose all material facts to each other. This is especially true as regards those facts that will have a material impact on the success of the franchise and that may induce the potential franchisee to become part of the network. Earnings claims are particularly difficult and must be based on reliable and relevant empirical data – estimates must be clearly labelled as such. It is even possible that should the franchisor's directors or agents make dishonest or misleading statements to potential franchisees, they could be held personally liable according to Section 311(3) of the Civil Code.

Franchisors should therefore be very cautious in marketing their franchises in Germany. Any failure to comply with the principle of *culpa in contrahendo* will mean that a contract could be set aside, and any fees paid may have to be repaid in full. There is a statutory period of limitation of three years for claims that a contract failed to comply with this principle, which commences at the end of the year in which the claim arose and the franchisee obtained knowledge of the circumstances giving rise to the claim.

iii Registration

Germany does not require franchises to be registered.

iv Mandatory clauses

The ongoing relationship between franchisor and franchisee is especially affected by agency laws¹⁶ if the franchisee commits to the ongoing purchase of products and equipment. Antitrust law, based upon Article 101 of the Treaty on the Functioning of the European Union (TFEU), also has an impact on issues such as the grant of exclusivity, tying and price control.

A test of fairness by the rules on unfair contract terms will be imposed on any provision in a standard form agreement that has not been negotiated by the rules on unfair contract terms.¹⁷ The threshold for qualifying as 'negotiated' is rather high in Germany, so it is very likely that a standard form agreement will fall within the scope of the rules on unfair contract

16 Agency laws, inter alia, impose the duty on franchisors to pay compensation to franchisees on termination, the principle of good faith, the rule that unfair contracts are void and the principle that long-term contracts can be terminated for good reason, and cooling-off rights in accordance with European consumer protection law.

17 Section 305 et seq. of the Civil Code.

terms. Special justification is generally needed if a provision deviates from the fallback position as set out in the Civil Code to the detriment of the franchisee. Franchisees can be treated as if they were consumers in domestic agreements.

Several statutory provisions will be implicit in the agreement, such as a right of the franchisee to terminate and the franchisor's obligation to provide certain services. There is a great deal of case law on the question of what constitutes sufficient grounds for termination, so franchisors must be cautious when exercising or contesting this right.

v Guarantees and protection

The principle of *contra bonos mores* has a limiting effect on securities, especially if the value of the surety clearly exceeds the debt; where this is the case, the suretyship agreement might be declared void or the debtor can demand a partial release of the security.

V TAX

i Franchisor tax liabilities

Franchisors that are tax resident in Germany are liable for corporation tax of 15 per cent plus a solidarity surcharge that is added to the corporate income tax and set at a rate of 5.5 per cent of the corporate income tax rate (equalling an additional 0.825 per cent) and trade tax. Trade tax is a municipal tax. As such, tax rates are individually determined by each municipality (the German average is around 14 per cent). Withholding tax of 25 per cent is payable on dividends.

Royalty fees for the granting of rights under the German Copyright Act (e.g., software licences, although not the licences to use patents or trademarks) bear a reduced VAT rate of 7 per cent, while all other fees paid to the franchisor by the franchisee are subject to VAT at 19 per cent. The initial franchise fee is usually amortised over the duration of the franchise for income tax purposes.

ii Franchisee tax liabilities

In addition to corporation tax and the solidarity surcharge, trade tax is also payable by franchisees.

Tax on personal income falls into bands ranging from 14 to 45 per cent; corporate tax, municipal trade tax and VAT also apply at the rates mentioned in Section V.i.

VI IMPACT OF GENERAL LAW

i Good faith and guarantees

Franchisors cannot exercise their contractual rights or change their business formats with impunity, as the concepts of good faith and fair dealing are implicit in all agreements. Although both franchisors and franchisees benefit from and carry reciprocal burdens, it is generally franchisors, as the dominant parties, that find they have to defend themselves from allegations of behaving unfairly or in bad faith. This is particularly the case when franchisors seek to issue disciplinary or other actions against their franchisees, so their actions need to be proportionate.

ii Agency distributor model

The courts often apply agency law to franchise agreements by analogy.

iii Employment law

Some employers in low-skill businesses, such as contract cleaning, have been known to use a form of 'false franchising' as a way of reducing their liabilities to their employees. The German courts are very sensitive to this type of abuse and the Federal Labour Court's decision in the *Eismann* case¹⁸ established that franchisees can be deemed to be 'in fact' employees of a franchisor if the franchisor controls every aspect of an individual franchisee's business.

As of 2015, a uniform nationwide statutory minimum wage was introduced in Germany. This wage is intended to be reviewed by a commission every two years. As of 1 January 2020, it was increased from €8.84 to €9.35.

iv Consumer credit protection

Section 513 of the Civil Code protects new businesses, including some franchisees, in relation to loans, respites or any other forms of financial aid, as well as instalment supply contracts. Specific statutory information requirements apply and such franchisees may be entitled to withdraw from their contracts.

v Competition law

German competition law is based on the corresponding provisions contained in the TFEU. Nevertheless, the German courts can be particularly strict in their approach.

vi Restrictive covenants

Franchisors can prevent their franchisees from competing with them for the duration of their agreements, but prohibiting franchisees from supplying other franchisees within the same franchise systems is regarded as contravening Article 4(b) of the Block Exemption Regulation. Post-termination restrictive covenants must be explicitly provided for in the franchise agreement and limited in time, scope and territory, and are only enforced by the courts in the event that the franchisor has paid the franchisee a consideration for them.

vii Termination

The franchisor cannot terminate a franchise contract for a minor breach. Termination must be proportionate, fair and in good faith.

If the franchisee undertakes to sell its business to the franchisor on termination, this will be enforced by the courts, but is not common practice among franchisors in Germany.

viii Anti-corruption and anti-terrorism regulation

In practice anti-corruption and anti-terrorism compliance considerations do not apply in the context of franchising in Germany.

18 NJW 1997, 2973.

ix Dispute resolution

Foreign law is generally acceptable in agreements. Even if foreign law has been agreed, mandatory German and European laws will apply if the franchisee is operating in Germany. Under the Brussels I Regulation, judgments of a court of an EU Member State are enforceable in other Member States without the need for any special procedures, and arbitration awards are fully recognised; mediation is also available.

Injunctions are relatively easy to obtain. Ex-franchisees that continue to use former franchisors' marks are easily stopped by way of interim injunctions. Damages can be awarded but are usually intended to cover actual losses incurred.

VII CURRENT DEVELOPMENTS

The courts continue to wrestle with issues concerning pre-contractual disclosure, termination, the need to give notice, and cooling-off periods. It is likely that this will remain the situation for the next few years.

HONG KONG

Michelle Chan and Hank Leung¹

I INTRODUCTION

The Hong Kong Special Administrative Region (Hong Kong) is an important centre for international finance and trade, and is perennially ranked as one of the freest economies in the world. With its high standard of living, cosmopolitan population and low barrier of entry for businesses, the city has also become internationally famous as a shopping destination and food centre. Many international brands have an established presence in the city, and those without a presence see Hong Kong as an important link to the ever-growing mainland Chinese market.

Hong Kong does not have any laws or regulations specific to franchising. Local and foreign companies alike are free to establish and operate franchises as they see fit, subject to general consumer protection legislation.

The Hong Kong General Chamber of Commerce has established the Hong Kong Franchise Association (HKFA) committee to monitor and promote the development of franchising in the territory. Membership of the HKFA and adherence to its guidelines are on a voluntary basis.

II MARKET ENTRY

i Restrictions

There are no franchise-specific restrictions on foreign franchisors who wish to enter the Hong Kong market. Foreign entities are free to grant their local partners master franchise or development rights. Foreign entities are also free to own real property or equity in a local business.

ii Foreign exchange and tax

The Hong Kong dollar is the currency of Hong Kong. The Hong Kong dollar is pegged to the US dollar at around HK\$7.8 to US\$1. The Hong Kong dollar is fully convertible into other currencies around the world. There are no capital restrictions on capital flows into and out of Hong Kong, neither are there foreign exchange restrictions in Hong Kong.

Hong Kong has a straightforward tax regime. Companies simply need to pay profits tax on income sourced in Hong Kong. There is no tax on dividends, capital gains, goods and services. However, withholding tax is levied on income (royalty payment) derived from the use of intellectual property rights in Hong Kong. The current effective rate is at 4.95 per cent.

¹ Michelle Chan and Hank Leung are partners at Bird & Bird.

III INTELLECTUAL PROPERTY

i Brand search

The Hong Kong government's Intellectual Property Department (IPD) maintains an online central database of trademarks, patents and registered designs.² Anyone can access the database for free via the internet and search for intellectual property currently registered with the IPD. Alternatively, the IPD provides a service where they can perform the search for a small fee.

ii Brand protection

Trademarks are protected first by registering with the IPD. Registration requires the completion of an application form that can be downloaded from the IPD website.³ The application must then be submitted to the IPD in person or by post, together with the application fee (HK\$2,000 for one class as at November 2019). The IPD will then review the application to ensure that all the required information has been provided.

A search will then be conducted to ensure there are no conflicts. If conflicts are cleared, the IPD will publish a public notice that the application has been filed. There is a three-month period from the date of publication of the notice during which an objection to the application can be filed. If there have not been any objections, the IPD will issue a certificate of registration at the end of the period. The official date of registration of the trademark will be the filing date of the application.

iii Enforcement

Enforcement of intellectual property rights is performed through the Hong Kong Courts. The process of filing a claim against a trademark infringer follows the same process as that of a normal civil claim (see Section VI). Failure to comply with a court order will be considered contempt of court, punishable by a fine or imprisonment.

More importantly, in Hong Kong, enforcement of provisions under the Copyright Ordinance, the Trade Description Ordinance and the Trademark Ordinance that give rise to a criminal offence are undertaken by the Customs and Excise Department, which has been given broad powers, including seizing and removing articles that may be infringing copies of a copyright work and entering and searching premises to carry out its duties, upon obtaining of a warrant from a magistrate.

iv Data protection, cybercrime, social media and e-commerce

Hong Kong does not have any specific legislation regulating social media or e-commerce. Activities will be regulated under general law.

In relation to personal data and data protection, the primary legislation is the Personal Data (Privacy) Ordinance (PDPO).⁴ The PDPO governs the use of personal data, which is defined as any data that relates to a living individual from which it is practicable for the identity of the individual to be ascertained. Collection of personal data is only allowed if the individual is first informed of the purpose for which the data is to be used; and the classes of persons to whom the data may be transferred. Personal data may not be used for a new purpose without the prescribed consent of the individual.

² <https://research.ipd.gov.hk/nis-pos-view/>.

³ www.ipd.gov.hk/eng/applicants/trademarks.htm.

⁴ Chapter 486 of the Laws of Hong Kong.

Any collection and use of personal data for direct marketing purposes requires the express consent of the individuals concerned.

Franchises must ensure that all personal data that has been collected are accurate and are protected against unauthorised or accidental access, processing, erasure, loss or use. Franchises must also ensure that the personal data collected are accessible to the individual they relate to upon the individual's request for access or correction.

Personal data collected may not be retained for longer than is necessary for the fulfilment of the purpose for which they were obtained.

On cybercrime, the Telecommunications Ordinance⁵ expressly provides for a number of criminal offences relating to unauthorised access of data contained on a computer.⁶

IV FRANCHISE LAW

i Legislation

There is no specific franchise legislation enacted in Hong Kong. However, there are a number of consumer protection laws that would be relevant to a franchise and basic common law principles would also apply:

- a* the Consumer Goods Safety Ordinance⁷ requires manufacturers, importers and suppliers to ensure that consumer goods meet the general safety requirement;
- b* the Control of Exemption Clauses Ordinance⁸ prevents the supplier of goods or services from the exclusion or restriction of particular liabilities in its contractual terms;
- c* the Sales of Goods Ordinance⁹ provides that goods for sale must be of merchantable quality, fit for purpose as described on the package or by the seller, and must correspond with any samples on display;
- d* the Supply of Services (Implied Terms) Ordinance¹⁰ sets out the implied terms applicable to all service contracts, for example reasonable care and skill, performance within a reasonable time and that a reasonable charge should be paid;
- e* the Trade Descriptions Ordinance¹¹ prohibits false trade descriptions in respect of goods and services made in consumer transactions; and
- f* the Unconscionable Contracts Ordinance¹² empowers the court to give relief to consumers in respect of contracts relating to the sale of goods or supply of services found to be unconscionable.

Statutory and common law in relation to intellectual property will also be relevant with regard to activities relating to franchises.

5 Chapter 106 of the Laws of Hong Kong.

6 For example, Section 27A, *ibid*.

7 Chapter 456 of the Laws of Hong Kong.

8 Chapter 71 of the Laws of Hong Kong.

9 Chapter 26 of the Laws of Hong Kong.

10 Chapter 457 of the Laws of Hong Kong.

11 Chapter 362 of the Laws of Hong Kong.

12 Chapter 458 of the Laws of Hong Kong.

ii Pre-contractual disclosure

There are no specific pre-contractual disclosure requirements. The HKFA has published a Code of Ethics,¹³ which states that a franchisor should provide to the prospective franchisee full and accurate written disclosure of all information material to the franchise relationship within a reasonable time prior to execution of the agreement. A franchisee should provide full and frank disclosure of all information material to facilitate the franchisor's selection of a franchisee.

Under Hong Kong law, however, a misrepresentation is a ground for rescission of a contract or the award of damages. This is where one party – the representor – makes a false representation to another – the representee – to induce the representee to enter into a contract. Under Hong Kong common law, if the representation was made fraudulently or negligently, the representee may also claim for damages suffered as a result of entering into the contract. Under the Misrepresentation Ordinance,¹⁴ the representee may also claim for damages despite the absence of fraud.

In a franchise context, the key elements required for a franchisor or a franchisee to bring such a claim against the other party are: (1) the misrepresentation was an untrue statement of fact or law; (2) the statement induced it to enter the contract; and (3) it has suffered a loss as a result of the entering into of the contract.

iii Registration

There are no franchise registration requirements.

iv Mandatory clauses

There are no mandatory clauses specific to franchise agreements.

v Guarantees and protection

There is no legislation or mandatory legal requirement under Hong Kong law relating to guarantees and protection. It is for the parties to agree whether guarantees from the principle owner or parent company are required.

V TAX

i Franchisor tax liabilities

Hong Kong operates a territorial system of taxation. All profits derived from Hong Kong are subject to profits tax while any foreign-sourced income is non-taxable. The current tax rate applicable to corporations is 8.25 per cent on assessable profits up to HK\$2 million and 16.5 per cent on any part of assessable profits over HK\$2 million.¹⁵

13 www.franchise.org.hk/en/code_of_ethics.html.

14 Chapter 284 of the Laws of Hong Kong.

15 www.gov.hk/en/residents/taxes/taxfiling/taxrates/profitsrates.htm.

ii Franchisee tax liabilities

All profits derived from Hong Kong are subject to profits tax while any profit derived overseas is non-taxable. The current tax rate applicable to corporations is 8.25 per cent on assessable profits up to HK\$2 million, and 16.5 per cent on any part of assessable profits over HK\$2 million.¹⁶

Owners of property are charged property tax, which is computed at the standard rate on the net assessable value of the property. The current standard rate is 15 per cent.¹⁷ Depending on the terms of the retail property's lease, a franchisee may be required to pay to the owner all or a portion of the property tax.

iii Tax-efficient structures

Hong Kong has a relatively simple system of taxation. The guiding principle is that all profits derived from Hong Kong will be subject to profits tax.

VI IMPACT OF GENERAL LAW

i Good faith and guarantees

Decisions of the English courts on good faith relating to good faith cooperation and implied terms of good faith when making a genuine decision and relating to honesty¹⁸ are likely to be applied and followed by Hong Kong courts. Although court decisions of England and Wales no longer form part of the law of Hong Kong, the case of *Yam Seng Pte Ltd v. International Trade Corp Ltd*¹⁹ was applied in a Hong Kong court decision (albeit that the case was cited with regard to an issue unrelated to good faith).²⁰ The *Yam Seng* case has also been relied on to argue for an implied duty of good faith before the Hong Kong courts in the recent cases of *Golden Miles Group Holdings Ltd v. Jacob & Co Ltd*²¹ and *Lau Yu v. Hongkong and Shanghai Banking Corp Ltd*.²² Recently, however, it was held by the Hong Kong courts that any implied duty of good faith cannot override the express provisions of the contract.²³ It is therefore important to consider the implications of these cases in assessing the obligations of the franchisor and the franchisee under Hong Kong law.

In addition, the HKFA has published a Code of Ethics (the Code) that generally states the parties should act in good faith.²⁴ The Code is a guideline for HKFA members to follow and is not binding. The Code specifically points out that disputes should be resolved with

16 *ibid.*

17 www.gov.hk/en/residents/taxes/taxfiling/taxrates/propertyrates.htm.

18 See corresponding United Kingdom chapter, Section VI.i.

19 *Yam Seng Pte Ltd v. International Trade Corp Ltd* [2013] EWHC 111.

20 *Ng Chi Kwan, Danny Summer (alias 夏韶聲) & Anor v. Yeung Yiu Kwan & Anor* [2014] 5 HKLRD 744.

21 *Golden Miles Group Holdings Ltd v. Jacob & Co Ltd* [2018] HKCFI 441, [2018] HKEC 571.

22 *Lau Yu v. Hongkong and Shanghai Banking Corp Ltd* [2018] HKCA 744, [2018] HKEC 3144. It should be noted that Hong Kong courts have yet to express a definitive view on whether an implied duty of good faith could arise in the circumstances to be decided before the courts.

23 *Shek Kin Pong and Others v. FTLife Insurance Co Ltd (formerly known as Ageas Insurance Company (Asia) Limited)* [2019] HKCU 2677.

24 www.franchise.org.hk/en/code_of_ethics.html.

good faith and goodwill. To the extent reasonably possible and with good faith, the franchisor shall give notice to the franchisee of any contractual breach and grant reasonable time to remedy the default.

ii Agency distributor model

Franchisors and franchisees may contractually agree to an agency or distributor business model. In an agency model, the franchisee will sell the franchisor's products on behalf of the franchisor as agent to customers. Legally, the products are never owned by the franchisee. In a distributor model, the franchisee will purchase the franchisor's products in its own right and will then sell the products to customers.

iii Employment law

It is unlikely that a franchisee would be considered an employee of a franchisor. To be considered an employee, one must enter into a contract of employment whereby one person agrees to employ another and that other agrees to serve his employer as an employee. If a franchisee is considered an employee of the franchisor, the franchisee would be entitled to the minimum statutory protection and benefits conferred under the Employment Ordinance²⁵ (e.g., statutory rest days, mandatory provident fund payments and employees' compensation insurance).

iv Consumer protection

It is unlikely that franchisees would be considered consumers or 'dealing as a consumer' under Hong Kong law. They would therefore be considered businesses and would be required to comply with the consumer protection legislation discussed in Section VI.i, in their dealings with consumers.

In Hong Kong, there is no comprehensive or overarching consumer legislation. Statutory protection is offered under a number of ordinances in Hong Kong.²⁶

v Competition law

In June of 2012, Hong Kong enacted its first legislation governing cross-sector competition, the Competition Ordinance.²⁷ The Competition Ordinance seeks to: (1) prohibit agreements and cooperation arrangements from restricting competition (price fixing, limiting supply to drive up prices, dividing segments of the market between competitors, etc.); and (2) prohibit the abuse of substantial market power to restrict competition. The Competition Ordinance came into full effect on 14 December 2015. The law will be enforced by the Competition Commission.²⁸

²⁵ Chapter 57 of the Laws of Hong Kong.

²⁶ See Section IV.i.

²⁷ Chapter 619 of the Laws of Hong Kong.

²⁸ Where a matter concerns the telecommunications and the broadcasting sectors, the Competition Commission will have concurrent jurisdiction with the Communications Authority. See Section 159 of the Competition Ordinance and the Memorandum of Understanding between the Competition Commission and the Communications Authority entered into pursuant to Section 161 of the Competition Ordinance.

In July 2015, the Competition Commission and Communications Authority jointly issued six guidelines on how the Competition Ordinance will be interpreted and enforced by the authorities, namely:

- a* the Guideline on the First Conduct Rule;
- b* the Guideline on the Second Conduct Rule;
- c* the Guideline on the Merger Rule;
- d* the Guideline on Complaints;
- e* the Guideline on Investigations; and
- f* the Guideline on Applications for a Decision under Sections 9 and 24 (Exclusions and Exemptions) and Section 15 Block Exemption Orders.

The Guideline on the First Conduct Rule, for example, provides that retail price maintenance (i.e., where a franchisor establishes a fixed or minimum resale price for the franchisee to follow) might be considered, by its nature, to be anticompetitive (see the two landmark decisions by the Competition Tribunal below). Nevertheless, the guidelines further provide that retail price maintenance might be exempted if the arrangement can be proved to entail pro-competitive benefits. For example, retail price maintenance may assist a franchise arrangement to organise a coordinated price campaign of limited duration.

In addition to the six guidelines mentioned above, the Competition Commission also issued in November 2015 two policies specifically on enforcement entitled ‘Enforcement Policy’ and ‘Leniency Policy for Undertakings engaged in Cartel Conduct’ in anticipation of the coming into force of the Competition Ordinance.

On 17 May 2019, the Competition Tribunal issued judgments for the first two enforcement cases brought by the Competition Commission relating to alleged contraventions of the First Conduct Rule of the Competition Ordinance. In *Competition Commission v. Nutanix Hong Kong Limited and others*,²⁹ a case involving the submission of ‘dummy bids’ in response to a tender, it was held that the Competition Commission is not required to prove that an arrangement actually affected competition so long as it can be shown that the conduct has ‘by its nature’ an anticompetitive object. Pertinently, it was also held that vertical agreements aimed at distorting the competitive process and preventing any further potential competition can also constitute infringement. Businesses should therefore be aware that any arrangement with an object of distorting competition would risk infringing the Competition Ordinance, even if the arrangement were between non-competitors.

In *Competition Commission v. W. Hing Construction Company Limited and others*,³⁰ a case involving agreements between 10 renovation contractors to allocate designated floors in particular flats to carry out decoration work for individual tenants, and price-fixing, it was held the Competition Commission did not have to prove that the arrangements actually adversely affected competition, as both the floor allocation agreement and the package price arrangement were found to have the object of restricting competition.

There have been no enforcement cases involving franchisees and franchisors in Hong Kong to date.

29 [2019] HKCT 2.

30 [2019] HKCT 3.

vi Restrictive covenants

Generally restrictive covenants are unenforceable in Hong Kong on public policy ground. The courts may find exception to the rule provided the franchisor can demonstrate that it has a legitimate interest to protect (e.g., system of the business, confidential information vital to the business) and that the scope of the restriction is no more than is reasonably necessary for the protection of that interest.³¹ To ensure the enforceability of restrictive covenants, the restriction should be limited in scope, time period and geographical area.

A breach of a restrictive covenant contained in the franchise agreement may be enforced by applying to the court for an interim injunction. To obtain an interim injunction, the franchisor will need to satisfy the court that there is a serious issue to be examined and that if the franchisee's activities are not immediately stopped, the damage to the franchisor's business could be so great that there could be no adequate financial compensation. In urgent cases, the franchisor may make the application to court without notice to the franchisee.

vii Termination

Termination of a franchise agreement is a contractual matter and should follow the termination clause of the agreement. As a matter of common law, the parties have a right to terminate the agreement in the event of a repudiatory breach and where it is clear that the party in breach does not intend to honour the agreement.

Depending on the contractual terms, a franchisor may take over the franchisee's business. There are no restrictions on foreign ownership of local business or leasing property.

viii Anti-corruption and anti-terrorism regulation

A franchisor or franchisee's liability for fraud will mainly be in the context of fraudulent misrepresentation, as discussed in Section II.iv.

There are a number of relevant laws that set out a range of offences relating to bribery, money laundering and terrorism that may apply to the franchise relationship. These are:

- a* the Prevention of Bribery Ordinance,³² which provides that any person who, acting as an agent (this includes an employee), solicits or accepts any advantage (e.g., money, loans, commission, contracts, services and favours) as an inducement or reward to do any act in relation to its principal's affairs, commits an offence;
- b* the Drug Trafficking (Recovery of Proceeds) Ordinance³³ and the Organised and Serious Crimes Ordinance,³⁴ which states it is a criminal offence to deal with any property knowing or having reasonable grounds to believe that the property, in whole or in part, directly or indirectly, represents proceeds of drug trafficking or an indictable offence; and
- c* the United Nations (Anti-Terrorism Measures) Ordinance,³⁵ which provides that it is a criminal offence to provide or collect property, by any means, directly or indirectly, with the intention that the property will be used, or knowing that the property will be used, in whole or in part, for the purposes of terrorism.

31 See, for example, *Lush Ltd & Anor v. Red Channel International Ltd & Ors* [2015] HKCU 1349, in which Lush alleged that Red Channel has been in breach of a non-compete provision.

32 Chapter 201 of the Laws of Hong Kong.

33 Chapter 405 of the Laws of Hong Kong.

34 Chapter 455 of the Laws of Hong Kong.

35 Chapter 575 of the Laws of Hong Kong.

ix Dispute resolution

As a dispute resolution forum, arbitration and litigation are equally valid; this will depend on the circumstances of each case. For court proceedings, the parties must file a mediation certificate with the court signifying that they have at least considered mediation soon after the close of pleadings (i.e., filing of the statement of claim and defence). The Hong Kong courts will generally uphold a foreign choice-of-law clause. As a matter of best practice, Paragraph 9 of the HKFA's Code of Ethics states that the parties should resolve disputes through arbitration.³⁶

There are no litigation procedures specific to resolving franchising disputes. A franchise dispute will follow the standard court procedure for contractual disputes:

- a* to commence a court action, a writ of summons and statement of claim must be filed with the court and served on the defendant. The statement of claim must state the nature of the claim, the facts relied upon and the remedy claimed;
- b* the defendant must file an acknowledgment of service within 14 days of service of the writ to indicate if it wishes to defend the action; any defence must be filed with the court and served on the plaintiff within 28 days of the time limit for acknowledgment of service or after the statement of claim is served on him, whichever is later;
- c* the parties then enter the discovery phase and must disclose all documents related to the case and allow the other party to inspect the actual documents;
- d* each party must file and serve a timetabling questionnaire within 28 days of pleadings as provided in paragraph (b) being closed (the questionnaire assists the parties and the court in managing the case);
- e* within 14 days of receiving the timetabling questionnaire from all defendants, the plaintiff is to issue a case management summons for the court to give directions on the management of the case;
- f* after the court has given directions that the case may be set down for trial, the plaintiff should make an application to the court to do so and pay the prescribed fee;
- g* at the trial, the court will hear the submissions of the parties and any witness evidence. The court may adjourn the case if further information or evidence is required;
- h* the court may give its judgment on the date of the trial or at a later date; and
- i* a party can notify the court and other party of its intention to appeal the decision within the time limit.

It is possible to obtain an interim or permanent injunction to prevent the continued breach of a non-compete provision or unauthorised use of trademark (see the discussion on restrictive covenants above). The court will seek to place the plaintiff into the position that it would have been in had the contract been fully performed. Damages for breach of contract are calculated based on actual loss arising from the breach. The court will generally order the unsuccessful litigant to pay all or part of the legal costs of the successful party (in addition to paying its own costs).

³⁶ www.franchise.org.hk/en/code_of_ethics.html. The court would also stay proceedings for petition for a winding up order against a joint venture company set up for operating a franchise pending the decision of the related arbitration proceeding if the relevant franchise agreement has provided for disputes to be resolved through arbitration, and this includes if the shareholders have grounds to petition for the winding up of the joint venture company. See *Quiksilver Greater China Ltd v. Quiksilver Glorious Sun JV Ltd & Anor; sub nom Re Quiksilver Glorious Sun JV Ltd* (HKLRD) [2014] 4 HKLRD 759.

Hong Kong is a signatory to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitration Awards, and will enforce foreign arbitral awards. In addition, arbitral awards made in Hong Kong are enforceable in mainland China under the Arrangement Concerning Mutual Enforcement of Arbitral Awards between mainland China and Hong Kong.³⁷

In the case of *TGI Friday's Inc v. Perfect Wave Ltd*,³⁸ the franchise agreement was terminated by the franchisor for poor performance. The franchisee continued to operate the restaurant under the franchisor's brand name. The franchisor sought an interim injunction to stop the operation of the restaurant under the brand name. The court found that the agreement had been validly terminated and granted the injunction on the basis that the franchisor would have suffered irreparable damage if the franchisee had been allowed to continue.

VII CURRENT DEVELOPMENTS

Although there are already a substantial number of foreign brands with an established presence in Hong Kong, other brands are seeking to enter into the market. This is due to Hong Kong's reputation as a regional centre for shopping and food, and the rapid growth of mainland Chinese tourists visiting the territory. To illustrate, the period between 2015 and 2018 saw the opening of various fashion retailers, such as Lululemon, Decathlon, Foot Locker, 2XU and Canada Goose.

In terms of case law in relation to contractual law development, the Supreme Court held in *Cavendish Square Holding BV v. Talal El Makdessi* and *ParkingEye Limited v. Beavis*³⁹ that it is no longer necessary to show a genuine pre-estimate of loss in enforcing a liquidated damages clause. Instead, the Supreme Court found that penalty clauses should be determined based on whether the innocent party's legitimate interest in enforcing the counterparty's contractual obligations were 'out of all proportion'. This is relevant in the franchising context as a liquidated damages clause is common in franchising agreements. Where franchisees and franchisors have equal or similar bargaining power in negotiating franchising arrangements, the court will be more reluctant to interfere with a contractual liquidated damages clause. *Cavendish Square Holding BV v. Talal El Makdessi* and *ParkingEye Limited v. Beavis* were cited in various cases in the Hong Kong Court of First Instance,⁴⁰ the District Court⁴¹ and the Lands Tribunal.⁴² However, the Hong Kong Court of Appeal has not expressed its view on *Cavendish Square Holding BV v. Talal El Makdessi* and *ParkingEye Limited v. Beavis* in the case of *Brio Electronic Commerce Limited v. Tradelink Electronic Commerce Limited*⁴³ in relation to liquidated damages and penalty clauses. Whether this new test will be adopted by the Hong Kong higher courts remains to be seen. Nevertheless, the Court of Appeal rejected the rigid

37 www.doj.gov.hk/eng/mainland/pdf/mainlandmutual2e.pdf.

38 [2013] HKEC 488.

39 *Cavendish Square Holding BV v. Talal El Makdessi* and *ParkingEye Limited v. Beavis* [2015] UKSC 67.

40 *Leung Wan Kee Shipyard Ltd v. Dragon Pearl Night Club Restaurant Ltd* (No 2) [2016] 1 HKLRD 657.

41 *Tictas System Automation Ltd v. Explorer Travel Ltd* DCCJ 3826/2013; *Force Way Engineering Ltd* (宏立工程有限公司) v. *The Incorporated Owners of Grand Court* (格蘭大廈業主立案法團) DCCJ 3216/2016.

42 饒旋鋒 對 黃麗惠 LDPE 642/2015, 龍珠島別墅F1至F7座業立案法團 對 LDBM 155/2014.

43 *Brio Electronic Commerce Limited v. Tradelink Electronic Commerce Limited* CACV 271/2013.

test in *Murray v. Leisureplay Plc*,⁴⁴ which examines the discrepancy between the liquidated damages and the losses that would have been suffered in every case. In its approach to find the liquidated damages clause enforceable in *Brio Electronic Commerce Limited v. Tradelink Electronic Commerce Limited*, the Court of Appeal has shown its willingness to respect parties' contractual intention.

⁴⁴ *Murray v. Leisureplay Plc* [2005] EWCA Civ 963.

HUNGARY

Péter Rippel-Szabó, Bettina Kövecses and Péter Sziládi¹

I INTRODUCTION

Franchising in Hungary is a common business model and enjoys continuously growing popularity. In aggregate, around 300–350 franchise networks operate in Hungary, the number of franchisees is approximately 20,000, and around 100,000 employees (including suppliers) work in the franchise sector. The vast majority of franchise networks are active in the retail, services and hospitality industries.²

Hungary's membership status in the EU since 2004 has contributed to the growth of the number of foreign franchisors. According to publicly available data³ there are currently approximately 350 foreign franchise networks with more than 20,000 units in Hungary. Most of them are from the United States (20) and Germany (14). Some well-known franchisors are present in the country, including Spar, McDonald's, Nordsee, Dallmayr, BioTechUSA, Kodak and Hertz. Famous Hungarian franchises include Fornetti (food), Diego (decor), Duna House (real estate) and Coop (retail).

The Hungarian Franchise Association (HFA) was established in 1991 and currently has approximately 60 members. The HFA, working to the European Code of Ethics for Franchising and its own Code of Ethics,⁴ supervises the operation of franchise networks and represents and promotes the Hungarian franchise sector and its own members. The HFA has acceded to the European Franchise Federation and the World Franchise Council.

To date, no government report has been prepared on franchising in the Hungarian market, but a brief overview of the local franchise market in English is accessible on the HFA's official website⁵ and the HFA, from time to time, issues short summaries on the status of its members and franchising in general.

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2 Source: Hungarian Franchise Association, 'Franchising in Hungary', accessible at www.franchise.hu/English/Franchising+in+Hungary (last accessed 24 October 2019).

3 Source: official website of the Hungarian Franchise Association, accessible at www.franchise.hu (last accessed 24 October 2019).

4 The Code of Ethics is accessible at www.franchise.hu/Etikai+k%C3%B3dex (last accessed 24 October 2019).

5 See footnote 2.

II MARKET ENTRY

i Restrictions

As a general rule, no restrictions apply and no approval is required by foreign franchisors to enter the Hungarian market. However, if a foreign franchisor pursues economic activity in Hungary, it might be required to set up a local company (see Section V.i); setting up such a company follows the general rules of company formation (see Section IV.iii).

There is no general restriction on a foreign entity granting a master franchise or development rights to a local entity, although the parties to franchise agreements must comply with the provisions of competition law (see Section VI.v) and some specific sectoral rules may also affect the establishment of a master franchise relationship.

There is no general restriction on foreign franchisors owning equity in a local business. EU- and EEA-based individuals and entities, and entities that enjoy the same treatment on the basis of an international treaty, can acquire title of ownership to Hungarian non-agricultural real estate under the same conditions as Hungarian nationals. Other foreign individuals or entities may acquire Hungarian non-agricultural real estate if they obtain a permit granted by the county or metropolitan government office; however, no foreign party, whether a private individual or company, may acquire title or any other right to Hungarian agricultural land or protected natural areas. The same restriction applies to acquisitions by Hungarian subsidiaries owned by foreign investors.

ii Foreign exchange and tax

No withholding tax is levied in Hungary on dividends. However, cross-border franchising can face value added tax (VAT) issues (e.g., when offsetting marketing and other services fees against franchising fees in the form of a discount).

III INTELLECTUAL PROPERTY

i Brand search

The Hungarian Intellectual Property Office (HIPO) – as well as the European Union Intellectual Property Office (EUIPO)⁶ – maintains an online database of all Hungarian and EU-registered intellectual property (IP) rights, such as trademarks, patents and design rights. Before considering the use of a sign or device as a brand identifier, conducting a search in the HIPO and EUIPO databases is recommended. To avoid the risk of future opposition or cancellation of a trademark the search should cover not only the identical, but also the possible similar versions of the proposed sign to avoid any conflict with earlier registered rights. When considering the scope of the search, special attention must be paid to the goods and services for which the sign or design is to be used. Although the existence of a company name does not hinder the registration of a similar or identical sign as a trademark, a preliminary assessment should include a search of the company register for any commercial and company names that have been in the market for a long time and may cause problems in the future. The principal data on Hungarian companies, including company names, is freely accessible through the online company registry. An online presence may be identified by searching in the official .hu (dot hu) domain registry operated by the Council of Hungarian

⁶ <https://euipo.europa.eu/ohimportal/en>. The European Union Intellectual Property Office maintains a register only on European Union trademarks and registered community designs.

Internet Providers. As the Hungarian language uses accented letterforms (á, é, í, ó, ö, ő, ú, ü, ű) and such use is also allowed in domain names, a search for variations is strongly recommended to avoid cybersquatting.

ii Brand protection

A Hungarian trademark is obtained through registration with the HIPO. A sign can be registered as a Hungarian trademark, a European Union trademark or as an international trademark designating Hungary under the Madrid Agreement of 1891 Concerning the International Registration of Marks and the Madrid Protocol of 1989. The use of a sign does not create trademark protection in Hungary; a trademark must be registered. Trademark protection has generally been granted for any signs, provided these are capable of distinguishing goods or services from the goods or services of other undertakings and can be represented in the trademark register in a manner that enables the authorities and the public to clearly and precisely determine the subject matter of the protection applied for or granted to its holder (origin-indicating function). A sign is excluded from trademark protection if it is devoid of any distinctive character. The procedure for registration of a trademark begins with the filing of a trademark application with the HIPO or the EUIPO; registration is granted for 10 years and may be renewed without limitation.

Design protection grants legal protection for the appearance of a product. Design protection is granted for any design that is new on a worldwide level and has individual character, and for which there are no grounds for refusal that exclude it from protection. Design protection can be obtained by filing a design application with the HIPO, with the EUIPO or by filing an international application under the Hague Agreement Concerning the International Deposit of Industrial Designs. The term of design protection is five years, which may be renewed four times for an additional five-year period each time (i.e., for 25 years altogether).

Under the Hungarian .hu top-level domain, domain names may be registered according to the Domain Registration Rules and Procedures of the Council of Hungarian Internet Providers.

A licence for the use of a trademark or design must be given in writing, and to gain effect against third parties, it must be registered with the relevant registry (i.e., the HIPO or the EUIPO).

iii Enforcement

The trademark owner (or licensee) can prevent any third party from using a sign without the proprietor's consent in the course of trade. The Trademark Act⁷ contains examples of use that can be objected to: (1) using the trademark on goods or on packaging thereof; (2) putting on the market or offering for sale goods under the trademark or stocking them for these purposes; (3) offering or supplying services under the trademark; (4) importing or exporting goods under the trademark; and (5) using the trademark in business correspondence and in advertising. In addition to the uses listed by the Trademark Act, the Hungarian Competition Act sets out the following further examples: (1) using the sign as a trade or company name or part of a trade or company name; and (2) using the sign in comparative advertising in a manner that is contrary to the Hungarian Competition Act.

⁷ Act XI of 1997 on the Protection of Trademarks and Geographical Indications.

Under the Design Act,⁸ design protection confers on its holder the exclusive right to exploit the design. The holder of the design protection is entitled to prevent any person not having the holder's consent from exploiting the design. Exploitation covers in particular the making, using, putting on the market, offering for sale, importation and exportation of the product embodying the design, as well as the stocking thereof for those purposes.

The trademark proprietor or the holder of a design right is entitled to start proceedings to stop infringement of that right. A licensee recorded in the Trademark or Design Register may also commence infringement proceedings in his or her own name if he or she provided the right holder with an opportunity to take appropriate actions against infringement, but the right holder has failed to take actions. The civil law sanctions are (1) establishment of infringement by the court; (2) permanent injunction to cease infringing activity or any activities directly threatening to infringe, as well as to desist from doing so in the future; (3) providing information about the persons who participated in the production and distribution of the goods concerned by the infringement, and about the business relations created for the dissemination of the goods; (4) public apology; (5) recovery of unjust enrichment; and (6) seizure, transfer, recall and definite removal from the channels of commerce; destruction of the infringing products and the packaging thereof, as well as the means and materials exclusively or principally used for infringement. These sanctions can be claimed regardless of whether the infringer acted in good or bad faith. The trademark or design owner (or licensee) can also claim compensation for damage (in the amount exceeding the unjust enrichment), but for such a claim the general provisions of the Civil Code⁹ would apply, requiring the culpability of the infringer to be proven as well.

In cases of trademark and design infringement, it is also possible to commence preliminary injunction (PI) proceedings either before commencement of the infringement proceedings (the main action) or in the main action. This provides the rights holder with the opportunity to stop the infringement (by way of a cease-and-desist order) on a preliminary basis prior to reaching a final decision in the infringement suit, and this provides an effective tool against damage caused by the infringer. There are certain legal preconditions to be satisfied for a PI to be granted; nevertheless, for trademark and design right holders, the law provides a legal presumption granting more effective protection in cases of trademark and design infringement taking place in Hungary.

General civil law applies in relation to questions that are not regulated by the Trademark or Design Acts. Under the Civil Code, individual rights enjoy protection. Individual rights include (1) the right to bear a name, and (2) protection of goodwill. Under the Civil Code, a remedy – an award (lump sum) – for the infringement of individual rights can also apply. For the application of this remedy, it is not necessary to prove the amount of damage or the culpability of the infringer, only the fact of the infringement.

As from 2018, the provisions of the Trade Secrets Act¹⁰ implement the rules of the EU Trade Secrets Directive, therefore a trade secret is no longer a right relating to personality. Trade secrets enjoy special protection under the Trade Secrets Act that follows the same rationale and sanction system as that for intellectual property protection. The provisions of the Civil Code apply generally to matters that are not specifically regulated by the Trade Secrets Act. In the past, both the Civil Code and the Unfair Market Practices Act could serve

8 Act XLVIII of 2001 on the legal protection of designs.

9 Act V of 2013 on the Civil Code.

10 Act LIV of 2018 on the Protection of Business Secrets.

as a legal basis in cases of violation of trade secrets. Following the introduction of the new Trade Secrets Act, the former provisions of the Unfair Market Practices Act on trade secrets no longer apply, as trade secrets are now protected uniformly by the new Trade Secrets Act.¹¹

iv Data protection, cybercrime, social media and e-commerce

The rules of the EU General Data Protection Regulation (GDPR)¹² apply to the processing of personal data by franchisees or franchisors, as controllers or processors, if any of these have an establishment in the EU, regardless of whether the processing takes place in the EU or not. Moreover, the GDPR applies to the processing of personal data of data subjects in the EU even if the franchisees or franchisors, as controllers or processors, are not established in the EU, but their processing activities are related to: (1) the offering of goods or services, irrespective of whether a payment from the data subject is required, to such data subjects in the EU; or (2) the monitoring of the behaviour of such data subjects, as far as their behaviour takes place within the EU.

The GDPR imposes various new or extended obligations on the controller and the processor regarding the documentation of data processing activities and transparent communication with data subjects. The new obligations include maintaining records of data processing, submitting data breach notifications or data protection impact assessments and has notably extended obligations regarding the handling of data subjects' requests. Therefore, we also strongly recommend that franchisors and franchisees conclude a written agreement about the exact terms and conditions of any data transfer between them. We strongly recommend that franchisors and franchisees either pay special attention to data protection matters themselves or else seek adequate legal advice, because if a company fails to comply with the GDPR, the authorities can impose extraordinarily high fines (up to €20 million or 4 per cent of a company's total worldwide annual turnover for the preceding financial year, whichever is higher).

The threshold for being considered a data controller is relative low.¹³ The data controller shall alone or jointly with others determine the purposes and means of the processing of personal data. Even if franchisors do not 'collect' data directly, they still might be considered joint data controllers along with the franchisees. This role and liability should be considered on a case-by-case basis.

Pursuant to the GDPR, any transfer of personal data undergoing processing or to a third country or to an international organisation shall take place only if: (1) the European Commission has decided that the third country (or a territory or one or more specified sectors within that third country) or the international organisation in question ensures an adequate level of protection; and (2) the controller or processor has provided appropriate safeguards, and on condition that enforceable data subject rights and effective legal remedies

11 For further information, see Bird & Bird on Hungary's implementation of the Trade Secrets Directive at <https://www.twobirds.com/en/in-focus/trade-secrets/trade-secrets-directive-tracker/hungary> (last accessed 24 October 2019).

12 Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation).

13 CJEU Case C-40/17. (*Fashion ID* case).

for data subjects are available. In the absence of the aforementioned possibilities, a transfer of personal data to a third country or an international organisation shall only take place subject to one of the special conditions set out in Article 49 of the GDPR.

The E-Commerce Act,¹⁴ in full harmonisation with the related EU laws, regulates (1) the service provider's obligations on the provision of data, (2) the service provider's liability, (3) the conclusion of contracts via electronic means, (4) notice and takedown proceedings and (5) the rules concerning electronic advertisements. Crimes in relation to cybercrimes and franchising under the Criminal Code¹⁵ may include the circumvention of protective technologies or technologies protecting information systems, as well as violation of information systems or data.

There is no specific law on social media. This area is primarily regulated by the general provisions of civil law as well as the Data Protection and E-Commerce Acts.

IV FRANCHISE LAW

i Legislation

In the absence of a dedicated franchise act, franchises are subject to the same laws – primarily the Civil Code¹⁶ – that govern other businesses. The general rules of civil and contractual law as well as the Civil Code's specific chapter on franchise agreements (in the wording of the Civil Code, 'agreements on the lease of rights') apply to franchises in Hungary. According to the definition of the Civil Code, the lessor (i.e., the franchisor), in exchange for remuneration, licenses its copyright, IP rights and know-how to the lessee (i.e., the franchisee), whereas the franchisee manufactures and sells products or provides and sells services through the use of the franchisor's rights. This definition does not include any reference to the licensing of trademarks and focuses on service and distribution franchises instead of the most common commercial franchises. The Civil Code also includes provisions on (1) the licensing of copyright, IP rights and protected know-how, (2) the franchisor's supply obligation, (3) the protection of the good reputation of the franchise network, (4) the franchisor's instruction and supervisory rights, and (5) rules on the termination of contracts concluded for an indefinite period. Because of the Civil Code's dispositive nature the parties may deviate from these provisions in their agreements. Since the focus of the franchise agreement in the Civil Code is rather one-sided and the provisions are not comprehensive, the parties, using the freedom-of-contract principle, usually exclude the application of the provisions of the Civil Code on franchise agreements.¹⁷

The Civil Code entered into force as of 15 March 2014 and replaced the previous Civil Code.¹⁸ The rules of the previous Civil Code apply to agreements that were in place

14 Act CVIII of 2001 on certain issues of electronic commerce services and information society services.

15 Act C of 2012 on the Criminal Code.

16 Act V of 2013 on the Civil Code.

17 In the summer of 2016, a draft amendment of the new Civil Code was accepted by the parliament. The original conception of this draft amendment intended to take out all franchise rules from the Civil Code on the basis that the rules of the Civil Code cannot contribute to the growing importance of franchise agreements in relation to small and medium-sized companies, and in relation to the Hungarian national economy. Ultimately, the accepted version of the amendment did not modify the current provisions on franchise agreements.

18 Act IV of 1959 on the Civil Code.

on 15 March 2014 as do statements and amendments made concerning such agreements. Nonetheless, the parties may agree to apply the provisions of the current Civil Code to their contract even if the contract was entered into before 15 March 2014.

Franchise agreements must be in compliance with the Competition Act.¹⁹ In the absence of a special block exemption regulation on franchises, the Block Exemption Regulation²⁰ sets out the criteria as to how franchise agreements may be exempted from the prohibitions relating to the restriction of competition.

In relation to IP rights and know-how, the provisions of the Trademark Act, Copyright Act,²¹ Patent Act²² and Trade Secret Act²³ may apply to franchise agreements.

Although they are not binding legislation, the Code of Ethics and the HFA guidelines²⁴ have been considered by courts in civil proceedings on an increasing number of occasions. Additionally, these regulations may also serve as a basis for assessing whether the parties to a franchise agreement acted in good faith and according to the applicable standard of conduct in a particular situation.

ii Pre-contractual disclosure

Under the rules of Hungarian civil law, contracts must be concluded on the basis of mutual agreement by the parties. The parties must agree on all material details. There is no need to agree on details that are regulated by law. However, the Civil Code does not define the term 'material details'. According to the standard practice and the HFA's Code of Ethics, in the case of franchise agreements material details include: the licensing of know-how, commercial appearance, trademarks, the franchisee fee and royalties to be paid, and duration and termination of contract (see Section IV.iv).

The Civil Code recognises the doctrine of *culpa in contrahendo*. Under this principle the parties are obliged to (1) cooperate during the conclusion of the franchise agreement, (2) respect each other's rightful interests and (3) before the conclusion of the franchise agreement, inform each other regarding all essential circumstances in relation to the proposed contract. There is no explicit statutory provision on the formal requirements of the pre-contractual information duty concerning franchise agreements.

Under Hungarian law, a franchisor may be exposed to a damages claim in tort over pre-contractual statements if the franchisee is able to prove that (1) the franchisor unlawfully concealed or misrepresented essential circumstances prior to entering into the franchise agreement (breach of duty); (2) the franchisee incurred damage (damage); (3) the damage was incurred by the franchisee because of the concealment or misrepresentation of essential circumstances (causal link); and (4) the franchisor is not able to excuse itself by proving that it proceeded as generally expected under the given circumstances (i.e., acted according to the applicable standard of conduct in the particular situation). However, neither party may be held liable for not entering into the agreement.

19 Act LVII of 1996 on the prohibition of unfair and restrictive market practices.

20 Government Decree No. 205/2011 (X.7) on the exemption for certain groups of vertical agreements from the prohibition of restriction of competition.

21 Act LXXVI of 1999 on copyright.

22 Act XXXIII of 1995 on the protection of inventions by patents.

23 Act LIV of 2018 on the protection of trade secrets.

24 The guidelines are accessible at www.franchise.hu/Ir%C3%A1nyelvek (last accessed 24 October 2019).

It is generally accepted practice that, to protect their business interests and trade secrets, franchisors require franchisees to sign a non-disclosure agreement or a unilateral non-disclosure declaration before the franchisor delivers the draft of the franchise agreement.

iii Registration

There are no specific registration requirements for franchises. However, there are registration requirements that may have an impact on franchising:

- a* for the purpose of pursuing economic activities in Hungary, everyone can freely establish a company. Companies are registered by registry courts;
- b* before a newly established company can be registered by the competent registry court and its tax number issued, a preliminary tax registration procedure is completed by the tax authority;
- c* after their registration by the registry court, companies are obliged to apply for registration at the competent chamber of commerce and industry within five days; and
- d* if the franchisor or the franchisee pursues a specific activity, additional registration (e.g., at chambers or authorities) may be required.

iv Mandatory clauses

Under Hungarian law, there are no specific mandatory statutory clauses to be included in franchise agreements. According to the general contractual rules, the parties must agree on all material details of the contract, otherwise it may be invalid or unenforceable. The Civil Code regulates some of the basic content of franchise agreements (see Section IV.i). However, parties may deviate from or even exclude these statutory provisions and agree on additional contractual provisions.

The HFA's Code of Ethics, which does not constitute a mandatory legislative act, is often considered by courts as a guideline for assessing the fulfilment of the duty of good faith. It sets out minimum requirements to be included in franchise agreements. These are (1) the franchisor's and the franchisee's rights and obligations; (2) the description of goods and services to be provided to the franchisee; (3) the term of the agreement, which must be sufficiently long to enable the franchisee to achieve a return on its initial investments; (4) provisions on renewal of the agreement; (5) conditions under which the franchisee may sell or assign the business being subject to the franchise agreement and the franchisor's related rights; (6) the advantages on the franchisee's side resulting from the use of the business name, trademarks, signs, images and other marks of the franchisors; (7) the franchisor's rights to adapt new or changed methods with regard to the franchise system; (8) termination of the agreement; and (9) conditions for post-contractual mechanisms concerning goods, real estate etc. that belong to the franchisor or third parties.

v Guarantees and protection

The franchisor may request guarantees or other types of securities from the franchisee. Those securities are regulated in the Civil Code. The parties to the franchising agreements usually rely on suretyship, security deposit, liens, bank guarantee, contractual penalty or purchase options. Under the Civil Code, in line with the protection of the good reputation of products and services subject to franchise agreements, each party is obliged to protect the good reputation of the franchise network.

Guarantees provided to the franchisor by the franchisee are enforceable. To ensure proper enforcement, the guarantee should be properly drafted. It is also recommended that the scope of the franchisee's collateral commitments cover the franchisee's breach of its contractual obligations towards suppliers.

V TAX

i Franchisor tax liabilities

Generally, the position of a foreign franchisor will most likely not constitute a permanent establishment in Hungary. Thus, there will be no tax liabilities for the franchisor in Hungary. However, if there is a permanent establishment or a branch office or a commercial representative office established by the franchisor, general tax liability will arise as described below.

Foreign entrepreneurs may conduct their business in Hungary by opening a branch office in the country. Such a branch office is a separate organisational unit of the foreign business association without legal personality registered by the Hungarian court of registration. Through their branch offices, foreign businesses are entitled to carry out permanent business activities in Hungary and are represented towards the authorities and third parties by their branch offices.

A commercial representative office is a unit of a foreign company without a legal personality, which can operate from the time it is registered in the company register. The scope of activities of commercial representative offices is limited to mediating and preparing contracts and carrying out information, advertising and propaganda activities on behalf of the foreign company.

If the franchisor is a Hungarian entity, there are advantageous tax allowances in connection with the franchising fee if it qualifies as a royalty. Provided that certain conditions are fulfilled, 50 per cent of the revenues accounted as royalties may reduce the tax base.

ii Franchisee tax liabilities

Taxpayers with Hungarian residence have tax-paying obligations for their income originating both from Hungary and abroad. Non-resident businesses are only taxable on activities conducted in Hungary.

Corporate tax is 9 per cent of the positive tax base. Companies are required to file a corporate tax return every year (for each business year). Generally, the financial year is identical to the calendar year, but companies may use a different financial year and, in relation to this, a tax year different from the calendar year. Business associations are required to file their corporate tax returns and pay corporate tax by 31 May following the tax year. If the taxpayer opts for a different tax year, the filing and payment deadline is the last day of the fifth month after the last day of the financial year.

As well as corporate income tax, general VAT rules apply to franchise businesses. Currently, with some exceptions, the VAT rate is 27 per cent.

iii Tax-efficient structures

Numerous structuring solutions are favoured. Because of the deduction from the corporate income tax base of 50 per cent of received royalties, a franchisor set-up in Hungary is definitely an option to be considered.

VI IMPACT OF GENERAL LAW

i Good faith and guarantees

According to the general principles of civil law, in the course of exercising civil rights and fulfilling applicable obligations, the parties must act in good faith and cooperate with each other. Unless stricter requirements are prescribed by law, the parties must act according to the generally applicable standard of conduct in the particular situation (i.e., during the conclusion, fulfilment and termination of franchise agreements). Compliance with the standards of good faith and cooperation is especially required in the case of long-term relationships (such as franchise agreements) and during the fulfilment of requirements concerning the provision of information. The duty of good faith is further specified in some provisions of the Civil Code (e.g., in relation to breach of contract). Upon the incurrence of any damage, the person incurring the damage may claim damages, if all relevant prerequisites are met (see Section IV.ii). Courts and arbitration tribunals rarely decide on a case expressly and exclusively on the basis of a violation of the duty of good faith under the Civil Code.

ii Agency distributor model

Under Hungarian law franchisors or franchisees are not treated as agents or distributors.

Under the provisions of the Civil Code on agency agreements agents intermediate in sale, purchase or other agreements in exchange for a fee. Under the main rule, agents may not enter into agreements on behalf of the principal. In the case of long-term agency arrangements, however, agents are entitled to conclude agreements on behalf of their principal. In any scenario, agents are only entitled to the agency fee; the economic results of the agreements concluded by the agents exclusively benefit the principal. The Civil Code expressly sets out that franchisees proceed under their own name and at their own risk.

The Civil Code also contains specific regulations on distribution agreements; such agreements, however, solely relate to the purchase and selling of goods. The supplier is only entitled to instruct the distributor on the appropriate distribution of the goods. So, although retail franchises usually have some common features with distribution agreements, distribution and franchise agreements have some significantly different features in practice. In comparison with distribution agreements, franchise agreements constitute a closer cooperation of the parties. In the case of distribution agreements, the manufacturer does not instruct and closely monitor the distributors and does not provide extensive support to the distributors.

iii Employment law

Courts do not treat franchisees as employees and to date there is no case law from the Hungarian Supreme Court dealing with this issue. Considering the basic features of the employment relationship under the Labour Code²⁵ (e.g., employees can only be individuals, not undertakings or private entrepreneurs; work must be performed in accordance with the employer's instructions; employees must arrive at work on time, in a condition fit for work, perform work during working hours and cooperate with fellow workers) and the standard practices of franchise agreements, it is very unlikely that franchisees will be considered employees by Hungarian courts.

25 Act I of 2012 on the Labour Code.

iv Consumer protection

Under the Civil Code and the Consumer Protection Act²⁶ the term ‘consumer’ means a private individual (i.e., a natural person) who is a party to a contract concluded for reasons other than the person’s economic or professional activity. As franchise agreements necessarily relate to the franchisee’s economic and professional activity, franchisees cannot be treated as consumers.

v Competition law

The Competition Act, in full harmonisation with Article 101 of the TFEU and further related EU regulations, sets out that (1) agreements; (2) concerted practices between undertakings; and (3) decisions by social organisations of undertakings, public corporations, associations or other similar organisations that have as their object or potential or actual effect the prevention, restriction or distortion of competition are prohibited. Under this prohibition, franchise agreements, in the vast majority of cases, constitute vertical restrictions of competition as they are concluded between undertakings from different levels of the value chain. However, franchise agreements may fall within the scope of statutory exemptions:

- a* agreements concluded by undertakings that are not independent of each other do not qualify as agreements restricting competition. However, as the independence of the franchisee is an essential feature of franchising, this exemption cannot be applied to franchise agreements;
- b* franchise agreements of minor importance are not prohibited, unless the agreements relate to price-fixing or market sharing. A franchise agreement is of minor importance if the joint market share of the participating undertakings and undertakings that are not independent from them does not exceed 10 per cent of the relevant market;
- c* if franchise agreements are in compliance with the provisions of the Block Exemption Regulation, they are automatically exempted from the prohibitions on the restriction of competition. The block exemption does not apply to agreements in which, by the cumulative effect of those agreements and similar other agreements on the relevant market, the requirements of general exemptions are not satisfied; and
- d* the prohibition of restriction of competition may also be inapplicable if the franchise agreement fulfils the criteria for general exemption under the Competition Act.

The Block Exemption Regulation applies to vertical agreements entered into between an association of undertakings and its members, or between such an association and its suppliers, if all its members are retailers of goods and if no individual member of the association, together with its connected undertakings, has a total annual turnover exceeding the sum of Hungarian forints equalling €50 million. The exemption also applies to the licensing of IP rights provided that these provisions (1) do not constitute the primary object of the franchise agreement; (2) are directly related to the use, sale or resale of goods or services by the franchisee or its customers; and (3) do not contain restrictions of competition having the same object as vertical restraints that are not exempted under the Block Exemption Regulation. The exemption, however, applies only if the franchise agreement does not contain mutual

26 Act CLV of 1997 on consumer protection.

vertical restrictions and the franchisor is not a competitor to the franchisee concerning the production of goods or the provision of services. Finally, to be exempted, the market share of both the franchisor and the franchisee may not exceed 30 per cent on the relevant market.

Franchise agreements may not be granted exemption from the prohibition if the objective is the limitation or restriction of (1) the franchisee's ability to determine its sale price; (2) the territory or clientele in or to which the product or service can be sold; (3) the active or passive sale at the retail level of a selective distribution system; (4) the cross-supply among distributors of a selective distribution system; or (5) the sale of components as spare parts, if the agreement was concluded between the supplier and the person who incorporates the spare parts (specific exemptions may apply in some cases).

No exemption may be granted for (1) any direct or indirect non-compete obligation, the duration of which is indefinite or exceeds five years; (2) any direct or indirect obligation causing the franchisee, after termination of the agreement, not to manufacture, purchase, sell or resell goods or services (specific exemptions may apply); (3) any direct or indirect obligation causing the franchisee as a member of a selective distribution system not to sell the brands of particular competing suppliers.

Reasonable and necessary contractual clauses on exclusivity and full line forcing, which are essential features of most franchise agreements, may usually be exempted from the prohibition of the restriction of competition, if the parties comply with the statutory provisions and the case law of the Hungarian Competition Authority (see Section VI.vi). Any agreement or practice to fix prices is, in the vast majority of the cases, prohibited and cannot be exempted. It is important to note that compliance with competition law must be assessed by the parties themselves. Improper formulation of franchise agreements may entail significant legal risks, therefore it is strongly recommended that franchisors and franchisees seek proper legal advice and prepare an economic analysis on a case-by-case basis.

vi Restrictive covenants

Generally, all non-compete and other restrictive covenants that fall within the scope of hardcore or excluded restrictions, or do not fulfil the requirements under the Block Exemption Regulation, may not be enforced. In addition, all clauses that unnecessarily and unreasonably narrow the scope of the franchisees' freedom to set (reselling) prices and make decisions as to where to purchase the goods subject to the franchise agreement restrict the competition.²⁷ Thus, franchise agreements may be exempted under the Block Exemption Regulation, or the general exemption, if they contain only restrictive provisions that are in compliance with the principles of franchising and necessary for the protection and operation of the licensed know-how.

Therefore, the parties are advised to (1) continuously supervise the compliance of the franchise agreement with the provisions of competition law; and (2) avoid any clauses that unnecessarily and unreasonably restrict or have an objective to restrict the competition. Non-compete and other restrictive covenants may be enforced by incorporating appropriate clauses into the franchise agreements.

27 Position statements 2006 of the Competition Council of the Hungarian Competition Authority; Section 11.26 (Vj-171/2002). Pursuant to the Competition Council, the safeguarding of competition within a given brand where only a handful of competitors are present is especially important. The position statements reflect the Competition Council's law interpretation with regard to the Competition Act.

vii Termination

Under the Civil Code, the parties may freely determine the rules regarding the termination of contracts entered into for both a definite and an indefinite period. Franchise agreements may be terminated by the mutual consent of the parties or by one of the parties giving notice of termination. If the contract is terminated with immediate effect, it ceases to exist upon the time of delivering of the notice. Otherwise the agreement terminates at the end of the notice period.

The Civil Code sets out specific rules with regard to the termination of franchise agreements concluded for an indefinite period, from which the parties may deviate by mutual consent. Franchise agreements concluded for an indefinite period may be terminated any time, effective as of the last the day of the calendar month concerned. The termination period is one month in the first year of the agreement, two months in the second year, three months in the third and following years. Upon the termination of the franchise agreement, all rights of the franchisee relating to copyright, IP rights or protected know-how cease to exist. The Civil Code contains no provisions on the termination of franchise agreements concluded for a definite period; nonetheless, the parties, under the principle of freedom of contract, will be entitled to enter into a franchisee agreement for a definite period and regulate the termination of such an agreement.

If agreed by the parties, the franchisor may take over the franchisee's business after the termination of the franchising agreement.

viii Anti-corruption and anti-terrorism regulation

If the services set out in the franchise agreement fall within the scope of the Anti-Money Laundering and Anti-Terrorism Act,²⁸ the service provider must comply with the general provisions on customer due diligence measures, reporting obligations and preparation and application of internal regulations. The Anti-Money Laundering and Anti-Terrorism Act does not provide for any specific franchise-related regulations.

ix Dispute resolution

In practice, parties to franchise agreements tend to opt for litigation via ordinary courts and arbitration tribunals. While mediation is a recognised form of alternative dispute resolution, it is not mandatory under Hungarian law and parties are usually reluctant to choose this way of solving their disputes. There is no specific procedure or industry practice for franchising disputes; neither does the HFA offer mediation or arbitration rules or services. However, the HFA, upon request by HFA members, may play a conciliatory role in disputes arising between members.²⁹

Under the recently adopted Code of Civil Procedure,³⁰ business entities (i.e., franchisors and franchisees) can file claims with ordinary courts without an obligation to attempt resolution by way of mediation. Nevertheless, mediation is available for all parties before filing an action. Ordinary court proceedings, including first and second instances, may last for several years, although the objective of the new Code of Civil Procedure is to

28 Act LIII of 2017 on the Prevention and Combating of Money Laundering and Terrorist Financing.

29 Article 3.4.6 of the statutes of the HFA. The HFA statutes are accessible only in Hungarian at www.franchise.hu/Alapszab%C3%A1ly (last accessed 24 October 2019).

30 Act CXXX of 2016 on the Code of Civil Procedure.

increase the efficiency of civil proceedings. To this end, the new Code introduced a two-part structure to the procedure (a preparatory phase and a merits phase) and increased the level of professionalism by ordering mandatory legal representation before the courts of general jurisdiction and any in appellate proceedings.

A PI request may generally be filed before the complaint is filed with the court. (Under the previous Code of Civil Proceedings this option was restricted to intellectual property and competition matters.) In this case, the party seeking the interim relief is obliged to file its complaint within a maximum of 45 days of the filing of the PI request. The court may order a PI upon request: (1) for the purpose of preventing any change in the status quo, if subsequent restitution would not be possible; (2) to safeguard the applicant's subsequent exercise of rights; (3) to prevent any imminent damage the applicant may be exposed to; or (4) in other exceptional circumstances. Regardless of which of these grounds are relied on by the plaintiff, there is an additional general precondition to be fulfilled: the disadvantages caused by the PI should not exceed the advantages achieved thereby. It is therefore possible to obtain a PI to prevent a former franchisee from continuing to trade in breach of a non-compete provision or from using the franchisor's trademarks or other IP rights. The court decides on the PI in expedited proceedings and must issue a ruling on the request within eight days of its filing, at the latest.

Ordinary courts recognise and uphold foreign choice-of-law or jurisdiction clauses, if the clauses are in compliance with relevant Hungarian laws and EU laws, especially if these are not against public order or mandatory Hungarian statutes. Arbitration proceedings are usually shorter and more commercially oriented, although more expensive than ordinary litigation.

Under Hungarian contractual law, the party breaching the contract may be held liable for damages. The franchisor or the franchisee is not liable for the damage caused, if it is able to prove that (1) the circumstances causing the damage were out of its control, (2) the circumstances were not foreseeable by it at the date of the conclusion of the agreement, and (3) it was not obliged to prevent the circumstances or damage. The consequential damage and lost profit must only be reimbursed if the injured party is able to prove that the potential damage could have been foreseen at the time of entering into the franchise contract. If the damage was caused wilfully, the full amount of the damage must be compensated. The person incurring damage has the obligation to mitigate the damage and the party causing the damage will not be held liable for that portion of the damage that could have been avoided by the person incurring the damage.

Litigation costs are allocated proportionally between the parties depending on the outcome of the litigation. These costs are not statutorily capped; however, excessive attorney fees and court costs may be reduced by the court.

To enforce foreign ordinary court judgments and arbitral awards, the following requirements must be met: (1) a foreign court must have jurisdiction over the subject matter; (2) that court's decision must be legally binding or have equivalent effect; and (3) the decision must meet none of the grounds for refusal, such as violation of public order.³¹ Hungarian courts readily recognise foreign arbitral awards from other member countries of the New York Convention,³² although violation of Hungarian public order may serve, among others, as grounds for refusal.

31 Act XXVIII of 2017 on Private International Law.

32 United Nations Convention on the Recognition and Enforcement of Foreign Arbitration Awards, implemented into Hungarian law by Law Decree No. 25 of 1962.

VII CURRENT DEVELOPMENTS

Because of its strategic geographical location, its EU membership status, its relatively cheap and skilled workforce, and low investment requirements, Hungary is likely to remain a target country for foreign franchisors and there are no current developments that would deter foreign franchisors from entering the Hungarian market. The Civil Code contains specific provisions on franchise agreements, which may serve as guidance for franchisors when entering into contracts with franchisees. The parties, however, usually exclude the application of the provisions of the Civil Code on franchise agreements for practical reasons.

The new GDPR rules require special attention and franchisors or franchisees operating in the EU, if they have not already done so, may have to adapt their current data processing activities to comply with the new legislation.

With the rapid increase in the use of social media by business in the past couple of years, authorities, courts and legislators have all endeavoured to catch up and Hungary is no exception. The Hungarian Competition Authority has issued basic guidelines on social media content that is sponsored or endorsed in any way, and these serve as a cornerstone for all market participants. The Hungarian Competition Authority now strictly assesses and enforces compliance with these guidelines and is not reluctant to impose fines for severe irregularities; for example, in particular, where (1) the 'paid-for' nature of social media is not communicated simply, clearly and unambiguously (i.e., the sponsored product or company must be clearly indicated as such in the content) and in a way that is emphasised, easily noticeable and necessarily and conspicuously understandable by consumers (the *#reklam*, or *#advertisement*, hashtag must preface the content description; or (2) the content is not an independent, neutral opinion or offer but is in fact also paid for or the result of some other direct economic interest.

INDIA

Nipun Gupta and Divya Sharma¹

I INTRODUCTION

India is an attractive destination for a franchising entrepreneur. The continued growth of the economy and the central government's continuous efforts to liberalise the foreign investment policy and improve ease of doing business has led to foreign investors considering India as an attractive investment destination. The Indian franchising market has been growing steadily, to the tune of 30 to 35 per cent annually.²

Today India is home to a large number of international brands that have entered the market using the franchising model. Many of these are food and beverage (F&B), apparel and luxury brands. Prominent examples include Burger King, Pizza Express, Dunkin' Donuts, Hard Rock Cafe, Hermès, Fendi, Burberry, Bottega Veneta, Paul Smith, Jimmy Choo and Roberto Cavalli. In 2018, Bath & Body Works opened stores in India, in partnership with Major Brands and in 2019 Replay entered India in partnership with Reliance Brands.

Looking ahead, F&B, education, retail, beauty, healthcare and hospitality will continue to emerge as high-potential service sectors for franchising.³

II MARKET ENTRY

Various market entry options are available to foreign brands. The available options include operating the Indian business through an Indian subsidiary wholly owned by the foreign brand; entering into a joint venture, franchise arrangement or licensing arrangement with an Indian partner; or a combination of these structures. Considering the size and diversity of India, and to cater to local tastes, franchisor's often localise their offering to appeal to the Indian consumer; for example, McDonald's and Starbucks have both introduced food options that cater to Indian tastes and Uniqlo launched a special collection of kurtas (tops) for India when opening its first store.

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2 See <https://www.ibef.org/blogs/india-s-franchise-industry-the-road-so-far-and-way-forward> (last visited on 18 December 2019) and also see 'Indian Franchise Industry Outlook for 2018' available at <https://india.franchiseasia.com/information/indian-franchise-industry-outlook-for-2018> (last visited on 18 December 2019).

3 'Indian franchise industry outlook for 2018', available at <https://india.franchiseasia.com/information/indian-franchise-industry-outlook-for-2018> (last visited on 18 December 2019).

Restrictions

Foreign investment is permitted in most sectors of the Indian economy, except for atomic energy, lottery, gambling, etc. where foreign direct investment (FDI) is not permitted. The few limitations that may affect a prospective franchise arrangement are as follows.

FDI policy

India's FDI policy is relevant for foreign brands looking to own an equity interest in Indian businesses. The policy prescribes the requirements for foreign investment, including the extent to which foreign investment is permitted and if the investment needs any government approval. India's current policy makes the following provisions.⁴

Single brand

Foreign companies can own up to 100 per cent equity interest in an Indian company offering single-brand retail services. For this purpose single-brand retail refers to retail trading of products that are sold under a 'single brand' – that being the brand name under which the products are sold internationally. Products should be branded as such during manufacturing. International brands such as Zara, IKEA, Mothercare, Clarks and Marks & Spencer have entered India using this route.

If foreign investment in the Indian company exceeds 51 per cent, then 30 per cent of the value of goods procured must be sourced from India, preferably from micro, small or medium-sized enterprises, village and cottage industries, artisans and craftspeople. These sourcing norms do not apply up to three years from the opening of the first store or commencement of online retailing by single-brand retail entities having state-of-the-art and cutting-edge technology, and where local sourcing is not possible. All procurement from India by a single-brand retail entity for a single brand is counted in relation to local-sourcing norms, whether the goods are sold in India or exported overseas. Set-off for local-sourcing norms is available against products sourced from India for global operations.

Entities permitted to undertake single-brand retail trading through bricks-and-mortar stores are also permitted to undertake e-commerce activities. Retail trading through e-commerce can be undertaken prior to opening bricks-and-mortar stores, provided bricks-and-mortar stores are opened within two years of commencing online retail.⁵

Multi-brand

Foreign companies can own up to 51 per cent equity interest in an Indian company offering multi-brand retail services, with prior government approval. An Indian company operating multi-brand stores, and that has foreign investment, can set up stores in states that have permitted multi-brand retailers to operate. In the permitted states, stores may be set up in cities above a specified population. Additionally, sourcing conditions similar to those set out

⁴ For details refer to the FDI Circular published by the Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce and Industry, Government of India. The circular as at 28 August 2017 is available at https://dipp.gov.in/sites/default/files/CFPC_2017_FINAL_RELEASED_28.8.17.pdf (last visited on 13 December 2019). See also Press Note 2 of 2018 available at https://dipp.gov.in/sites/default/files/pn2_2018.pdf (last visited on 13 December 2019).

⁵ See Press note 4 of 2019 available at https://dipp.gov.in/sites/default/files/pn4_2019.pdf (last visited on 9 December 2019).

above for single-brand retail apply to multi-brand retail: multi-brand retailers are required to invest a minimum amount of US\$100 million and certain requirements for investment in back-end infrastructure must be satisfied. UK-based Tesco Plc was the first to apply and obtain DIPP approval for multi-brand retail trading in India, but stores have not been opened. The Modi government, which took office in 2014, has not changed the FDI policy in this respect, but equally this sector has not seen any foreign investment since the Modi government took office.

Setting up master franchise agreements in India

An international franchisor that does not wish to own an equity interest in the Indian business may, subject to Indian law, grant franchise rights to a local franchisee to establish and operate the brand in India through a contractual mechanism. There are no restrictions on a foreign entity granting master franchise or development rights to a local entity and, given the geographical size of India, it is not uncommon for international franchisors to appoint several master franchisees responsible for specific parts of India. Currently foreign investment rules do not permit foreign companies to invest in or establish companies in India that are engaged in an inventory-based model of e-commerce,⁶ although relaxations have been made for single-brand retail companies to engage in e-commerce, and FDI up to 100 per cent has been permitted in marketplace-based models of e-commerce, subject to certain conditions.⁷

Owning real estate

Indian exchange control regulations impose restrictions on non-Indian nationals and companies acquiring real estate in India. However, franchisors who have established a branch office or other place of business in India, or companies incorporated in India that are owned by international franchisors, can acquire immovable property, including through a lease as necessary for or incidental to carrying on their activity.⁸

Foreign exchange

Indian exchange control laws⁹ are relevant to several aspects of franchise arrangements, particularly with regard to payments between Indian franchisees and international franchisors. Indian franchisees can make royalty payments and remit fees for technical services to international franchisors without any limit and without approval of the RBI. Certain other trade payments may also be made without approvals. If the payment sought to be made to an international franchisor does not fall within the permissible categories, the Indian franchisee will require specific approval from the RBI to make the payment. The approval process can be time-consuming and it is uncertain whether the RBI would grant approval. Therefore, it is advisable to seek legal advice on the type of payments proposed to be made under the franchise arrangement to ensure that the payments are correctly structured to be freely permissible under the Foreign Exchange Management Act 1999 (FEMA).

6 An inventory-based model of e-commerce is defined as a model in which inventory of goods and services is owned by the e-commerce entity and sold to consumers directly.

7 A marketplace model of e-commerce is defined as the provision of an information technology platform by an e-commerce entity on digital and electronic networks to act as a facilitator between buyer and seller.

8 Under the provisions of the FEMA.

9 Indian exchange control laws are comprised of the FEMA and rules, regulations and notifications made under it from time to time. The FEMA is administered by the RBI, India's central bank.

III INTELLECTUAL PROPERTY

Following India becoming a signatory to the WTO TRIPS Agreement, with effect from 1 January 1995,¹⁰ Indian intellectual property (IP) laws were amended to make them more consistent with globally accepted IP norms and practices. These amendments coupled with better enforcement of the law have significantly improved the IP protection regime.

To protect their trademarks and brands, franchisors will normally also register their trademarks in India. They enter into contractual arrangements with the franchisee, such as trademark licence agreements or by including detailed provisions in the franchise agreement.

i Brand search

The process of searching for protected trademarks and other IP relevant to franchises (such as image rights) is quite simple. This can be done using the public search engine for trademarks on the Ministry of Commerce and Industry website.¹¹ For a franchisor considering India as a franchising destination, this search engine can be helpful as it enables a potential franchisor to identify commonly known marks and prohibited marks, while also showing business images that are currently trademarked in India.

ii Brand protection

To register a trademark, the proprietor of the mark must make an application in the prescribed form.¹² Applications for registration of trademarks are examined by the Registrar of Trade Marks. If the Registrar decides to accept the application, the application is published in the official gazette, the Trade Marks Journal. Following publication in the gazette, any person can, within a specified period, file an opposition. Where oppositions are filed they must be dealt with according to the procedure prescribed and the decisions of the Registrar may be appealed before the Intellectual Property Appellate Board. If no opposition is filed within three months, the trademark proceeds to registration. Registered trademarks are protected in perpetuity subject to renewal of the registration after every 10 years.

iii Enforcement

If a trademark is infringed, civil remedies can be pursued under the law of passing off or under the Trade Marks Act 1999 (the Trademarks Act) depending on whether the trademark in question is registered, pending registration or unregistered. Further, in respect of registered trademarks, criminal remedies set out by the Trademarks Act may also be available. Typically, in cases of trademark infringement, provided the court is satisfied, interim injunctions may be obtained to stop the infringing conduct until the infringement suit is decided. Such injunctions are normally granted at an early stage of the trial.

Indian courts have generally been good at recognising the international reputation of trademarks whether registered or not in India. There have been numerous examples of courts stepping in to protect registered and unregistered trademark holders; for example, in the *Calvin Klein* case¹³ and in the *H&M* case, where the Delhi High Court recently held that for

10 The Agreement on Trade-Related Aspects of Intellectual Property Rights is Annex 1C of the Marrakesh Agreement Establishing the World Trade Organization, signed in Marrakesh, Morocco on 15 April 1994.

11 <https://ipindiaonline.gov.in/tmrpublicsearch/frmmmain.aspx> (last visited on 10 December 2019).

12 <https://ipindiaonline.gov.in/trademarkefiling/user/frmlogin.aspx>.

13 *Calvin Klein Inc. v. International Apparel Syndicate* 1996 PTC 293 (Cal).

a mark or brand to have a reputation or goodwill in India, the setting up of a shop in India or sales in India are no longer a necessity.¹⁴ The introduction of web-based sales, which enable Indians to shop for whatever brands or goods available wheresoever, has further increased familiarity in India with the marks and brands essentially sold and marketed outside the country and courts have also dealt with issues relating to liability of online retailers for selling spurious and infringing goods.¹⁵ Recently, Skechers USA and its affiliates obtained a permanent injunction restraining defendants from infringing their trade dress and passing off the defendants' shoes as Skechers shoes. This case was also noteworthy as significant costs were awarded in favour of Skechers.¹⁶

In addition to the Trademarks Act, customs laws prohibit import of infringing goods into India. Holders of registered trademarks may notify Indian customs authorities of goods infringing their IP rights. Customs authorities are empowered to suspend clearance of infringing goods and take certain other actions as are specified in the relevant rules.¹⁷

Know-how belonging to a franchisor may also be protected under the Indian Copyright Act 1957 or the Patents Act 1970 if it is capable of protection under those laws. If statutory protection is not available, contractual remedies will still be available to the franchisor and it is usual to see detailed provisions in the franchise agreement dealing with protection of know-how.

iv Data protection and e-commerce

Customer data is important for companies looking to market or cross-sell their products. India's data protection provisions are not located in one cohesive piece of legislation. This can therefore be an area that needs careful consideration by lawyers reviewing the types of personal data that may be collected by the franchisee or the franchisor and the impact that legislation such as the Information Technology Act 2000 (the IT Act) and the Information Technology (Reasonable security practices and procedures and sensitive personal data or information) Rules 2011 (the DP Rules) may have on the manner in which personal data is collected, handled, stored and processed.

On a strict reading of the DP Rules, difficulties can arise in determining whether the DP Rules apply to personal data that is not sensitive personal data and to companies that are not based in India. The pragmatic view is that consent should be obtained to collect, process, store, handle and export personal data. In addition to the DP Rules, Indian law, including

14 *H&M Hennes & Mauritz AB & Anr. v. HM Megabrands Pvt. Ltd. & Ors*, IA No. 7259/2016 in CS(COMM) No. 707/2016, decided on 31 May 2018, available on <https://indiankanoon.org/doc/90123644/> (last visited on 10 December 2019).

15 In the case of *Christian Louboutin SAS v. Nakul Bajaj & others*, the Delhi High Court, held that the online retailer would be liable for trademark infringement if it can be proven that the goods it was selling were counterfeit. The decision is available at <https://indiankanoon.org/doc/99622088/> (last visited on 2 January 2019). This decision was also followed in *L'Oréal v. Brandworld and another*, decided on 12 November 2018 (available at <https://indiankanoon.org/doc/55867232/> (last visited on 2 January 2019)), which dealt with sales of spurious cosmetics by an online retailer.

16 *Skechers USA Inc. & Ors v. Pure Play*, Delhi High Court, IA No. 6279/2016 and IA No. 8409 of 2018.

17 Intellectual Property Rights (Imported Goods) Enforcement Rules 2007, available at www.wipo.int/wipolex/en/text.jsp?file_id=201652 (last visited on 2 January 2019), as amended by the Intellectual Property Rights (Imported Goods) Enforcement Amendment Rules 2018, available at <https://www.manupatrafast.com/ba/Ruledispatch.aspx?nActCompID=13364&ciActID=1861> (last visited on 2 January 2019).

through recent judgments of the Supreme Court of India,¹⁸ generally recognises the right to privacy of an individual and a person who discloses personal data in violation of their contractual obligations commits an offence under the IT Act.

So far as sensitive personal data is concerned (which includes bank and credit card information), the DP Rules would generally apply. Under the DP Rules, sensitive personal data must not be exported to a country that does not afford the same level of data protection as offered by the DP Rules, although export is permitted if the transfer is necessary for performance of a contract or if consent for the transfer has been obtained from the data controller or the data subject.

The IT Act also deals with cybercrime such as hacking, identity theft, tampering with computer records, and prescribes penalties and offences in respect of those matters.

Currently, India is looking to enact comprehensive data protection legislation. The final draft of the Personal Data Protection Bill 2019 has been tabled before the lower house of Parliament in India. The Bill is clearly inspired by the UK and European approach taken with the General Data Protection Regulation, rather than a US approach to data protection.

IV FRANCHISE LAW

i Legislation

Unlike many jurisdictions, India does not have a specific statute dealing with franchise matters. The closest point available for interpretation was contained in India's Finance Act, which has now been repealed, owing to the introduction of the Goods and Services Tax. The Finance Act had defined a franchise, in the context of service tax, to mean an agreement by which the franchisee is granted the representational right to sell or manufacture goods or to provide service or undertake any process identified with a franchisor, with respect to any trademark, service mark, trade name, logo, etc. A franchisor was defined as any person who enters into a franchise with a franchisee and the term 'franchisee' is construed accordingly.¹⁹ These definitions are not mentioned in the law relating to the Goods and Services Tax.

However, the Indian Contract Act 1872 (the Contract Act), the Sale of Goods Act 1930 and the Specific Relief Act 1963, which apply to all commercial arrangements, are relevant to franchise agreements (these are discussed in detail below).

In contrast to the requirements in the United States, there are no laws requiring a franchisor to provide a lengthy franchise disclosure document to potential franchisees within a stipulated period prior to signing the franchise agreement. Aspects of potential litigation, bankruptcy, initial fee, estimated initial investment, etc. are expected to be captured by a party's own due diligence and commercial understanding. Franchise agreements are not required to be registered in India.

Indian law does not regulate termination of franchise agreements. Parties are therefore free to incorporate provisions in the franchise agreement dealing with termination. Franchise agreements will usually permit termination for breach of contract and insolvency, and stipulate the consequences of termination.

If the franchise agreement is terminated, an international franchisor's ability to take over the franchisee's business is predicated on applicable foreign investment guidelines. If the

18 *Justice K Puttaswamy & others v. Union of India and others*, available at https://www.sci.gov.in/supremecourt/2012/35071/35071_2012_Judgement_24-Aug-2017.pdf (last visited on 2 January 2019).

19 Finance Act 1994 (as amended), Chapter V, definitions 47 and 48.

Indian company operating the business is a joint venture between the international franchisor and the Indian franchisee, in the single-brand retail sector, the franchisor could acquire the franchisee's interest in the joint venture such that the Indian company becomes a wholly owned subsidiary of the international franchisor. However, if the Indian company operates in the multi-brand retail sector, and assuming the current foreign investment guidelines continue to apply, the international franchisor could not acquire all the franchisee's interest in the joint venture and would have to find a local Indian partner to own 49 per cent interest in the Indian company. Alternatively, if the international franchisor wishes to exit the joint venture, it could sell its stake in the joint venture, to the franchisee.

The FEMA provides that transfer of shares in an Indian company by a foreign party to an Indian party must not take place at a price more than the fair value calculated using any internationally accepted pricing methodology for valuation of shares on an arm's-length basis. The foreign party must not be assured an exit price at the time of making its investment and the price must be certified by a chartered accountant or a merchant banker registered with the Securities and Exchange Board of India.²⁰

In a purely contractual relationship where the franchisor does not own an equity interest in the franchisee or the Indian company operating the business, the franchise agreement should specify the consequences of termination, including any step-in rights for the franchisor. Step-in rights must be drafted keeping the FEMA in mind. For example, under the FEMA, foreign companies cannot directly enter into a lease for property in India, except in limited circumstances (as discussed in Section II). Therefore, an international franchisor desirous of stepping into the franchisee's position will need to establish an entity in India to whom the lease may be assigned.

Contract Act

The Contract Act deals with various matters, including formation, performance and breach of contracts. Contracts are voidable at the instance of an innocent party in certain circumstances, including if consent to the contract was granted by the innocent party because of misrepresentation. Alternatively, the innocent party may insist on performance of the contract consented to as a result of misrepresentation, and be put in a position such that the misrepresentation was not made.²¹ Misrepresentation is defined in the Contract Act as:

- a* a positive assertion of untrue matters (although the person making the assertion believes it to be true);
- b* a breach of duty that gains advantage to the person committing the breach by misleading the other person to their prejudice; and
- c* causing (even innocently) a party to a contract to make a mistake as to the subject of the contract.²²

Importantly, a contract that is formed as a result of consent being given on account of a misrepresentation is not voidable if the innocent party had means of discovering the truth by due diligence.²³

20 RBI master direction on foreign investment in India, https://www.rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=11200 (last visited on 2 January 2019).

21 Section 19 of the Contract Act.

22 Section 18 of the Contract Act.

23 See the exception to Section 19 of the Contract Act.

Sale of Goods Act

Inter alia, the Sale of Goods Act 1930 stipulates conditions that are implied into contracts for sale of goods (some of which can be contractually waived), rules relating to passing of title and risk in the goods, and the remedies for breach of such contracts.

Specific Relief Act

The Specific Relief Act 1963 set outs the remedies available for enforcement of contracts. Until recently, specific performance of a contract was a discretionary remedy that was awarded if the court was satisfied that damages would not be adequate for breach of a contract. However, pursuant to the amendments made by the Specific Relief Amendment Act 2018, courts are now bound to award specific performance except in certain cases.²⁴ Additionally, under the substituted performance regime introduced by the Specific Relief Amendment Act 2018,²⁵ the aggrieved party can engage a third party or an agent to perform the contract and recover expenses and costs actually incurred by it in seeking this substituted performance from the defaulting party. Further, if the substituted performance remedy is exercised, the aggrieved party cannot seek specific performance but can seek damages for breach of contract.

ii Guarantees and protection

Franchise agreements may require a franchisee to deliver a parent company guarantee or a bank guarantee, guaranteeing performance of the franchisee's contractual or payment obligations under the franchise agreement. Guarantees are contractual in nature and are regulated by the Contract Act.

Under the FEMA, an Indian company or individual cannot issue a guarantee in favour of a company or individual resident outside India, except in limited circumstances, without prior permission of the RBI and there is no certainty as to whether the permission would be granted by the RBI.

V TAX

Normally payments under franchise agreements attract direct and indirect taxes in India. Income tax will be payable by a franchisee on the income earned from franchise operations. If the franchisee is providing a service to consumers (for example, a restaurant), Goods and Services Tax will be payable by the entity providing the services.

i Franchisor tax liabilities

A franchisor may be liable to pay income tax in India if it is resident in India for tax purposes. If the franchisor is based outside India, the franchise agreement should be structured carefully to ensure that the franchisor is not considered to have a permanent establishment in India.

24 Section 10 of the Specific Relief Act 1963 as amended by the Specific Relief Amendment Act 2018. For contracts that are not specifically enforceable see Section 14 of the Specific Relief Act 1963 as amended by the Specific Relief Amendment Act 2018.

25 Section 20 of the Specific Relief Act 1963 as amended by the Specific Relief Amendment Act 2018.

ii Franchisee tax liabilities

Subject to the FEMA provisions, a franchisee can make royalty payments to an international franchisor from India.²⁶ However, the franchisee will be obliged to withhold tax on payments towards royalties and technical services made to the franchisor under the franchise agreement. The rate of withholding tax is 10 per cent (plus any additional cess or surcharge). This is subject to double-taxation avoidance agreements (DTAA), or treaties, and for treaty countries the effective withholding tax liability may be reduced. India has in force DTAAs with approximately 120 countries.²⁷

The fee payable for the use or enjoyment of intellectual property is a taxable service under the Goods and Services Tax regime in India and attracts tax at the rate of 12 per cent. If the franchisor is based outside India, the franchisee will be legally obliged to pay Goods and Services Tax to the Indian tax authorities. Furthermore, depending on the terms of the franchise agreement, additional taxes such as customs duty may be levied on goods imported by the franchisee from the franchisor.

iii Tax-efficient structures

International franchisors often route their investment or contractual arrangements in India through entities based in tax-efficient jurisdictions.

VI IMPACT OF GENERAL LAW

i Good faith

Except in the context of fiduciary relationships, Indian law does not imply an overarching duty of good faith in contractual arrangements. Parties may, however, contractually agree a duty to act in good faith. Having said that, in the event of a dispute, even in the absence of any contractual understanding regarding good faith, courts will consider conduct of the parties in granting relief and the equitable principle that a party cannot take advantage of its wrongdoing may be considered by the court in granting relief.

ii Agency

The Contract Act deals with contracts of agency. An agency arises if a person is employed to undertake acts for another person or to represent that person. Franchise agreements will normally be drafted to clarify that the parties do not intend to create a principal–agent relationship. If an agency relationship is taken to exist, the provisions of the Contract Act that deal with such relationships would apply, including the principal being liable for acts of the agent in certain circumstances, such as tortious acts. There could also be tax consequences for the franchisor if the agent is considered to constitute a permanent establishment of the franchisor in India.

In instances of sub-franchising, the sharing of liability between parties would be governed by the contractual agreements between them.

26 Press Note No. 8 (2009 series), <http://pib.nic.in/newsite/erelease.aspx?relid=56146> (last visited on 12 December 2019).

27 DTAAs, www.incometaxindia.gov.in/Pages/international-taxation/dtaa.aspx.

iii Employment law

It is unlikely that the franchisee would be treated as an employee of the franchisor under Indian employment laws, as often the franchisee would be a corporate entity rather than an individual. It would be advisable to incorporate clear drafting in the franchising agreement demarcating responsibilities with respect to franchisee employees, and their salary and benefits. There is a plethora of employment laws in India, which cover aspects such as wages, payment of benefits, gratuity and leave. Companies formed in India are bound by these laws, and additional regulations depending on individual states may also apply.

iv Consumer protection

The Consumer Protection Act 1986 deals with the rights of consumers. While consumers can seek relief under this legislation for deficiency in goods or services supplied to them, by definition an entity that purchases goods, hires or avails itself of services for resale or commercial purposes is excluded from the definition of a consumer. Accordingly, a franchisee may not be able to pursue actions against a franchisor under this legislation, unless a more expansive view of the definition of a consumer is adopted by the courts.

In August 2019, the Consumer Protection Act 2019, which seeks to repeal the Consumer Protection Act 1986, was passed by Parliament, but it has not been brought into force as yet. The definition of a consumer under the Consumer Protection Act 2019 excludes persons who purchase goods or services for commercial purposes and hence franchisees would continue to be excluded from the definition. However, the Consumer Protection Act 2019 entitles consumers to make product liability claims against product manufacturers and product sellers. The definition of a product seller includes persons who import and sell products, and who place such products for a commercial purpose, and may therefore include a franchisee who imports products from a franchisor for sale into India. Further, disclosure of personal information given by a consumer in confidence to another person (except as permitted by law has now been included as an unfair trade practice, for which consumers would have a claim against the person selling or distributing the product concerned.²⁸ Franchisee's may have to be mindful of these obligations.

v Competition Act and restrictive covenants

The Competition Act 2002 deals with anticompetitive agreements and arrangements that constitute an abuse of a dominant position. Broadly speaking, anticompetitive agreements, such as exclusive distribution agreements are void if they cause or are likely to cause an appreciable adverse effect on competition within India, although there are exceptions that entitle a person to restrain infringement of or impose reasonable conditions to protect rights conferred on it under the Trademarks Act and other specified statutes protecting IP. If the Competition Commission determines that a party is abusing its dominant position, based on the criteria specified in the Competition Act 2002, civil penalties may be levied.

²⁸ Consumer Protection Act 2019 available at <https://consumeraffairs.nic.in/sites/default/files/CP%20Act%202019.pdf> (last visited on 11 December 2019).

Non-compete covenants that apply during the term of a contract would normally be enforced. Clauses in franchise agreements restraining a franchisee from carrying out competing business may be treated as reasonable by the Indian courts and historically have been held enforceable.²⁹

The Contract Act generally provides that except in limited circumstances contracts in restraint of trade that operate after termination of the contract are void. Having said that, it is not unusual for franchise agreements to contain post-termination non-compete arrangements, while recognising that there may be limits on their enforceability. Non-solicitation obligations restricting a party from poaching employees of another party that apply during or after the term of a contract are generally enforceable.

vi Anti-corruption

Several statutes in India deal with fraud, anti-corruption and money laundering matters. In general, the Prevention of Corruption Act 1988 penalises corruption by public officials and both the public official as well as the giver of a bribe are potential offenders. Further, the Prevention of Corruption Act 1988 was amended in 2018 to specifically include an offence of bribing public officials by persons associated with commercial organisations. It is important to note that there are no exceptions for speed money or facilitation payments under the Prevention of Corruption Act 1988. The Prevention of Money Laundering Act 2002 seeks to prevent money laundering, including laundering of property derived from corruption.

In addition to Indian laws, the US Foreign Corrupt Practices Act 1977 and the UK Bribery Act 2010 may also be relevant to the Indian operations, given their wide scope of operation. Recently, anti-corruption allegations seem to have been more robustly investigated and some convictions of high-profile people have occurred. A more transparent environment and rigorous enforcement of corporate governance and anti-corruption legislation is a positive development.

vii Dispute resolution

Since litigants face backlogs and delays in the Indian court system, it is usual for commercial contracts to provide for disputes to be settled by arbitration in India or outside India; for example, through the London Court of International Arbitration or the Singapore Court of International Arbitration. Domestic arbitration in India tends to be ad hoc. Institutional arbitration mechanisms do exist, however; for example, through the rules of the Mumbai International Arbitration Centre (established in 2016), which provides a mechanism for institutional arbitration.³⁰

The Arbitration and Conciliation Act 1996 (the Arbitration Act) is the Indian legislation relating to arbitration. The Arbitration Act is divided into several parts. Part I of the Arbitration Act deals with various stages of arbitration proceedings such as initiation and conduct of arbitration and enforcement, and challenge of arbitral awards. Part II of the Arbitration Act deals with enforcement of foreign arbitral awards (being awards delivered in foreign-seated arbitration proceedings) pursuant to either the New York Convention on Recognition and Enforcement of Foreign Arbitral Awards 1958 (the New York Convention) or the Geneva Convention on the Execution of Foreign Arbitral Awards 1927 (the Geneva Convention).

29 *Gujarat Bottling Company Limited v. Coca-Cola Company*, AIR (1995) Supreme Court 237.

30 See <http://mcia.org.in/> (last visited on 2 January 2019).

In recent years, Indian courts have adopted a pro-arbitration stance and the Arbitration Act was amended by the Arbitration and Conciliation (Amendment) Act 2015 (the Amendment Act)³¹ to bring the Arbitration Act in line with global standards and to address certain ambiguities in the law. Further amendments to the Arbitration Act have been proposed and these are pending approval by the Indian Parliament.

Pursuant to the Commercial Courts, Commercial Division and Commercial Appellate Division of High Courts Act 2015,³² separate commercial courts at the district level and a commercial division of High Courts at the appellate level have been established to decide on commercial disputes of a specified value (currently 10 million rupees), including applications or appeals arising out of domestic or international commercial arbitrations. Importantly, the definition of commercial disputes includes disputes arising out of franchising agreements, distribution and licensing agreements.

While the enactment of these laws is encouraging, given the backlogs in the Indian court system and the delays often seen in ad hoc domestic arbitration proceedings, it is still recommended that franchisors choose to settle disputes by arbitration outside India over submission to jurisdiction of Indian courts.

When structuring their legal documentation, franchisors should be careful to ensure that the contracting parties have the ability to perform their obligations, that adequate protections or indemnities are obtained from the franchisee's promoters, and that available legal remedies are aggressively pursued to protect the franchisor's interests. A case in point, is the dispute between McDonald's and one of its Indian franchisees. McDonald's terminated the franchise arrangement for non-payment of royalties, but the termination was challenged by the franchisee and the franchisee continues to use the company's system despite the termination citing interests of consumers, employees and vendors. Both parties litigated the dispute at various levels in the Indian court system and through arbitration proceedings in London before a settlement was reached.³³

VII CURRENT DEVELOPMENTS

India has remained steadily on the reform-oriented trajectory adopted by successive governments since 1996, and we expect the country to continue on this trajectory. Therefore, despite the limitations on FDI in multi-brand retail and a slowdown in the economy, we believe there are significant opportunities available for international companies looking to establish a presence in India through the franchising model.

IRAN

*Shelley Nadler and Farid Kani*¹

I INTRODUCTION

Iran is the second-largest economy in the Middle East and North Africa region after Saudi Arabia, with gross domestic product in 2017 of US\$447.7 billion.² It also has the second-largest population of the region after Egypt, with a population of 80.6 million people in 2017.³ Official statistics indicate that over 23.9 per cent of the Iranian population is aged between 15 and 29.⁴

The retail market, though remaining underdeveloped, has recently been growing extensively. As a result of the transition from street shopping to modern shopping malls, the country is estimated to have around 16 million square metres of commercial property nationwide (mainly shopping malls).⁵ It is estimated that with an average income of US\$17,000 per head, Iranian consumers exercise more purchasing power than consumers in comparable developing countries such as India, Brazil, Egypt and China.⁶ It is generally acknowledged that there is high demand in the Iranian market for the presence of western brands and that Iranian consumers, particularly the growing young population, want more choice in areas such as fashion, retail and food and beverage concepts.

The retail market in Iran is also expanding through the emergence of e-commerce companies. Digikala, an online e-commerce platform, has become the biggest in the Middle East, with around 750,000 unique visitors per day and estimated to be worth US\$150 million as at May 2015.⁷

There is also potential for service industries in Iran, including a great deal of interest in children's development and well-being, for all ages, from toddlers to university students.

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- 1 Shelley Nadler is a legal director at Bird & Bird LLP and Farid Kani is a partner at Atieh Associates Law Firm. The information in this chapter was accurate as at January 2019.
 - 2 Iran overview, The World Bank (2016), available at www.worldbank.org/en/country/iran/overview; Iran GDP Forecast 2016–2020, Trading Economics (2016), available at www.tradingeconomics.com/iran/gdp/forecast.
 - 3 Ibid.
 - 4 Iran National Data Centre, Report of Year 13960 (2017), available at <https://www.amar.org.ir/Portals/0/News/1397/jameat.pdf>.
 - 5 'Tehran Teeming With Shopping Malls', *Financial Tribune* (2015), available at <https://financialtribune.com/articles/economy-business-and-markets/23543/tehran-teeming-with-shopping-malls>.
 - 6 'Luxury tempted Iran is a dream market for retail', *exportiamo.ir* (2016), available at www.exportiamo.it/aree-tematiche/12836/luxury-tempted-iran-is-a-dream-market-for-retail/.
 - 7 'From Digikala to Hamijoo: the Iranian startup revolution, phase two', *The Guardian* (2015), available at www.theguardian.com/technology/2015/may/31/amazon-iranian-style-digikala-other-startups-apat-hamijoo-takhhifan.

With an ageing population and poor local provision, there would also be demand for domiciliary care franchises that would train staff to provide care at a higher standard. Fitness and weight management is another area with potential in Iran, particularly for full-service gyms segregated at different times for men and women.

The lifting on 16 January 2016 of the economic and financial nuclear sanctions through the Joint Comprehensive Plan of Action (JCPOA) allowed Iran to trade more freely globally. The trend slowed down, however, rather significantly with the withdrawal of the United States from the JCPOA. It remains to be seen how this withdrawal is going to impact the local market given the considerable thirst for international retail products among local consumers in what is one of the largest emerging markets in the region.

It is recommended that proper advice be sought in relation to sanctions and that due diligence checks are carried out for parties either directly or indirectly involved in a transaction before entering into any legally binding arrangement.

II MARKET ENTRY

i Restrictions

There are in principle no restrictions *per se* imposed on local or foreign franchisors wishing to operate a franchise business in the Iranian market. No prior approval by regulatory bodies is required before entering into a franchise agreement. Indeed, Iranian law adopts a fairly flexible approach towards franchise agreements. This authorises the parties to regulate their business freely in all sorts of franchise schemes, including setting up area development agreements or master franchise agreements, to the extent that mandatory provisions of the Iranian law are complied with. These mandatory provisions are generally enforced in the form of a requirement to obtain specific licences for a certain activity or in the form of payment of statutory taxes and duties.

Franchisors have the option to set up a business directly or enter into an arrangement with a local franchisee. In principle, there exists no legal restriction on shareholdings by foreign persons in companies established in Iran, and foreign persons may hold up to 100 per cent of the shares in an Iranian company without the need for Iranian participation, sponsorship, or any special formalities or licences such as are required in other jurisdictions.

Further, to the extent that the area of activity triggers a requirement for a special licence, including by way of example a licence from the Ministry of Health (MOH) in the case of import and sale of health-related products, or a licence from different affiliates of the Ministry of Industry Mine and Trade (MIMT) in the case of the sale of durable goods, the licences, in the vast majority of cases, are required regardless of whether the franchisee's shareholders are of Iranian or foreign nationality. These licences must be obtained by any company trading in the applicable sector, whether it is franchising or not.

There are a number of corporate vehicles available to foreign entities and individuals investing or doing business in Iran. From a legal point of view, the foreign investor is free to choose from any type of entity permitted under the Iranian Commercial Code, or it may register a branch or representative office.

In practice, the most common vehicle used by foreign investors in Iran is the private joint stock company, followed by the limited liability company. These two types of entity have proven themselves to be the most suitable for the purposes of modern business. Once established, the company will be deemed of Iranian nationality irrespective of the percentage of the foreign shareholding.

There exists an additional restriction with respect to direct ownership of real property by foreign persons (i.e., individuals and legal entities). Such ownership is conditional on the specific permission of the Iranian Council of Ministers and this is rarely granted. The restriction does not apply to registered Iranian entities (as described above) irrespective of the percentage of the foreign shareholding.

No restrictions on the rent of real property exist, whether in relation to a foreign company or a local entity owned fully or partly by a local company.

ii Tax and foreign exchange

The Iranian Direct Taxation Code applies tax liability to foreign persons (individuals and entities) deriving Iran sourced income from payments of royalties by Iranian entities. Therefore, to the extent that foreign investors enter into a franchise agreement with a local entity (even those fully owned by the foreign company) and royalties are charged, the liability for payment of royalty tax is triggered. Depending on the category of royalties (i.e., type of contract), from 10 to 40 per cent of the received royalties are deemed profit, which is taxed at a rate of 25 per cent.

There are no restrictions on local currency transactions save for those caught by anti-money laundering regulations. Following the withdrawal of the United States from the JCPOA, the government imposed restrictions on foreign exchange transactions. The Iranian rial had been under considerable pressure during the period prior to this, and this was seen as way of controlling the slide in value of the currency. As the government is seemingly providing sufficient foreign exchange to satisfy the requirements of importers, this should not in principle impact franchise businesses.

III INTELLECTUAL PROPERTY

i Brand search

Searches for trademarks, patents and industrial designs, as well as searches for trade names and information on corporate entities, can be made in the database of the Official Gazette available at www.rrk.ir. The State Organization for Registration of Deeds and Properties Intellectual Property Center (the Registry) also provides for a database search of all intellectual properties available at <http://iripo.ssaa.ir>.

ii Brand protection

Trademark registration is not compulsory for franchisors under Iranian law; this is only a legal requirement for advertising purposes. Registration of a trademark will, however, provide the trademark owner with the maximum protection available under Iranian law. Such protection is highly recommended, given the various common infringements found in the market. Protection is granted under the umbrella of the Law on the Registration of Patents, Industrial Designs and Trademarks 2009. Iran is also a member of the following international agreements, and therefore offers the protections and mechanism provided by these treaties:

- a* Madrid Agreement Concerning the International Registration of Marks of 1891 together with its Protocol (1989); and
- b* the Paris Convention for the Protection of Industrial Property 1883.

To register a trademark an application must be submitted with information on the applicant as well as details and descriptions of the trademark itself.

Upon receipt of the application, the Registry reviews the application within 30 days to ensure compliance with the relevant laws and regulations. It also cross-checks and confirms that the trademark classes applied for are in conformity with the international trademark classes. If the application is rejected because of any faults or discrepancies, the Registry will require the modification of the application within 30 days. If the application is approved, the trademark will be published in the Official Gazette.

Third parties will have the right to object to the application within 30 days of it being published. Otherwise, the registration will be finalised. The validity of the registration will be for a period of 10 years, with the possibility of renewal for an unlimited number of times.

iii Enforcement

Violations of trademark rights are handled by a specialised court sitting in the capital (i.e., Tehran), which processes all lawsuits related to trademark and trade name disputes in all civil and criminal claims. There is also a special prosecution office vested to hear criminal complaints made for breach of trademark and trade name rights. In dealing with breach of trademark rights (including, for example, the sale of counterfeit products) a number of remedies are available. These are, inter alia, imposing pecuniary penalties, requesting compensation, ordering product recalls and issuing necessary injunctions or preventive measures.

iv Data protection, cybercrime, social media and e-commerce

Data protection is a relatively new area of law under the Iranian legal regime and is not particularly well regulated. There is no specific law on private data, but this is an area dealt with in a number of laws and regulations including, inter alia, the Law on Electronic Commerce 2003 (EC), the Publication and Free Access to Information Law 2009, the Law on Cyber Crimes 2009 (LCC), and the newly amended Penal Code 2014.

Private data are protected from disclosure and all state, public or private organisations and entities dealing with such data and information must comply with the pertinent regulations.

Private data are defined as 'data belonging to a real person' including the name, surname, residential and work address, family situation, personal habits, physical disorders, bank account number and passwords of the relevant person. Data are defined as 'any representation of facts, information and concepts which is produced, sent, received, stored or processed by electronic, optical or other new technological means'.

As noted above, regulations exist in areas of e-commerce, namely the EC, the LCC in relation to cybercrime, and various by-laws issued by the Ministry of Culture regulating the activities of social media, in particular, the Implementing By-laws on Regularising and Development of Digital Media 2010.

IV FRANCHISE LAW

i Legislation

The concept of a franchise is not explicitly provided for by Iranian law, including the Iranian Civil and Commercial Codes. Therefore, there are no specific commercial agency or franchise laws in Iran granting special rights to franchisees and agents. In addition, franchise and agency relationships are not regulated under Iranian legislation.

This distinguishes Iran from most other Middle Eastern countries, where there are regulations in place protecting local franchisees, distributors and agents and, in particular, commercial agency laws that provide the local party with enhanced rights on the termination of the relationship.

Given the lack of specific legislation addressing this matter in Iran, franchise agreements will be governed and regulated by ordinary contract principles. As such, the parties to a franchise agreement have the freedom to determine the different aspects of their relations such as the terms of the contract, notices, early termination, payment of damages, etc.

ii Pre-contractual disclosure

In general, no particular duty of good faith or recognition of the doctrine of *culpa in contrahendo* can be identified in Iranian contract law provisions. There is a school of thought that believes that a fraudulent disclosure of facts in a pre-contractual disclosure can result in liability based on the general civil liability provisions of Iranian law. However, this approach is not widely accepted in Iranian jurisprudence.

iii Registration

A factor that is quite distinct from the general freedom of parties to enter into a franchise agreement is that mandatory registrations must be made with certain authorities, namely the MIMT and the MOH for import and distribution of foreign products. These registrations are the responsibility of the franchisee and not the franchisor.

In particular, in line with the provisions of the Consumer Protection Law 2009 (CPL) all providers of capital and durable goods must register themselves with affiliates of the MIMT, as without this registration the import of products into Iran is not possible. To implement the CPL requirements, the MIMT has issued instructions relating to the registration of distributors and agents, namely the 2018 Instructions, which are currently in force.

From a legal perspective, registration with MIMT is not for the purpose of granting or triggering commercial agency protection of registered franchisees in Iran, as there are no legal provisions regarding such protection under Iranian law. Rather, the registration is intended to ensure continuity of supply, aftersales and similar requirements.

The same applies to the import and distribution of health-related products, where approval must be obtained from the MOH pursuant to Article 16 of the Law on Foodstuffs, Beverages, Cosmetics and Hygiene 1967. Numerous implementing regulations have been issued to implement the above in all different sorts of areas including pharmaceutical drugs, medical devices, foodstuffs, beverages, cosmetics, etc. by the Iranian Food and Drug Administration.

iv Mandatory clauses

There are no mandatory clauses required in franchise agreements under Iranian law.

v Guarantees and protection

No particular legislation addresses this matter. To the extent that a franchise agreement contains provisions relating to a personal guarantee and guarantees from entities to the franchisor, those guarantees are in principle valid and enforceable (subject to compliance with general mandatory provisions).

V TAX

i Franchisor tax liabilities

As noted above, foreign persons receiving an income from Iranian persons (individuals or entities) for any grant of royalty, technical assistance, transfer of technology, rights to use property and any grant of rights, privileges or licences to Iranian persons, will be subject to withholding tax payments. Taxation is calculated on a deemed profit basis. Depending on the category of royalties (i.e., type of contract) between 10 to 40 per cent of the received royalties are deemed profit and are taxed at a rate of 25 per cent. Given the scarcity of foreign entities in Iran, it is the responsibility of the Iranian party making the payment to withhold and deduct the tax and pay it to the Tax Office on behalf of the foreign party. Previously, the provision of services was also subject to withholding service tax. However, pursuant to a recent amendment of the Tax Law approved in early 2016, the only withholding tax applicable to foreign entities is in relation to royalties. Therefore, in cases where a foreign franchisor provides support in the form of training of personnel, or if it charges the franchisee service fees for services provided under the franchise agreement, these will be free of withholding tax.

ii Franchisee tax liabilities

All corporate entities in Iran irrespective of their shareholding or nature of business (including representative offices and branches of foreign companies) must pay tax on their taxable income at a rate of 25 per cent. Taxable income is income less allowable expenditures and exemptions. All companies (as well as certain individuals) are required to maintain statutory records of accounts (comprising a journal and a general ledger) that must be sealed by the Tax Office prior to the commencement of each fiscal year.

There is additionally a value added tax at the rate of 9 per cent applicable on the purchase or supply of goods and services. In addition, withholding tax on salary and rent also applies.

iii Tax-efficient structures

Incentives exist for setting up entities in free trade zones or special economic zones. Most of which, however, apply to the income generated from those specific areas, so this would probably not be that helpful for a franchise business. Iran has also concluded a number of tax treaties with various countries, including Croatia, France, Germany, Norway, Russia and Turkey to avoid double tax payments on, inter alia, income, capital and transport, which can be used in adopting an efficient tax structure.

VI IMPACT OF GENERAL LAW

i Good faith and guarantees

Iranian law and Iranian jurisprudence take a fairly formalistic approach towards contract interpretation and performance of contracts. Therefore, there are no statutory provisions under Iranian contract law pertaining to the principle of good faith in performing contractual obligations.⁸ Good faith can nevertheless be voluntarily incorporated as a contractual clause if the parties agree to this and, if it is incorporated, this obligation must be complied with.

⁸ Except for limited areas, including insurance laws.

There exist other contractual principles, including, by way of example, the *La Zarar* principle, which is quite similar to the doctrine of abuse of right under the UNIDROIT principle of International Commercial Contracts.

ii Agency distributor model

The concept of 'franchise' under Iranian law, despite being known in many forms (e.g., agency, representation), is best described as having the form of a distributor agreement in which products are involved. In fact, in a franchise agreement involving products, the supplier (franchisor) sells products directly to the distributor (franchisee), who then sells the products on to its customers, adding a margin to compensate its costs and provide profits. The distributor cannot in principle create any legal relationship between the supplier and the customer.

Iranian law offers great flexibility in its contract law, as there are no mandatory contractual requirements for franchise agreements, and because of the fact that no specific commercial agency or franchise law exists in Iran. Therefore, parties to a franchise agreement are free to agree to extend, limit or materially alter the nature of their rights and obligations to one another insofar as mandatory provisions of the general law are complied with and the terms are agreed between the parties.

iii Employment law

Iranian law does not regard the parties to a franchise agreement as entering into an employer–employee relationship and therefore franchise agreements are excluded from employment law provisions.

iv Consumer protection

Under Iranian law, in particular, Article 4 of the CPL, importers and distributors of goods and services such as franchisees are defined as suppliers and therefore cannot benefit from the statutory protections provided under the CPL relating to consumer protection.

v Competition law

Iran adopted its competition law in 2008, which is otherwise known as the Law Amending Certain Provisions of the Fourth Development Plan Act and Principle 44 of the Constitution 2008. The 2008 law addresses various issues including, inter alia, pricing, tying agreements and territorial restrictions. In principle, and as in many other jurisdictions, Iranian competition law addresses the following two main issues, and which are prohibited:

- a* discriminatory behaviour and agreements, concerted or solo practices that restrict or impede free trade and competition between businesses, or those aiming to distort the market; and
- b* abusive behaviour by a company by dominating a market, or practices that tend to lead to a dominant position, as well as supervising mergers and acquisitions of large corporations resulting in distortion of the market or creation of a dominant position in the market.

A number of prohibited anticompetitive behaviours that are potentially relevant to a franchise agreement are discussed below:

- a* Discriminatory pricing, which is defined as the provision of goods and services of a similar nature or condition at different prices to different parties or in different geographical areas.
- b* Concerted practices or agreements between parties with the aim of fixing prices, limiting or controlling the supply or sale or forcing discriminatory conditions on supply, sale or purchase of goods or services and dividing or limiting access to the market.
- c* Tie-in agreements by way of forcing the purchase of intended goods and services by the other party to be dependent on obtaining extra services or goods.
- d* Obligatory sale, whereby the sale of a product or service becomes subject to obligatory sale in a way that another party is barred from transacting with a competitor.
- e* Territorial restriction.
- f* Pricing restrictions, whereby it would be unlawful to make the sale of a product or service subject to a limitation or restriction on the resale price.

Implementation of the Competition Law is mainly carried out by the Competition Council, which also supervises the proper enforcement of the Competition Law's provisions.

vi Restrictive covenants

There are no statutory provisions of Iranian law preventing parties from entering into agreements on non-compete terms or restrictive covenants. Such agreements are binding and enforceable to the extent that they are not contrary to the mandatory provisions of Iranian law, in particular, the laws and regulations relating to Competition Law. Notable examples of such provisions are territorial restrictions, restrictions on resale price and restrictions on entering into business arrangements with certain third parties.

vii Termination

In general, Iranian law takes a strict view on termination of an agreement. For the most part, termination is not automatically allowed and a party must either apply to a court to obtain a judgment of termination or the agreement must specifically empower a party with the right to terminate under certain circumstances including for cause or convenience. Given the above, even in cases of a breach, the non-breaching party may not exercise the right of termination and the right does not exist automatically. Rather, the non-breaching party must apply to a court to compel performance and, if this is not possible, to request a court order for a third party to perform and, if not successful as a last resort to request termination of the contract through a court order. Conversely, to the extent that parties to an agreement provide provisions for termination of their agreement and the agreement is subject to a foreign law where a contractual right to terminate under the agreement is permitted, Iranian law would generally recognise the rights of termination according to the terms of the agreement.

The termination of the franchise agreement will not have any effect on those terms and conditions of the contract that have been explicitly or implicitly (by custom) agreed to survive upon termination.

One issue that must be addressed is the deregistration of the registered franchisee with the pertinent authorities, including the MOH. The practice of these authorities is that in cases of termination of the franchise agreement, so long as the marketing authorisation licence issued by these authorities remains valid, they will be likely to require the consent

of the franchisee before they effect the termination and the deregistration. In particular, if the licence is still valid upon termination of the franchise agreement, the franchisee will, in the view of the Iranian authorities, still be authorised to continue trading the products or services under the franchise. The franchisor must ensure that the franchise agreement is drafted in such a way that the franchisor secures, to the extent possible, means to prevent the franchisee from continuing such trading, and requires the franchisee to promptly apply for deregistration. There have been trends recently for the lifting of this restriction in certain sectors (e.g., in the pharmaceuticals industry), whereby the foreign supplier-owned subsidiary takes over the local franchisee business.

viii Anti-corruption and anti-terrorism regulation

Numerous regulations exist under Iranian law that deal with fraud, anti-corruption and money laundering. Notable examples are the newly amended Penal Code 2014, Anti-Money Laundering Law 2008, the Law Intensifying the Penalties of the Perpetrators of Embezzlement, Fraud and Bribery 1985, and the Law on Anti-Corruption 2011. Iran is additionally a member of the United Nations Convention against Corruption 2004.

In accordance with the legislation mentioned above, fraud, corruption (including bribery) and money laundering are criminal offences and punishable by penalties including, for example, pecuniary penalties and imprisonment.

ix Dispute resolution

In general, there are no legal prohibitions in choosing a law other than the law of Iran to govern an agreement. There are procedural issues to be complied with for such a choice to be deemed valid under Iranian law. If these conditions are met, foreign governing law clauses will be recognised and enforced in Iran. However, Iranian law provides for the rejection of foreign laws if they are found to be against public order.

While Iranian law has restrictions on choice of forum in court, with regard to the dispute settlement mechanism, Iranian law provides for absolute freedom for parties to select domestic or international arbitration as a dispute resolution mechanism. Commercial arbitration is recognised under the Iranian Civil Procedure Act and the Law on International Commercial Arbitration. Iran is also a member of the New York Convention on Recognition and Enforcement of Foreign Arbitral Awards 1958 (the New York Convention). Therefore, to the extent that a foreign arbitration award has been obtained in a Member State of the New York Convention, such an award is in principle enforceable in Iran.

In the absence of parties' choice of forum for disputes in the agreement, disputes are settled by referring the matter to an Iranian court of law. Iranian courts are divided into civil and criminal courts governed by the Code of Civil Procedure 2000, the Law on Formation of Public and Revolutionary Courts 1994 as amended, the Law on Dispute Settlement Councils 2015 and the Code of Criminal Procedure 2015.

Commercial disputes (including any dispute over matters related to a franchise agreement) are treated the same as any other civil dispute, as there are no separate procedural regulations related to such disputes. Courts can, at the request of the claimant, grant injunctions and provisional orders, and preventive orders if the claimant's action is successful.

With regard to damages resulting from a breach of contractual obligations, two elements must exist in respect of a claim for damages: first, the loss must in fact have been suffered (or the suffering of it is a certainty) – therefore by implication it must be a monetary loss; second, the loss was a direct result of (1) the failure of the other party to perform or

(2) a delay in performance by the other party. Claims for loss of profit or consequential loss are not recoverable. In our opinion, these losses should be recoverable if contractually expressly agreed to by the parties.

No other official dispute settlement mechanism exists under Iranian law.

VII CURRENT DEVELOPMENTS

We do not expect any major changes in the laws and regulations relating to franchising or franchise agreements in the near future.

ITALY

*Claudia Ricciardi*¹

I INTRODUCTION

The good news from the 2012 study by Assofranchising is that, notwithstanding the current difficult economic situation, franchising is developing in Italy.² The reason for this is seen as being the strength of brands, which are likely to be viewed by consumers as a guarantee, especially during periods of recession, of the quality claimed for purchased services or products, in addition to offering reduced prices. Compared with stand-alone strategies, on one hand franchising networks facilitate the diffusion of the brand while maintaining a uniform standard of quality and, on the other, they may benefit from a reduction of fixed costs, resulting in reduced prices for the end customer. This is why every day more entrepreneurs in Italy decide to invest money in franchising networks.

Concrete figures for franchising in 2012 include an increase in turnover of 4.4 per cent and the number of active networks has grown from 878 in 2011 to 938 in 2012. Of the new franchising networks that opened in Italy in 2012 in the field of food and beverages, most are dedicated to the sale of ice cream. The presence of foreign franchising is also significant. In Italy in 2012 foreign master franchisors numbered 66, with 34 foreign networks operating in the country with registered offices in other countries.

II MARKET ENTRY

i Restrictions

Our analysis of the Italian legislation on franchise contracts is conducted from the standpoint adopted by the legislature in relation to the entry of foreign franchisors to the domestic market.

Notably, the sole reference to international franchising made by the legislator within the Franchise Act is regarding the disclosure to be made by foreign franchisors intending to set up

1 Claudia Ricciardi is an associate at Studio Legale Bird & Bird. The information in this chapter was accurate as at January 2019.

2 From a study by the Italian Association of Franchising (Assofranchising Italia). See www.assofranchising.it. The Italian franchising sector is represented by two national associations: Assofranchising Italia and Federazione Italiana del Franchising. Both associations have adopted ethical codes on the basis of the experience accrued in other European countries.

a franchise network in Italy;³ in particular, in Section 4.2 of the Franchise Act, the legislature required the government to issue a specific regulation detailing the quantity and quality of the information to be provided by foreign franchisors to Italian potential franchisees.⁴

The main issue with this regulation, issued by the Ministry of Manufacturing Activities⁵ as Decree No. 204/2005, is that it is applicable solely to those franchising agreements regulated by Italian laws by operation of international law; indeed there is still a gap in the law as no specific rule is provided with reference to pre-contractual agreements between foreign franchisors and local potential franchisees (the weak party of the agreement, in the view of the law) wherein the parties may have covenanted to have the contract regulated by a foreign law.

That said, from a practical standpoint, in addition to the information that the franchisor is required to provide to the franchisee under Decree No. 204/2005,⁶ upon request the latter may be given any information concerning the contract and the relevant annexes in Italian.

ii Foreign exchange and tax

See Section V.

III INTELLECTUAL PROPERTY

i Brand search

Brand searches are carried out among Italian and Community applications and registrations, and international registrations with effect in Italy to verify that there is no identical or similar trademark nor reference to identical or similar products or services that could prevent the use of the protected trademark relevant to the franchise nor be a valid basis for starting a nullity action against the trademark.

Internet searches are also carried out to verify the validity of previously traced trademarks, if any, and also any prior use of identical or similar trademarks or identical or similar products or services that could present a challenge to the validity of the protected trademark relevant to the franchise.

It is also possible to carry out similar searches regarding designs rights for Italian and Community designs.

ii Brand protection

If searches do not identify any obstacles, an Italian trademark application can be filed in respect of the goods or services that are the subject of the franchise. The application will be examined and then published by the Italian Patent and Trademark Office. If no objections are raised by third parties within three months of the date of publication, the relevant registration will be issued.

3 The Italian Franchise Act, enacted in 2004, is mainly aimed at regulating the pre-contractual stage, by setting the legislature's requirements regarding the disclosure obligations of the parties to the agreement (see Section IV.ii).

4 The Italian Franchise Act does not allow the franchisor and franchisee to belong to the same corporate group, requiring that the parties to the agreement are independent, from an economic and a juridical standpoint.

5 Ministero delle Attività Produttive.

6 See www.assofranchising.it/testi/Decreto_204_2005.pdf.

In Italy rights run from the filing date of the application. Moreover, within six months of the filing date, it is possible to extend the protection in other countries, claiming priority under the Paris Convention (Article 4).

Italian and Community design applications can be also filed and the registration process is straightforward as no examinations are carried out by the relevant offices.

iii Enforcement

Franchise-related intellectual property rights can be enforced on an administrative and a judicial level.

It is possible to file oppositions against subsequent identical or similar trademarks referring to identical or similar products before both the Italian and the Community trademark authorities. Moreover, cancellation actions can also be started before the Office for Harmonization in the Internal Market, which administers the Community Trade Mark.

At the judicial level, trademark owners are entitled to start the following types of actions:

- a* infringement and non-infringement actions (including possible counterclaims for revocation or invalidation of the trademark at issue);
- b* action for revocation or invalidity; and
- c* all other actions regarding trademarks (i.e., licence disputes).

Infringement and non-infringement actions

The owner of a registered trademark is entitled to start proceedings based on its trademark rights. The owner of a non-registered trademark and the owner of an application for registration of a trademark have the same right.

In cases of infringement, the following remedies may be requested of the competent court:

- a* prohibition of the manufacturing, commercialisation and use of the infringing goods;
- b* seizure of the infringing goods;
- c* withdrawal of the infringing goods from the market;
- d* a penalty to be paid for every violation or non-fulfilment of the decision or for every day of delay in the execution of what was provided by the decision;
- e* destruction of the infringing goods;
- f* assignation of the infringing goods to the trademark owner;
- g* compensation of the damage suffered by the trademark owner;
- h* surrender of the profit enjoyed as a result of the infringement;
- i* publication of the decision at the defendant's expense; and
- j* administrative fines.

Moreover, as long as the two requirements of the *fumus boni iuris* (i.e., likelihood of the validity of the enforced trademark and of the infringement) and of the *periculum in mora* (i.e., urgency of the requested measures) are deemed to subsist, Italian legislation provides for the possibility for the trademark owner to ask for different preliminary measures.

In cases of trademark infringement, the two most important measures are seizure – which may apply to allegedly infringing goods as well as goods with which the infringement is carried out – and the preliminary injunction. In granting the said injunction, the court may also provide for a penalty due for every violation or day of delay in complying with the court's order.

Another very typical measure of the Italian system is the ‘description’, which is aimed at gathering evidence of the claimed infringement when it is not otherwise available (e.g., when the purchase of goods is not feasible or not sufficient to provide evidence of the infringement).

In those cases in which the summoning of the counterparty is likely either to compromise the effectiveness of the granted precautionary measures or to irreparably damage the interests of the applicant, the above-mentioned precautionary measures can be granted *ex parte* and the court should set the hearing for the appearance of the parties no later than 15 days from the issuing of the order.

Along with the order granting the precautionary measures, the judge is required to provide a term for the parties to start the relevant proceeding on the merits. In the absence of the provision of this term, the proceeding may be started no later than 20 working days (or 31 calendar days, whichever term is the longer) from the communication of the order. If the parties fail to proceed within this term, the granted precautionary measures lose any effectiveness, with the exception of those measures that anticipate the effects of the decision in the action on the merits (injunction orders are deemed to be included in such measures).

Action for revocation or invalidity

Any interested party can seek the invalidity of a trademark, for non-use or lack of distinctiveness, within a judicial proceeding aimed at obtaining the invalidation of a trademark.

In addition, the owner of an earlier trademark may claim before the relevant court the revocation of a trademark (1) for lack of novelty because of the existence of prior trademarks; (2) because the contested trademark infringes a third party’s copyright, intellectual property or other exclusive right; (3) because the contested trademark infringes a third party’s right on his or her name or portrait; (4) because the contested trademark has been registered by a non-entitled subject. Such actions can be started by the prior right owner or by the relevant assignee only.

iv E-commerce

Building an online franchise network sets a number of issues not only on the structural or organisational side, but also from a juridical standpoint.

In this last respect, the most likely issues to be explored by literature and case law would relate to:

- a* the way in which the know-how would be transferred during the contract and how the franchisor could be protected upon termination of the agreement in that regard;
- b* the protection of the trademarks upon termination of the contract; and
- c* the scope of the possible exclusivity right upon the franchisee, since no specific reference could be made to territory.

IV FRANCHISE LAW

i Legislation

The Italian Franchise Act is over 10 years old, having been approved by Parliament on 6 May 2004⁷ after a gestation of more than seven years (the first bill having been proposed in 1997).

Italian law recognises a number of types of contract (which find their specific definition and regulation within the Civil Code or within ad hoc acts), though it also allows for parties regulating their respective relationships outside those recognised contracts (e.g., a trademark or patent licence is not a recognised contract in our jurisdiction; nevertheless such contracts are fully effective and enforceable on condition that they include those basic elements required under general Italian contractual law).

With the entry into force of the Franchise Act, the franchising contract has finally been recognised by Italian law,⁸ being defined (under Article 1) as:

the contract that, irrespective of the relevant naming, is executed between two juridical parties, legally and economically independent, with which a party grants to the other party, against a consideration, the right to dispose of a number of industrial and intellectual property rights related to trademarks, trade names, signs, utility models, design, copyright, know-how, patents, technical and commercial assistance and advice, including the franchisee in a system constituted by a plurality of franchisees distributed on the territory, to commercialise certain goods and services.

From a very first reading it can therefore be inferred that the franchising contract is distinguished by the following two main elements:

- a* the franchisor grants to the franchisee the right to use certain intellectual property (IP) rights and undertakes to provide to the latter certain services for the exploitation of the activity; and
- b* the franchisee pays a consideration in relation to the grant of IP rights and for the provision of the services mentioned.

From a subjective standpoint the legislature, on the one hand, has expressly not excluded that an individual may be a party to a franchising agreement; however, the mention of the commercial purpose of the activity would lead to the assertion that the parties must in any case be entrepreneurs; and, on the other hand, has required that franchisor and franchisee are ‘juridically and economically independent’, thus entailing that the parties to the contract should not belong to the same corporate group or be parties to a joint venture in which control is reserved for the franchisor.

Finally, a number of debates have arisen over the provision according to which the franchisee should be included ‘in a system constituted by a plurality of franchisees distributed on the territory’, and also in relation to the rule set out under Article 3, Paragraph 1, which states that ‘for the purposes of the establishment of a franchising network, the franchisor shall have tested its commercial formula on the market’. While these questions certainly

⁷ The Franchise Act was published in the Official Gazette on 24 May 2004 and entered into force on 25 May 2004.

⁸ Previously, since its adoption by the European Court of Justice on 28 January 1986, the decision within the high-profile *Pronuptia* case constituted the main reference for both literature and case law.

deserve a much deeper analysis, it is anticipated that the main issue will continue to be the applicability of the Franchise Act to the 'pilot contracts', through which the franchisee starts experiencing its commercial formula.

ii Pre-contractual disclosure

The legislature's requirements in the Franchise Act (which consists of nine articles) focus, in substantial part, on pre-contractual obligations.

In particular, Section 6 of the Franchise Act sets out generic information obligations upon the franchisor, stating that the latter should be timely in providing any data and information that it believes necessary or useful for the franchisee for the execution of the contract (to the extent that the data and information are not confidential or the relevant disclosure would not entail the violation of third parties' rights).

Section 4 provides a list of specific information to be provided to the franchisee at least 30 days before the date of the execution of the franchising agreement. Namely, as well as the full copy of the agreement to be executed, enclosures providing the following information are to be delivered to the franchisee:

- a* main data relating to the franchisor (including the corporate name, corporate capital and – if the franchisee so requires – a copy of the balance sheet for the past three years);
- b* an indication of the trademarks used within the franchising system (mentioning the data relating to the filing or registration of the licence granted to the franchisor by a third party or the documents attesting to the use of the trademark);
- c* a short description of the elements that feature the activity constituting the subject matter of the franchising;
- d* a list of the franchisees belonging to the network and of the direct points of sale of the franchisor;
- e* an indication of the variation, year by year, of the number of franchisees (including the relevant locations in the past three years or, if the shorter period, from the starting of the activity); and
- f* a short description of the possible judicial or arbitration cases started against the franchisor and concluded within the past three years in relation to the franchising system.

Although providing a detailed disclosure obligation for the franchisor, the legislature has omitted to state the sanction to be applied in the event that the franchisor fails to disclose any of the mandatory information. Indeed, Section 8 of the Franchise Act allows a party to claim the annulment of the contract only in cases of 'false information' having been disclosed, thus limiting the range of situations in which this sanction may be applied.

We consider, therefore, the general principles that apply in matters of pre-contractual liability; in brief, these entail that:

- a* the franchisor may be required to compensate the possible damage suffered by the potential franchisee through withdrawal from the negotiations as a result of conduct by the former contrary to the bona fide principle; and
- b* should the contract be executed despite conduct by the franchisor contrary to the bona fide principle, the possibility should be explored that the franchisee's will to execute the agreement may be affected by that conduct, allowing the possibility of claiming the annulment of the contract and compensation for the damage suffered (or even solely this latter, should the franchisee decide to maintain the contract in place).

Notwithstanding that the franchisee is plainly seen as the weak party of the agreement, the legislature actually intended there to be two-way disclosure obligations, stating that the franchisee (in addition to a general bona fide obligation) should in its turn, in a timely manner, provide the franchisor with exact and complete information and data that may be necessary or opportune to the franchisor in view of the execution of the contract (though not specifically required by the franchisor).

The wording used by the legislature in relation to the franchisee's obligations does not exactly mirror that used with reference to the franchisor, and is actually more favourable to the latter. This slip can be explained by recalling that the franchise contract is characterised by the *intuitus personae* and, thus, certain information (which could hardly be known or obtained by the franchisor otherwise) should be spontaneously disclosed by the franchisee.⁹

iii Registration

Franchisees should observe all corporate and administrative regulation regarding registration (e.g., registration with the Chamber of Commerce) and collection of the required licences, and which may depend on the subject matter of the franchise.

iv Mandatory clauses

Under Section 3 of the Italian Franchise Act the legislature sought to provide a sort of checklist of the elements that must and may be included within the agreement.

The following are mandatory elements of the agreement, lack of which renders the whole contract null and void:

- a* an indication of the investment required by the franchisee prior to the start of the activity;
- b* the modalities of calculating and paying royalties; in this respect according to a view in Italian legal literature, royalties may be omitted in a franchise contract under certain circumstances in specific cases;
- c* the specification of the know-how to be provided;
- d* the features of the services to be provided by the franchisor (i.e., technical and commercial assistance, dressing and design of the point of sale); and
- e* the terms and conditions for the renewal and termination of the agreement.

As mentioned, Section 3 also indicates those elements (i.e., possible entry fees, possible minimum takings, possible exclusivity related to a certain territory, possible provisions on the assignment of the contract and possible modalities for recognising the know-how provided by the franchisor) that, while not mandatory, may be included in the agreement. The inclusion of such a list has been questioned, given that the failure to include any of these elements within the agreement entails no specific consequence in terms of the nullity of the agreement.

By the same rule (implicitly), the term of the contract may be either open-ended or provide a specific duration. In the latter case, the term of the agreement should allow the franchisee to amortise the investment and, in any case, should be no less than three years. In accordance with the aforementioned principle, legal literature unanimously asserts that in

⁹ The failure of the franchisee to comply with these obligations will entail the same consequences as those outlined regarding the possible failure of the franchisor to comply with obligations set out under Section 4 or Section 6 of the Franchise Act.

the case of open-ended contracts no withdrawal should be allowed before the expiration of a three-year term from the date on which the contract becomes effective, and that no right of withdrawal should be admitted in a contract of a specific term before the expiration of the three-year term.

v Guarantees and protection

Although the Italian Franchise Act requires that the parties to a franchise agreement are autonomous and independent of one another, facts show how franchising networks produce close integration between franchisor and franchisees due, *inter alia*, to the use of the same trademarks and of the same layout of the points of sale, such that third parties (including, but not limited to, consumers) may consider franchisees' outlets as mere branches of the same company.

Case law has been required following such an event to evaluate whether a third party – having contracted with a franchisee while believing they had contracted merely with a branch of the franchisor – could start an action against the franchisor and, if so, whether the franchisor could require indemnification from the franchisee.

According to the 'appearance principle', the guiltless trust of the third party who, on the basis of the seeming facts, believed they had contracted with a branch of the franchisor's business should be protected.

However, these appearances may be determined by the conduct of either the franchisor or the franchisee. Thus, the jurisprudence – moving from one orientation to another – has tried to fix the main principles according to which the franchisor might be directly liable towards the third party for the conduct of the franchisee; briefly (as the matter warrants much deeper examination), the Court of Appeal of Naples, on 3 March 2005 stated that the franchisor has an obligation to control the conduct of the franchisee and the way in which the franchise activity is performed. Lack of such control would thus entail an extra-contractual liability of the franchisor towards the third party in respect of the conduct of the franchisee.¹⁰

V TAX

i Franchisor tax liabilities

Pursuant to Articles 85 and 109 of the Italian Tax Code (ITC) royalties arising from a franchising agreement are relevant for corporate income tax purposes (IRES). They qualify as revenues and are added to the taxable base of the franchisor on an accrual basis.

If the franchising agreement provides for an entry fee, this latter is subject to the aforesaid tax provisions, and as a consequence is relevant for IRES purposes and added to the taxable base of the franchisor on an accrual basis.

Pursuant to Article 5 of the Italian Regional Production Tax (IRAP) Law both royalties and entry fees are subject to this regional income tax and are included as taxable income.

Pursuant to Article 3 of the VAT Law both royalties and entry fees qualify as services and consequently value added tax (VAT) is applicable.

In cases of cross-border franchising, according to domestic law, royalties due to a non-resident franchisor are relevant for tax purposes in Italy and a withholding tax of

¹⁰ Relevant decisions have been issued by the Court of Milan on 21 July 1992; by the Court of Crema on 23 November 1994 and by the Court of Fermo on 3 November 2001.

30 per cent is applied on the amount of royalties paid by the franchisee (or on 75 per cent of the amount of royalties paid, if certain requirements are met); however, a double-taxation treaty between Italy and a third country (i.e., the country of the franchisor) may entitle the franchisor to a lower withholding tax.

Clause-by-clause analysis of the particular franchising agreement is needed to determine whether, and to what extent, the entry fee constitutes remuneration for services or IP rights. Generally speaking if the entry fee qualifies as a consideration for the licence or right to use IP (e.g., trademarks, patents and know-how), the domestic and international tax treatment is that described above. If the entry fee qualifies as a consideration for services rendered by the franchisor (advisory services, technical assistance, etc.), upon certain conditions, the income deriving from such activity should be taxable only by the country in which the franchisor is resident.

ii Franchisee tax liabilities

Pursuant to Article 109 of the ITC, royalties arising from a franchising agreement are relevant for IRES purposes. They qualify as costs and are deductible from the taxable base of the franchisee on an accrual basis.

If the franchising agreement provides for an entry fee, according to Italian generally accepted accounting principles,¹¹ this amount has to be capitalised as an intangible asset and subject to amortisation for a period equal to the life of the franchising agreement. Pursuant to Article 103, Paragraph 2 of the ITC, the amortisation charge recorded in the profit and loss is deductible for IRES purposes.

Pursuant to Article 5 of the IRAP Law both royalties and entry fee are relevant for IRAP and are deductible from the taxable base.

VAT charged on royalties and entry fees can be deducted by the franchisee.¹²

Registration tax is applicable under the following conditions:

- a if all the provisions included in the franchising agreement are relevant for VAT purposes and it is concluded as private deed, the agreement is subject to registration tax (€200) only in cases of use;¹³ and
- b if the franchising agreement is concluded as a public deed or with authenticated signing, registration tax is due (€200) within 20 days of the signing.

In cases of cross-border franchising, the reverse-charge mechanism for VAT should be applied by the franchisee both for entry fees and royalties.

iii Tax-efficient structures

The franchising agreement may provide that the franchisor allows the franchisee to use an immovable property in which to carry out its business and the compensation for this use is included in the royalties amount. In such an event, the tax authorities¹⁴ have stated that

¹¹ See Italian Accounting Standard OIC No. 24 – Intangible Assets.

¹² The VAT Law provides some limitations on VAT deductibility connected to some activities. It is possible, therefore, that the franchisee may not be able to deduct the VAT, partially or entirely, depending on the activity carried out.

¹³ A case of use, or *caso d'uso*, is when the agreement has to be used during a judgment in front of a court.

¹⁴ Ministerial Resolution No. 49/E, 13 March 2007.

the use of an immovable property qualifies as a lease and therefore it has to be treated for registration tax purposes as a separate agreement. As a consequence, the compensation for the lease is subject to registration tax (1 per cent).

As regards cross-border franchising, if the master franchisee and the franchisor are respectively resident and non-resident in Italy for tax purposes, and they qualify as ‘related parties’, pursuant to Article 110, Paragraph 7, the transactions between the two entities must take place at fair market value. Therefore it is important to support the master franchising agreement with a transfer pricing study.

VI IMPACT OF GENERAL LAW

i Good faith and guarantees

See Section IV.ii.

ii Agency distributor model

Under Italian law franchise agreements and agency agreements appear alike in many respects.

First, both the franchise and the agency distributor model are characterised by the stability of the contractual relationship between the parties involved. The relevant contracts, in fact, do not aim at regulating one or more affairs concluded by the franchisee or the agent individually considered, but rather they regulate the entirety of the affairs concluded by the franchisee or the agent while carrying out their activity.

Furthermore, the contracts at issue are also characterised by the fact that the franchisee as well as the agent autonomously undertake the business risk and bear the costs necessary to perform their activities.

However, notwithstanding the aforementioned resemblances, the franchise agreement and the agency agreement also show several structural differences that distinguish the two types of contracts from one another and make any overlap, even partial, impossible.

In fact, according to the Italian Franchise Act, the franchisee, unlike the agent, pursues his or her activity in the name and on behalf of him or herself, albeit through the franchisor’s brand and trademarks. The franchisee then remunerates the franchisor – in fees and royalties – because the latter makes it possible for the franchisee to start up his or her business, whereas the agent is remunerated by the principal in light of the business volume generated by the agent’s activity.

iii Employment law

The subjection of the franchisee to strict control by the franchisor regarding the organisation of the business may take franchising agreements close to employment contracts.

The Italian courts, however, have denied the existence of such a subordinate, job-like relationship between the franchisor and the franchisee on the grounds that both parties are necessarily autonomous entrepreneurs and that the franchisee does not lose such status as a result of the contractual bonds to which the affiliate company is subject.

Moreover, one of the main features of an employment contract is the absence of work-related risk for the employee, who carries out the activity under the direction of the employer, who undertakes the business risks.

On the contrary, the franchisee retains a certain degree of organisational autonomy (i.e., in involving other people as well as in managing or financing the activity), and the controlling powers of the franchisor are largely related to the franchise agreement only.

iv Consumer protection

As stated previously, the franchise agreement is a contract between entrepreneurs. However, in a large number of cases the franchisee actually acquires this status on joining the franchise network.

In the past, this has given rise to the question of whether the protection provided by Legislative Decree No. 206/2005 to consumers, because of their weaker contractual position with respect to entrepreneurs, was applicable to franchisees as well.

The answer to this question can only be negative because, as previously explained, the franchisee carries out an entrepreneurial activity and, therefore, does not meet the criteria required by law to qualify as a consumer.

Nonetheless, since, as stated previously, pursuant to the Italian Franchise Act the franchisor must provide the franchisee with the general terms and conditions of the contract the parties are going to enter into, Articles 1341 and 1342 of the Italian Civil Code apply, requiring the specific written approval of certain onerous clauses (also at a business-to-business level) unless the clauses have been specifically negotiated. Thus the franchisee, while not considered a consumer, is still granted a particular level of protection in light of the assumption by the Italian legislator of the weaker contractual position of the franchisee with respect to the franchisor (again, solely in the event that general terms and conditions have not been specifically negotiated with reference to those categories of clauses listed under Article 1341 of the Italian Civil Code).¹⁵

v Competition law

The domestic antitrust law, Act 287/1990 (the Antitrust Act),¹⁶ applies to the sole extent that the concerned vertical agreements, abuse of dominant position or concentrations do not fall within the scope of the EU rules (this principle being explicitly provided under Section 1 of Act 287/1990). In other words, domestic antitrust law applies solely to those franchise agreements that do not jeopardise intra-EC commerce. Pursuant to a consolidated EU case law, even agreements affecting the whole of a national territory are seen as affecting trade among Member States.

However, not only is the domestic regulation substantially the same as the EU regulation, Article 2 on anticompetitive agreements is also very similar in its wording to Article 101 of the TFEU and must be interpreted consistently with EU competition case law. The same articles of the Antitrust Act should indeed be interpreted in accordance with the principles of the EC in matters of competition.

Act 57/2001 sought to recognise that the abuse of economic dependence might produce anticompetitive effects, and thus provided the Italian Antitrust Authority with the power to intervene in such cases.

Furthermore, the prohibition of the abuse of the economic dependence¹⁷ of a third party, as set out under Article 9 of Act 192/1998, which is specifically aimed at regulating the sub-supply, is now considered a general principle of our jurisdiction.

15 Failure to obtain in writing the specific approval of these clauses renders them null and void, and consequently unenforceable.

16 The present paragraph is limited to the domestic provisions relevant in antitrust issues and does not deal with the provisions set out under EC regulations.

17 According to the stated provision, economic dependence is the 'situation in which a company is able to determine, in the relationship with a third party, an excessive imbalance of rights and obligations' (such

From an antitrust standpoint, such an abuse has been defined by one author as a situation of relative dominant position.¹⁸ Nonetheless, from a practical point of view, the abuse of economic dependence has a very restricted application: should this correspond to an abuse of a dominant position, Section 3 of Act 287/1990 would apply, while the weaker party would preferably claim before the ordinary judicial authority the abuse of the right and the protection of the weaker party.

vi Restrictive covenants

As far as the non-compete obligation is concerned, the consensus in the legal literature is that it does not represent a 'natural element' of the franchise agreement. The enforcement of the non-compete obligation therefore requires that the contract include a specific provision in that respect.

As admitted by Commission Regulation (EU) No. 330/2010 (under the conditions provided therein) and explained under the Commission Guidelines of May 2010, such an obligation *ratione temporis* may concern either the period in which the contract is in full force and effect between the parties or may represent a post-contractual obligation upon the franchisee.

On the enforceability of such a clause, the Court of Pesaro, in the decision issued on 3 April 2008 in the context of a preliminary injunction proceeding, recalling the principles and conditions stated under Regulation (EC) No. 2790/1999 on vertical restraints, confirmed the validity of a post-contractual non-compete clause (the violation of which was the subject of the plaintiff's complaint), and finally prohibited the franchisee from marketing, either directly or indirectly through third parties, products competing with those of the franchisor, throughout the whole period set out in the non-compete clause.¹⁹

vii Termination

In practice, termination of the franchise contract presents a number of issues in terms of management of the conflicting interests of the parties.

As the Franchise Act is silent on the subject, should the franchise contract omit any reference to goodwill compensation, the franchisee would have no statutory right to such compensation upon termination or non-renewal. While Article 1751 of the Italian Civil Code guarantees this right for commercial agents, there is no legal precedent extending this provision by analogy to franchisees.

Another contentious issue related to the termination of a franchise contract is the management of leftover stock. In particular, commentators from both sides of the debate have questioned whether the franchisor should be considered to be obliged to repurchase leftover stock according to the general principle of bona fide (according to which each party would have an obligation to safeguard the other party's interest to the extent that this does not entail a substantial sacrifice) in the absence of any contractual provision to this effect.

a situation is to be evaluated taking into consideration the possibility of the third party finding possible satisfactory alternatives on the market).

18 A Frignani, 'Abuso di posizione dominante', in *Diritto Antitrust Italiano*.

19 Accordingly, see also the decisions of the Court of Torino issued on 29 November 2007 and on 23 April 2008.

viii Dispute resolution

Pursuant to Section 7 of the Italian Franchise Act, the parties may agree to try to amicably resolve the disputes arising from the franchise agreement before resorting to the courts or to arbitration. The parties are, in fact, free to opt for such a dispute resolution procedure, which, under Italian law, is not mandatory in the context of franchise claims.

The same principle has recently been confirmed by Law No. 69/2010 (concerning mediation aimed at settling disputes in civil and commercial matters), which does not include franchises among the areas in which mediation is mandatory.

The mediation procedure can be carried out before public or private entities; to this end, the chambers of commerce have created specific bodies to promote and facilitate mediation for the resolution of disputes arising from franchise agreements.

Furthermore, to foster fair contractual practices, the national franchise associations Assofranchising and Federfranchising have been set up; these associations are responsible, *inter alia*, for promoting awareness of the franchise system, of setting contractual and behavioural standards between industry operators, and thereby helping to prevent issues arising in relation to franchise agreements.

While offering enormous advantages in terms of cost and time saving, mediation has not had much success in Italy so far. Parties have been more inclined to resort either to the courts or to arbitration, consequently suffering the slowness of Italian proceedings, which usually last an average of between two and five years.

An exception is represented by preliminary injunction proceedings, as provided for by Article 669 *et seq.* of the Italian Civil Procedure Code, which usually last a few months (one to six months, save for the necessity of particular technical assessments). Said provisions apply also with regard to enforcing clauses included in franchise agreements, if the legal requirements (such as the likelihood of the right at issue and the urgency requirement) are met. Preliminary injunction proceedings, because of their brevity, are particularly suitable for settling disputes regarding the breach of non-compete clauses by the franchisee (see Section VI.vi).

Another particularly relevant issue to be considered is that of damage compensation and fees and costs allocation between the parties. Under Italian law, damages are awarded and calculated on the basis of whether they arise from contractual liability (pursuant to Article 1218 *et seq.* of the Italian Civil Code) or tort liability (pursuant to Article 2043 *et seq.* of the Italian Civil Code); however, Italian courts usually do not award very high amounts for damage compensation.

Ultimately, the allocation of fees and costs of the proceedings will be provided by the judge according to liabilities ascribable to the parties as ascertained during the proceedings, as well as to the specific circumstances of the case at issue.

KAZAKHSTAN

*Nick Green and Saule Akhmetova*¹

I INTRODUCTION

Franchising has been used as a route to the Kazakhstan market by overseas businesses since the 1990s, when brands such as Coca-Cola, Adidas and InterContinental appeared on the market.² Over the past few years the country's strong economic growth, rising household incomes and the government's ambitious diversification plan³ have prompted other foreign franchisors to turn their sights to the country, which is quickly becoming a leading market in Central Asia. International brands such as Zara, Pizza Hut, Debenhams, Mothercare, Mango, Regus, Gap, Next, Burberry, Cinnabon and KFC are currently represented in the market, and major player Alhokair Fashion Retail recently increased its investment in Kazakhstan with the opening of two new New Look stores and further Accessorize, F&F and Blanco outlets. It is estimated that the number of foreign brands franchising in Kazakhstan will reach 550 by 2022.⁴

Franchising is used as a business system by foreign and domestic brands in nearly every industry that contains small and medium-sized businesses, but as in other Central Asia markets it is most common in the fast-food and casual dining, retail and leisure, and services sectors. Many foreign franchisors prefer to work on the basis of sub-franchising agreements with master franchisees in other countries rather than contracting directly with Kazakhstani partners, although the number of direct franchises is growing.

There is a range of agencies and associations with an interest in promoting franchising and foreign business in Kazakhstan. The Kazakhstan Franchise Association was created with the support of the US Agency for International Development as a non-governmental industry group to promote franchising by offering a variety of services, including consultation, information, matchmaking programmes and other educational events,⁵ although associations such as the Eurasian Franchise Association and Central Asian Franchising and Licensing

1 Nick Green is an associate at Bird & Bird LLP and Saule Akhmetova is a partner at GRATA Law Firm LLP. The information in this chapter was accurate as at January 2019.

2 Beknur Kisikov, 'In 2014 one expects demand on Restaurant franchise', MinTax (1 January 2014). Accessible at: <http://mintax.kz/eng/files/v-2014-godu-budet-spros-na-restorannye-franshizy.html>.

3 Central Intelligence Agency, 'The World Factbook: Kazakhstan'. Accessible at: <https://www.cia.gov/library/publications/the-world-factbook/geos/kz.html>.

4 Raissa Kaziyeva, 'Franchise Expectations: Case of Kazakhstan', CBU, International Conference Proceedings 2014: Innovation, Technology Transfer and Education (3–5 February 2015).

5 Andrei Chursov, 'New Legislation Improves Franchising Opportunities in Kazakhstan' Business Information Service for the Newly Independent States. Accessible at: www.ad-mkt-review.com/public_html/govdocs/bis/wmfs/wmfs02111.html.

Agency have also previously taken on similar roles. The Franchise Union of Kazakhstan also provides education and referral services and general advice on franchise arrangements and practices.

The Entrepreneurship Development Fund JSC (EDF) was established by the Kazakhstan government in 2001 with the objective of supporting and promoting small businesses in Kazakhstan, providing financial and non-financial support to small to medium-sized enterprises. The EDF also works alongside the state to improve financial resource management and the allocation of funding to small businesses.⁶

II MARKET ENTRY

Franchising in Kazakhstan is regulated by specific franchise legislation and general commercial law that varies between sectors and according to the structure of the commercial relationship.

One of the most important steps for franchisors contemplating entering the Kazakhstan market to take is protecting their intellectual property – in particular any trademarks or know-how that will be licensed to and used by a local franchisee. Kazakhstan's intellectual regime is relatively sophisticated, recognising that exclusivity arises in relation to a variety of types of intellectual property. Kazakhstan is a member of many of the major international organisations – including the Singapore Treaty of the Law of Trademarks, the Trademark Law Treaty, the Berne Convention and the Madrid Agreement Concerning the International Registration of Marks⁷ – and trademarks, service marks, utility models and other industrial designs are generally capable of being registered.

In most areas of business, Kazakhstan law does not require any approvals and does not contain any restrictions on franchisors entering the local market. In fact, the law provides for the support and promotion of franchising in the country. Kazakhstani legislation is not burdened with details and nuanced obligations, nor does it provide detailed restrictions governing the relationship between the parties to a franchise agreement. In this regard, there are no specific restrictions or limitations on a foreign entity granting a master franchise or development rights to a local entity.

In most cases, the law does not impose restrictions on foreign franchisors owning equity in a local business or owning real property. Certain restrictions, however, can be specified in respect of owning equity, where the business is associated with areas of strategic importance for the state, such as telecommunications, and other issues relating to national security and public safety. In addition, there are some restrictions on ownership of real estate in Kazakhstan by foreign nationals and entities.

Franchisors should also keep in mind the geographical issues involved in entering the Kazakhstan market. Kazakhstan is a large country but has a very low population density with less than six people per square kilometre.⁸ Almaty and the capital, Astana, are the largest

6 DAMU Entrepreneurship Development Fund JSC, 'Development Strategy for 2014–2023' (2014). Accessible at: www.fund-damu.kz/content/files/FundDamuStrategy2014_2023EngFinal.pdf.

7 IP-Coster, 'Intellectual property protection system in Kazakhstan' (April, 2015). Accessible at: <https://www.ip-coster.com/IPGuides/c/intellectual-property-kazakhstan>.

8 The World Bank Group, Data: Population density. Accessible at: <http://data.worldbank.org/indicator/EN.POP.DNST>.

cities by population but account for a very small fraction of the country's total population. Franchisors should therefore undertake careful due diligence on the geographic reach of any potential local partner, and consider how best to treat any potential exclusive arrangement.

Payments made between Kazakhstan residents (whether entities or individuals) must be made in the local currency, Kazakhstani tenge. Under the Law on Currency Regulation and Control No. 57-III dated 13 June 2005, payments made between residents and non-residents may generally be in any currency, although certain transactions must be notified to or registered with the National Bank of the Republic of Kazakhstan (the Bank). A franchise agreement falls under currency regulation as an import (or export) of goods (or works or services) operation. Depending on the terms and payment obligations of the parties under a franchising agreement (e.g., an obligation for a resident to pay more than US\$500,000, or for a non-resident to pay more than US\$100,000), the agreement may need to be registered with or notified to the Bank, in accordance with the relevant regime.

III INTELLECTUAL PROPERTY

Recently Kazakhstan has been taking significant steps to attract foreign investment into the country, including through changes to its intellectual property-specific legislation. For example, on 3 July 2018, the Law on Amendments and Additions to Certain Legislative Acts of the Republic of Kazakhstan on the Improvement of Legislation in the Field of Intellectual Property (the IP Amendment Law) entered into force. The IP Amendment Law amends and supplements a number of legislative acts with a view to improving intellectual property legislation, simplifying registration procedures and eliminating legislative gaps. Furthermore, it aims to eliminate regulations that have been creating impediments in the field of intellectual property protection. The principal agency involved in regulating intellectual property matters is the National Institute of Intellectual Property (NIIP) of the Ministry of Justice, which has the following two key functions within Kazakhstan's intellectual property rights regime.

i Intellectual property searches

Preliminary searches should be made to establish whether there are any similar or identical marks already on the register. Kazakhstan is a 'first-to-file' and not a 'first-to-use' jurisdiction, so it is important to register intellectual property rights as soon as possible to protect them.

ii Intellectual property protection

Patents must be registered with the NIIP to be protected. Patent protection is given to an invention if it is new, involves an inventive step and is industrially applicable. Patent protection can be granted for inventions, utility models, industrial designs and selection achievements. The duration of protection varies for each protected item. As of 1 January 2015, a party can choose to apply for a national patent or a Eurasian Patent – a unitary patent that, if registered in one of the eight contracting states (Armenia, Azerbaijan, Belarus, Kazakhstan, Kyrgyzstan, Russia, Tajikistan and Turkmenistan), is valid upon grant in each of those jurisdictions (provided that corresponding annual fees are paid for the selected countries after the issuance of the patent).

Trademarks should also be registered with the NIIP, although they may also be protected without national registration under international treaties to which Kazakhstan is a party. Trademark and service mark registration is granted for 10 years, renewable every 10 years.

Applications for registration of patents or trademarks should be filed with the NIIP, which assesses the applications and determines whether to grant or refuse registration. Assignments and licences for patents and trademarks must be registered with the NIIP to be valid.

Copyright items are protected by virtue of their creation without registration or other formalities (although it is advisable to register them with the NIIP). Copyright does not apply to ideas, concepts, principles, methods, systems and processes, discoveries and facts. The NIIP will not examine the materials or verify the information in a copyright application. Copyright applies during an author's lifetime plus 70 years. An author is free to assign his or her copyrighted work.

Confidential know-how and trade secrets are protected provided that the information: (1) has an actual or potential commercial value by virtue of its being unknown to third parties; and (2) cannot be freely accessed on a legal basis. It is also necessary for the holder of such information to take measures to protect its confidentiality.

iii Enforcement

While Kazakhstan is a signatory to most major international agreements and conventions on intellectual property, enforcement of the law is not always strong. A number of state authorities protect and enforce intellectual property rights, including customs. Owners of certain intellectual property rights (e.g., trademarks) can ask the customs authorities to add their trademark to the customs register of intellectual property rights. Following such a registration, the customs authorities can suspend the import of any objects bearing that trademark for 10 business days. This period can be extended for another 10 business days; however, this is conditional on the custom authorities being provided with documentation confirming the rights holder's appeal to the court. They will also alert the rights holder of the importation so that the rights holder may challenge the import or request interim relief.

The legislation of Kazakhstan provides for civil, administrative and criminal forms of protection of intellectual property rights.

Civil protection

Civil remedies – including damages and injunctive relief – can be claimed through court proceedings for infringement of intellectual property rights. The damages calculation process is subject to the usual civil remedies limitations. Both direct losses and loss of profits can be claimed, although the process of proving loss of profits in court is fairly complicated. Pursuant to the Draft Law, instead of damage recovery a rights holder may make a claim for the infringer to pay compensation of a sum ranging from 500 to 10,000 monthly calculation indexes as ruled by the court, depending on the nature of the infringement, or up to twice the value of the goods unlawfully bearing the trademark.

Administrative protection

Alternatively, infringement can constitute an administrative offence. Such offences can be pursued via an application from the rights holder to the relevant authority. The primary administrative sanction is a fine calculated according to the size of the infringing entity. In accordance with the Administrative Code of the Republic of Kazakhstan, government revenue authorities and judicial authorities are empowered to initiate administrative litigation. If the

actions of the offender constitute anticompetitive conduct, the rights holder can apply to the anti-monopoly authority, which has competence to independently review the case as an administrative offence and impose an administrative penalty.

Criminal protection

Infringement of intellectual property rights can constitute a criminal offence in some circumstances, the consequences of which can be severe. For example, criminal liability for illegal use of a trademark can result in either a fine or correctional labour, or a sentence of community service, or arrest.

The elements that must be established to constitute an administrative or criminal offence are similar. Whether a particular act will qualify as a crime is dependent on the scale of the damage caused to the copyright holder or the state.

IV FRANCHISE LAW

i Legislation

There are two key areas of legislation that franchisors need to be aware of when entering the Kazakhstan market. The Law of the Republic of Kazakhstan No. 330-II on Complex Entrepreneurial Licence (Franchise) (the Franchise Law) was passed in 2002, and is a law specifically regulating franchises in Kazakhstan. The legislation defines a franchise (a 'complex entrepreneurial licence') as 'entrepreneurial activity, in which a holder of the complex of exclusive rights provides it into use on a paying basis to another individual or entity'. The legislation also sets out the general rights and obligations of a franchisor and franchisee, in particular in relation to the requirement for the franchisor to provide to the franchisee a set of exclusive rights (such as know-how, trademarks, service marks, etc.) for the franchisee to utilise in its entrepreneurial endeavours.

The Civil Code of the Republic of Kazakhstan also sets out general principles of contract law that apply to every commercial agreement, and the Civil Code (Special Part) No. 409-I dated 1 July 1999 requires certain businesses to obtain a business licence before commencing operations.

ii Disclosure

There is a pre-contractual disclosure requirement under the Franchise Law, which is specific and unusual. Under the Franchise Law, a franchisor must provide the franchisee with details of the bundle of exclusive rights being granted to the franchisee, and must inform the potential franchisee of the confidential nature of this information. This provision of the Law, however, can be interpreted by courts both as a franchisor's right and as a franchisor's obligation, as the case may be. The Franchise Law does not prescribe how much information has to be provided, however, nor how much detail has to be given or what format the information is to be provided in. Best practice, therefore, is to provide as much information as the franchisor considers sufficient to allow the prospective franchisee to make an informed decision on the viability of the franchised business. Franchisors contemplating master franchise arrangements should also be aware that master franchisees will need to provide similar information to their sub-franchisees.

The absence of a comprehensive pre-contractual disclosure requirement does not give franchisors a 'free pass' with regard to pre-contractual sales and recruitment activity, however. Franchisors may be held liable for losses suffered by a franchisee as a result of fraud or wilful

misrepresentation by the franchisor. The franchise agreement may also be held invalid if the franchisee can demonstrate it entered into the arrangement either based on an error material to the transaction, or as a result of fraud. A consequence of invalidity of the agreement may, at the court's discretion, be that the parties are obliged to return to the other all benefits received during the relationship, or financially compensate the other party where such a return is not possible. Damages may also be awarded in addition.

iii Registration

Pursuant to the Civil Code of the Republic of Kazakhstan and the Law on Franchising, franchise agreements are subject to registration with the NIIP.

The new IP Amendment Law has significantly simplified and accelerated the registration process – though franchisors should still note that to register the agreement, the relevant trademarks being licensed must themselves first be registered with the NIIP. Under the new IP Amendment Law, the requirement for the franchise agreement to be submitted to the NIIP within six months of the signing date has been abolished – there is no time requirement now – and the time it takes for the NIIP to register franchise agreements following submission has been reduced from two months to 10 business days. Moreover, the IP Amendment Law envisages the simplification of the requirements for execution of franchising contracts. Only one copy of the contract is now required for registration, rather than four as before, and formalities such as having to include a title page in the contract, use a paper seal, stamp the document and have the signatures of both parties on the submitted contracts have also been abolished. This should make it much easier for franchisors to enter into franchise agreements and register them with the NIIP.

In accordance with these amendments, a franchising contract should be submitted for registration in Kazakh or Russian (choice of language is at the discretion of the parties). Foreign names and nominations of legal entities should be provided in Kazakh or Russian transcription.

iv Mandatory clauses

Franchisors and franchisees are generally free to determine the terms of the agreement between them in accordance with the principle of freedom to contract. This includes the ability for the parties to elect that the agreement is governed by a foreign law and subject to a foreign jurisdiction.

There are some restrictions, however, on this general freedom. One key area often found to be of concern to foreign franchisors is the limitation on the scope of the franchisee's indemnity to the franchisor for liability to third parties. This is a common clause in many international franchise agreements, but under Kazakhstani law non-contractual liability to third parties falls on the person responsible for the action causing the third party's loss, which may be the franchisor or franchisee.

Another key area is in relation to provisions in the agreement dealing with intellectual property. As mentioned above, a franchisor may only license a trademark to a franchisee if the trademark itself is registered in Kazakhstan and the period of protection for such a trademark will determine the term of the agreement. The franchise agreement should also clearly define what intellectual property rights are being transferred or licensed, the scope of any exclusive territory, the specific purposes for which the rights may be used and when the grant of the

rights will expire. The franchisor should also be sure to include audit and inspection rights in respect of goods and services provided by the franchisee and any premises from which the franchisee operates to ensure they are adequate and comply with brand standards.

V TAX

Kazakhstan's tax regime is set out in the Code No. 99-IV of the Republic of Kazakhstan on Taxes and Other Obligatory Payments to the State Budget dated 10 December 2008 (the Tax Code), which was rewritten in 2009. It provides for a relatively simple framework based on self-assessment with inspections and audits. Franchisors should note, however, that the penalties for non-compliance (such as improper declaration or non-payment) are high – even if unintentional – and that keeping proper documentation to evidence proper reporting and payment is critical. A difficulty both residents and non-residents often encounter is the lack of coherence between the Tax Code and widely accepted international taxation principles (on which many of the double-taxation treaties Kazakhstan is party to are based). This ambiguity can lead to an inconsistent approach both by parties to an agreement and by the relevant tax authorities across the country, causing uncertainty.

Often of most importance to foreign franchisors is the application of withholding tax to payments made by a resident to a non-resident legal entity. In Kazakhstan the withholding tax rate depends on the type of payment in question, although the rules on what rate applies to the different type of source income paid to non-residents are complex and at times inconsistent. Non-residents' business income is generally subject to a 20 per cent withholding tax. This includes (among other things) income from the sale of goods or services or generally for the performance of work in Kazakhstan, income from management, consultancy, legal and audit services performed outside Kazakhstan, and capital gains from a sale of shares or interest in a Kazakhstan registered entity. Royalties⁹ (traditionally the main fee type to be earned by a franchisor), however, are subject to a 15 per cent withholding tax, as are dividends, capital gains and interest. If a franchisor is to provide a level of management or consultancy, or supply goods or services, the franchise agreement should be clear on the anticipated rates applicable to the different fees due, or – for tax efficiency and administrative ease – separate the arrangement into individual agreements.

Franchisors should also be aware that different rules apply to non-residents depending on where the non-resident is tax registered. Any payments being made to a resident of a recognised tax-haven jurisdiction are subject to a 20 per cent withholding tax rate. The List of Tax Haven Jurisdictions approved by Decree of the Government the Republic of Kazakhstan No. 1318 dated 31 December 2008 sets out those jurisdictions that are considered to be tax havens, and the list is updated annually by the central tax authorities. As of 1 January 2015, Kazakhstan had concluded and ratified 46 double-taxation treaties (DTTs) – with another five currently pending – which typically reduce the applicable withholding tax rate on dividends, interest and royalties. Most royalty rates are reduced to 10 per cent to 15 per cent, provided the conditions in the relevant treaty are met. These conditions are largely administrative requirements set out in the Tax Code, and include ensuring the franchisee has been provided with a tax resident certificate confirming that the franchisor is a tax resident in a DTT country before the end of the year in which the relevant income was

9 Defined by the Tax Code as a payment for the use of trademarks, patents, copyright, software, designs, models, know-how and other similar rights.

paid. The tax certificate must include the franchisor's full and accurate name and address, state the period in which the franchisor was a tax resident, be signed by an authorised employee of the franchisor and the signature and company seal must be notarised and apostilled. The practice shows that the most tax-efficient franchising structure is one implemented through countries that have effective double-tax treaties with Kazakhstan, such as the Netherlands, Luxembourg and the UAE. Such a structure will allow reduced withholding tax rates to be paid on royalty payments.

In addition, franchisors working in the education sector should note that royalty payments made by a resident franchisee that is recognised as an autonomous educational organisation are exempt from withholding tax in Kazakhstan. An 'autonomous educational organisation' means a non-commercial organisation established by the decision of the Parliament of Kazakhstan and engaged in educational, healthcare or scientific activity.

Royalty payments for the use or right to use trademarks, patents, know-how, technologies or other similar types of right are also subject to the reverse-charge value added tax (VAT) at a rate of 12 per cent. Under the Kazakhstani tax law, services are subject to VAT if they are deemed to be supplied in the territory of Kazakhstan under the 'place-of-supply' rules and if such services are supplied by a taxpayer registered as a VAT payer. Under the place-of-supply rules, services on transfer of right to use trademarks, patents, know-how, technologies or other similar types of right are deemed to be rendered at a location of the acquirer's business (i.e., the Kazakhstani franchisee) and, consequently, constitute a VAT-able operation in Kazakhstan. As a result, the Kazakhstani franchisee will be required to self-assess and pay VAT in Kazakhstan at a rate of 12 per cent on the amount of royalties payable to the non-resident franchisor under the franchise agreement. Subject to certain conditions, the amount of the reverse-charge VAT can be offset.

The franchisee is the party responsible for retaining and paying withholding tax (acting as a 'tax agent' for the franchisor), and must pay in accordance with the strict time frames established under the Tax Code. The franchisee must also be provided with confirmation from the franchisor of its tax residency status.

VI IMPACT OF GENERAL LAW

i General

The Civil Code contains a general requirement for citizens and entities to abide by the moral principles of Kazakhstan society and act in good faith, reasonably and fairly when exercising their rights. These requirements cannot be contracted out of or excluded in an agreement, even if subject to a governing law that is not Kazakhstani law. There is no objective test for these terms, however, so in each case their meaning will depend on the circumstances and the interpretation of the courts.

ii Agency distributor model

Provided the franchise agreement is clearly and expressly stated to be a franchise agreement, and is carried out by the parties as a franchise arrangement, then it should not risk being interpreted as a commercial agency agreement. In practice, franchisors – particularly those supplying goods – should be careful when imposing minimum purchase requirements on franchisees and should ensure that franchisees act at all times on their own behalf and at their own financial risk.

iii Employment

Kazakhstani employment law is prescriptive and enforces a Labour Code, which sets out certain minimum requirements that an employment contract must contain. It is rare for a franchisee to be classified as an employee, so in most instances this will not be an issue, but franchisors should take care to structure the documentation so that the relationship of the parties is not in any doubt.

iv Consumer protection

Franchisees do not fall under the definition of consumers under Kazakhstani consumer law, as they purchase goods and services for the purposes of business rather than for their own personal needs. Accordingly, consumer legislation does not apply to franchise arrangements. For additional protection franchisors may consider only entering into franchise agreements with franchisees that are legal entities (rather than individuals) to confirm that it is a business-to-business relationship. However, franchisors should bear in mind that a consumer has the right to proper quality of goods and services, including when buying them from a franchisee, and the Civil Code does provide for the subsidiary liability of a franchisor in relation to consumer claims against its franchisee in respect of the quality of goods and services provided.

v Competition law

Kazakhstan's competition law is primarily set out in the Entrepreneurial Code of the Republic of Kazakhstan dated 29 October 2015, No. 375-V (the Entrepreneurial Code). The Entrepreneurial Code expressly prohibits anticompetitive practices, abuses of dominance and monopolistic activity. The Entrepreneurial Code does, however, generally permit vertical agreements – including franchise agreements – and the Civil Code provides certain restrictive conditions that may be included in a franchise agreement even though they are considered in other circumstances to be anticompetitive. This includes the ability for the parties to agree that the franchisee has the exclusive rights to the franchised business in a particular territory to the exclusion of both third parties and the franchisor, and in-term and post-term non-compete restrictions on the franchisee. Resale price maintenance is prohibited in all agreements, however, as are exclusivity arrangements that seek to carve up a market based on specific categories or types of customer.

vi Termination

The respective termination rights of the parties will generally be determined by the governing law to the agreement. If the agreement is subject to Kazakhstani law then the Civil Code provides restrictions and conditions for termination rights. If the agreement is for a fixed term, then it may only be terminated by mutual consent, where one party is in material breach or in circumstances clearly detailed within the agreement. In many franchise agreements, therefore, the parties include a schedule detailing 'termination events' or grounds upon which one or both parties may end the arrangement. Franchisors should note, however, that in most cases one month's notice is required to terminate an agreement. The Civil Code also states that if the agreement is for an indefinite term then both parties may terminate with six months' notice (or such other longer period as may be stated in the agreement).

vii Anti-corruption

Kazakhstan has a broad range of legislation designed to combat corruption including, among others, the Law on Fighting Corruption (1998), the Law on Preventing Legalisation (Laundering) of Illegal Proceeds and Financing of Terrorism (2009) and the Law on Law Enforcement Bodies (2011). The Law on Fighting Corruption sets out the fundamental principles of the anti-corruption regime, defining what corruption is, what constitutes a corruption offence and the liability for committing such offences. A new Criminal Code also came into effect on 1 January 2015, which introduces additional sanctions for corruption-related crimes, such as loss of rank and a lifetime ban on holding public office. The government has also implemented programmes, such as its 2015–2025 strategy, to help foster an anti-corruption culture.

At an international level, in 2008 Kazakhstan ratified the UN Convention against Corruption and the UN Convention against Transnational Organized Crime and all its protocols. The ratification of these significant anti-corruption conventions serves to effectively prevent corruption and ensure alignment between national legislation and international principles.

Additionally, Kazakhstan entities, specifically their joint venture partners, suppliers, agents and service providers, are required to comply with the provisions of the US Foreign Corrupt Practices Act (1977) and the UK Bribery Act (2010). Under this legislation, future partners or contractors of US and UK companies must have anti-corruption compliance policies in place. These policies will be thoroughly examined before any contract is concluded. Complex due diligence is undertaken by the US and UK companies to ensure they do not assist in any corruption, and such an examination is a key aspect of this process. Therefore, both of these foreign laws contribute to efforts to reduce the prevalence of corruption in Kazakhstan.

viii Dispute resolution

Kazakhstan legislation does not require a particular dispute resolution forum to be used, so the parties may agree on the resolution method that will apply to disputes arising in relation to the franchise agreement.

Arbitration, mediation and other forms of alternative dispute resolution (ADR) are used in Kazakhstan to varying effect. Arbitration is the most commonly used ADR method, whether through the Kazakhstani International Arbitrage (KIA) or other arbitral regimes. The KIA may be selected as a dispute forum if at least one party is a non-resident of the Republic of Kazakhstan and the parties have agreed in the franchise agreement – by way of an arbitration clause – that the KIA will have jurisdiction.¹⁰ Mediation is available in Kazakhstan, and is offered as a resolution forum by the KIA, although it is not currently as popular as arbitration or litigation.

Kazakhstan is a signatory to a number of international treaties providing for or relating to the enforcement of foreign court judgments and arbitral awards, including:

- a* the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 1958;
- b* the European Convention on International Commercial Arbitration (Geneva, 1961);

10 KIA Rules of Arbitration, Section 1, Article 1. Accessible at: www.arbitrage.kz/145.

- c* the Agreement on the Procedure for Settling Disputes Relating to Economic Activities (Kiev, 1992); and
- d* the Convention on Legal Assistance and Legal Relations in Civil, Family and Criminal Matters (Chisinau, 2002).

A foreign judgment may be filed for enforcement within three years of the date the decision became effective, and will only be enforced by a local court if provided for by Kazakhstani law (very limited grounds are detailed in the Civil Procedure Code, mostly relating to family and marital law) or an international treaty.

The Civil Procedure Code provides that a party in receipt of an arbitral award may apply to a Kazakhstani court for its enforcement if the other party does not perform its obligations voluntarily. The court will review the application within 15 days of receipt and provide notice to the parties of the time and date of the review for the parties' attendance (although attendance is not required). The court may issue an enforcement order that may be used by the claiming party as the basis for initiating enforcement proceedings. The Civil Procedure Code and the Kazakhstan arbitration legislation set out the circumstances in which a court may refuse to enforce an arbitral award, which reproduce the grounds for refusal detailed in the New York Convention.

VII CURRENT DEVELOPMENTS

Although franchising in Kazakhstan is still relatively new compared with other jurisdictions, its popularity as a route to market for foreign brands continues to grow. The number of foreign brands currently franchising in Kazakhstan is close to 500, estimated to equate to over 3,000 franchising outlets generating an annual turnover of US\$1.2 billion. Those 500 are expected to rise to 550 by 2022.

The rapidly developing infrastructure of retail outlets – in particular new shopping malls and hypermarkets – is one key element of this growth, as it opens up opportunities for franchisors to target more easily large groups of consumers in one space, particularly those with mid-market and premium brands that require quality retail space. Several new hypermarkets have opened in Almaty and Astana over the past few years and this scale of development looks likely to be repeated in other major cities. Challenges for Kazakhstan include the significant currency depreciation in August 2016 triggered by China's economic slowdown, which resulted in higher inflation and living costs and a decrease in consumer confidence. However, with increased government support for business development and an improving regulatory environment, including stronger intellectual property protection, Kazakhstan looks set to remain an attractive prospect to foreign and domestic franchisors.

MALAYSIA

Lee Lin Li and Chong Kah Yee¹

I INTRODUCTION

The Malaysian government has been an active proponent of franchising as a business model. As at April 2019, there were 877 registered franchises in Malaysia, which contributed 30.03 billion ringgit to the Malaysian gross domestic product (GDP),² compared to 27 billion ringgit in 2017.³ On the basis of the positive performance by the top three franchise companies in 2018, namely 99 Speedmart, McDonald's and Seng Heng, which registered sales of 3.4 billion ringgit, 2.2 billion ringgit and 998 million ringgit respectively, the government is confident that Malaysia is on track to contribute 35 billion ringgit to GDP with sustained strong growth and to achieve its aim to become a regional franchise hub for South East Asia by 2020.⁴

The Ministry of Domestic Trade and Consumer Affairs (MDTCA) has been charged with monitoring the continued growth of the franchising sector in Malaysia. These efforts have culminated in the enactment of the Franchise Act 1998 (amended in 2012) (the Act) and the establishment of the Franchise Registry.

Foreign franchisors, particularly those with unique franchise models and concepts, are actively encouraged to enter into the Malaysian market. Between January 2000 and June 2019, the number of registered franchise businesses from various sectors in Malaysia increased to 1,003, up from 975 last year, and of which 602 are local brands and 401 are foreign brands.⁵ This represents an increase of approximately 2.79 per cent of registered franchise businesses in Malaysia.

The Malaysian government, in recognition of the revenue streams that franchising models offer, has actively promoted the growth of domestic franchises. This support has been in the form of state grants, soft loans and business education programmes organised by the MDTCA and Perbadanan Nasional Berhad (PNS). PNS falls within the joint purview of the Ministry of Finance and the MDTCA. PNS is charged with spearheading the growth of the local franchise industry and assisting its expansion abroad, allocating and managing

1 Lee Lin Li is a partner and Chong Kah Yee is an associate at Tay & Partners.

2 See <https://malaymail.com/news/money/2019/04/05/saifuddin-franchise-industry-to-contribute-rm35b-to-gdp-in-2020/1740246>.

3 See <https://www.nst.com.my/business/2018/04/359944/malaysias-franchise-industry-expected-grow-five-cent-year>.

4 *ibid.* at 2.

5 See <https://www.kpdnhep.gov.my/kpdnkk/wp-content/uploads/2019/10/STATISTIK-UTAMA-KPDNHEP-JUN-2019.pdf>.

grants and offering business support in the form of franchise consultation and other advisory services. These efforts have led to significant growth in the number of local franchisors in the past decade.

The government has introduced various schemes and incentives to assist and support franchisors and franchisees in developing their brands and expanding their franchise businesses, such as the Franchise Financing Scheme, Franchise Development Assistance Fund, Small Franchise Financing Scheme, Franchise Development Programme, and Local Franchise Product Development Programme.

The Malaysian Franchise Association (MFA) was formed in 1994. It has a wide membership base that includes representatives from the franchising industry, service providers such as accountants, franchise consultants and bankers, and government bodies. All members are required to abide by the MFA's Code of Ethics of a Professional Conduct of Franchise Practitioners.⁶ The MFA maintains professional and ethical standards by enforcing this code of practice among its members.

The MFA serves as a resource centre for franchisors and franchisees, the media and the public. It also acts as a networking and discussion forum between the private sector, franchise industry and government agencies.

II MARKET ENTRY

i Restrictions

Prior to the introduction of the Act, parties were free to negotiate their own terms and were governed by contract and common law. This allowed for a higher degree of flexibility. The franchising industry is now regulated by the Act, which places greater restrictions on foreign franchisors and introduces criminal liability for certain acts.

Section 54 of the Act requires that all foreign franchisors intending to set up franchises or enter into franchise agreements with any Malaysian citizen obtain prior approval from the Franchise Registry. Applications for registration are required to be supported by documents that include:⁷

- a* a sample franchise agreement;
- b* a certified true copy of the applicant's certificate of incorporation;
- c* document evidencing changes in shareholding of the company, if applicable;
- d* details of the franchise concept, including the uniqueness of the brand's franchise system and franchise experience;
- e* official declaration from the Insolvency Department that the board of directors are free from bankruptcy;
- f* a certified true copy of the registration certificate of the franchise's trademarks issued by the intellectual property office of the brand's country of origin and the Intellectual Property Corporation of Malaysia (MyIPO) (or proof of an application for such a registration);
- g* the company's brochure or profile;
- h* pictures of a prototype outlet; and

⁶ See <http://www.mfa.org.my/newmfa/background/>.

⁷ See <https://myfex.kpdnhep.gov.my/>.

- i* a certified true copy of the latest three years' audited accounts that have been notarised by a notary public.

Decisions are communicated by the Franchise Registrar in writing and the approval remain in place until the Registrar issues an order suspending, terminating, prohibiting or refusing the sale and registration of the franchise as permitted under the Act or where an applicant or franchisor seeks a cancellation of the approval.

Apart from Section 54 of the Act, there are no restrictions placed on foreign franchisors with regard to granting a master franchise or development rights to a local franchisee. The appointed master franchisee or a franchisee of the foreign franchisor is required to register its franchise with the Franchise Registry before making an offer to sell the franchise to any person or commencing the franchise business, respectively.⁸

Foreign franchisors are permitted to acquire equity in local businesses and real property subject to certain conditions.

Franchises with foreign equity must be incorporated locally, either as a subsidiary, a representative or branch office to carry on business in Malaysia.

All distributive trades, which includes retailers, wholesalers, franchise practitioners and direct-selling businesses, are required to obtain approval from the MDTCA before they are able to operate in Malaysia and are required to comply with the MDTCA's Guidelines on Foreign Participation in the Distributive Trade Services (the MDTCA Guidelines).⁹

These Guidelines are extensive and cover the following:

- a* acquisitions, mergers or takeovers by foreign participation;
- b* the opening, relocation, expansion of branches or outlets or chain stores;
- c* buying over or taking over of outlets of other operators; and
- d* real property transactions relating to distributive trade activities (prior to obtaining other necessary approvals or licences from local authorities and other government agencies).

In addition, all distributive trades with foreign equity are required to:

- a* appoint a *bumiputra* director or directors (*bumiputra* is a local term that refers to the indigenous peoples of Malaysia encompassing ethnic Malaysia and other minority indigenous ethnic groups);
- b* hire personnel at all levels, including management, to reflect the racial composition of the Malaysian population;
- c* formulate clear policies and plans to assist *bumiputra* participation in the distributive trade sector;
- d* utilise local airports and ports in the export and import of goods;
- e* utilise local companies for legal and other professional services;
- f* submit annual financial reports to the MDTCA;
- g* comply with all local authority by-laws and regulations; and

8 A master franchisee is required to obtain approval under Section 6 of the Franchise Act 1998, whereas a franchisee of a foreign franchisor is required to obtain approval under Section 6A of the Franchise Act 1998.

9 Guidelines on Foreign Participation in the Distributive Trade Services Malaysia, by the MDTCA; see <http://www.kpdnhep.gov.my/kpdnkk/wp-content/uploads/2017/05/guidelines-on-foreign-participation-in-the-distributive-trade-services-malaysia.pdf>.

- b* ensure that persons with disabilities make up at least 1 per cent of their total hypermarket workforce (in relation to franchises operating in the hypermarket sector).

The MDTCA Guidelines also impose specific conditions on franchises operating in certain industry sectors. These include:

- a* for businesses operating in the hypermarket sector, a minimum capital requirement of 50 million ringgit and a requirement for a minimum 30 per cent of equity to be held by *bumiputras*;
- b* in the department store sector, a minimum capital requirement of 20 million ringgit;
- c* for superstores operating as self-service distribution stores retailing mainly consumer goods that comprise of a mix of food and non-food products, a minimum capital requirement of 25 million ringgit; and
- d* for specialty stores serving an exclusive brand name, product or line of goods, a minimum capital requirement of 1 million ringgit.

Generally, in an effort to promote local participation, government agencies are actively tasked with encouraging the formation of joint ventures between Malaysians and foreign investors instead of allowing wholly foreign-owned corporations to operate independently.

Pursuant to the National Land Code, a foreigner is required to obtain prior approval from the relevant state authority for transactions regarding real property. Any property transactions without this formal approval are rendered void.¹⁰ In addition to the requirements of the National Land Code, there are further restrictions in place and these are, broadly, as follows:¹¹

- a* foreigners are generally prohibited from purchasing properties valued at below 1 million ringgit; and
- b* where the property is valued at or above 1 million ringgit, there are generally no restrictions, but where a property is valued at over 20 million ringgit and the purchase results in the dilution in the ownership of property held by *bumiputra* interest or government agency, prior approval will be required from the Economic Planning Unit.

i Foreign exchange and tax

Foreign exchange

Foreign exchange issues are governed by the Foreign Exchange Administrative Rules issued by the Central Bank of Malaysia (BNM) and the Financial Services Act 2013 (FSA).

Residents¹² and non-residents¹³ are defined within Section 213 of the FSA. The Malaysian market is generally accessible by foreign investors. Payment for investments can be made in a foreign currency or in Malaysian ringgit. Non-residents are free to remit

10 Sections 433A, 433B and 433C of the National Land Code 1965.

11 Guidelines on the Acquisition of Properties (2014), by the Malaysian Economic Planning Unit; see <http://103.8.145.121/en/en/sites/default/files/GP%2520EPUJPM%2520-%2520English%25202014.pdf>.

12 Section 213 of the Financial Services Act 2013. Residents include Malaysian citizens, foreign citizens who have been accorded permanent residence status and who reside in Malaysia and companies incorporated in Malaysia.

13 Section 213 of the Financial Services Act 2013. Non-residents include foreign citizens, foreign embassies or high commissions, supranational Malaysian citizens who have acquired permanent residence status abroad and who reside abroad and foreign corporate entities.

divestment proceeds, profits, dividends or any income arising from investments in Malaysia abroad. Any repatriation of funds must, however, be made in foreign currency. Non-residents are also free to:

- a* open ringgit or foreign currency accounts in Malaysia;
- b* obtain credit facilities in Malaysia in ringgit or foreign currency;
- c* obtain loans of any amount from Malaysian residents to finance the purchase of immovable properties in Malaysia; and
- d* enter into foreign exchange contracts on a spot or forward basis with onshore licensed banks to hedge investments in Malaysia.¹⁴

Non-resident travellers may:

- a* bring in or take with them, Malaysian currency up to the value of US\$10,000; and
- b* bring in any amount of foreign currency, including traveller's cheques.¹⁵

Tax

The imposition of tax is governed by the Income Tax Act 1976. Non-resident companies are subject to withholding tax on royalty payments derived from within Malaysia. This imposes a legal obligation on the party or franchisee making the payment to a non-resident to withhold tax at source and remit it to the Inland Revenue Board of Malaysia within a specified period (usually within a month of the date of the payment or royalties).¹⁶

III INTELLECTUAL PROPERTY

i Brand search

Registration of intellectual property rights (IPRs) such as, trademarks, patents, industrial designs and geographical indications is administered by MyIPO. Prior to filing an application to register marks, it is prudent for franchisors seeking to enter into the Malaysian market to undertake trademark searches against the databases maintained by MyIPO to ascertain whether there are any conflicts, potential or otherwise. Similar searches may be conducted with regard to other IPRs, such as industrial designs and patents.

Following the launch of an online search portal by MyIPO in 2010, all trademark searches are now conducted online.¹⁷ However, as the online search portal is limited in its field of searches, the search results may not be comprehensive. It is, therefore, advisable to conduct searches using the online facilities provided at the Registry of Trade Marks. Such searches will be subject to official fees but will provide more comprehensive search results.

MyIPO also maintains databases for granted patents and registered industrial designs, which are open to public search and inspection and which may similarly be searched using

14 Foreign Exchange Administration Rules, by the BNM; see http://www.bnm.gov.my/files/doc/fea/archive/FEA_rules_Part_2_Non-residents%202019.pdf.

15 *ibid*.

16 Section 109(1) of the Income Tax Act 1967.

17 See <https://iponlineext.myipo.gov.my/SPHI/Extra/IP/TM/Qbe.aspx?sid=637102816544748876>.

the MyIPO online search portal.¹⁸ As with trademarks, however, it is advisable to conduct searches at the Registry of Patents and the Industrial Designs Registration Office to obtain more comprehensive search results.

Franchisors should also perform further searches against the database for registered companies and businesses maintained by the Companies Commission of Malaysia (CCM).¹⁹ The CCM is charged with approving applications for, and maintaining the registration of, companies and businesses in Malaysia. As the CCM does not, as a matter of practice, conduct any cross-reference searches with MyIPO, a registered trademark may well be registered by a third party as a company name. In such an instance, and in the absence of any direct settlement with the company or business concerned, the only recourse available to a trademark owner is to commence court proceedings for the alteration of the registered company or business name.

ii Brand protection

Section 24 of the Act requires a franchisor to register any trademarks relevant to his or her franchise prior to applying for registration with the Franchise Registry. Trademark applications take time to mature to registration. Hence, it is important to file the applications for registration of the marks early, before the franchise commences operation and, wherever possible, as soon as practicable after the franchisor has made a decision to expand its franchise in Malaysia. The Franchise Registry usually accepts proof of filing for registration in place of a certificate of registration of the marks.

The trademark filing process involves two main stages. After the trademark application is filed, it will be examined for compliance with formalities and substantive requirements. If the requirements were met, the Registrar would issue a request for publication of the application, which essentially means that the application is accepted for registration, subject to third-party oppositions. The application would then be published in the Government Gazette for opposition purposes by third parties. If there are no oppositions, the certificate of registration will be issued. The entire process takes between nine and twelve months from the filing date to registration. If the requirements were not met, the Registrar would issue an office action containing the objection to the application. The applicant would be required to submit a response to the objection by filing written submissions and evidence of use. Thereafter, if the application is accepted, a request for advertisement is issued. If the application were not accepted, the applicant would be given an opportunity to submit oral arguments at an *ex parte* hearing. If the applicant is successful at the *ex parte* hearing, a request for advertisement would be issued and the steps indicated above are followed until the certificate of registration is issued. If the applicant is unsuccessful at the *ex parte* hearing, the application will be refused registration. An applicant may appeal to the High Court against a decision by the Registrar refusing an application and, thereafter, there is a final recourse by way of an appeal to the Court of Appeal.

The initial period of registration is 10 years from the date of application, which is deemed to be the date of registration.²⁰ The trademark may be renewed every 10 years before

18 See database of the Registry of Patents at <https://iponlineext.myipo.gov.my/SPHI/Extra/IP/PT/Qbe.aspx?sid=637102817725493492> and database of the Industrial Design Registration Office at <http://onlineip.myipo.gov.my/index.cfm/search/id/index>.

19 See <https://www.ssm-einfo.my/page.php>.

20 Section 32(1) of the Trade Marks Act 1976.

the expiry date. If it is not renewed before the expiry date, late renewal may be filed within one month of the expiry date. If late renewal is not filed, an application to restore and renew the registration may be filed within one year of the expiry date. Failure to do either of these will result in the registration being removed from the Register.

A registered trademark is also vulnerable to cancellation on the grounds that: (1) the trademark was registered without an intention in good faith to use the trademark in relation to the goods or services and, in fact, there has been no use in good faith of the trademark up to one month prior to the date of the application seeking the cancellation of the registration; or (2) there has been no continuous use of the trademark, in good faith, for a period of three years up to one month prior to the date of the application seeking the cancellation of the registration.²¹

See Section VII.i(a), (b), (c), (d) and (e) on the amendments to be introduced under the new Trademarks Act 2019 (the new TMA).

iii Enforcement

The main IPRs applicable to a franchise are trademarks, confidential information or trade secrets, know-how and copyright. In certain businesses, other IPRs such as industrial designs and patents may also be applicable.

A registered proprietor has recourse under the relevant legislation or common law to seek relief for the infringement of any of its IPRs. Infringement actions in respect of trademarks, copyright, industrial designs and patents are generally initiated in the High Court. Other rights such as breach of confidentiality or trade secrets or passing off may also be initiated in the Sessions Court (a subordinate court) if the claim for damages does not exceed 1 million ringgit.²² Both the High Court and the Sessions Court have jurisdiction to grant interim or permanent injunctive and specific reliefs.²³ The reliefs ordinarily sought in civil actions for infringement are permanent injunctive orders prohibiting further infringing acts, orders for the delivery of the infringing articles, damages or an account of profits and legal costs.

Where a trademark is infringed, a registered proprietor or an exclusive licensee of the trademark may commence a civil action pursuant to the Trade Marks Act 1976 (TMA),²⁴ and where the mark has been used in Malaysia such that there is goodwill and reputation associated with it, there is additional recourse under common law for passing off. The standard reliefs are usually available in such actions. (See Section VII.i(f) on the amendments to be introduced under the new TMA.)

A registered proprietor may also have recourse to administrative relief, in the form of border protection measures to prevent the importation of counterfeit goods under the TMA, and criminal remedies pursuant to the Trade Descriptions Act 2011²⁵ whereby the Enforcement Division of the MDTCA may be moved to initiate a raid, seize infringing or counterfeit goods and prosecute the persons responsible. (See Section VII.i(g) on the amendments to be introduced under the new TMA.)

21 Section 46(1) of the Trade Marks Act 1976.

22 Section 65(1)(b) of the Subordinate Courts Act 1948.

23 Sections 65(1)(c) and (5)(a) of the Subordinate Courts Act 1948 and Section 25(2) of the Courts of Judicature Act 1964.

24 Section 38 of the Trade Marks Act 1976.

25 Section 8 of the Trade Descriptions Act 2011.

Know-how, trade secrets and confidential information are protected through contract law and under the common law tort of breach of confidential information. In the case of a franchise business model, Section 26 of the Act provides that a franchisee is required to provide the franchisor with a guarantee that the franchisee, including its directors, their spouses and immediate family, and its employees, may not disclose any information contained in the training or operation manual or information obtained from the franchisor during the term of the franchise agreement. Failure to provide such a guarantee is tantamount to an offence under the Act.

Where these obligations of confidence are set out in the franchise agreement or a confidentiality agreement or undertaking, a franchisor will also have recourse to a civil action for breach of confidentiality under contract and common law.

While there is no compulsory registration system for copyright in Malaysia, it is possible to provide voluntary notification of copyright ownership to the MyIPO. A work is eligible for copyright protection upon the fulfilment of certain conditions, which include labour, skill and judgement to make the work original, where the work is reduced in material form, written down or recorded and the author is a Malaysian or the work is produced or made in Malaysia. Works that are protected under copyright include literary, musical artistic or dramatic works.²⁶

When a copyright work is infringed, the proprietor of the copyrighted work may initiate a civil action and seek injunctive reliefs similar to the standard reliefs and, in addition, may seek statutory damages of not less than 25,000 ringgit for each work and not more than 500,000 ringgit on aggregate.²⁷ The copyright owner may also have recourse to criminal remedies provided under the Copyright Act 1987²⁸ by lodging a complaint with the Enforcement Division of the MDTCA to request that a seizure action be carried out in respect of the infringing activities.

Similarly, if other IPRs, such as patents²⁹ or industrial designs,³⁰ registered in Malaysia are concerned, the registered proprietor will have similar recourse to the civil remedies discussed above for such infringements.

iv Data protection, cybercrime, social media and e-commerce

The Personal Data Protection Act 2010 (PDPA) and regulations made thereunder, including the Personal Data Protection Regulations 2013, regulate personal data that is processed and maintained in relation to commercial transactions.

Personal data encompasses information in relation to commercial transactions that relates directly or indirectly to a data subject who is identified or identifiable from that information or other information in the possession of the data user, and includes any expressions of opinion relating to the data subject. 'Data subject' refers to an individual who is the subject of the personal data.

Commercial transactions are defined as any transaction of a commercial nature, whether contractual or otherwise, which includes any matter relating to the supply or exchange of goods or services, agency, investments, financing, banking and insurance. The

26 Section 7 of the Copyright Act 1987.

27 Section 37 of the Copyright Act 1987.

28 Section 41 and Part VII of the Copyright Act 1987.

29 Section 60 of the Patents Act 1983.

30 Section 35 of the Industrial Designs Act 1996.

PDPA applies to the operation of a franchise, as personal information of the franchisors' employees, customers, clients, suppliers and contractors that is collected will be in relation to a commercial transaction.

'Processing', in relation to personal data, means collecting, recording, holding or storing personal data or carrying out any operation or set of operations on personal data, including organisation, adaptation or alteration; retrieval, consultation or use; disclosure by transmission, transfer, dissemination, or otherwise making available; and alignment, combination, correction, erasure or destruction of personal data.

Although the personal data may be processed outside Malaysia, the PDPA will apply to such processing if the personal data is intended to be further processed in Malaysia.³¹ Accordingly, the PDPA may also apply to the foreign franchisor as a joint data user if it is involved in and has some form of control over the processing of such data by its Malaysian franchisee.

A data user who belongs to any of the following class of data users as specified in the Schedule to the Personal Data Protection (Class of Data Users) Order 2013 is required to be registered under the PDPA:³²

- a* communications;
- b* banking and financial institutions;
- c* insurance;
- d* health;
- e* tourism and hospitality;
- f* transportation;
- g* education;
- h* direct selling;
- i* services;
- j* real estate;
- k* utilities;
- l* pawnbroker; and
- m* moneylender.

To process personal data, a data user must comply with the following Personal Data Protection Principles (collectively, the PDP Principles):³³

- a* General Principle;
- b* Notice and Choice Principle;
- c* Disclosure Principle;
- d* Security Principle;
- e* Retention Principle;
- f* Data Integrity Principle; and
- g* Access Principle.

The General Principle requires a data user to obtain the consent of its data subjects, which in this case would include the franchisor's employees, customers, clients, suppliers and

31 Section 3(2) of the Personal Data Protection Act 2010.

32 Section 14(1) of the Personal Data Protection Act 2010.

33 Section 5(1) of the Personal Data Protection Act 2010.

contractors, prior to processing their personal data.³⁴ There is no specific form in which the consent must be obtained as long as the consent is capable of being recorded and maintained properly by the franchisor.³⁵

Under the Notice and Choice Principle, franchisors must give written notice in Malay and English to the data subjects with the following information when they first collect, or before they use, personal data:³⁶

- a* a statement that personal data of the data subject are being processed by or on behalf of the franchisor and a description of the personal data;
- b* the purposes for which the personal data are being or is to be collected and further processed;
- c* the sources of the personal data;
- d* the data subject's right to request access to and correction of the personal data, and how to contact the franchisor with any enquiries or complaints in respect of the personal data (i.e., by providing the designation of the contact person, phone number, fax number (if any), email address (if any) and such other related information);³⁷
- e* the class of third parties to whom the franchisor discloses or may disclose the personal data;
- f* the choices and means the franchisor offers the data subject for limiting the processing of personal data;
- g* whether it is obligatory or voluntary for the data subject to supply the personal data; and
- h* where it is obligatory for the data subject to supply the personal data, the consequences for the data subject if he or she fails to supply the personal data.

Under the Disclosure Principle, franchisors are prohibited from disclosing the personal data of their employees, customers, clients, suppliers and contractors for any purpose or to any party other than for the purposes that were made known to the data subjects at the time the personal data were collected, unless further consent is obtained.³⁸

The Security Principle requires franchisors to take practical steps to protect personal data from any loss, misuse, modification, unauthorised or accidental access or disclosure, alteration or destruction.³⁹ Franchisors must develop and implement a security policy that complies with the security standard set out in the Personal Data Protection Standard 2015 (the Standard). If the franchisor engages a third party (data processor) to process the personal data on its behalf, it must ensure that the data processor provides sufficient guarantees in respect of the technical and organisational security measures governing the processing to be carried out, and takes reasonable steps to ensure compliance with those measures.⁴⁰

Under the Retention Principle, franchisors must not keep personal data longer than is necessary for the fulfilment of the purposes for which they were collected. If the personal data are no longer required, the franchisor must take reasonable steps to ensure that the personal data are permanently deleted.⁴¹ There is no specific retention period or destruction timeline

34 Section 6(1) of the Personal Data Protection Act 2010.

35 Regulation 3(1) of the Personal Data Protection Regulations 2013.

36 Section 7 of the Personal Data Protection Act 2010.

37 Regulation 4 of the Personal Data Protection Regulations 2013.

38 Section 8 of the Personal Data Protection Act 2010.

39 Section 9(1) of the Personal Data Protection Act 2010.

40 Section 9(2) of the Personal Data Protection Act 2010.

41 Section 10 of the Personal Data Protection Act 2010.

under the PDPA for the storage of personal data and this may be subject to requirements of other legislation, such as employment laws, company laws and tax laws, which may require personal data to be retained for a specific period. The data retention must comply with the Standard.

The Data Integrity Principle requires franchisors to take reasonable steps to ensure that the personal data of their employees, customers, clients, suppliers and contractors are accurate, complete, not misleading and kept up to date, and this must be carried out in accordance with the Standard.

The Access Principle gives data subjects the right to access and correct their personal data where the personal data are inaccurate, incomplete, misleading or not up to date.⁴² Franchisors should implement a system that allows their employees, customers, clients, suppliers and contractors controlled access to their personal data for purposes of updating the personal data.

The PDPA allows a data subject to withdraw his or her consent to the processing of personal data by written notice to the data user. Accordingly, data users must, upon receiving such notice, cease processing the personal data. Failure to comply is an offence and, on conviction, the data user is liable to a fine of up to 100,000 ringgit or imprisonment for a term not exceeding one year, or both.⁴³ In view of the fact that processing includes storage, a request to delete arguably amounts to a withdrawal of consent to process personal data. Therefore, a request to delete must be complied with.

Franchisors are prohibited from transferring any personal data to places outside Malaysia except to places specified by the Minister of Communications and Multimedia and notified in the Gazette or unless it meets one of the conditions set out below:⁴⁴

- a* the data subject has given consent;
- b* the transfer is necessary for the performance of a contract between the data subject and the franchisor;
- c* the transfer is necessary for the conclusion or performance of a contract between the franchisor and a third party that:
 - is entered into at the request of the data subject; or
 - is in the interests of the data subject;
- d* the transfer is for the purpose of any legal proceedings, for obtaining legal advice, or exercising or defending legal rights;
- e* the franchisor has reasonable grounds to believe that in all circumstances of the case:
 - the transfer is for the avoidance or mitigation of adverse action against the data subject;
 - it is not practicable to obtain the consent in writing of the data subject to that transfer; and
 - if it were practicable to obtain that consent, the data subject would have given his or her consent;
- f* the franchisor has taken all reasonable precautions and exercised due diligence to ensure that the personal data will not, in that place, be processed in any manner that, if that place is Malaysia, would be a contravention of the PDPA;

42 Section 12 of the Personal Data Protection Act 2010.

43 Sections 38(1), 38(2) and 38(4) of the Personal Data Protection Act 2010.

44 Sections 129(1) and 129(3) of the Personal Data Protection Act 2010.

- g* the transfer is necessary to protect the vital interests of the data subject; and
- h* the transfer is necessary in the public interest.

In addition to obtaining the general consent for the processing of personal data, franchisors should also obtain consent from their employees, customers, clients, suppliers and contractors to transfer the personal data to places outside Malaysia. Alternatively, franchisors may transfer the personal data if they are able to show that they have taken all reasonable precautions and exercised all due diligence to ensure that the personal data of the data subjects will not, in that place outside Malaysia, be processed in any manner that, if that place were Malaysia, would contravene the PDPA. In this connection, data users may consider entering into an agreement with the recipient of the personal data outside Malaysia and conducting regular audits to ensure that the recipient complies with the PDPA.

A data user who transfers personal data outside Malaysia in breach of the PDPA commits an offence that carries a fine of up to 300,000 ringgit or imprisonment of up to two years, or both.⁴⁵

The Malaysian Personal Data Protection Commissioner has issued a public consultation setting out jurisdictions that it is considering recommending to be approved under the PDPA as places to which personal data may be transferred outside Malaysia.⁴⁶ If the proposed jurisdictions are specified by the Minister under the PDPA, franchisors may transfer personal data to the following places: the European Economic Area (EEA) member countries; the United Kingdom; the United States; Canada; Switzerland; New Zealand; Argentina; Uruguay; Andorra; Faeroe Islands; Guernsey; Israel; Isle of Man; Jersey; Australia; Japan; Korea; China; Hong Kong; Taiwan; Singapore; Philippines; and Dubai International Financial Centre (DIFC).

There is no requirement under the PDPA to appoint a designated data protection officer to oversee compliance and administration of the PDPA within the organisation. However, under the Notice and Choice Principle, the written notice must specify how the data subject can contact the data user with any inquiries or complaints in respect of the personal data. For this purpose, franchisors must provide in the written notice at least the designation of the contact person, with phone number and fax number, if any; email address, if any; and such other related information.

In addition to the PDPA, franchisors should generally be aware of other Malaysian legislation that regulates matters relating to cybercrime, e-commerce and social media. In brief:

- a* the Computer Crimes Act 1997 sets out offences relating to the misuse of computers, including unauthorised access to a computer, unauthorised access with intent to commit other crime and also the communication of information, such as passwords, to unauthorised persons;
- b* the Electronic Commerce Act 2006 provides a legal framework for and recognises the use of electronic messages in commercial transactions and the use of such messages to fulfil legal requirements and to enable and facilitate legal transactions; and

⁴⁵ Section 129(5) of the Personal Data Protection Act 2010.

⁴⁶ Public Consultation Paper No. 1/2017 entitled Personal Data Protection (Transfer of Personal Data to Places Outside Malaysia) Order 2017, by the Personal Data Protection Commission; see http://www.pdp.gov.my/images/pdf_folder/PUBLIC_CONSULTATION_PAPER_1-2017_.pdf.

- c* the Communications and Multimedia Act 1998 and the Malaysian Content Code regulate the provision of content, including online content, and apply to persons within and outside Malaysia if the content is made available in Malaysia. Compliance with the Content Code is generally voluntary unless the Communications and Multimedia Commission issues mandatory compliance directions.

IV FRANCHISE LAW

i Legislation

The Act provides a dedicated legislative framework relating to the franchising industry. It provides for the registration of franchises and regulates franchises, including setting out mandatory terms and conditions that have to be contained within a franchise agreement. Contravention of the Act may render a franchise agreement void or expose a franchisor or franchisee to criminal penalties.

Apart from complying with the Act, franchisors and franchisees should also be aware of other relevant legislation such as the Contracts Act 1950, the TMA (and legislation relating to the protection of other IPRs as set out above), the Employment Act 1955 and the Competition Act 2010.

ii Pre-contractual disclosure

Specific pre-contractual disclosure is covered within the Act and it may also generally fall within the scope of the Contracts Act 1950 and common law.

The Act requires a franchisor to provide disclosure documents to a prospective franchisee at least 10 days before the franchisee signs the franchise agreement.⁴⁷ The information required to be disclosed to the franchisee includes:

- a* description of the franchise business;
- b* details of intellectual property rights, fees and payments required from the franchisee;
- c* financial obligations;
- d* whether the franchisee is required to purchase or obtain supplies or materials from a designated source;
- e* territorial rights;
- f* franchise terms, including terms for renewal and termination, obligations upon termination; and
- g* audited accounts of the franchisor's business (at present, the Franchise Registry requires a minimum of the latest three years' audited accounts).

In the event that the information within the disclosure documents is false or misleading, the franchisor may be liable to both criminal and civil action under the Act. It is a criminal offence under the Act to make false statements or omissions that render the information within the disclosure documents misleading.⁴⁸

⁴⁷ Section 15(1) of the Franchise Act 1998.

⁴⁸ Section 37 of the Franchise Act 1998.

Section 39 of the Act sets out the applicable penalties if a person is found guilty of an offence under the Act where no express penalties have been specified. Upon conviction, a person will be liable:⁴⁹

- a* for the first offence under the Act, to pay a fine of not less than 5,000 ringgit and no more than 25,000 ringgit or to imprisonment of no more than six months; and
- b* for the second or any subsequent offences, a fine of not less than 10,000 ringgit and no more than 50,000 ringgit or imprisonment of no more than one year.

If the alleged offender is a body corporate, it will, upon conviction, attract:⁵⁰

- a* for the first offence under the Act, a fine of not less than 10,000 ringgit and no more than 50,000 ringgit; and
- b* for the second or any subsequent offence, a fine of not less than 20,000 ringgit and no more than 100,000 ringgit.

Further, the court has the power to declare the franchise agreement null and void and may order the franchisor to refund any payments made by the franchisee, and the court may further prohibit the franchisor from entering into any new franchise agreements or from appointing any new franchisees.⁵¹

In addition to the Act, an aggrieved party may also bring an action for damages for misrepresentation under tort law and, if proven, the court may rescind the franchise agreement. The Contracts Act 1950 also expressly provides for misrepresentation, which potentially renders the contract or agreement voidable at the option of the franchisee.⁵²

The franchisor should therefore seek to expressly protect its position within the franchise agreement by ensuring that all projections of profits and revenue and pre-contractual information, where provided to the franchisee pursuant to the disclosure documents under the Act or during the course of negotiations leading to the franchise agreement, do not amount to legally binding representations, guarantees or warranties, to avoid any potential action for misrepresentation or a criminal prosecution under the Act.

iii Registration

There are four categories of registration under the Act, namely registration by:

- a* a local franchisor or master franchisee of a foreign franchisor before offering to sell its franchise to any party;
- b* a foreign franchisor intending to sell its franchise in Malaysia or to Malaysian citizens;
- c* the franchisee of a local franchisor; and
- d* the franchisee of a foreign franchisor.

49 Section 39(1)(b) of the Franchise Act 1998.

50 Section 39(1)(a) of the Franchise Act 1998.

51 Section 39(2) of the Franchise Act 1998.

52 Section 19(1) of the Contracts Act 1950.

Local franchisor or master franchisee

Section 6 of the Act requires a local franchisor or a master franchisee of a foreign franchisor to register its franchise with the Franchise Registry before operating a franchise business or offering to sell its franchise to any party. A breach of this Section is an offence under the Act and a person will upon conviction, be liable:⁵³

- a* for the first offence under the Act, to pay a fine not exceeding 100,000 ringgit or to imprisonment of no more than one year; and
- b* for the second or any subsequent offence, to pay a fine not exceeding 250,000 ringgit or to imprisonment of no more than three years.

If the alleged offender is a body corporate, it will, upon conviction, attract:⁵⁴

- a* for the first offence under the Act, a fine not exceeding 250,000 ringgit; and
- b* for the second or any subsequent offence, a fine not exceeding 500,000 ringgit.

The local franchisor is required to submit its application for registration together with all supporting documents, which include the disclosure documents, a sample of the franchise agreement, operation manual, the training manual, its latest audited accounts,⁵⁵ financial statements and the auditors' or directors' reports and any other information required by the Registrar.⁵⁶

The Registrar may approve, impose conditions or reject the application, and all such decisions are communicated in writing to the applicant. In the case of an adverse decision, the applicant may submit an appeal to the Minister within one month of the date of communication of the decision. The Minister's decision is final.⁵⁷

Foreign franchisor

Section 54 (read together with Section 6) of the Act requires a foreign franchisor to apply for prior approval before making an offer to sell its franchise in Malaysia or to any Malaysian citizen. The Registrar may approve, impose conditions on or refuse such an application, and the rights of appeal are set out above.⁵⁸

Franchisee of a local franchisor

Pursuant to Section 6B of the Act, a franchisee who is granted a franchise by a local franchisor is required to register the franchise with the Registrar within 14 days of the date of signing of the franchise agreement between the franchisor and the franchisee.

⁵³ Section 6(2)(b) of the Franchise Act 1998.

⁵⁴ Section 6(2)(a) of the Franchise Act 1998.

⁵⁵ The Franchise Registry presently requires a minimum of the latest three years' audited accounts to be submitted in support of such applications.

⁵⁶ Section 7 of the Franchise Act 1998.

⁵⁷ Section 17 of the Franchise Act 1998.

⁵⁸ *ibid.*

Franchisee of a foreign franchisor

Upon entering into a franchise agreement with a local franchisee and prior to the commencement of operations, the franchisee of a foreign franchisor is required to make an application to register its franchise with the Registrar pursuant to Section 6A of the Act.

iv Mandatory clauses

The Act provides for the inclusion of certain mandatory clauses in a franchise agreement pursuant to Section 18 of the Act, failing which a franchise agreement will be void. Section 18 provides that a franchise agreement will include:

- a* the name and description of the product and business of the franchise;
- b* the territorial rights granted to the franchisee;
- c* the franchise fee, promotion fee, royalties, or any other related payment that may be imposed on the franchisee;
- d* the obligations of both the franchisor and franchisee;
- e* the franchisee's right to use the intellectual properties belonging to the franchisor;
- f* the conditions under which the franchisee may assign the rights given under the franchise;
- g* a statement confirming a cooling-off period of at least seven working days during which the franchisee may terminate the agreement and seek the refund of any franchise fee paid to the franchisor subject to reasonable expenses incurred in the preparation of the franchise agreement that may not be refundable;
- h* a description pertaining to the mark or any other intellectual property owned or related to the franchisor that is used in the franchise;
- i* if the agreement is related to a master franchisee, the franchisor's identity and the rights obtained by the master franchisee from the franchisor;
- j* the type of assistance to be provided by the franchisor to the franchisee;
- k* the duration of the franchise (minimum five years) and the terms of renewal; and
- l* the effect of termination or expiration of the franchise agreement.

Further, the franchisor is required to set up a promotion fund, managed under a separate account, if the franchisee is required to make any payment for the promotion of the franchise.⁵⁹

v Guarantees and protection

The Act provides for the following written guarantees to be provided by a franchisee:

- a* the franchisee, including its directors, their spouses and immediate family, and its employees must not disclose any information contained in the operation manual or any information obtained while undergoing training organised by the franchisor during the whole of the franchise term and for a period of two years after the expiration of the agreement;⁶⁰ and

⁵⁹ Section 22 of the Franchise Act 1998.

⁶⁰ Section 26 of the Franchise Act 1998.

- b* the franchisee, including its directors, their spouses and immediate family, and its employees must not carry out any other business similar to the franchised business for the whole of the franchise term and for a period of two years after the expiration of the agreement.⁶¹

Failure to provide the above guarantees amounts to an offence under the Act and the penalties are set out above (see Section IV.ii).

In addition, any written guarantees given by a party will also be enforceable under contract and common law. In the event of failure to provide the guarantees, the franchisor or the aggrieved party may have the option of terminating the agreement and suing for damages for breach of the guarantees given. Alternatively, depending on the nature and extent of the guarantees, the aggrieved party may choose instead to continue with the contractual relationship and claim for damages to put them in such a position as if the guarantees had been performed and fulfilled.

V TAX

i Franchisor tax liabilities

Tax liabilities generally arise in relation to any income derived within Malaysia. For a franchisor, this would include income arising from royalties, financial gains arising from dividends or profits paid. Capital payments, such as lump-sum payments for the grant or acquisition of a franchise, are normally not taxable. 'Capital payment' represents a payment made for the purchase of a capital asset for the enduring benefit of the business of the franchisee. Taxable income is defined within Section 4 of the Income Tax Act 1967.⁶²

Different tax rates will apply depending on whether the franchise business is managed and owned through a company (thus attracting corporate tax rates) or if it is being managed as a sole proprietorship (which attracts rates payable by individuals).

Royalty payments and interest arising from within Malaysia and payable to non-residents will be subjected to withholding tax at the rate of 10 per cent and 15 per cent, respectively, and must be paid within one month of paying or crediting the royalty.⁶³

Apart from income taxes, the franchisor may also be subject to other general tax liabilities such as stamp duties arising from the execution of the franchise agreement, real property gains tax, excise duty and sales and services tax (SST).

SST was introduced by the Sales Tax Act 2018 and the Services Tax Act 2018, which came into force on 1 September 2018, replacing the current goods and services tax. SST is charged and levied at the rate of between 5 and 10 per cent on taxable goods⁶⁴ manufactured in Malaysia by a taxable person and sold, used or disposed of by that taxable person, and on

61 Section 27 of the Franchise Act 1998.

62 Classes of income on which tax is chargeable pursuant to Section 4 of the Income Tax Act 1976 are gains or profits from a business; gains or profits from an employment; dividends, interest or discounts; rents, royalties or premiums; pensions, annuities or other periodical payment not mentioned and other gains and profits not mentioned under Section 4.

63 Section 109 of the Income Tax Act 1976.

64 'Taxable goods' is defined under Section 2(1) of the Sales Tax Act 2018 as 'goods of a class or kind not exempted from sales tax'.

taxable goods imported into Malaysia.⁶⁵ Any person who manufactures taxable goods must be registered if the annual turnover has exceeded the 500,000-ringgit threshold.⁶⁶ SST is charged and levied at the rate of 6 per cent of the price and value of the taxable services on any taxable services⁶⁷ provided in Malaysia by a registered person in carrying on his or her business.⁶⁸ Any person specified in the First Schedule of the Service Tax Regulations 2018 providing any taxable service that exceeds the specified threshold for the total value of the taxable service must be registered under the Services Tax Act 2018.⁶⁹

ii Franchisee tax liabilities

Franchisees are similarly required to pay tax on taxable income;⁷⁰ apart from income tax, the franchisee may also be subject to other general tax liabilities, such as SST as explained above (see Section V.i).

The expenses incurred by a franchisee in undertaking the franchise business – royalty payments, promotion fees, advertising costs, training fees and services fees – are tax deductible. Any franchise fee paid to a foreign franchisor is, however, not tax deductible. Franchise fees paid to a local franchisor, on the other hand, are tax deductible pursuant to the Income Tax (Deduction for Expenditure on Franchise Fee) Rules 2012.

VI IMPACT OF GENERAL LAW

i Good faith and guarantees

Section 29(1) of the Act requires both franchisor and franchisee to act in an honest and lawful manner and requires them to endeavour to pursue the best franchise practice of the time and place. However, the Act does not expressly stipulate any penalties for non-compliance. For the aggrieved party to bring an action for the breach of this statutory provision or duty, they must prove that the alleged breach has resulted in actual damage and that the damage was a type contemplated as a foreseeable consequence of the breach.

The Malaysian courts do not recognise any duty of honesty or good faith in a contract where both parties are free to negotiate terms at arm's length. The courts will recognise the principle of freedom of contract and uphold the terms in an agreement unless there are vitiating factors such as coercion, undue influence, misrepresentation or mistake. This was recently confirmed in *Aseambankers Malaysia Berhad & Ors v. Shencourt Sdn Bhd & Anor*⁷¹ and was subsequently adopted in *SCOMI Transit Projects Sdn Bhd v. Prasarana Malaysia Berhad*.⁷² In *Aseambankers*, the court held that if it were to allow the defendant's counterclaim on the grounds that there is a general duty of good faith, the court would effectively be creating new law.

65 Section 8(1) of the Sales Tax Act 2018 and Order 2 of the Sales Tax (Rates of Tax) Order 2018.

66 Sections 12 and 13 of the Sales Tax Act 2018 and Order 2 of the Sales Tax (Total Sale Value of Taxable Goods) Order 2018.

67 'Taxable services' refer to the services specified in the First Schedule of the Service Tax Regulations 2018.

68 Section 7 of the Service Tax Act 2018 and Order 3 of the Service Tax (Rate of Tax) Order 2018.

69 Sections 12 and 13 of the Service Tax Act 2018.

70 *ibid.* at 48.

71 [2014] 4 MLJ 619.

72 [2016] MLJU 622.

ii Agency distributor model

Section 29(3) of the Act requires the franchisee to operate its business separately from the franchisor and specifies that the relationship between the franchisee and the franchisor will not at any time be regarded as a partnership, service contract or agency. Thus, the agency model has no role to play in a franchise system in Malaysia. A franchisee may, however, distribute a franchisor's products as this is not prohibited under the Act, and such an arrangement may be subject to a separate distribution agreement.

iii Employment law

The Employment Act 1955 applies to employees whose wages do not exceed 2,000 ringgit a month and to all manual labourers (irrespective of wages).⁷³ All other employees are governed by their employment contracts and common law principles developed through case law. Given the express provision within the Act that franchises are not regarded as service contracts, there will be no presumption of an employer–employee relationship between a franchisor and a franchisee.

iv Consumer protection

Franchisees are not treated as consumers under existing laws in Malaysia or pursuant to the Consumer Protection Act 1999, which principally governs consumer rights and protection.

v Competition law

Franchise agreements commonly incorporate provisions that restrict or prevent competition; for instance, selective or exclusive distribution provisions and restrictions on the use of IPRs licensed under the franchise agreement. These provisions are permissible if they can be justified as proportionate and can be shown to be necessary to safeguard the goodwill that has been built up into a brand by the franchisor.

The Competition Act 2010 expressly prohibits anticompetitive agreements, which include horizontal and vertical agreements, between enterprises that have the object or effect of significantly preventing, restricting or distorting competition in any market for goods or services.⁷⁴ The franchise agreement, being a form of vertical agreement, is prohibited if it has an anticompetitive object or effect that is significant in the relevant market unless:

- a* the parties to the agreement are competitors who are in the same market and their combined market share does not amount to more than 20 per cent; or
- b* the parties to the agreement are not competitors and, individually, each party has less than 25 per cent of shares in any relevant market.⁷⁵

The Competition Commission of Malaysia (MyCC) will generally take a strong stance against resale price maintenance and will deem any form of maximum pricing or recommended retail pricing that serves as a focal point for price determination to be anticompetitive.⁷⁶

⁷³ Section 2(1) of the Employment Act 1955.

⁷⁴ Section 4 of the Competition Act 2010.

⁷⁵ Guidelines on Chapter 1 Prohibition: Anti-competitive Agreements (2012) by the MyCC; see https://www.myc.gov.my/sites/default/files/pdf/newsroom/MYCC-4-Guidelines-Booklet-BOOK1-10-FA-copy_chapter-1-prohibition001_1.pdf.

⁷⁶ *ibid.*

As the Competition Act 2010 has only come into force relatively recently, MyCC has, as yet, not issued any guidelines to address the competing tensions between the IPRs or franchise agreements on the one hand and free competition on the other. Resale price maintenance is one area of potential conflict. If a recommended price sought to be provided in a franchise agreement is a genuine recommendation and does not become a focal point for price determination, it is likely that it will be permitted.

vi Restrictive covenants

Non-compete clauses and restrictive covenants are generally upheld as contractual terms and enforceable for the duration of the agreement. Breach of these covenants entitles the aggrieved party to sue for damages and specific reliefs and may also form the grounds of a complaint to the Franchise Registry. Breach of restrictive covenants set out in the Act is tantamount to an offence under the Act.⁷⁷

vii Termination

When introduced in 1998, the Act prohibited only the franchisee from terminating a franchise agreement before expiration of the franchise term. Following amendments made in 2012, a similar a similar prohibition now applies to franchisors.⁷⁸

In any event, either party may not terminate a franchise agreement before the expiration date except for good cause as stipulated in the Act. 'Good cause' is defined to include failure of the franchisee or franchisor to comply with the terms of the franchise agreement or any other relevant agreement between the parties and their failure to remedy the breach within a specified period, which may not be less than 14 days.⁷⁹

Termination without the requirement of notice and the opportunity to remedy the breach is also permissible in certain specified circumstances such as bankruptcy or insolvency, voluntary abandonment of franchised business, assignment of franchise rights for the benefit of creditors or a similar disposition of the assets to any other persons, conviction of a criminal offence that substantially impairs the goodwill associated with the franchisor's mark or other IPRs, and repeated failure to comply with the terms of the agreement.⁸⁰

Non-compete clauses are expressly permitted under the Act for a period of two years post-termination of the franchise⁸¹ and they form an exception to contract law principles, which generally hold a restraint of trade clause post-contract as void.⁸²

Apart from pursuing a civil action for a breach, the covenant may also be enforced by the franchisor by lodging a complaint with the Franchise Registrar, and this may potentially lead to a criminal prosecution.⁸³

Nothing in the Act prevents the franchisor from taking over the franchise business granted to the franchisee upon termination of the franchise term; however, in a non-renewal of the franchise agreement, the franchisor is under an obligation to compensate the franchisee

77 Section 27 of the Franchise Act 1998.

78 Section 19 of the Franchise (Amendment) Act 2012 and Section 31 of the Franchise Act 1998.

79 Section 31(2) of the Franchise Act 1998.

80 Section 31(3) of the Franchise Act 1998.

81 Section 27 of the Franchise Act 1998.

82 Section 28 of the Contracts Act 1950.

83 Section 27(3) of the Franchise Act 1998.

either by a repurchase or other means of compensation at a price agreed between the franchisor and franchisee in consideration of the diminution in value of the franchised business caused by the expiration of the franchise where:

- a* the franchisee is barred by the franchise agreement or by the refusal of the franchisor to waive any portion of the franchise agreement that prohibits the franchisee from continuing with the business; or
- b* the franchisee has not been given written notice of the franchisor's intent not to renew the agreement at least six months prior to the expiration date.⁸⁴

viii Anti-corruption and anti-terrorism regulation

The Anti-Money Laundering and Anti-Terrorism Financing Act 2001 (AMLA) is the primary legislative framework combating money laundering and terrorist financing. The AMLA not only criminalises money laundering and financing of terrorism, but also imposes various obligations on reporting institutions. Any person who engages in, or attempts to engage in or abets the commission of money laundering, commits an offence under the AMLA.

Anti-corruption is governed by the Malaysian Anti-Corruption Commission Act 2009, which was enacted to provide for the establishment of the Malaysian Anti-Corruption Commission and to make further and better provision for the prevention of corruption.

In addition, in the absence of any specific legislation, regard must also be had to the Malaysian Penal Code, which covers fraudulent and dishonest acts such as criminal breach of trust,⁸⁵ cheating⁸⁶ and criminal misappropriation of property.⁸⁷

ix Dispute resolution

Litigation can be an expensive, lengthy and complex process especially where foreign law is applied within a franchise agreement. Civil proceedings may be initiated in the Sessions or High Court depending on the proposed cause of action and quantum of damages sought.

It is a usual practice for parties, particularly where a foreign party is involved, to include a law and jurisdiction clause within their franchise agreement. Generally, the local courts will recognise and uphold a choice of foreign law or jurisdiction clause; however, the choice of foreign law may only cover the interpretation of the terms and conditions of the franchise agreement and may not exclude compliance with other Malaysian laws, such as the Act, which may still continue to apply and which may, in some instances take precedence over the terms of the franchise agreement.

Parties may also opt for arbitration or mediation as the preferred method of resolving disputes. Arbitration is governed by the Arbitration Act 2005 and mediation is governed by the Mediation Act 2012. Mediation is, however, not a mandatory form of alternate dispute resolution and there are no costs or other penalties that can or may be imposed if a party refuses to pursue mediation and decides instead to initiate a court action.

Parties are generally encouraged by the Franchise Registry to resolve disputes informally, through good faith negotiations or mediation. The Franchise Registry may, at the request of the parties, act as a mediator. Mediation is, however, not a mandatory form of dispute resolution.

84 Section 32 of the Franchise Act 1998.

85 Sections 405-409 of the Malaysian Penal Code.

86 Sections 415-424 of the Malaysian Penal Code.

87 Sections 403-404 of the Malaysian Penal Code.

Where informal dispute resolution mechanisms fail, the court process remains the primary means of enforcement.

Injunctive relief, both interim and permanent, is available to restrain the infringement of any IPRs or a breach of a restraint of trade covenant.

Where a contract is breached, the injured party is entitled to initiate a civil action for damages. Calculation of damages in a breach of contract action (including misrepresentation) depends on whether the injured party is claiming for expectation loss or reliance loss. Expectation loss aims to put the injured party in such a position as if the contract had been fully performed and where the injured party would have made certain profits or earnings; any such losses will have to be proven on a standard of balance of probabilities. If the injured party is claiming for reliance loss, the injured party must prove the expenses incurred arising from his or her reliance on the contract. In any event, the loss must not be too remote such that it must arise as a natural consequence of the breach or the parties must be aware of the loss.⁸⁸

Under the Contracts Act 1950, the parties must also restore or compensate for any advantage received where the injured party rescinds a contract that is void or has become voidable as a consequence of the breach.⁸⁹ The Contracts Act 1950 also requires that an injured party takes all reasonable steps to mitigate the loss and must not incur unreasonable expenses in the act of doing so.⁹⁰

An injured party may also seek to pursue a claim under tort. Damages under tort are calculated to place the claimant in such a position as if the breach or tort had not taken place. They are generally quantified under two headings, namely general and special damages.

To successfully recover any damages, a claimant must prove on a balance of probabilities that the losses were caused by the defendant's actions or breach and there has been no break in the chain of causation leading to the losses suffered. Losses that are too remote are not recoverable.

Litigation costs usually follow the event and are awarded to the successful party. There are no capped costs and in the absence of agreement between parties, the quantum of costs will be determined by the court through taxation proceedings.

The registration and enforcement of foreign court judgments is governed by the Reciprocal Enforcement of Judgments Act 1958 (REJA). REJA is limited to final judgments⁹¹ awarded by a superior court from a country listed in its First Schedule, and they are Brunei, Hong Kong, India, New Zealand, Singapore, Sri Lanka and the United Kingdom. If the foreign judgment is from another jurisdiction, the only method of enforcement would be to initiate fresh proceedings and secure a Malaysian court judgment.

Malaysia is a signatory to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention) and therefore Malaysian courts will recognise foreign arbitral awards made in a New York Convention contracting state unless any of the grounds for refusal of recognition stated under Section 39(1) of the Arbitration Act 2005 are successfully established.

88 Section 74 of the Contracts Act 1950.

89 Section 66 of the Contracts Act 1950.

90 Explanation to Section 74 of the Contracts Act 1950.

91 Section 2 of the Reciprocal Enforcement of Judgments Act 1958. Judgments capable of registration are judgments or orders given or made by a court in any civil or criminal proceedings for the payment of a sum of money in respect of compensation or damages.

VII CURRENT DEVELOPMENTS

i The new TMA

On 27 September 2019, Malaysia deposited its instrument of accession to the Protocol Relating to the Madrid Agreement Concerning the International Registration of Marks (also known as the Madrid Protocol) with the World Intellectual Property Organisation, which allows the filing of a single application to register a trademark in up to 120 countries.⁹² In preparation for accession to the Madrid Protocol, Malaysia has introduced the Trademarks Bill 2019 (the Bill), which is a complete revamp and overhaul of the current TMA. The Bill is presently pending being gazetted, having been passed by the House of Representatives and the Senate of the Malaysian Parliament on 2 July 2019 and 23 July 2019 respectively. To implement the Bill, MyIPO issued a consultation paper setting out proposed changes and new provisions concerning trademark regulations under the Bill.⁹³ It is anticipated that the resultant new TMA will come into force on 27 December 2019, bringing about, *inter alia*, the following changes:

- a* The new TMA will expand the scope of registrable marks to include non-traditional marks such as sound, scent, holograms, positioning and motion marks, and allow multiple classes within the same application.
- b* While trademark applications will be subject to formal and substantive examinations that largely resemble the existing regime, the substantive examination will specifically consider absolute and relative grounds of refusal for registration, with the former applying in relation to the inherent distinctiveness of marks and the latter being based on the existence of earlier marks, including well-known marks. If the requirements are not met, an applicant may only avail itself of one round of argument in response to the provisional refusal issued by the Registry of Trademarks, as opposed to the present two rounds of arguments.
- c* If the refusal is maintained following the applicant's single challenge, a total provisional refusal will be issued, whereupon the next course of action available to the applicant would be an appeal to the High Court. If a mark is acceptable for registration, it will be published in the official Intellectual Property Online Journal for public inspection. Upon successful registration, a sealed notification of registration will be issued in place of a certificate of registration unless otherwise requested.
- d* While the validity period of registration remains 10 years, a request for renewal must be made not later than six months after the expiry date, failing which the mark will be deemed removed and if the mark is not restored within six months of removal, the registration will cease.
- e* The grounds for revocation for non-use of mark have been expanded to include (1) the trademark has become a common name in the trade because of the registered proprietor's inactivity; and (2) the use of the trademark by the registered proprietor would mislead the public. Any use by the registered proprietor within the three-month period (as

⁹² See <http://www.myipo.gov.my/en/malaysia-accedes-to-madrid-protocol/>.

⁹³ Consultation Paper No. 1/2019/CP/REGTM entitled Proposed Changes & New Provisions Concerning Trademark Regulations under the New Trademarks Bill 2019, by the Intellectual Property Corporation of Malaysia; see <http://www.myipo.gov.my/wp-content/uploads/2019/09/Consultation-Paper-Trademarks-Regulations.pdf>.

opposed to the present one-month period) before the application for revocation is filed will be disregarded unless preparations for this use began before the proprietor became aware that application for revocation might be made.

- f The standard reliefs awarded to the successful party in infringement proceedings are codified in the new TMA, including: (1) injunctions; (2) damages; (3) account of profits; and (4) mandatory orders (including making an order for the erasure of the offending sign, destruction of goods bearing the offending sign or delivery up or disposal of infringing goods, material or articles).
- g The new TMA introduces criminal enforcement procedures by transferring the relevant provisions on anti-counterfeiting from the current TDA to criminalise acts of (1) counterfeiting a trademark; (2) falsely applying a registered trademark; (3) making or possessing articles for committing an offence; and (4) importing or selling goods with falsely applied trademarks.

ii **Kah Z & Z Sag (TG) Sdn Bhd v. Syarikat Abdul Ghaffar Trading Sdn Bhd**

The Franchise (Amendment) Bill 2019 was passed by the House of Representatives after its second reading on 3 December 2019 and will be tabled in the Senate of the Malaysian Parliament for approval. While there have been no significant franchise law cases over the past year, it may be relevant to note the case of *Kah Z & Z Sag (TG) Sdn Bhd v. Syarikat Abdul Ghaffar Trading Sdn Bhd*⁴ concerning discrimination between franchisees by the franchisor in offering different prices for the same goods, which is prohibited under the Act. In this case, the plaintiff (the franchisee) applied for an order under Order 43 Rule 1 of the Rules of Court 2012 for (1) an account to be taken of the sum received by the defendant (the franchisor) from the plaintiff; (2) a forensic account to be taken of the price of each delivery of goods and product delivered by the defendant to the plaintiff and of the defendant's account of profits and losses, including the submission of documents relating to the price of each product supplied to the plaintiff and a comparison of prices of products supplied to other franchisees; and (3) an inquiry to be conducted to ascertain the correct sum payable by the plaintiff to the defendant.

In making this application, the plaintiff claimed that the defendant had imposed an excessively higher price on the plaintiff than on other franchisees for the same product, thereby breaching the franchise agreement and contravening Section 20 of the Act by discriminating against the plaintiff in the charges offered or made for goods. In support of its allegation, the plaintiff relied on the prices at which products were supplied by the defendant to one LKK Supplier and one Yaacob and Sons Enterprise, showing that they had been charged lower prices. However, the defendant argued that LKK Supplier and Yaacob and Sons Enterprise were wholesalers and not the defendant's franchisees, and the plaintiff was unable to adduce evidence to show otherwise.

In dismissing the plaintiff's application, the High Court held that it was not appropriate for the court to grant the remedy sought by the plaintiff as there were preliminary issues to be tried as to whether the defendant had in fact supplied products to other franchisees at lower prices and hence practised discriminatory pricing. The non-discrimination provision therefore has yet to be tested and it remains to be seen how the courts will apply this provision in future cases.

94 [2019] 1 LNS 1284.

MEXICO

Eduardo Kleinberg¹

I INTRODUCTION

Franchises in Mexico constitute one of the most dynamic sectors of the economy, since it is considered to be a very successful business model with minimum risks. Up until 2016, around 11,800 new stores belonging to franchise systems had been opened in Mexico, with approximately 1,500 franchise brands, creating around 75,000 points of sale and over 890,000 direct employment positions.²

The Mexican Franchise Association (AMF) is a private entity, dedicated to the development of franchising in Mexico, providing support to commercial organisations working with the private and public sectors. There is no legal obligation for a franchise system to be affiliated with the AMF. However, according to the AMF, the associated franchises nationwide have generated more than 700,000 jobs and until this year 6.5 per cent of gross domestic product in Mexico.

The franchise sector was expected to grow 7 to 10 per cent in 2017, generating 230 to 250 points of sale,³ and to continue to have a huge potential to generate jobs and wealth in Mexico.

II MARKET ENTRY

i Restrictions

Mexico's Foreign Investment Law and its regulations impose some restrictions on foreign investment in Mexico, and while these have been relaxed considerably in recent years, they still have an impact upon foreign investors in Mexico. For example, an initial registration with the National Foreign Investment Registry is required for foreign investments to be made in Mexico and thereafter periodic filings must be submitted.

The Foreign Investment Law may, in some cases, prohibit or restrict certain types of investments, partially or completely, although these are not usually of concern to most franchisors since they only apply to a narrow range of business operations, mostly within governmental reserved activities.

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2 <https://www.eleconomista.com.mx/empresas/En-2016-cada-hora-se-abrio-una-franquicia-en-Mexico-20170427-0122.html>

3 <http://expansion.mx/dinero/2016/12/08/franquicias-un-sector-que-resistira-embates-en-2017>.

Subject to any limitations imposed by the Foreign Investment Law, there is no restriction in Mexico on the nationality of shareholders or members. Nevertheless, Mexican law requires that all companies have in their articles of incorporation either a provision prohibiting foreign shareholders or members, or a clause by which they agree to consider themselves as Mexican nationals with respect to their interest in the company, and not to invoke the protection of their own government in the event of a dispute, under penalty of forfeiting their interest to the state for violation of the clause.

ii Foreign exchange and tax

Mexico does not have foreign currency exchange restrictions. The considerations agreed under a franchise agreement could be either in Mexican pesos or a foreign currency. There are certain rules applicable to the actual payment of the consideration. If it is agreed to carry out payment within Mexican territory, the payer could elect to pay with the elected foreign currency or with Mexican pesos using the exchange rate published by the Central Bank of Mexico on the day of payment.

Mexico follows the Organisation for Economic Co-operation and Development (OECD) international tax standards. Thus, all transactions carried out with foreign residents (related parties or not), should fulfil the requirements of the arm's-length principle.

Income earned by foreign residents from a Mexican source is, in general, subject to withholding tax at various rates, which will depend on various factors, such as type of income (royalties, technical assistance), the tax residence of the receiving party, among other circumstances, but, in general, the withholding rate is 25 per cent over gross income. In the case of royalties, the withholding tax rates are between 25 per cent and 35 per cent, depending on the type of royalty paid to the foreign resident.

Foreign residents are subject to tax in Mexico for income earned from a source of wealth located in Mexico.

Mexico currently has over 75 tax treaties in force with other countries, including the United States, the United Kingdom, Canada, Japan, Germany, Spain, France and Switzerland. Mexico is constantly negotiating tax treaties with other countries. In addition, on 7 June 2017, Mexico signed the Multilateral Instrument,⁴ which allows it to swiftly amend existing bilateral tax treaties to implement tax avoidance measures developed by the OECD. Tax treaties can reduce taxation or even completely remove the withholdings described above.

III INTELLECTUAL PROPERTY

i Brand search

Clearance word searches may be conducted online through the Mexican Institute of Industrial Property (IMPI) database. The word search will provide trademarks that are identical, similar or have a word in common. The results are mostly reliable, but, given that the IMPI takes approximately two days to update the database, the provided information may not include a trademark that could constitute a legal impediment or data corresponding to possible designations to which Mexico could be subject, pursuant to the Protocol Relating to the Madrid Agreement Concerning the International Registration of Marks.

⁴ The OECD Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS, also known as the Multilateral Instrument.

The information contained in the search result does not constitute an official communication in terms of the Industrial Property Law (IPL).

ii Brand protection

In Mexico, it is not possible to file multi-class applications; rather individual applications, per mark per class, should be filed. If a trademark application has been previously submitted in another jurisdiction, priority may be claimed within six months of the filing date of the foreign application.

The approximate time frame for obtaining the registration of a trademark is three to six months. However, if an opposition is filed by a third party or if the trademark examiner issues an office action to clarify the listed goods or services, or citing an identical or confusingly similar trademark or otherwise objecting to the registrability of the proposed mark, the registration process will be extended up to a year or in some cases even more than a year.

Once the application is filed, it is published for opposition and will be examined by the examiner. In the event that a similar prior application or registration is found, or the mark is considered not to be distinctive, the examiner issues an office action communicating the objection. At that point, the applicant is given an opportunity to file arguments to try to overcome the citation or objection.

The trademark should be used by the owner or by the recorded licensee to distinguish the products or services for which it was registered. If the trademark registration is used only by a licensee or franchisee, the licensee or franchisee should be recorded with the IMPI. If the owner, licensee or franchisee does not use the trademark during three consecutive years, a third party could request a non-use cancellation action based on lack of use.

Amendments to the IPL entered into force on 10 August 2018. Some of the changes introduced are relevant to franchises: (1) non-traditional trademarks – sound, olfactory and holographic trademarks – can be registered; and (2) the amendment introduces the possibility of registering as a trademark a plurality of operative and image elements that combine to distinguish products or services in the market, which in the international market is known as trade dress.

iii Enforcement

Article 213 of the IPL establishes several types of conduct that constitute administrative infringements, such as the unauthorised use of a registered trademark or not providing the franchise disclosure document (FDD) when requested. Administrative infringements can be sanctioned with: (1) a fine up to 20,000 times the current minimum wage approved in Mexico City; (2) an additional fine of up to 500 days' worth of the current minimum wage approved in Mexico City for each day that the infringement persists; (3) temporary closure of up to 90 days; (4) permanent closure; and (5) administrative detention of up to 36 hours. The infringement action is filed with the IMPI, which conducts an investigation and imposes any fines.

Additionally, breach of obligations stipulated in the agreement, such as payment of royalties, will incur civil liabilities.

iv Data protection, cybercrime, social media and e-commerce

Data protection

Following constitutional amendments that included the right to data protection as a basic right of individuals, in 2010 the Federal Law on Protection of Personal Data held by Private Parties was enacted, followed, in 2011, by its Regulations (together the Data Protection Law). These pieces of legislation – which are complemented by guides issued by Mexico's data protection authority, the National Institute for Transparency, Information Access and Personal Data Protection – apply at a federal level and make up the Mexican data protection legal framework.

The Data Protection Law applies to all processing of personal data by private entities or individuals, except when it is processed for personal or domestic use or by credit bureaus.

Franchisors and franchisees will be data controllers with respect to certain personal data they process; for example, franchisees will be controllers of their employees' personal data and, in some cases, a franchisor is a data controller of customer data.

In this regard, when processing personal data or any information concerning identified or identifiable individuals, both franchisors and franchisees need to be aware of their obligations and responsibilities, which are more onerous for data controllers. Some of the obligations of data controllers are: (1) to maintain appropriate physical, technical and organisational security measures, (2) to provide a privacy notice to all data subjects, (3) to collect consent from data subjects, where necessary, and (4) to allow data subjects the exercise of their rights (access, rectification, cancellation, objection, etc.).

Personal data can be transferred to third countries regardless of the level of protection a country provides if transfers are covered by an agreement that is in compliance with the Data Protection Law and with the privacy notice that was made available to data subjects. Consent from data subjects for the transfer of their personal data is sometimes required.

Failure to comply with the provisions of the Data Protection Law may result in hefty fines and, if personal data is processed deceitfully or for profit, penalties of imprisonment may be imposed.

Cybercrime

Although Mexico intends to ratify the Budapest Convention on Cybercrime, it has not done so and it is not clear when it will be ratified.

Notwithstanding this, under the Federal Criminal Code, illicit accessing of systems and destruction or causing the loss of information are crimes, along with the disclosure of trade secrets and confidential information. Because of the lack of specific provisions, the police treat certain other cybercrimes as fraud.

Social media and e-commerce

There are no specific regulations or provisions applying to franchises and social media, nor codes of conducts in this regard; however, social media activity is mainly governed by the Data Protection Law and consumer protection legislation. In addition, certain products that may cause a risk to health, such as foods, beverages, tobacco products, alcoholic beverages, medical devices, pharmaceutical products, fertilisers, pesticides, cleaning supplies and cosmetic products are governed by the General Health Law and its regulations, and to advertise these on social media could require either a notice or a permit to be obtained from the Federal Commission for Protection against Sanitary Risk.

E-commerce is regulated in Mexico by several laws, including the Code of Commerce and the Federal Law on Consumer Protection, which protects consumers in Mexico, regardless of location of providers.

IV FRANCHISE LAW

i Legislation

In Mexico, the franchise agreement will be governed, and subject to the terms agreed, by the parties, as well as by the provisions set out in the IPL and its implementing Regulation and, for aspects not regulated in the IPL, the general rules of the Federal Civil Code and the Commercial Code. The government agency in charge of applying the IPL is the IMPI. Additionally, depending on the franchise, other laws may apply, such as the Data Protection Law.

A franchise is defined in Article 142 of the IPL, which establishes that a franchise exists when, with a licence to use a trademark granted in writing, technical knowledge is transmitted or technical assistance is provided, for the licensee to produce or sell goods or render services in a uniform manner and with the operating, commercial and administrative methods established by the owner of the trademark, to maintain the quality, reputation and image of the products or services distinguished by the trademark.

ii Pre-contractual disclosure

Prior to granting a franchise, and at least 30 business days before executing the franchise agreement, the franchisor must provide the prospective franchisee with the relevant company information in the FDD.

Article 65 of the Regulations of the IPL establishes that the FDD must contain at least the following technical, economic and financial information:

- a* name, corporate name or business name, domicile and nationality of the franchisor;
- b* description of the franchise;
- c* seniority of the original franchisor and, where applicable, of the master franchisee of the business object of the franchise;
- d* intellectual property rights involved in the franchise;
- e* amounts and types of payment that the franchisee must make to the franchisor;
- f* types of technical assistance and services that the franchisor must provide to the franchisee;
- g* definition of the geographical area in which the business exploiting the franchise operates;
- h* franchisee's right to grant sub-franchises to third parties and, if applicable, the requirements the franchisee must satisfy to do so;
- i* obligations of the franchisee with respect to the confidential information provided by the franchisor; and
- j* obligations and rights of the franchisee arising from the execution of the franchise agreement.

After timely delivery of the FDD, no additional requirements must be met before executing the agreement. There is no obligation to register the FDD with the IMPI.

A lack of veracity in the information disclosed in the FDD will entitle the franchisee, in addition to demanding the nullity of the agreement, to claim for losses and payment of damages. This right to claim payment of damages may be exercised by the franchisee within

the first year of the execution of the agreement, and the franchisee must be able to prove that the damages arose as a consequence of the lack of veracity in the information contained in the FDD.

Failure to provide the FDD upon request by the prospective franchisee is considered an administrative infraction of the IPL. The IMPI may sanction this conduct with an economic fine, temporary or permanent closure of the premises or administrative arrest.

iii Registration

The franchise agreement should be registered with the IMPI to be binding to third parties. In Mexico, trademark owners must prove use to prevent a cancellation action by any third party. If the franchise agreement is recorded with the IMPI, use of the trademark by the franchisee would be considered as having been made by the owner. However, although recommended, there is no legal obligation to record the franchise agreement. To maintain the confidentiality of certain aspects of the franchise agreement, a short version of the agreement may be recorded with the IMPI.

iv Mandatory clauses

According to Article 142 *bis* of the IPL, franchise agreements must be in writing and contain at least the following minimum provisions:

- a* the geographical zone;
- b* the location, minimum size and investment characteristics of the infrastructure, relating to the premises in which the franchisee shall carry out the activities deriving from the agreement;
- c* if applicable, the inventory, marketing and advertising policies, and the provisions relating to the merchandise supply and to contracting with suppliers;
- d* the policies, procedures and terms for any reimbursement, financing and other considerations that fall within the parties' charge in the terms agreed in the agreement;
- e* the criteria and methods applicable to determining the franchisee's commission and profit margins;
- f* the characteristics of the technical and operational training of the franchisee's personnel and the manner in which the franchisor shall provide technical assistance;
- g* the criteria, methods and procedures of supervision, information, evaluation and valuation of the performance and quality of the services under the responsibility of the franchisor and the franchisee;
- h* the terms and conditions governing sub-franchising, in the event that it is agreed by the parties;
- i* the reasons for termination of the franchise agreement;
- j* the assumptions under which the terms or conditions relating to the franchise agreement may be reviewed and, if applicable, modified by mutual agreement;
- k* unless otherwise agreed, the absence of an obligation for the franchisee to sell its assets to the franchisor or whoever the franchisor designates at the end of the agreement; and
- l* any provisions regarding the franchisee's obligation to sell or transfer the shares of its company to the franchisor or to make the franchisor a partner in the company.

v Guarantees and protection

Mexican law contemplates real and personal guarantees. Real guarantees allow creditors to enforce a payment obligation by recourse to the debtor's real estate or personal property, as the case may be. Personal guarantees bind the guarantor to fulfil an obligation (normally payment of money owed) in the event of the debtor's breach. In both cases, the guarantees are aimed at enforcing the creditor's interest by way of a right exercisable over the debtor's property or that of the guarantor.

Each guarantee is specifically regulated. For instance, joint obligors and sureties, as well as mortgages, are regulated by the Federal Civil Code and local civil codes; pledges are regulated by the General Credit Instrument and Transactions Law; and bonds are dealt with under the Insurance and Bonding Institutions Law.

Each guarantee has a specific implementation and, in some cases, a specific enforcement procedure. The convenience of adopting a determined guarantee in a contract should be assessed on a case-by-case basis, in light of the specific covenants to be secured and any other particularities, especially those that might impact the guarantee's enforcement. In Mexican franchise legal practice, the most used guarantee is the personal guarantee.

V TAX

i Franchisor tax liabilities

A franchisor resident for tax purposes in Mexico is required to pay income tax on its worldwide income. A legal entity is deemed to be a Mexican resident for tax purposes if its main administration or seat of effective management is located in Mexico. Mexican residents are subject to income tax on their profits at a general rate of 30 per cent.

Regarding income from foreign sources, Mexico allows legal entities to credit direct and indirect foreign income taxes capped at the Mexican corporate tax rate, provided the income is subject to tax in Mexico.

Franchisors may deduct only expenses that are strictly necessary to fulfil their corporate purpose, and these include business expenses, certain local taxes and social security contributions, among others.

Mexico has controlled foreign corporation rules, whereby income derived from foreign investments must be taxed in Mexico when accrued in the foreign jurisdiction, even if it has not been distributed to the investor. The foregoing applies where income subject to foreign taxation is taxable at a rate of less than 75 per cent of the applicable income tax rate in Mexico or not taxed at all.

Mexican transfer pricing rules apply to business transactions entered into by and between related parties. These provisions are based on the arm's-length standard, as Mexico has adopted most of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations.

Franchisor foreign resident for tax purposes

Domestic law provides that foreign residents obtaining income arising from a source of wealth located in Mexico are required to pay income tax in Mexico. In the case of income arising from royalties or technical assistance (if the technical assistance qualifies as a royalty (know-how)), the source of wealth shall be considered to be in Mexican territory when the goods or rights for which the royalties or the technical assistance are paid are used in Mexico,

or when the royalties or the technical assistance are paid by a Mexican resident or by a foreign resident with a permanent establishment in Mexico. The income tax must be withheld by the person making the payments if this is a Mexican resident (Mexican franchisees).

The income tax withheld or paid by the foreign franchisor may be creditable in its country of tax residency.

If the income for royalties is earned by a foreign franchisor whose income is subject to a preferential tax regime, the income for royalties shall be subject to a 40 per cent withholding tax rate, without any deductions, rather than at the tax rates indicated above.

ii Franchisee tax liabilities

Pursuant to domestic law, the income tax associated with royalties paid to foreign residents must be withheld by the person making the payments if this is a Mexican resident (Mexican franchisees) or even a foreign resident.

If the payment is made by a franchisee Mexican resident, the franchisee should withhold the income tax and pay it directly to the Mexican tax authority.

In practice, it could be complicated for the foreign withholding party to pay the relevant tax in Mexico, since there is no an easy mechanism for foreign residents to pay the relevant tax directly.

Mexican franchisees should determine whether the payments for royalties fulfil the Mexican requirements to be deducted as expenses for tax purposes, including in relation to transfer pricing rules.

iii Tax-efficient structures

Mexico has adopted the OECD international tax standards, including recommendations made in relation to base erosion and profit shifting actions. Thus, the tax efficiency of franchising structures should be analysed carefully before any implementation.

Mexico currently has over 75 tax treaties in force with other countries. While these vary considerably in scope and conditions, several grant relief on royalty payments.

VI IMPACT OF GENERAL LAW

i Good faith and guarantees

The Mexican Federal Civil Code provides that contracts are perfected by, and binding on, the parties by their mere consent (except for those contracts that require the fulfilment of certain formalities). Once perfected, the parties are bound not only by the covenants expressly agreed, but also by the consequences that, according to the nature of the contract, are consistent with good faith, usage and the law. Similarly, Article 6 *bis* of the Mexican Commercial Code, obligates individuals and entities engaged in commercial activities to act in accordance with honest practices.

These articles, applicable to the IPL, incorporate the principle of good faith in contracts, which entitles the affected party to claim for damages and lost profits under general liability provisions set out in Mexican Federal Civil Code.

ii Agency distributor model

Mexican law is very specific as to what constitutes a franchise, therefore, agency or distribution agreements that contain the elements of a franchise will be subject to the IPL, and to the civil or commercial laws applicable to contracts. The government agency in charge of enforcing the IPL is the IMPI.

iii Employment law

In Mexico, the Federal Labor Law (FLL) defines an employment relationship as the rendering of a subordinated personal service by one person to another in exchange for the payment of a wage. The main element of an employment relationship is subordination, which the Fourth Chamber of the Supreme Court of Justice of Mexico has defined as the employer's legal right to control and direct the employee and the employee's corresponding duty to obey the employer. Once an employment relationship exists, all the rights and obligations under the FLL apply automatically, regardless of how the agreement is characterised by the parties, and regardless of the nationality of the employee.

From an employment standpoint, a franchisee in Mexico should not be considered or treated as an employee. Even if the franchise agreement includes certain instructions or obligations charged to the franchisee, they should not be considered work-related instructions but merely the obligations deriving from a commercial agreement.

The franchise agreement should state that both parties are independent contractors and that franchisees are responsible for complying with local employment law by paying employees at the least the minimum statutory benefits afforded by law.

iv Consumer protection

In Mexico, consumer protection is regulated by the Federal Consumer Protection Law (FCPL) and its Regulations. The FCPL applies to both domestic and foreign companies rendering services or providing goods in Mexico.

According to the FCPL, in general terms, a consumer is considered the final beneficiary of the products or services rendered by a supplier; thus, a supplier is someone who offers, distributes, or sells a product or renders a service to a consumer.

In principle, franchisees cannot be treated as consumers, since their activities correspond to the provisions and regulations established for suppliers; however, the FCPL does contemplate an exception and authorises claims by individuals or entities that acquire, warehouse, use or consume goods or services to incorporate them in a productive process, as long as the claims do not exceed 488,736.58 Mexican pesos.

v Competition law

The economic competition framework in force in Mexico is grounded in Article 28 of the Federal Constitution, and further regulated by the Federal Economic Competition Law (FECL). The agency in charge of enforcing the FECL is the Federal Economic Competition Commission (FECC), although it is enforced by the Federal Telecommunications Institute in the broadcasting and telecommunications sectors.

The FECL applies to economic agents, construed as individuals, legal entities, economic groups and in general any private or public agent involved in economic activity.

The FECL regulates four main types of anticompetitive behaviour, namely: (1) absolute monopolistic practices, including hardcore cartel behaviour; (2) relative monopolistic practices, which refer to abuses of a dominant position in the market; (3) anticompetitive concentrations or mergers; and (4) barriers to competition.

There are no specific provisions or exceptions applying specifically to franchises (or e-commerce) in terms of competition enforcement and as such, these will be governed by general provisions. Because of their nature, however, it is common for franchise agreements to include provisions that will be relevant in terms of antitrust assessment and enforcement, as outlined below.

Single-firm conduct and vertical restraints

Pursuant to Articles 54 to 56 of the FECL, exclusive distribution, exclusive supply and, in general, exclusivity clauses, along with product ties, full-line forcing or vertical price-fixing (a common practice in franchise agreements) and other vertical restraints or single-firm conduct⁵ can qualify as illegal relative monopolistic practices if: (1) the parties have substantial market power in the relevant market;⁶ (2) the agreement has the object or effect of unduly displacing or restricting third-party market access; and (3) the parties are not able to prove efficiencies outweighing any negative effects of the practice.

These provisions are assessed for their overall impact on competition and thus, while they are not illegal per se, if the effects assessment is negative, the FECC will order the alleged wrongdoers to cease the conduct and is empowered to impose fines of up to 8 per cent of the wrongdoer's annual accruable income.

Horizontal agreements

Although less common in the context of franchises, competition provisions in Mexico will allow active investigation and penalising of agreements between competitors that have the object or effect of fixing prices, restricting output, allocating markets or bids, or the exchanging of information with any of these effects. Such agreements or exchanges of information are per se illegal and will incur not only large administrative fines, but also criminal liability for employees.

In the context of franchises, it is important to bear in mind that franchisees within the franchise might be competitors in the same market; as such, parties within the franchise that are acting as competitors in any market should be careful to avoid such agreements or exchanges of information.

vi Restrictive covenants

As general rule, the will of the parties is the governing law of the agreement. That is to say, the parties are free to agree on the terms and conditions to be included in an agreement, provided they are not contrary to law.

Accordingly, any contractual covenants will be governed and subject to the terms agreed by the parties, as well as, in specific cases, provisions set out in the IPL and civil and commercial principles.

5 e.g., refusal to sell, price discrimination, raising rivals' costs, margin squeeze and so on.

6 The capacity to fix prices or restrict the supply in the relevant market without competitors being actually or potentially capable of counteracting this capacity.

Notably, Article 5 of the Mexican Constitution grants all persons the right to develop the activity, industry, commerce or job they choose as long as it is legal. However, according to the criteria sustained by the Supreme Court of Justice, restrictive agreements or clauses (e.g., non-compete clauses) may be enforceable as long as they are subject to a determined term and territory, and a consideration is paid in exchange. Nevertheless, enforceability may be subject to a court proceeding, which may be time sensitive and, as in any proceeding of this nature, results cannot be anticipated.

vii Termination

Mexican law differentiates termination and rescission of an agreement. Termination is the consequence of the expiration of the term, or achievement of its subject matter, while rescission is the consequence of a breach, which might be declared by the non-breaching party without judicial intervention if this possibility is expressly agreed in the contract. In the case of both termination and rescission, under Mexican law and based on the freedom to contract, the parties can validly agree on restrictive covenants that would survive the termination or rescission of the contract and can be enforced at the request of the interested party.

The Mexican legal system forbids the parties to take matters into their own hands. Following this principle, agreements allowing the franchisor to unilaterally 'de-identify' the franchise facilities, or to take over a franchisee's leases, premises or business are unenforceable and carrying out these actions might trigger criminal and civil actions against the franchisor.

Pursuant to the provision of the IPL, the franchisor and the franchisee cannot terminate the agreement unilaterally, unless it has been executed for an indefinite time, or there is a just cause for it. Should the franchisee (or franchisor) wish to terminate the agreement in advance, whether this happens by mutual agreement or rescission, the franchisee (or franchisor) must comply with the requirements and procedures established in the agreement. In the case of a violation of the provisions, the early termination of the agreement made by the franchisor or franchisee will result in payment of the conventional penalties established in the agreement or in lieu of compensation for the damage caused.

Post-termination of the agreement, certain specific provisions will continue in full force and effect. According to the IPL, both during the term of the agreement and after its conclusion, the franchisee must maintain the confidentiality of any information of that character, and of the operations and activities of the franchise.

viii Anti-corruption and anti-terrorism regulation

Mexico has several regulations on fraud, anti-corruption and anti-money laundering. Fraud is included in the Federal Criminal Code (FCC); anti-corruption is regulated by the Federal Constitution, as well as in secondary laws, such as the General Administrative Liabilities Law, and the FCC; anti-money laundering is regulated by the Federal Act to Prevent and Identify Illegally Funded Transactions (the Anti-Money Laundering Law).

Fraud is classified as a criminal offence under the FCC. Companies in Mexico have a legal duty to create internal mechanisms to avoid, prevent or detect this kind of illegal activity; thus, franchisees must be aware what such criminal activity entails and its implications for doing businesses in Mexico.

As part of the National Anti-Corruption System, Congress enacted the General Administrative Liabilities Law, which contemplates several sanctions for public officials, individuals and companies involved in acts of corruption such as bribery, unlawful

participation in public bids, collusion, misuse of public resources and unlawful contracting with former public officials. Sanctions range from onerous fines to the dissolution of the infringing company for particularly serious offences.

The Anti-Money Laundering Law is a federal law and aims to protect the financial system and the economy of the country by providing means and procedures to detect and prevent activities or transactions involving illegally obtained funds. This Law establishes a catalogue of activities considered to be 'vulnerable activities' in that they may facilitate the dispersion of illegally obtained funds. If a company or a franchisee performs any of these activities habitually, it could be subject to the provisions and regulations of the Anti-Money Laundering Law, and thus would have certain additional obligations.

ix Dispute resolution

In Mexico, when a dispute in relation to a franchise agreement exists, the parties can choose to resolve their disputes through the courts (litigation) or by alternative dispute resolution mechanisms, such as arbitration.

If the parties to the franchise agreement have agreed to submit any resulting disputes to the jurisdiction of any of the local courts of the states of Mexico to be decided under Mexican law, the judicial proceeding will be heard by a local court, generally referred to as a first level or first instance court, which will be responsible for resolving the dispute through a final judgment. This judgment may be challenged through an appeal, which will be decided by a higher-level court, generally referred to as a second instance court. The parties can file a writ of *amparo* against a final judgment from a second instance court whenever they consider fundamental or constitutional rights to have been violated by an unlawful act or omission by the local courts. The writ of *amparo* will be heard and resolved by a federal court, which will issue a final judgment.

In the event that the parties agree to arbitrate, either through an arbitration clause in the agreement or after the controversy has arisen, the parties will be forced to honour the terms of the arbitration agreement and have their dispute decided by an arbitral tribunal. There are two types of arbitration: ad hoc arbitration and institutional arbitration. It is fairly common for parties to agree to institutional arbitration for commercial and business matters. By submitting to arbitration, the parties agree that their dispute will be decided by an impartial adjudicator, identified as the arbitrator, whose decision will be final and binding to the parties (the award).

Foreign judgments and arbitral awards that do not contravene Mexican law (public order) are enforceable through a procedure of recognition and enforcement that is carried out before a first instance court. As one of the 159 states contracting to the New York Convention, Mexico is obliged to enforce arbitral awards.

Mediation, is a non-binding alternative dispute resolution mechanism available to any of the parties in a franchise dispute, either through any of the mediation centres of the Superior Court of Justice or through other institutions that have certified mediators. Mediation will not proceed if the counterparty does not agree to mediate and resolve the dispute through a settlement agreement between the parties.

In Mexico, as the administrative authority in matters of industrial property, the IMPI is in charge of resolving any claim of administrative infringement initiated by a franchisor against any person who violates the provisions of the IPL. In this regard, the IPL provides

for an administrative conciliation process, in which a neutral intermediary (the IMPI), at the request of one or both parties and at any time during the dispute, will strive to provide an alternative solution. However, this conciliatory process is not common in practice.

VII CURRENT DEVELOPMENTS

There are no developments of particular relevance for franchising in Mexico at present.

NEW ZEALAND

*Stewart Germann*¹

I INTRODUCTION

Franchising in New Zealand is developing at a very fast rate and is becoming more sophisticated. It is often said that New Zealand is one of the most deregulated countries in the world in which to conduct small to medium-sized businesses, and the fact that we have no franchise-specific legislation is also of great assistance.

The following international franchisors have a presence in New Zealand (although this list is not exhaustive): Anytime Fitness, Bakers Delight, BB's Café, Brumby's Bakeries, BurgerFuel, Cafe2U, Cartridge World, Cash Converters, Cheesecake Shop, Coffee Club, Domino's, Esquires, Gloria Jean's Coffees, Jamaica Blue, Jani-King, Jim's Mowing, Just Cuts, Kip McGrath, Kwik Kerb, LJ Hooker, LJS Seafood Restaurants, Lone Star, McDonald's, Midas Car Care, Mini Tankers, Mr Rental, Muffin Break, Oporto, PappaRich, Pita Pit, Pizza Hut, Quest Serviced Apartments, RE/MAX, Smallprint, Snap-on Tools, Snap Printing, Specsavers, Speedy Signs, Subway, The Athlete's Foot, Toni&Guy, VIP Home Services, and Zambrero.

The following local franchisors operate in New Zealand (although this list is not exhaustive): AA Auto Centre, Active Plus, Armstrong, At Your Request, Baby on the Move, Bedpost, Business Buddy, Cleancorp, Clean Planet, Coffee Guy, Colourplus, Columbus Coffee, Cookie Time, Cookright, Corporate Cabs, CrestClean, Crewcut, Green Acres, Guthrie Bowron, Hardy's Health Stores, Hire A Hubby, Hollywood Bakery, Just Cabins, Kitchen Studio, Landmark Homes, Laser Electrical, Laser Plumbing, Liquorland, Mad Butcher, MathZwise, Meticulous Home Services, Mexicali Fresh, Mike Pero Mortgages, Mr Plumber, Mr Whippy, New Zealand Natural Ice Cream, Night 'n Day Foodstores, Number Nurses, Palmers, Paper Plus, Para Rubber, Paramount Services, Pit Stop, Refresh Renovations, Robert Harris Coffee Roasters, Rodney Wayne, Shoe Clinic, Sierra Coffee, Signature Homes, Small Business Accounting, Stirling Sports, Streetwise Coffee, Super Liquor and Super Shuttle.

The Franchise Association of New Zealand (FANZ) was formed in 1996 and it has Rules, a Code of Practice and a Code of Ethics. The following are the three principal types of franchisors in New Zealand:

- a* those franchisors who belong to the FANZ, publish a disclosure document and have very high standards;
- b* those franchisors who do not belong to the FANZ, do not publish a disclosure document but have high standards; and

¹ Stewart Germann is the principal of Stewart Germann Law Office.

- c* those franchisors who do not belong to the FANZ, do not publish a disclosure document and do not have high standards nor a good reputation.

Category (c) is diminishing because of the growing interest in and effect of the FANZ, which as at November 2019 had 137 franchisor members, one individual and 66 affiliates, including attorneys, accountants and banks, for a total of 204 members (see www.franchiseassociation.org.nz).

Survey of franchising

The latest survey of franchising in New Zealand, in 2017, showed the following key results:

- a* 631 business format franchisors in New Zealand in 2017, compared with 446 in 2012, which leads the world on a per-system-per-head-of-population basis;
- b* the number of units operating with business format franchise systems has also increased: with an estimated 37,000 units compared with 22,400 in 2012;
- c* franchised businesses are estimated to contribute around NZ\$27.6 billion to the New Zealand economy;
- d* 124,200 people are employed in New Zealand franchises;
- e* dominant sectors include retail trade (23 per cent), 'other services' (20 per cent), accommodation and food retail (18 per cent) and administration and support services (8 per cent).
- f* 72 per cent of franchises are New Zealand-founded;
- g* the median initial franchise fee is NZ\$35,000 for retail and NZ\$28,750 for non-retail;
- h* the median total start-up cost is NZ\$308,500 for retail and NZ\$87,550 for non-retail;
- i* 50 per cent have been franchising since before 2000; and
- j* the median time before franchising is 4.5 years and 36 per cent are franchised within the first year.

There will be another survey of franchising in New Zealand undertaken in 2020 and the results should be available by June. There are also other reliable franchise-specific reports available, and Statistics New Zealand has a number of statistics relevant to commerce and population in general.

II MARKET ENTRY

i Restrictions

Foreign franchisors who wish to enter New Zealand must be aware of a range of legislation, including, but not limited to, the Commerce Act 1986, the Companies Act 1993, the Fair Trading Act 1986, the Financial Reporting Act 2013 and the Overseas Investment Act 2005 plus any amendments. In relation to the formation of a company in New Zealand, the following will apply:

- a* 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
- b* all directors must provide their place and date of birth.

This is a departure from the previous position whereby a director resident anywhere in the world could be appointed as a director of a New Zealand company.

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 accounting periods (1) the total assets for the company and its subsidiaries were more than NZ\$20 million, or (2) the total revenue was more than NZ\$10 million, the company must be audited and must file group financial statements pursuant to the Financial Reporting Act 2013. In relation to foreign investment, there are no barriers for funds coming into New Zealand. If a foreign entity wishes to buy land in New Zealand and the land is greater than five hectares in area, an application must be made to the Overseas Investment Office for consent to the purchase before it can proceed. There are no restrictions on a foreign entity granting a master franchise or development rights to a local entity, and there are no restrictions on foreign franchisors owning equity in a local business.

However, if a foreign franchisor who is deemed to be an overseas person, or an associate of an overseas person, wishes to acquire sensitive land or an interest in sensitive land (for example, by buying shares in a company that owns sensitive land) or business assets worth more than NZ\$100 million, or a fishing quota or an interest in a fishing quota, an application must be made to the Overseas Investment Office for consent to such an acquisition before it can proceed. Land will be sensitive if it comes within the types of land and area thresholds detailed in Part 1 of Schedule 1 of the Overseas Investment Act 2005 (OIA) (as amended by the Overseas Investment Amendment Act 2018, which came into force on 22 October 2018). Generally, consent under the OIA must be obtained in the two scenarios set out below:

- a* Where there is an overseas investment in significant business assets. This includes:
 - the acquisition of rights or interests in securities of a person (A) where, as a result of the acquisition, the overseas person has a 25 per cent or more ownership or control interest in A or an increase in an existing 25 per cent or more ownership or control interest in A and where, in each case, the value of the securities or the consideration provided, or the value of the assets of A or A and its subsidiaries where A has a 25 per cent or more ownership or control interest, exceeds NZ\$100 million;
 - the establishment of a business in New Zealand where the business is carried on for more than 90 days in any one year (whether consecutively or in aggregate) and the total expenditure expected to be incurred in setting up the business exceeds NZ\$100 million; or
 - the acquisition of property (including goodwill and other intangible assets) in New Zealand used in carrying on business in New Zealand where the total consideration paid or payable for the assets exceeds NZ\$100 million.
- b* Where an overseas person (or an associate of an overseas person) wishes to acquire 'sensitive land' or an interest in sensitive land, the definition of which is set out in Schedule 1 to the OIA and includes several types of land, including non-urban land of an area over five hectares, and any foreshore and seabed land, irrespective of the size of the area.

ii Foreign exchange and tax

Non-resident withholding tax (NRWT) is payable in respect of any income such as interest, dividends and royalties paid to non-residents in New Zealand when the income is repatriated overseas. NRWT is deductible from gross income and no expenses can be deducted. New

Zealand has a double-taxation treaty with a number of countries and it is important to check the relevant double-taxation treaty for any specific rates that might apply. Further information can be obtained from www.ird.govt.nz.

III INTELLECTUAL PROPERTY

i Brand search

If a foreign franchisor owns any trademarks and wishes to register them in New Zealand, a search must be made of the trademark register, which is administered by the Intellectual Property Office of New Zealand (IPONZ). The Trade Marks Act 2002 governs registration of all marks capable of registration, including trademarks or service marks. A search can be made at www.iponz.govt.nz, but it is wise to instruct a trademark and patent attorney in New Zealand to undertake a thorough search at IPONZ to ensure that the way is clear for registration of a foreign franchisor's trademark.

ii Brand protection

Assuming that the trademark is available, protection for it is afforded by filing an application and paying the requisite fee. IPONZ issues an application number, which is the unique trademark registration number for New Zealand. In relation to manuals and other intellectual property owned by a foreign franchisor, except for patents that are restricted, there is copyright protection under the Copyright Act 1994 and copyright exists at law with no registration required.

iii Enforcement

If trademarks have been registered, registration prevents any competitor from lawfully using the same or similar mark on any goods or services in New Zealand. Trademark registration would also prevent a subsequent registration of an identical or confusingly similar mark. If a third party breaches a registered trademark, action would be taken pursuant to the Trade Marks Act 2002 and the Fair Trading Act 1986. There are also remedies for breaches of the intellectual property of a franchisor that are not governed by the Trade Marks Act 2002 but are found in common law.

iv Data protection, cybercrime, social media and e-commerce

With the increasing use of e-commerce and social media in franchise businesses, franchisors must ensure that they observe the privacy principles contained in separate codes and in the Privacy Act 1993, which outlines how businesses should collect, use, store and disclose information about clients and customers. Other relevant law includes the Crimes Act 1961, which deals with crimes involving computer systems, and the Unsolicited Electronic Messages Act 2007.

IV FRANCHISE LAW

i Legislation

As stated earlier, there is no franchise-specific legislation in New Zealand. There are a number of statutes and laws that affect franchising, including (but not limited to) the Building Act 2004, Commerce Act 1986, Commerce (Cartels and Other Matters) Amendment Act

2017, Commerce (Criminalisation of Cartels) Amendment Act 2019, Companies Act 1993, Contract and Commercial Law Act 2017, Copyright Act 1994, Fair Trading Act 1986, Employment Relations Act 2000, Financial Reporting Act 2013, Health and Safety at Work Act 2015, Income Tax Act 2007, Overseas Investment Amendment Act 2018, Privacy Act 1993, Resource Management Act 1991 and the Trade Mark Act 2002. Any franchise or master franchise agreement is a contract and there are robust legal principles affecting the law of contract and its enforceability. Also, a recent amendment to the Commerce Act 1986, under Part 2: Restrictive Trade Practices (known as the cartel provisions), should be considered carefully in relation to franchise agreements (see Section VI.v).

ii Pre-contractual disclosure

There are no mandatory pre-contractual disclosure requirements in New Zealand. However, if a franchisor or a master franchisee is a member of the FANZ, a disclosure document that complies with the FANZ Code of Practice must be given to any prospective franchisee at least 14 days before the franchise agreement, or master franchise agreement as the case may be, is executed. If a disclosure document contains misrepresentations, the franchisor or master franchisee will most likely be liable to action under the Fair Trading Act 1986. The key elements to prove a claim of misrepresentation include that the facts are false or misleading, the potential franchisee relied upon those facts and the potential franchisee has suffered a loss.

Being an English common law country, the law of torts, including equitable estoppel, is applicable in addition to promissory estoppel and unconscionability. However, while every case will be dealt with on its own facts, the Court of Appeal has commented that it would be unreasonable for a party to claim misrepresentation on pre-contractual disclosure where they were independently advised and that independent advice ought to have explained the meaning of the contract (*David v. TFAC Limited*;² see also *PAE (New Zealand) Limited v. Brosnahan & Ors*).³ Remedies may include damages for loss and general damages, and cancellation of the agreement; it is thus imperative that franchise agreements are properly drafted to mitigate any losses against the success of any misrepresentation claims.

iii Registration

There are no registration requirements for franchises. All franchise systems must comply with New Zealand laws, so if a particular franchise is in a special industry such as the medical industry, for example, or uses controlled products such as drugs, those franchises would need to comply with the relevant statutes and regulations. Great care should be taken rather than assuming that there are no restrictions in New Zealand.

iv Mandatory clauses

If a franchisor belongs to the FANZ mandatory clauses include: a seven-day cooling-off period whereby a prospective franchisee can 'cool off' or change its mind after signing the franchise agreement; a clause saying that the FANZ Rules, the Franchising Code of Practice and Code of Ethics must be adhered to and followed by both franchisor and franchisee; and

² *David v. TFAC Limited* [2009] NZCA 44.

³ *PAE (New Zealand) Limited v. Brosnahan & Ors* [2009] NZCA 611.

that the franchise agreement must contain a dispute resolution clause with the recommended mode of resolving a dispute being mediation or arbitration. If a franchisor does not belong to the FANZ, no mandatory clauses apply.

v Guarantees and protection

The law of contract governs guarantees and it includes both statute and case law. It is common for a franchisor to require personal guarantees of all shareholders and directors of the franchisee company. Guarantees executed by individuals and companies are enforceable by the franchisor. Where there is more than one guarantor, liability should be joint and several in all cases. It is prudent for franchisors to require that all personal guarantors obtain independent legal advice evidenced by a solicitor's certificate to mitigate against possible future claims that the guarantors misunderstood the effect of the guarantee that they executed or that they suffered any duress.

V TAX

i Franchisor tax liabilities

Tax is governed by the Income Tax Act 2007 and the corporate tax rate for both resident and non-resident companies is 28 per cent. New Zealand has tax treaties with many countries and NRWT must be deducted from all interest and royalty income before funds are repatriated. The NRWT rate in relation to the United Kingdom, China, Taiwan and Canada is 10 per cent; for Fiji, Indonesia, Malaysia and the Philippines the rate is 15 per cent; and for Singapore, Japan, Australia and the United States the rate is 5 per cent. The overseas entity should be able to claim a tax deduction in the relevant country because a NRWT certificate will be provided. If dividends are repatriated, NRWT at 15 per cent must be deducted.

ii Franchisee tax liabilities

Franchisees and master franchisees will be required to deduct NRWT before remitting any royalties, dividends or interest income to a foreign franchisor. The liability to deduct NRWT is on the franchisee who must obtain a NRWT certificate from the Inland Revenue and provide it to the franchisor or master franchisee. Failure to deduct NRWT will render a franchisee liable to a late payment penalty of 1 per cent after the due date plus a further 4 per cent penalty after seven days. Franchisees also have the requirement to deduct pay-as-you-earn tax from all employees and to pay goods and services tax at the rate of 15 per cent to the Inland Revenue.

iii Tax-efficient structures

The most common business structure used for franchise businesses in New Zealand is an incorporated company. A company can be formed by filing relevant documentation to the Companies Office (www.companiesoffice.govt.nz/companies). The Companies Act 1993 applies and Part 18 applies for overseas companies. It is wise to have a separate constitution governing a company's operation.

There are other structures used to conduct franchise businesses such as sole traders, limited partnerships, traditional partnerships and trading trusts. It is essential to obtain expert legal advice and accounting advice from an experienced tax accountant prior to entering the market.

Foreign franchisors typically use one of three methods: direct franchising between the foreign franchisor and local franchisees; forming a subsidiary company that acts as the franchisor; or appointing a local master franchisee and the latter two are the most common.

VI IMPACT OF GENERAL LAW

i Good faith and guarantees

New Zealand courts have been reluctant to recognise that there is a general duty of good faith implied in all commercial agreements. Courts have been more willing to accept that there is an implied duty of good faith in contracts of a 'relational' character or that when there is a 'clear lacuna' in contracts it is necessary to imply a duty of good faith to achieve the purpose of the contract. While some overseas courts have classified franchise agreements as relational, the Court of Appeal in New Zealand ruled that a franchise agreement is indistinguishable from a commercial transaction in which a full disclosure is made and parties are independently advised.⁴ Franchisees are considered to be experienced business persons and the courts generally respect the sanctity of a contract entered into by informed parties.⁵

Unlike New Zealand, Australia has franchising regulation that explicitly includes an obligation to act in good faith.⁶ The Code of Practice prepared by the FANZ, and revised in April 2018,⁷ does not explicitly impose any good-faith obligations on the parties, but the Code of Ethics published by the FANZ does stipulate that each member must act in an honourable and fair manner.⁸

It remains to be seen how New Zealand law will develop in this area, but in my opinion good faith will keep developing and may be recognised by the courts soon. It is noted that there are similar trends in the United Kingdom.

ii Agency distributor model

The general rules of agency law apply. Notwithstanding the fact that franchisees are separate legal entities, it remains possible for a franchisor to be pursued in claims for damages or otherwise by a person claiming reliance through agency.

The consequences of a franchisor or a master franchisee being found to be a principal for the actions of its franchisee that have caused loss to another person may result in a claim for those losses and possibly exemplary damages.

It is imperative for a franchisor to have appropriate contractual considerations within its franchise agreement prohibiting a franchisee from holding itself out as the franchisor or an agent, and acknowledging that the franchisee is not an agent, partner or otherwise

4 *David Anor v. TFAC Limited* [2009] NZCA 44 at 23 and 61.

5 Maree Chetwin, 'The Seven Secret Herbs and Spices of Franchise Regulation: Some Suggested Options?' (2009), 15 *NZBLQ* 151 at 156.

6 Trade Practices (Industry Codes – Franchising) Regulations 1998 (AU), 23A.

7 Code of Practice of the FANZ: 'The purpose of the Code is to promote high standards of Franchising conduct and procedure in accordance with the objects of the Association.'

8 Code of Ethics of the FANZ: 'Each Member of the Association will: . . . Act in an honourable and fair manner in all its business dealings and in such a way so as to uphold and bring credit to the good name of the Franchise Association of New Zealand Inc.'

legally connected to the franchisor; and to ensure that its manuals and initial and continuing education materials set out specific requirements to be followed by the franchisee so that the public is aware that the franchisee is a separate legal entity.

In addition there may be circumstances where franchisors find themselves liable for breaches of the workplace health and safety regime, and the current statute is the Health and Safety at Work Act 2015, which contains extensive changes to the prior legislation and increased penalties for breaches of the Act.

iii Employment law

Franchisees conduct their own independent businesses and franchisors are not liable in any way for the actions of franchisees and their employees except for vicarious liability in some cases. As the law stands at present, franchisees cannot be treated as employees by the courts and all employment law is governed by the Employment Relations Act 2000. Franchisors must, however, ensure that they are not acting as employers in respect to a franchisee's employees.

iv Consumer protection

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.

The Fair Trading Act 1986 (FTA) was amended by the Fair Trading Amendment Act 2013. The FTA 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 FTA also has a new right to contract out of certain provisions of the FTA in business contracts. Penalties for contravening the FTA go up to NZ\$200,000 for individuals and NZ\$600,000 for companies.

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:

- a* contracting out of the CGA;
- b* collateral credit agreements; and
- c* indemnification of gas and electricity retailers.

v Competition law

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 came into force on 14 August 2017. The most significant change made by the Act was the replacement of 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 quite an impact on franchise networks. Some additional clauses must be inserted into franchise agreements and there must be explanations, in plain language, 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 caught. 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 direct to the end consumer, yet at the same time has franchisees who sell to those consumers, it may also be in competition with its franchisees. There may also be instances where the franchisees are in competition with each other. Where a franchisor is in competition with a franchisee or where franchisees are found to be in competition with each other, there will be a competitive relationship, so the franchisor needs to be cognisant that there may be provisions in its franchise agreements that amount to cartel provisions.

There is no prohibition or law around third-line forcing or full-line forcing in relation to franchising.

Note that, before the Amendment Act was passed, an original proposal to criminalise cartel conduct was dropped by the government. Accordingly, the enforcement of such conduct remains as it previously was and the maximum penalties involved are similar to those that apply in Australia. However, on 8 April 2019, the Commerce (Criminalisation of Cartels) Amendment Act 2019 became law. The Act introduces a new criminal offence for cartel conduct and the proposed new criminal sanctions reflect the covert nature of cartels and the harm they cause to consumers and the economy. 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 (for example, joint ventures or franchise arrangements), joint buying, vertical supply contracts and specified liner shipping arrangements as stated earlier in this chapter. There are no defences for mistakes of fact relating to the elements of joint buying and promotion and vertical supply contracts. Therefore, it would be possible in the future for a director of a franchisor company to be criminally liable under the Act for a cartel offence. 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, so great care must be taken. The new Act does not apply until April 2021.

vi Restrictive covenants

The New Zealand courts have recognised that it is reasonable for a person in the position of a franchisor to impose a contractual restraint upon competitive conduct by a franchisee or an ex-franchisee, but such restraints must not exceed the boundaries of the court's notion of reasonableness. The first principle is that it is reasonable for a person to stipulate that if he or she is willing to disclose all secrets of how to establish a particular business enterprise, then the recipient of the information cannot immediately terminate the contract and set up a competitive business using the information received during the course of the relationship. If the courts did not provide protection to franchisors against conduct like this, there would be no incentive for the owners of established businesses to share their secrets with others and enhance their business skills. The second principle is that it is important for the well-being of the community that every individual should, in general, be free to advance his or her skills and earning capacity.

The Contract and Commercial Law Act 2017 in New Zealand gives the courts authority to rewrite a restrictive covenant and to allow an excessive covenant to be enforced at a lesser level. Section 83 of the Act states as follows:

83 *Restraints of trade*

- (1) *The court may, if a provision of a contract constitutes an unreasonable restraint of trade –*
 - (a) *delete the provision and give effect to the contract as so amended; or*
 - (b) *so modify the provision so that, at the time the contract was entered into, the provision as modified would have been reasonable, and give effect to the contract as so modified; or*
 - (c) *decline to enforce the contract if the deletion or modification of the provision would so alter the bargain between the parties that it would be unreasonable to allow the contract to stand.*
- (2) *The court may modify a provision even if the modification cannot be effected by deleting words from the provision.*

The ability of the courts to modify excessive restraints is constrained by the principle that terms that could never have been considered reasonable will not be modified, as to do so would be contrary to the public interest. This is the doctrine of restraints that are *in terrorem*, which translates into ‘contracts that terrorise a contracting party’. If a franchisor could only ever have reasonably sought a two-year restraint within a 5-kilometre radius of the business in which the person established goodwill, then a nationwide restraint for 10 years could never be regarded as reasonable; and in that case the courts would refuse to rewrite the clause to determine that the period of 10 years should be two years and the area of the restraint should be 5 kilometres rather than the entire country. What then is a reasonable restraint? There are two factors – area and time. So the message is clear in New Zealand – for a restraint to be enforceable, it must be reasonable.

There have been a number of restraint-of-trade cases in the franchising sector in recent years. Some recent New Zealand restraint-of-trade franchising cases include the following: *Dorn Investments Ltd v. Hoover*;⁹ *Mike Pero (New Zealand) Ltd v. Krishna and Mortgage Suite Ltd*;¹⁰ *Mad Butcher Holdings Ltd v. Standard 730 Ltd and Wightman*;¹¹ and *Mainland Digital Marketing Ltd v. Willetts and Meyers*.¹²

Non-compete and other restrictive covenants need to be included in the relevant franchise agreement to be enforced during the term of the agreement. The type of clause that I often include is as follows:

The franchisee covenants that it shall not during the term except with the prior written approval of the franchisor carry on or be directly or indirectly engaged or concerned or interested whether as principal, agent, partner, shareholder, investor, financier, lender, director, employee, consultant, independent contractor or otherwise howsoever in any business conducted in competition with the [particular franchise business], the franchisor or any of its other franchisees.

9 *Dorn Investments Limited v. Hoover* [2016] NZHC 1325.

10 *Mike Pero (New Zealand Limited v. Krishna and Mortgage Suite Ltd* [2016] NZHC 1255.

11 *Mad Butcher Holdings Limited v. Standard 730 Limited and Wightman* [2019] NZHC 589.

12 *Mainland Digital Marketing Limited v. Willetts and Meyers* [2019] NZHC 1201.

In other words, a franchisor and a franchisee have a relationship for the term of the franchise agreement. During that period the franchisee must not compete with the particular franchise system and must not divulge confidential information to any third party outside the system without the consent of the franchisor. A breach of these covenants will usually give rise to an event of termination allowing a franchisor to terminate the franchise agreement with the particular franchisee plus it will allow the franchisor to enforce the personal covenants given by the directors and shareholders of the franchisee in relation to the restraint.

vii Termination

The courts have recognised that it is reasonable for a person in the position of a franchisor to impose a contractual restraint upon the competitive conduct of franchisees and that contractual restraints are known as restrictive covenants or agreements in restraint of trade. The case of *SKIDS v. McNeill*¹³ reached our Court of Appeal, which determined that a 90-day restraint was reasonable under the circumstances. Such agreements must not exceed the boundaries of the courts' opinion of reasonableness and there are two competing principles that govern the courts' decision-making process.

The first principle is that it is reasonable for a person to stipulate that if he or she is willing to disclose all secrets of how to establish a particular business enterprise, the recipient of the information cannot immediately terminate the contract and set up a competitive business using the information received during the course of the educational process. If the courts did not provide protection to franchisors against conduct like this, there would be no incentive for the owners of established businesses to share their secrets with others and to enhance their business skills.

The second principle is that it is important for the well-being of the community that every individual should be free to advance his or her skills and earning capacity. The way these two conflicting principles are resolved is to require that a restrictive covenant must be 'reasonable' in its terms before it will be enforced.

The recent case of *Dorn Investments Limited v. Hoover*¹⁴ is worthy of mention. Paul Hoover, who was 60 years old and had a background as a rigger and truck driver, was the defendant and Dorn Investments Limited was a franchisee of Green Acres Franchise Group Ltd (Green Acres), which had an exclusive licence to operate the Green Acres Lawnmowing and Garden Care Services in a mapped territory in the Waikato region. Paul Hoover had some medical issues and he entered into a sub-franchise agreement with Dorn Investments. The relationship between the parties was not good and in the course of his work for the franchise Mr Hoover had been performing lawn mowing and gardening services for an entity called Spotless. In September 2015, Dorn Investments became dissatisfied with the way in which Mr Hoover was carrying out the Spotless work, so it took the contract off him and gave it to another franchisee. Following that, Mr Hoover made the decision to give up the franchise and to commence trading on his own account and he did so by rebranding as the Lawn Ranger. He destroyed the Green Acres business cards and signage and never had a manual. When Dorn Investments found out it terminated the sub-franchise agreement and sought an undertaking that Mr Hoover would not provide lawn and gardening services in competition with the Green Acres businesses in New Zealand. Mr Hoover provided no such undertaking, so injunction proceedings were served in late January 2016. Justice Asher dismissed the

13 *Skids Programme Management Limited & Ors v. McNeill & Ors* [2013] 1 NZLR 1; (2012) 98 IPR 324.

14 *Dorn Investments Limited v. Hoover* [2016] NZHC 1325.

application for an interim injunction and stated that, on the balance-of-convenience argument, the result of granting an injunction would be severe for Mr Hoover, as he would have to stop his business. The judge said that Dorn Investments acted too quickly in taking Spotless as a customer from Mr Hoover, and in issuing the proceedings. The judge said that damages would not be great in any event. What really swayed the judge to decline the injunction was, in my opinion, 'the preemptory removal of one-third of Mr Hoover's custom in September 2015 by Dorn Investments when it took the Spotless contract away from him'. This case goes to show that in restraint-of-trade cases there is no certainty that the court will grant an injunction.

The Contract and Commercial Law Act 2017 gives the courts authority to rewrite a restrictive covenant and to allow an excessive covenant to be enforced at a lesser level. For example, if an agreement provided for a three-year period of restraint when a two-year period was considered to be reasonable, the covenant would be enforced to the extent that it could be rewritten by the courts as being confined to a two-year term. The ability of the courts to modify excessive restraints is constrained by the principle that terms that could never have been considered reasonable will not be modified. The reason for this is that it is considered to be contrary to the public interest that a person should be able to intimidate a contracting party by stipulating for a wholly unreasonable constraint and then have the court come to its rescue and rewrite the agreement so that it falls within the boundaries of reasonableness. This is the doctrine of restraints that are *in terrorem* (see Section VI.vi). When would a restraint be reasonable? There are many factors to consider – time and area, nature of the rights to be protected, and public interest.

The courts view breaches of restrictive covenants very seriously. Whether or not the franchisor could take over the business of the franchisee who breaches a restrictive covenant depends on the circumstances and materiality of the breach. Well-drafted franchise agreements would always allow a franchisor to seek injunctive relief. In relation to the shareholders of a franchisee company, there is normally a restriction that shares cannot be transferred to any third party without the franchisor's knowledge and consent and contravention of this will be deemed to be an illegal transfer. Similar provisions apply to leases where a franchisee has leased premises.

The ability of any franchisor to take over a franchisee's business post-termination must be a matter of contract. Usually franchise agreements provide the right of a franchisor to purchase the assets of a franchisee at an agreed value or, failing agreement, to be determined by arbitration.

Franchisors are often empowered to take over the leases of franchisees by express provision in the franchise agreement but this will always depend upon the exact wording of the clause.

viii Anti-corruption and anti-terrorism regulation

The Fair Trading Act 1986 applies to any misrepresentations (unsubstantiated or false or misleading representation) made by a party to a franchise agreement.¹⁵ The Crimes Act 1961 and the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (the AML/CFT Act) apply to offences involving fraud and money laundering.¹⁶ The Organised Crime and Anti-corruption Legislation Bill passed into law in November 2015 by way of

15 Sections 9–16.

16 Sections 243–245.

15 amendment acts, with the aim of enhancing New Zealand's anti-corruption legislative frameworks by implementing amendments to the AML/CFT Act, the Crimes Act 1961 and various other enactments. The AML/CFT Act, which places obligations on New Zealand's financial institutions and casinos to deter and detect money laundering and terrorism financing, is being implemented in phases. Phase One applied to banks, casinos and a range of financial service providers. Phase Two, which was implemented on 1 July 2018, extended the AML/CFT regime to lawyers and conveyancers. Phase Three came in on 1 October 2018 and extended the regime to accountants and, from 1 January 2019, Phase Four, extended the regime to real estate agents.

ix Dispute resolution

Franchise agreements usually include a dispute resolution clause. Some clauses favour arbitration, but franchisors who belong to the FANZ normally include the dispute resolution clause from the Code of Practice, which favours mediation in the first instance; if this is the case, mediation will be mandatory.

A foreign judgment has no direct operation in New Zealand. However, some foreign judgments may provide the basis upon which a New Zealand court will grant a judgment that will then be enforced in the same way as any New Zealand judgment. At common law, a New Zealand court may grant judgment to enforce a money judgment given against a defendant by a foreign court whose jurisdiction over the defendant is recognised by New Zealand's Rules of Private International Law provided the judgment is for a debt, or definite sum of money other than a sum payable in respect of taxes or other charges of that nature, or in respect of a fine or other penalty; and the foreign judgment is final and conclusive.

There are certain types of judgments given in foreign courts that, as a matter of public policy, a New Zealand Court will decline to enforce. Examples are attempts to enforce foreign revenue and penal law; judgments obtained by fraud; and judgments given overseas in breach of the rules of natural justice as applied in New Zealand.¹⁷

As recently mentioned, mediation is the favoured mode of resolving disputes. Normally the parties to a dispute must meet and are given 21 days to resolve it, failing which one party can issue a mediation notice to the other party. The parties have 10 days to agree on the appointment of a mediator and failing agreement a third party will determine who the mediator is. Once the mediator has been appointed the mediation must take place within 14 days so the process is swift and time-effective.

If a franchise agreement has been terminated and the previous franchisee conducts a new business in breach of a non-compete provision or uses the franchisor's trademarks or other intellectual property rights, injunctive relief is available from the High Court of New Zealand. A plaintiff who succeeds in a claim for breach of contract is entitled to recover losses on an 'expectation' basis (i.e., the loss is the sum that the person expected to make (profits) if the contract had been fulfilled). If a party is successful in court, costs are awarded pursuant to a court scale and in special circumstances exemplary damages or costs are awarded.

A careful drafting of a dispute resolution clause is required in an international franchise agreement as it affects the franchisor's ability to enforce the agreement across other jurisdictions.

17 *Connor v. Connor* [1974] 1 NZLR 632.

Parties to a franchise agreement should also note that some disputes may not be submitted to arbitration. It is crucial that any subject matter of a potential dispute is capable of being settled by arbitration under the law of the country where enforcement of the arbitral judgment and award are likely to be sought and that enforcement is not contrary to the public policy of that country.¹⁸

New Zealand is a party to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958. An arbitration award rendered in another Convention country is generally enforceable in New Zealand unless there is a ground for non-enforcement that relates to grave procedural errors or conflicting public policy. International courts have taken a restrictive view of this exception¹⁹ and have required fraud or corruption in procuring a foreign arbitral award or a violation of international public policy, not domestic public policy.²⁰ New Zealand courts would be likely to apply a similar standard.

A franchising dispute involving a franchisor called Hire Intelligence International Limited resulted in proceedings being issued in the High Court and the reported decision is *Cityside Asset Pty Limited & Ors v. 1 Solution Limited & Ors*.²¹ The High Court proceeding involved discovery, the destruction of vital evidence and legal privilege. The dispute was subsequently resolved after a two-day mediation and the High Court proceedings were discontinued by consent.

VII CURRENT DEVELOPMENTS

In relation to franchising, the latest developments concerning competition law are outlined in detail under Section VI.v on competition law. In particular, note that the Commerce (Criminalisation of Cartels) Amendment Act 2019 became law on 8 April 2019 and will come into force in April 2021. Further, the Overseas Investment Amendment Act 2018 prevents certain people from overseas buying residential property in New Zealand (except for people from Australia and Singapore, who are exempt), so expert legal advice on this matter must be obtained.

POLAND

*Kuba Ruiz*¹

I INTRODUCTION

According to the experts, the Polish franchise and distribution network market will continue to grow in the coming years. In mid-2019, Forbes listed Poland among the 10 most attractive countries for franchising in 2019.² There is no precise data available yet for 2019, but at the end of 2018, there were more than 1,250 different franchise models in Poland, of both Polish and foreign origin, with approximately 78,000 franchise outlets. The most popular franchise trends and sectors in Poland are still food and grocery chain stores, although not without changes, mainly due to legal restrictions on commercial sales on Sundays and new technology trends (Carrefour with Express and BIO stores, Chata Polska and Żabka, Eurocash with ABC, 1 Minute, Delikatesy Centrum, Groszek, Lewiatan and Mila brands are still strong, Tesco is withdrawing from Poland, Dino is growing and Biedronka is introducing technology-driven changes); restaurant chains (including McDonald's, KFC, Da Grasso and Cukiernia Sowa); clothing retailers (including Vistula and Wólczanka, KappAhl, Solar, Tatum, Zara, H&M, although Marks & Spencer, Aldo and Gap have withdrawn from Poland); hotels (including Best Western and Accor/Orbis); and cosmetics retailers (Inglot, Yves Rocher, Ziaja, Rossmann, Sephora). A franchise remains one of the main ways of development for small entrepreneurs, and franchising provides jobs for up to 500,000 people in Poland.

The franchise market is continuing to see a move from classic shops to providing services online, where the franchisors create online central sales platforms for clients and then orders are delivered by local franchisees. This new solution has already been successfully adopted by Telepizza and McDonald's, with online orders delivered by local restaurants; and by Intermarché, with online orders being collected by clients at selected local-store pickup points (Intermarché, however, closed nine shops in 2019, and 22 in 2018).

We can observe both the increasing presence of international franchises in Poland, and the achievements of Polish export brands abroad. The biggest Polish participants in the international franchise market are companies such as Inglot (whose stores can be found on all continents, in 74 countries, including Dubai, Ivory Coast, Kazakhstan, the Philippines, Peru, Nepal and the United States), Gino Rossi, 4F, LLP (Reserved, House, Cropp, Mohito i Sinsay), CCC and Organique. Polish producers have also started expanding into different areas, gaining recognition in, for example, business-to-business markets.

Franchising is perceived as a safe business concept by Polish entrepreneurs. The growing number of 'multi-franchisees' (entrepreneurs who own more than one branch) is

¹ Kuba Ruiz is counsel at Bird & Bird Szepietowski i wspólnicy sp.k.

² <https://www.forbes.com/sites/hachemialiouche/2019/08/23/the-10-most-attractive-countries-for-franchising-in-2019/>.

evidence of the high levels of confidence in the franchise system. Companies belonging to the Polish Franchise Organisation use the Franchising Code of Ethics adopted by the European Franchise Federation.

II MARKET ENTRY

i Restrictions

Non-EU companies are obliged to establish a branch or subsidiary company to operate a business in Poland. Ownership of real estate is restricted for non-EEA franchisors and requires government approval.

Conducting business activity in Poland requires registration. Apart from registering, there are, in general, no strict rules on starting a business in Poland.

ii Foreign exchange and tax

There are no exchange controls in force. The standard Polish withholding tax rate due on franchise fees and dividends is 20 per cent. If a double-taxation agreement (DTA) applies, both franchise fees and dividends payable to foreign entities are subject to tax established thereunder. The Polish franchisee is a remitter of withholding tax in Poland and remains liable for payment of amounts due to the Tax Office. As of 1 January 2020, new withholding tax regulations came into force, introducing a completely new tax regime. The new model sees mandatory withholding tax collection from all transactions concluded with the same entity in one tax year if these are valued at over 2 million zlotys in total. Only the taxpayer or tax remitter (under an appropriate contract) can apply for its return. As a result, a large number of entities using preferential tax rates and exemptions are now obliged to pay withholding tax. However, this obligation has now been postponed until 1 July 2020. The new rules also provide for certain exceptions, whereby a taxpayer or tax remitter can apply a tax preference to payments exceeding 2 million zlotys if the tax remitter submits an appropriate statement or obtains an opinion from the tax authorities. Tax remitters are also obliged to exercise due diligence when collecting withholding tax and assessing the applicability of preferential taxes. For many this may mean introducing an additional procedure to verify payment recipients. The amendments also relate to the Fiscal Penal Code, under which fines of up to 21.6 million zlotys and imprisonment of up to five years may be imposed for concealing or submitting false information in statements or requests for opinions when applying for exemptions.

III INTELLECTUAL PROPERTY

i Brand search

A brand search allows assessment of the availability of a mark in the light of earlier registrations and applications. When conducted prior to filing, a brand search avoids the undesired costs of potential infringement proceedings or the unexpected necessity of changing the brand because of earlier registration of an identical or similar trademark.

The Polish Patent Office (PPO) provides online access to all published trademark applications and registrations, and can thus be used as a database for brand searches. Adequate

appreciation of the potential risk of confusion with earlier trademarks usually requires some level of proficiency. The assistance, therefore, of trademark or patent attorneys is strongly recommended when analysing search results.

As of 15 April 2016, the PPO examines absolute refusal grounds only. Conflicts with earlier trademarks are not examined *ex officio*. The holders of earlier trademarks may oppose conflicting applications before their registration. This requires ongoing scrutiny and monitoring of new trademark applications in relevant classes.

Brand searches are usually limited to earlier trademark applications and registrations; however, to identify all potential risks connected with the launch of a new brand, it is also worthwhile conducting a 'freedom to operate' search. This search concerns non-trademark prior rights, such as company names, trade names, unregistered trademarks and all other designations used on the relevant market. The simplest way to conduct it is by using an internet search engine.

ii Brand protection

In Poland, a trademark application can be filed either in paper or electronic form. The scope of protection is determined by the list of goods and services attached to the application, classified in accordance with the Nice Classification. Application proceedings can take as long as between 10 and 12 months, provided the application is not opposed.

Individuals and entities that have a domicile or a business seat in Poland, or on EEA territory, do not have to be represented in trademark registration proceedings by a professional representative. Individuals or entities from outside the EEA must be represented in trademark registration proceedings by a Polish-qualified professional (i.e., trademark attorney or attorney-at-law).

Information on trademark applications is published within two months of filing. If there are no absolute refusal grounds, the application is published in the official bulletin, and from this time any third parties may file their observations regarding absolute refusal grounds, regardless of the PPO's primary positive assessment. On the basis of these submissions, the PPO might change its view and dismiss the trademark application.

For published trademark applications, the PPO automatically runs an informative search of earlier identical or similar trademarks registered for identical or similar goods, for the purpose of registration.

Within three months of publication of the application, the holders of earlier trademarks, as well as the holders of earlier personal and economic rights, may oppose the trademark application. The opposition deadline is not extendable. The parties have two months (extendable to six months) to settle the case (cooling-off period). Following this, the PPO will proceed with the opposition. The likelihood of confusion is determined in cases of identical or similar registered trademarks applied in relation to identical or similar goods or services. The trademark applicant may raise a non-use claim against the earlier registration. The PPO is bound by the grounds of the opposition indicated by the opponent. Letters of consent are acceptable.

If no opposition is filed, the PPO issues a decision on trademark registration. Otherwise, the PPO also grants registration to the extent an opposition was dismissed by a final, non-appealable decision. Registration is conditional upon payment of the relevant registration and publication fees.

Trademark protection initially lasts for 10 years, with the possibility of unlimited extensions for subsequent 10-year periods.

A motion for invalidation of a trademark may be filed at any time after the registration based on absolute and relative refusal grounds. However, relative refusal grounds may only be raised by the holders of earlier trademarks, or earlier personal or economic right holders. Non-use cancellation is acceptable after five years of non-use, as long as there are no reasonable grounds for non-use. A non-use cancellation request may be filed by any person.

Brand protection is complementary to other intellectual property (IP) rights. A figurative or 3D mark can also be protected by copyright law or as an industrial design.

Poland implemented Directive 2015/2436³ through an amendment to the Industrial Property Law (IPL),⁴ which came into effect on 16 March 2019.

Transposition of the Directive has entailed changing the definition of a trademark, as the graphical representation requirement has been removed. The new definition that has been introduced provides that a trademark may consist of any sign that is capable of distinguishing the goods or services of one undertaking from those of other undertakings, and that can be presented in the register in a manner that enables third parties to determine the clear and precise subject matter of the protection.

Polish law recognises collective trademarks and guarantee trademarks. The amendment rephrased the definition of a collective mark. The legislators also decided to repeal the institution of collective guarantee marks from the Polish system, and replace them with newly added guarantee marks as stipulated in the Directive. Collective guarantee marks could be converted into guarantee marks within six months of the entry into force of the amendment.

iii Enforcement

Poland has a bifurcated system, in which trademarks can be invalidated only in proceedings before the PPO, while infringement cases are decided by the courts. Accordingly, invalidity arguments may not be raised as a counterclaim defence in court proceedings (except in EU trademark infringement proceedings). There are no specialist IP courts in Poland, apart from the court dealing with EU trademarks and Community designs, although there are plans to introduce such specialist courts in the future; however, to date, no text has been proposed for such an amendment.

In the case of a pending infringement case a court would usually stay the proceedings if a request for invalidation were filed before the PPO; however, as there is no legal provision addressing this particular issue, it is not obligatory, and in principle the decision to stay the infringement proceedings is left to the court's discretion.

In Poland, preliminary injunction (PI) requests are decided in *ex parte* proceedings (i.e., defendants are not informed about the PI request and generally have no opportunity to defend their rights until the decision on the grant of the PI is issued and served upon them, unless a court schedules a hearing to consider the PI request). There is also no formal way of submitting 'protective letters' (common in Germany), as they are generally not legally recognised in Poland. To obtain an injunction, the trademark holder has to prove that infringement is probable and that the trademark holder has a legitimate interest in the injunction (e.g., the lack of an injunction may cause the trademark holder irreparable damage). In the event that a PI is granted, a claim should generally be filed within 14 days of receipt of the PI decision.

3 Directive (EU) 2015/2436 of the European Parliament and of the Council of 16 December 2015 to approximate the laws of the Member States relating to trademarks.

4 Act of 30 June 2000 on Industrial Property Law (and its subsequent amendments).

In general, an action should be brought before the district court of the defendant's seat. However, if the infringing product is available throughout the whole territory of Poland (e.g., through an online shop), the claimant may try to file a PI request or a claim with any of the 45 district courts in Poland according to the place of an alleged infringement (although recently the courts have tended to reject such requests as forum shopping and transfer the case to the court of the defendant's seat).

In an infringement action the claimant may claim cessation of infringement, return of unlawfully obtained profits, publication of the final judgment (or information about it) and – in cases where the infringement is culpable – compensation for damage. Moreover, the court may also decide on the destruction, withdrawal from the market or transfer of ownership of the infringing goods.

In practice, seeking damages in trademark cases may be quite difficult from an evidential perspective. It is for the claimant to prove the actual damage it suffered and the adequate causal relation between the infringement and the damage. Damages can also be calculated based on the criterion of 'reasonable royalty', but this is very seldom used as there are serious doubts regarding its interpretation. Obviously, the most credible point of reference for a reasonable royalty would be the licence fee charged by the claimant in a similar case based on an existing licence agreement. This is, however, very rarely the case. Most typically, the rights holder rather claims the handing over of profits unlawfully obtained by the defendant, meaning revenues gained from sales of infringing products, as it is much easier to calculate this figure, and obtain reliable data on sales volumes and prices.

In a recent amendment to the IPL, which takes effect on 27 February 2020, Poland reformed the implementation of the Enforcement Directive in relation to requests to disclose information and secure evidence of an infringement. This was needed because of the previously incorrect implementation and subsequent to the judgment of the Polish Constitutional Tribunal of 6 December 2018, which declared Article 286 (1.iii) of the IPL, allowing the claimant to address an information request to a third party, to be too broad and unconstitutional. The new text is clearer in that these measures do not provide a means to 'secure a claim' but rather allow infringement claims to be enforced more efficiently. Some procedural provisions relating to the PI apply by reference, in particular the obligation to launch the infringement proceedings shortly after the court issues a decision granting the claimant's request (otherwise, the claimant may be liable for damage).

The period of limitation for all claims is three years, counted separately for each infringement from the time the right holder became aware of the infringement and the infringer; not later, however, than five years from when the infringement took place.

iv Data protection and e-commerce

Data protection

The EU General Data Protection Regulation⁵ has been fully implemented in Poland.

In the context of franchising relationships, in principle the franchisor or franchisee can be considered a data controller (data owner) or data processor (entity acting on behalf of a controller), or both of these, or joint controllers. If the franchisor as data

5 Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data and repealing directive 95/46/EC (General Data Protection Regulation).

controller outsources processing to a franchisee (or vice versa), both parties must conclude a data-processing agreement indicating at least the scope, purpose and duration of processing, the type of personal data and categories of data subjects, as well as the obligations and rights of the controller. If they are considered joint controllers, they must put in place appropriate arrangements regarding their respective responsibilities for compliance with their obligations and industry participants should reconsider their roles following European Court of Justice judgments giving a broad interpretation of joint controllership.⁶

The franchisee or franchisor (as controller) must have a legal basis for processing. In the context of its activity several legal bases for processing are possible, in particular, consent, legitimate interest of the data controller or data recipient, and performance of the contract with the data subjects (the latter would only be reserved to franchisees as a party to the agreement). For marketing purposes, the franchisee or franchisor can rely on legitimate interest to promote its own products or services (except for e-communication and telemarketing, where separate opt-ins are required). If, however, the franchisor would like to use the franchisee's clients' data for marketing purposes, it must first obtain an appropriate consent.

If the franchisee or franchisor, acting as a data controller, wants to transfer data to third countries that do not provide adequate levels of personal data protection, an additional legal basis is required. In practice, the most reliable legal basis would be entering into standard contractual clauses⁷ between the Polish franchisor or franchisee and the data importer from the third country. Standard contractual clauses have been issued by the European Commission as data transfer contract models. Following the decision in *Schrems* (C-362/14) invalidating EC decision 2000/520/WE on the Safe Harbor Framework, it is no longer possible to rely on Safe Harbor as a legal basis for data transfer to the United States. Its successor, the Privacy Shield Framework, entered into force in 2016; however, its validity is already being challenged.

The Data Protection Authority has already started imposing fines. It fined the online shopping platform morele.net approximately €650,000 for inadequate security measures and a data breach affecting more than 2 million users.

E-commerce

Mandatory provisions of Polish law protect consumers in business-to-consumer (B2C) relations. The protection exists regardless of whether the business is located in Poland. For example, if the business is located in Germany, it is obliged to follow Polish mandatory provisions protecting consumers if these are more restrictive than German law.

As an EU Member State, Poland has implemented the New Consumer Directive,⁸ which provides consumers with, inter alia, the right to withdraw from distance sales agreements within 14 days of signing and imposes obligations on e-businesses to appropriately inform consumers of relevant information.

6 *Wirtschaftsakademie* Case No. C-210/16; *Fashion ID* Case No. C-40/17; *Jehovan todistajat* Case No. C-25/17.

7 Commission decision of 5 February 2010 on standard contractual clauses for the transfer of personal data to processors established in third countries under Directive 95/46/EC of the European Parliament and of the Council.

8 Directive 2011/83/EU of the European Parliament and of the Council of 25 October 2011 on consumer rights, amending Council Directive 93/13/EEC and Directive 1999/44/EC of the European Parliament and of the Council and repealing Council Directive 85/577/EEC and Directive 97/7/EC of the European Parliament and of the Council.

B2C companies have to be mindful of ‘abusive clauses’, which cannot be included in standard agreements with consumers. Abusive clauses concern, for instance, limitation of liability of the service provider or seller towards consumers, and exclusive jurisdiction of the court applicable to B2C e-business. Clauses that the courts have held to be abusive (in cases initiated before April 2016) are contained in a register of abusive clauses, which currently contains more than 7,300 clauses. In April 2016, a legislative amendment came into effect whereby the Office of Competition and Consumer Protection Authority, rather than the civil courts, is competent to decide whether specific clauses are abusive (all decisions are available on the Office of Competition and Consumer Protection Authority website).⁹ The rationale behind the amendment is, inter alia, to curb the practice of suing entities being adopted as a business model. The regulator also has the authority to impose fines amounting to up to 10 per cent of the business’s turnover as a maximum penalty.

IV FRANCHISE LAW

i Legislation

Franchise contracts are not subject to specific regulation and the general principle of freedom of contract applies.

ii Pre-contractual disclosure

There is no mandatory pre-contractual disclosure requirement in Polish law, but there are some general rules that Polish law recognises, such as the pre-contractual principle of good faith (*culpa in contrahendo*) and certain other rules of the Civil Code. The confidentiality of trade secrets is protected under the Act on Combating Unfair Competition, even before entering into non-disclosure obligations.

V TAX

i Polish tax system

The Polish tax system is a complex combination of direct and indirect taxes based on Polish regulations, international treaties and EU law.

Poland has been a member of the Organisation for Economic Co-operation and Development (OECD) since 1996. The OECD issued and systematically updates the Model Tax Convention on Income and on Capital, as well as the commentary to the Convention. Most DTAs to which Poland is a party are based on the Model Convention.

Individuals and companies receiving income sourced in Poland are subject to Polish income tax, personal and corporate, respectively. Within this scope, Polish law applies unless any international agreements – including DTAs – provide otherwise.

DTAs significantly affect the tax treatment of cross-border transactions, but privileges under a DTA apply if a taxpayer submits a valid tax residency certificate issued by its local tax authority. Foreign tax residency certificates remain valid for Polish tax authorities throughout the validity period provided in the document. If a tax certificate does not include an expiry date, from 4 January 2015, it will be valid for 12 months following its issuance date unless the taxpayer changes its domicile within this period.

⁹ https://decyzje.uokik.gov.pl/bp/dec_prez.nsf (in Polish).

On 1 January 2020, fundamental changes in collecting withholding tax in Poland came into force. In general, a new tax refund mechanism has been introduced, namely withholding tax will now be collected by the withholding tax agent in full even where exemption applies under a DTA. After proving the right to apply a preferential rate, tax will be refunded by the tax authority.

The new provisions apply when payments exceed 2 million zlotys in a given tax year. Should payments exceed this amount, it will still be possible to apply an exemption set out in a DTA, provided that the management board issues the required statement to the tax authority that all requirements for the exemption have been met. If the management board members issue a false statement, they can be subject to criminal sanctions.

Poland is a member of the EU and thus is also a member of the harmonised VAT system.

ii Franchise taxation

Franchising is not expressly regulated under Polish contract and tax laws (mixed contract). Therefore, income and costs derived from franchising are taxed in a manner applicable to the taxation of those contracts to which franchising contracts are similar.

Under Polish law, following OECD guidelines, income derived from franchising should be divided for income resulting from certain sub-arrangements covered by the franchising relation, including provision of know-how, licensing and provision of services. Each part is then subject to the different tax treatment applicable to each particular type of income.

Moreover, in the event that any business arrangement – including a franchising contract – is set up between related parties (affiliates), transfer pricing regulations apply. If applicable, parties should draft and store transfer pricing documentation reflecting the market value of any payments made between parties under contract; any lack of relevant transfer pricing documentation may be challenged by the Polish tax authorities. Parties may also be required to pay increased tax as a result.

As of 1 January 2015, partnerships, in the same way as companies and individuals, are required to comply with transfer pricing regulations.

VI IMPACT OF GENERAL LAW

i Good faith and guarantees

Parties to a contract are expected to act in good faith and the courts will take this into account.

ii Agency distributor model

Although Polish courts have not yet awarded franchisees the protection provided to agents under the Polish Civil Code,¹⁰ it is possible that this may happen in the future.

iii Employment law

Franchising is commonly regarded as a form of business activity.

The franchisee cannot be treated as an employee, and operates under its own name, bearing the economic risk of its own activities. The relation between franchisee and franchisor can be described as cooperation, not as employee–employer subordination. Also, the

10 Chapter XXIII of the Civil Code – Agency agreements.

franchisor receives remuneration under a franchising agreement, while the employee receives remuneration in accordance with an employment agreement. Franchisees are not entitled to the same social protection as employees.

iv Consumer protection

As franchisees are considered businesses, they are not protected by Polish consumer law, even in the case of sole traders. Nevertheless, franchisees must comply with Polish consumer laws and regulations if they market products or services to consumers.

v Competition law

A franchise agreement is a type of distribution (vertical) relationship between independent entities. Under certain circumstances, such a relationship may affect trade by restricting or distorting competition in the relevant market, as it usually contains a combination of different vertical restraints. The Polish Competition Authority has issued several decisions regarding franchising. In June 2013, it issued a notable decision concerning the fixing of resale prices by Sfinks Polska SA, one of the restaurant chains operating in the casual dining sector in Poland.¹¹ That decision was appealed, and in January 2018 the Warsaw Court of Appeal confirmed that pricing arrangements between a franchisor and a franchisee may be considered anticompetitive. However, in the case at hand, the Court of Appeal significantly reduced the fine imposed as the potential anticompetitive impact was limited because of Sfinks Polska SA's limited share of the relevant market.¹² In its judgment of 9 October 2019, the Supreme Court finally settled that dispute, confirming the fine amount set by the Warsaw Court of Appeal. According to the Supreme Court, any anticompetitive action violates the public interest, whether or not there is an effect of restricting or eliminating competition.¹³

Franchising is defined as a distribution system in which the franchisee is directly or indirectly obliged to resell goods that have been acquired from the franchisor or from a company designated by the franchisor, and to use intellectual property rights and know-how that have been licensed from the franchisor. Since the scope of this definition is broad, it is common in practice to apply a more specific definition made under EU rules.

If a franchise agreement contains anticompetitive clauses, it can be exempted from the prohibition on anticompetitive agreements provided that the aggregate market share of competitors in the relevant markets does not exceed 5 per cent, or the market share of each non-competing entity in the relevant markets does not exceed 10 per cent.¹⁴ This provision constitutes the *de minimis* principle, but it is not commonly applied to franchise agreements as they tend to contain 'hardcore restrictions' (such as price-fixing or market-sharing arrangements between parties), which cannot be exempted under the *de minimis* principle.

If the *de minimis* principle cannot be applied, a relevant block exemption regulation can exempt anticompetitive provisions specified in the franchise agreement from the application of Article 101(1) of the Treaty on the Functioning of the European Union (TFEU) or its Polish equivalent. Depending on the geographical scope of a given franchise agreement, the EU Block Exemption Regulation (VBER), or the Polish Block Exemption Regulation, can be

11 Polish Office of Competition and Consumer Protection decision, 25 June 2013, No. DOK-1/2013.

12 Warsaw Court of Appeal, 10 January 2018, court ref. No. VII AGa 828/18.

13 Polish Supreme Court, 9 October 2019, court ref. No. I NSK 89/18.

14 Article 7 Section 1 of the Polish Act on Competition and Consumer Protection (consolidated text, Journal of Law of 2019, item 369).

applicable.¹⁵ Both block exemption regulations contain the same principles and rules. There is thus no difference in the application of any of these two block exemption regulations. These block exemption regulations apply to agreements that do not contain hardcore restrictions, and where the individual market shares of the franchisor and the franchisee in the relevant markets, as a rule, do not exceed 30 per cent.

The VBER lists the hardcore restrictions that will cause a franchise agreement to fall outside the scope of the VBER. This list includes price-fixing or resale price management. In principle, a franchisor may impose maximum or recommended resale prices. Under certain exceptional circumstances, a franchisor may also set fixed or minimum prices for low-price promotional campaigns lasting between two and six weeks (in most cases).¹⁶ The list of hardcore restrictions also includes restrictions on territories or customers to which a franchisee can sell products or provide services, such as bans on passive sales outside an exclusive territory or customer group.

The VBER also lists grey restrictions, which are invalid themselves, but do not result in the invalidation of the entire agreement. One of these is the non-compete clause (see Section VI.vi).

Other provisions that should be analysed from a competition law perspective concern IP rights licensing, approving or restricting the franchisee's advertising campaigns, and exclusivity and reserved customer groups.

If the VBER market-share thresholds are exceeded or the franchise agreement contains hardcore restrictions, the agreement is not exempted under the VBER. Nevertheless, the parties to the franchise agreement can argue that it benefits from the individual exemption if it fulfils four cumulative criteria set out in Article 101(3) of the TFEU or its Polish equivalent on the basis that the franchising agreement results in more efficiency gains than anticompetitive effects in the relevant markets. In such cases, the burden of proof lies with the franchisor and the franchisee. In fact, the franchisor and the franchisee must self-assess the applicability of the individual exemption as neither the European Commission nor the Polish Competition Authority issues decisions confirming the applicability of the individual exemption to specific agreements.

Franchise agreements may also be examined in relation to the rules on prohibition of abuse of a dominant position and merger control applicable to transactions involving the acquisition of control (such as mergers, acquisitions and establishment of joint ventures). In such cases, the general competition law rules apply.

vi Restrictive covenants

Both the Polish Block Exemption Regulation and the VBER define non-compete clauses as the franchisee's obligation to buy more than 80 per cent of goods from the franchisor or its supplier, and the franchisee's obligation not to deal with goods that are substitutes for those offered by franchisor.

15 Note that the Polish and EU block exemption regulations should be interpreted in conjunction with the results of the European Commission's sector inquiry into e-commerce; the European Commission's final report on the e-commerce sector inquiry, as announced on 10 May 2017, is currently available at: https://ec.europa.eu/competition/antitrust/sector_inquiries_e_commerce.html.

16 Para. 225 of the European Commission's Guidelines on Vertical Restraints, OJ C 130/1, 19.5.2010, pp. 1–46.

To be exempted under both block exemption regulations, in-term non-compete clauses have to be limited to five years or to the duration of the sublease if the franchisor owns the franchisee's premises. Non-compete clauses that are concluded for longer periods can be exempted under the individual exemption if all cumulative criteria are met.

To protect the franchisor's know-how, parties can conclude a post-termination non-compete clause that may last no longer than one year after the agreement's termination. Within that period the franchisee must agree not to deal with goods that are substitutes for those offered by the franchisor from the premises in which the franchisee operated during the franchise agreement.

If the franchisor provides the franchisee with know-how that is not in the public domain, the parties may consider concluding a post-termination non-compete clause for a longer period; however, such a non-compete clause would have to be exempted under the individual exemption of Article 101(3) of the TFEU or its Polish equivalent.

vii Termination

The franchise agreement is a long-term form of cooperation concluded for a fixed term (usually five, 10 or 20 years) or an indefinite period. There are two ways of terminating the agreement early under the Polish Civil Code: termination upon notice and rescission.

Termination upon notice occurs especially in the case of legal relations concluded for an indefinite period. The agreement can be terminated only upon notice *ex nunc*, which means that the notice is valid only for the future and not the past. Termination upon notice applies only to the relation expended in time. Generally, there is a notice period after which the agreement terminates (it might be a contractual, statutory or a customary term period). If a termination period is not provided, the agreement expires immediately after the termination notice is delivered.

Rescission is a remedy to a breach of contract – if one party commits a qualified delay in performing the contract, the other party may rescind it provided that the affected party notifies the defaulting party in writing of the intention to rescind, granting appropriate additional time for proper performance. If the set time limit lapses, the affected party is entitled to rescind the contract.

As mentioned in Section VI.vi, post-termination non-compete clauses of up to one year for franchise agreements are permitted under Polish law. A longer term for post-termination non-compete clauses can be established if the franchisor provides the franchisee with know-how that is not in the public domain.

It is advisable to include provisions on termination in the franchise agreement, including provisions concerning rescission. Explicit provisions can minimise the risk of confusion between the parties.

viii Anti-corruption and anti-terrorism regulation

Under Polish law, bribery is a crime committed by an individual giving or accepting a bribe. A person giving a bribe can avoid criminal liability if he or she informs the appropriate law enforcement institution of the circumstances of a crime before proceedings are initiated by that institution.

Organisations can be subject to criminal liability for crimes committed by employees or representatives only if the individuals have been convicted and the organisation failed

to properly choose its executives, and at the same time the organisation benefited from the crime. Therefore, from a practical point of view, bribery committed by a franchisee will most likely not result in criminal liability of the franchisor.

ix Dispute resolution

In franchise disputes, the parties can choose between litigation and alternative dispute resolution (arbitration or mediation).

Arbitration is the most common form of alternative dispute resolution. Arbitration clauses are generally enforceable in Poland. To refer the dispute to the arbitration court, the parties are required to provide an agreement specifying the subject matter or the legal relationship out of which the dispute arose or may arise.

Mediation can be conducted on the basis of a mediation agreement or court order directing the parties to mediation.

The Polish court system remains slow, with litigation proceedings before the Warsaw courts being statistically the most lengthy. In the agreement, parties can decide which court has jurisdiction to decide in the event of a dispute.

If the parties include an arbitration clause in the agreement, they usually determine which arbitration court will decide in the event of a dispute. In Poland, permanent arbitration courts do exist, the most established being the Court of Arbitration at the Polish Chamber of Commerce and the Court of Arbitration at the Polish Confederation Lewiatan. Parties can choose between permanent arbitration courts or indicate in the agreement that the arbitration court be established *ad hoc*. Usually, the arbitration court is one instance, unless the parties agree otherwise in the contract. This means that, unlike in ordinary courts, sentencing is faster. Arbitration courts are not bound by proceedings rules, and so less complex procedures can be used. The average length of arbitration proceedings is nine months.

Either party can file an appeal against the court's verdict if it is not favourable. It is also possible to challenge the arbitration court's award before the common court, but only on technical grounds – the merits of the case will not be examined.

Arbitration fees are usually higher than court fees, but the total cost of proceedings is usually lower in arbitration, as arbitration is statistically quicker and more specialised.

In Poland, the losing party is obliged to return the costs of lawyers to the successful party, but only within statutory limits that are not significant. So, in practice, in lengthy, complicated or high-value proceedings each party bears most of its legal costs.

From an international franchisor's perspective, it is important to note that Poland is a signatory to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards and so foreign arbitral awards are enforceable in Poland. Also, since Poland is an EU Member State, Polish courts will recognise and enforce court judgments from other EU Member States (in accordance with the EU Regulation).¹⁷

¹⁷ Regulation (EU) No. 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters.

VII CURRENT DEVELOPMENTS

In recent years the rapid development of franchising has been noticeable, and its popularity is constantly growing. Experts predict that the Polish franchise market will maintain its dynamic growth in the coming years. It was reported that the number of franchise systems had reached 1,250 in 2018, with the number of franchise outlets reaching 78,000.

More and more Polish companies are deciding on international expansion. The leader in terms of the number of owned foreign sales outlets is still LLP Group (clothing brand owner), but other Polish companies have also increased their international expansion significantly (e.g., CCC and Wittchen).

Customer support for domestic brands is a new visible trend on the Polish market. The increased interest of Polish consumers in Polish products is a chance for domestic franchises to compete successfully with foreign franchise systems, and to expand Polish brands on international markets.

RUSSIA

*Sergey Medvedev*¹

I INTRODUCTION

Franchising presents a double advantage. On the receiving side (the franchisee), it is a quick way to start a business under the umbrella of a renowned brand. The emerging business is backed by the solid commercial experience and positive reputation of the prominent company (the brand or franchise owner). On the giving side, the owner (franchisor) expands the brand and franchise to other markets and obtains a new platform for further business development, and this is achieved with the money being paid to, rather than by, the owner.

Unsurprisingly, international franchisors have already sought to secure franchising investments in the Russian jurisdiction. Global corporations such as Marriott, Hilton, McDonald's, Starbucks, Subway and many others have offered and successfully sold their franchises to local companies (franchisees). Local companies are also catching up and establishing their own franchise businesses in various sectors, including retail, services, restaurants, bars and hotels.

There are several national franchise associations operating in Russia. While membership of a national franchise association is not mandatory, it may be commercially advisable to a certain extent. There is a local non-profit public organisation called the Russian Franchise Association (RFA), established back in 1997, which helps its members to promote franchising activities in Russia. Although the RFA does not have any regulatory power, it provides useful practical advice on doing franchising business on the Russian market. More information about the RFA can be found on its official website, at www.rusfranch.ru.

From the legal standpoint, cross-border transactions are structured differently in the context of franchising. Many companies prefer direct franchising, while others engage master franchisees. In certain cases, franchise grants are mixed with development rights in one and the same contract, or through separate agreements. In rare instances, joint ventures are created when the franchise relationship involves a Russian element and a corporate entity.

According to the relevant provision of Russian law,² under a franchise agreement, the rights holder (franchisor) grants the user (franchisee), for consideration and for a definite or indefinite term, the right to use a set of the franchisor's intellectual property (IP) rights, including trademarks and other contracted IP rights, for the operation of the franchisee's business, in particular, trade names and trade secrets (know-how). The key element of the franchise agreement is a protected (registered) trademark. In the absence of a registered trademark, the contract may not be treated or interpreted as being a franchise agreement.

1 Sergey Medvedev is a partner at Gorodissky & Partners.

2 Article 1027 (1) of the Russian Civil Code (Part II).

Other IP rights, including but not limited to, trade names, know-how, copyrights, patents and software, may be added to the scope of the franchise agreement in addition to, but not instead of, the registered trademark.

In Russia, the principal rule of franchising is that the parties to a contract must be commercial entities. Non-commercial companies or governmental agencies may not enter into franchise agreements. Therefore, limited liability companies will normally represent franchisors in regular franchise deals. Sometimes, joint-stock companies are used in complex franchise transactions involving joint ventures.

II MARKET ENTRY

i Restrictions

For the most part, there are no legal restrictions on foreign franchisors in respect of local equity ownership or real estate ownership in Russia. When entering the Russian market by way of granting a master franchise or development rights to a local entity, foreign companies should comply with all relevant national laws and regulations governing conclusion of franchise contracts, performance of obligations and the general civil law principles applicable to business operations.

At the same time, certain areas of investment are of strategic importance and the Russian government seeks to secure state defence and national security in these areas. Hence, a special licence or permission from the government has to be obtained before investing into certain industries or transacting in certain assets (e.g., encryption, weaponry, space and aviation). The media and telecoms sectors also have certain restrictions in terms of corporate ownership and control.

In general, a foreign company is free to offer and sell a franchise or development rights directly or indirectly to a local entity. In other words, the foreign franchisor may enter into a franchise agreement directly with the Russian franchisee to develop the franchised business in Russia, or engage another partner (sub-franchisor) who will grant sub-franchises to different local entities (sub-franchisees) under the effective sub-franchise agreements. Indeed, there is no legal requirement to set up a new local entity or own equity in the Russian company as a condition precedent for carrying on franchising activities in Russia.

ii Foreign exchange and tax

Generally, with regard to foreign exchange issues, there are no legal restrictions on the repatriation of franchise fees to an overseas franchisor.

As a general rule, the Russian franchisee is required to register an international franchise agreement with a competent bank to remit the payment of the franchise fees to a foreign franchisor. The above rule applies only to the corresponding (importing) franchise operation for contracted amounts of 3 million roubles (or more). The bank will register an agreement (transaction document) if the underlying franchise agreement (the original document) is properly translated into Russian and the granted franchise is registered with the Federal Service for Intellectual Property (Rospatent). Without registration with both Rospatent and the competent bank, franchise fees cannot be sent to an overseas franchisor.

Basically, Russian currency control law does not prohibit the use of a foreign currency in the context of international franchising.

With regard to the issue of taxes, there is no special franchise tax applicable to cross-border franchising.

Usually, all franchise fees payable to the foreign franchisor will be subject to value added tax (VAT) and corporate income tax (CIT), which need to be withheld by the Russian franchisee from the relevant contract price. Importantly, there are certain VAT exemptions and CIT reliefs that should be considered when structuring franchise operations in Russia.

III INTELLECTUAL PROPERTY

i Brand search

Generally, the Rospatent online databases are publicly available to conduct IP searches and to obtain any related information on registered IP rights and published applications. The online databases of the Eurasian Patent Organisation are publicly available to conduct patent searches and obtain relevant information on Eurasian patents and published Eurasian applications. Information on international trademarks registered in Russia is also available in Madrid Monitor, the World Intellectual Property Organization online database. Information on Russian registered trademarks is available in the TMview online database system of the European Union Intellectual Property Office (formerly the Office for Harmonization in the Internal Market), while information on Russian registered designs is available in the same organisation's DesignView online database system.

In addition, different fee-based search tools are also available. For example, Rospatent provides trademark search and trademark proprietor search services. Different turnaround times are prescribed according to the Rospatent schedule of fees. Official search results may be obtained on an urgent basis, even within one day, but the associated costs are relatively high.

Other IP or franchise-related searches, including for image rights and business processes, may be conducted on the internet.

If there is conflict, it is possible to file oppositions, cancellations or even bring an infringement claim, depending on the situation at issue.

ii Brand protection

Trademarks

Trademark registration will be the very first and key element for every franchise transaction targeted at Russia. A trademark may not be granted for use within the scope of a franchise, unless it is properly protected (registered) in Russia. Therefore, a foreign trademark, or mark in use, or pending trademark application cannot be licensed by way of a franchise agreement.

Trademarks may be protected on a national or international basis. National marks will have to be filed and registered with Rospatent. Russia is a signatory to the Madrid Agreement and the Madrid Protocol, therefore, an international trademark registration (designating Russia) will also be protected in Russia.

The duration of the national trademark registration procedure is approximately one year. The examination procedure includes formal and substantive examination. In the course of substantive examination, Rospatent runs absolute and relative grounds tests to allow or refuse trademark registration.

Any words, pictures, three-dimensional configurations and other marks may be registered as trademarks. The registration of non-traditional marks, such as sounds, colours and smells, is permitted.

To be registered, a mark has to be new and distinctive. Distinctiveness may be inherent or acquired. A trademark can acquire distinctive character through intensive and actual use in commerce.

In general, use of the mark does not have to be claimed before registration. Further, no proof of use has to be submitted before the trademark application is filed. At the same time, the owner must start using the trademark within three years of registration. If the mark is not used during any three-year term following trademark registration, any interested person may apply for cancellation of the trademark protection on the grounds of its non-use.

When the trademark is registered, it is entered into the Russian Trademark Register and will be valid for 10 years. Trademark registrations can be renewed for 10-year periods an unlimited number of times.

Copyright

Most often, franchisees will be granted access to certain business standards, operations manuals and proprietary software. As a result, copyright vested in these works may be included (along with trademarks) in the content of the underlying franchise agreement.

Copyright subsists in scientific, literary and artistic works fixed in any tangible medium of expression, regardless of benefits, purposes or methods of their expression. To be copyrightable, a work of authorship must satisfy two fundamental criteria. It must (1) represent a result of creative input, and (2) be fixed in any tangible medium of expression (e.g., paper, CD-ROM).

Generally, the following examples of works of authorship can obtain copyright protection in Russia:

- a* literary works;
- b* dramatic works;
- c* musical works;
- d* choreographic works and pantomimes;
- e* audio-visual works;
- f* sculptural, graphic and design works;
- g* photographic works;
- h* architectural works;
- i* pictorial works;
- j* computer programs; and
- k* databases.

Essentially, copyright vests in a work of authorship from the moment of its creation. There is no need to register or comply with any other formalities to acquire, exercise, transact, franchise, protect or enforce copyright in Russia. However, there is a unique national system of registration available for computer programs and databases. This registration may give an 'irrebuttable' presumption of copyright ownership and protection.

Basically, the standard duration of copyright protection, which is applicable to all works of authorship, is the lifetime of the author plus 70 years after her or his death.

Know-how

Many franchise agreements will incorporate know-how licences, as the transfer of proprietary and confidential information is usually regarded as the most critical aspect of every franchise business.

Any piece of confidential information may be protected as know-how. Know-how is not to be registered or deposited; nevertheless, the owner must undertake certain reasonable measures to maintain the confidentiality of the relevant data. If these measures are not implemented, know-how protection will not be afforded to the confidential information.

One of the legal ways to acquire know-how protection would be to set up a 'trade-secrets regime', as it is described in the law. More specifically, the owner has to properly identify and list the confidential information, limit access to the confidential information by establishing an appropriate procedure for dealings with the same, affix the notice 'trade secret' to the medium in which the confidential information is stored (along with the owner's details) and follow up with other required steps. If one of these steps is ignored or omitted by the owner of the confidential information, the trade secrets regime will not be considered as having been introduced and, as a result, the know-how protection will not be afforded to the trade secret. At the same time, there are other reasonable measures, which can be undertaken in due course, to achieve know-how protection.

Know-how will be protected for as long as it is kept secret by its owner. When the confidentiality is lost, the exclusive rights lapse immediately.

iii Enforcement

The IP enforcement system is well developed in Russia. IP rights, whether franchise-related or not, are enforced quite actively and efficiently. Enforcement actions can be brought by IP owners or their registered exclusive licensees.

Infringement of IP rights may primarily be prosecuted through administrative, civil or criminal proceedings. Furthermore, a special quasi-judicial procedure based on unfair competition is available. Finally, cease-and-desist or warning letters are a mandatory pre-judicial remedy for companies wishing to sue infringers in court and claim damages or monetary compensation.

Administrative proceedings

In accordance with the applicable administrative law, unlawful use of a patent, trademark or copyrighted subject matter entails both an administrative fine, which has to be paid into the state budget, and confiscation of the counterfeit goods for the purpose of destruction.

Administrative proceedings usually begin with a complaint, which the IP owner has to file with the police office or customs authority, so that the latter can organise a raid or take any other necessary action.

Administrative action may take about three to five months to be completed, unless the decision of the first instance court is appealed by the infringer.

Practically, in the context of importation of counterfeit goods into Russia, an administrative procedure proves to be the most effective enforcement option to stop the IP infringement at the border. This measure is also applied when small shops offer for sale and sell fake products on the internal market.

Civil proceedings

In the framework of civil proceedings IP owner (or its registered exclusive licensee) is normally entitled to seek the following legal remedies: (1) injunctive relief (preliminary and permanent injunctions); (2) monetary relief (damages or monetary compensation); (3) seizure and destruction of counterfeit goods and related equipment or materials; and (4) publication of a court order.

Civil proceedings begin with a statement of claims (lawsuit), which is to be filed with the competent court. Russia does not support the discovery system at the pretrial stage, therefore, all pieces of evidence must be collected and secured in advance of the lawsuit. If it is not possible to obtain certain evidence from the infringer before the action, or the latter refuses to disclose the evidence, the plaintiff may discover the evidence through the agency of the court during the civil procedure.

The duration of civil action will vary depending on the IP subject matter involved and specifics of the case at issue. Typically, the decision of the court may be obtained within six to 12 months, unless appealed.

Practically, civil procedure is widely used as enforcement option to tackle parallel imports and grey market goods, including those offered on the internet. This measure is also applied when terminated or former franchisees continue doing business using the franchisor's trademarks, copyrights, know-how and other IP assets after termination of the underlying contractual relationship.

Criminal proceedings

Illegal use of IP rights may also lead to criminal prosecution.

In accordance with the applicable criminal law, unlawful use of a patent, trademark and copyrighted subject matter entails criminal liability only in the event of a substantial amount of damage being caused to the IP owner, or if the IP infringement is repeated.

The typical statutory criminal sanctions are the following: (1) criminal fine; (2) forced labour; (3) correctional works; and (4) imprisonment. In the course of criminal procedure, the IP owner is also entitled to file a civil lawsuit to recover damages.

The total duration of criminal proceedings is usually hard to predict, although the approximate timing is about one to two years, unless the decision of the first instance court is appealed by the infringer.

In practice, criminal procedure is applied against large-scale or gross infringers who are manufacturing and distributing counterfeit goods in large quantities.

Unfair competition action

IP infringement may be a matter of unfair competition, which is prohibited. Unfair acquisition and use of IP rights is not allowed either. Passing off and imitation of trade dress are also treated as unfair behaviour, which may be prosecuted.

The Russian Federal Anti-monopoly Service (FAS) is empowered to consider disputes related to unfair competition through a special quasi-judicial procedure. This type of procedure starts on the basis of a complaint filed by the injured party (e.g., the IP owner or local distributor).

Should the action on unfair competition be eventually successful, the respondent (infringer) would be forced to cease the established illegal activities and pay the administrative fine in favour of the state budget (which may be up to 0.15 per cent of the corresponding infringer's profits).

This procedure usually lasts about six to 10 months, although it can take longer if the binding order of the FAS is appealed in court.

Cease-and-desist letter

Cease-and-desist or warning letters are mandatory with regard to monetary claims in Russia. In other words, it is not possible to sue the infringer in court and claim damages or monetary compensation if a demand letter has not been dispatched in advance of the civil action.

In accordance with the applicable law, the infringer has 30 days to respond to the cease-and-desist letter. Failure to respond, or receipt of a negative reply, provides the IP owner (or its registered exclusive licensee) with legal standing to sue and seek monetary relief.

If the main goal is stop IP infringement, a cease-and-desist letter will not be a prerequisite for starting an action in court. Sending a demand letter to the alleged infringer asking for a voluntary cessation of IP infringement may be the easiest out-of-court enforcement option in many practical situations.

iv Data protection, cybercrime, social media and e-commerce

Data protection

In the context of franchising, if the parties deal with processing of personal data, especially in relation to Russian individuals (data subjects), the applicable data protection law has to be considered.

More specifically, both the franchisor and the franchisee (as applicable) can be considered the data operator (data controller); and, similarly, each can be considered the data processor (a person acting and processing data under the instructions of the data operator). If the franchisee outsources data processing to a franchisor, for example, both parties must enter into a data-processing agreement, conditional on the data subject's consent. If the franchisor would like to use the franchisee's clients' data for certain advertising or marketing purposes, the consent of the respective data subjects (addressees) must also be obtained.

In general, the data subject's consent must be specific, informed and conscious. Unless otherwise provided by the law, the data subject's consent can be obtained in any form, including online. In cases where the law requires the data subject's consent to be given in writing (e.g., biometric data), implied or inferred consent will not be regarded as valid. The burden of proof that the data subject's consent has been received remains with the data operator. In addition, a data operator that is processing Russian individuals' personal data must notify the Russian IT regulator (Roskomnadzor), provided it is not exempt from the notification obligation. The notification can be submitted by the data operator on paper or electronically.

In the event of cross-border data flow, it is essential to ensure that the rights and interests of data subjects are fully protected in an adequate manner in the corresponding foreign jurisdiction. International data transfer to a country that does not provide a level of adequate protection is only permitted if the written consent of the data subject concerned has been obtained, or the data transfer is made for the performance of a contract to which the data subject is a party.

Importantly, if the franchisor or franchisee (as the data operator) collects, systematises and accumulates any personally identifiable information on Russian citizens, that data must be stored in data centres or databases located in Russia.

Finally, the data operator must take necessary and sufficient measures, including from the technical, organisational and legal perspectives, to protect personal data that is being processed from unauthorised disclosure, access, use, distribution, theft, etc.

Social media and e-commerce

Generally, under the franchise agreement, the franchisee may be permitted to or prohibited from developing the franchised business on social media or in the digital arena. If the franchisee is permitted by the franchisor to advertise the franchised brand on social media and conduct e-commerce by offering the franchised products online to customers, the relevant national laws regarding telecommunications, data protection, advertising and online trade will apply and must be complied with.

Furthermore, pursuant to the provisions of Russian franchise law, it is possible to create an obligation for the franchisee to offer and sell goods exclusively within its contracted territory. At the same time, the relevant clause in the franchise agreement obliging the franchisee to sell goods solely to the customers located or residing in the contracted territory, shall be null and void.³ Hence, as long as the franchisee restricts its activities to the franchised territory, it is free to sell goods to different customers, especially by way of an online platform, from all over the world.

Finally, any use by the franchisee of the franchise trademark (or similar mark) on the internet or in its domain name after termination or expiration of the franchise agreement may lead to trademark infringement and other sanctions established by the applicable law and the contract. Unless assigned in an amicable (non-judicial) manner, which may be agreed between the parties, the conflicting domain name may be recaptured in the course of civil procedure (litigation) with the competent national court. Uniform Domain-Name Dispute-Resolution Policy (UDRP) proceedings are not effective for .ru, .su and .рф domains, although the Russian courts do recognise and apply the widely known UDRP principles (criteria) when establishing trademark infringement in the course of local domain-name dispute-resolution practice and litigation.

IV FRANCHISE LAW

i Legislation

There is no dedicated franchise act in Russia. Franchising activities are specifically regulated by the Russian Civil Code (Chapter 54 of Part II). In addition, the general provisions of the national civil law, especially those that govern the law of contracts and performance of obligations (Part I of the Russian Civil Code) and intellectual property law (Part IV of the Russian Civil Code), may also apply to franchise operations. Finally, the ongoing franchise relationship may also be affected by local laws on competition and commercial law, labour and employment, real estate and property law, tax and currency control, information technology and data protection, advertising and consumer protection, as well as other effective Russian laws and regulations.

ii Pre-contractual disclosure

Pre-contractual disclosure is not mandatory under Russian law. Nor does Russian law require the franchisor to provide disclosure updates within the term of the franchise agreement. The law only states that the franchisor shall provide technical and commercial documentation and any other necessary information for the franchisee to be able to develop the franchised

³ Article 1033 (2) of the Russian Civil Code (Part II).

business, and to instruct the franchisee and its employees on the aspects associated with franchising activities. However, this does not necessarily mean 'pre-contractual disclosure' in the sense understood in international franchise practice.

The foregoing disclosure obligations may be established by the parties on the basis of the doctrine of *culpa in contrahendo* and the principle of good faith at the stage of negotiations pertaining to a prospective franchise transaction.

The format of disclosure is not prescribed by Russian law or published by any governmental agency. Hence, the parties to a contract are free to use and be guided by the documentation normally used in overseas franchising deals.

iii Registration

Every franchise agreement has to be made in writing. In addition, the grant of franchise contemplated by the underlying franchise agreement must be registered with Rospatent. A franchise that is not registered with Rospatent will be invalid.⁴ As a result, the parties will not be able to enforce the contracted rights or obligations against third parties in the event of a non-registered franchise grant. Hence, registration shall not be waived, whether in the context of domestic or cross-border franchising.

Russian law does not set a specific limitation period within which the franchise grant has to be registered with Rospatent. Unless there is an agreement to the contrary, the registration obligation vests with the franchisor, who must prepare and file the appropriate set of documents with Rospatent.

There are various options regarding documents that may be submitted to Rospatent in support of the concluded transaction in addition to the power of attorney authorising the local representative (e.g., a trademark attorney) to make the filing. It is, therefore, possible to provide: (1) the original franchise agreement; (2) a notarised excerpt from the same; or (3) the statement of franchise (notification), executed by the parties. Before filing, it is essential to ensure that the original franchise agreement, as well as the document that has been chosen for submission to Rospatent, contains all essential elements (mandatory clauses) required by Russian law and dictated by local practice. Importantly, if the parties do not wish to disclose the original contract along with stated financial information or any other sensitive data, the best option would be to make and file an excerpt from the agreement, or present the notification.

In practice, the registration process may take about two to three months in the absence of office actions or Rospatent enquiries.

iv Mandatory clauses

The franchise agreement may contain various terms and conditions depending on the transaction structure and the parties' negotiations.

In general, a contract of this type will usually contain a section on the parties and a statement of their intentions, definitions and interpretation, the franchise or licence grant, term and renewal, franchise fees and payment order, the franchisor's and franchisee's duties, site selection or construction and approval, training and education, inspections and audits, accounting and records, advertising and promotion, protection of franchised assets and

⁴ Article 1028 (2) of the Russian Civil Code (Part II).

confidential information, default and termination, the franchisee's rights and obligations upon termination, franchise transfer and sub-franchising, and governing law and dispute resolution, as well as other general clauses.

As regards Russian law and registration, the franchise agreement must address the following essential elements (points):

- a* parties (i.e., corporate names and addresses);
- b* subject matter (i.e., registration numbers of the franchised trademarks and description of the other franchised IP rights (e.g., copyrights, know-how));
- c* franchised products (i.e., goods or services for which the licensed trademark is protected and licensed);
- d* scope of franchised rights (i.e., permitted manners of IP use and distribution of franchised goods or services);
- e* franchisee's duties and covenants (i.e., compliance with standards or manuals, quality compliance, confidentiality obligations, non-compete, site selection and approval, customers' support, etc.);
- f* consideration (i.e., franchise entrance fee, lump sum, royalties, etc.);
- g* type of franchise (i.e., sole versus exclusive versus non-exclusive);
- h* term (i.e., term of protection of franchised IP or certain specific period);
- i* territory (i.e., whole of Russia or certain specific areas);
- j* sub-franchising (i.e., permitted or prohibited, how many versus to whom, etc.);
- k* franchise renewal (i.e., franchisee's right of first refusal);
- l* termination (i.e., mutual or unilateral, for cause or convenience, etc.);
- m* post-termination (i.e., franchisee's rights, obligations and liabilities following termination); and
- n* signatures (i.e., names and titles of signees).

v Guarantees and protection

In the context of franchising, a franchisee can resort to different types of guarantees and protection measures to secure its contractual obligations to a franchisor. First of all, the franchisee can obtain insurance coverage from an insurance company for the risks associated with the development of the franchised business. Second, the franchisee may guarantee the performance of its duties through the agency of a third party, including the director general or company owner. In addition, the franchisor can be secured by way of engagement of a bank or other commercial organisation providing an independent guarantee over the transaction. Finally, the parties may negotiate the payment of security deposits or default interests to ensure the payment of franchise fees. Other guarantees and protection can be agreed in the course of parties' negotiations.

V TAX

There is no specific franchise-related tax in Russia. A foreign franchisor must take into account VAT and CIT on the contracted franchise fees, while the local franchisee, as the franchisor's tax agent, is responsible for withholding the corresponding taxed amounts. In addition, the parties should observe certain local transfer pricing rules.

i Franchisor tax liabilities

Foreign franchisors must add 20 per cent VAT on to franchise fees payable by Russian franchisees under the franchise agreement.

The licensing of patents, industrial designs, know-how, computer programs, databases and mask works are exempt from VAT, while trademark and copyright licences will be taxed under the underlying franchise agreement.

In addition, franchise fees payable to a foreign franchisor by a Russian franchisee are subject to 20 per cent CIT, unless there is a special double-tax treaty in place between Russia and the foreign state where the franchisor resides, as this would provide certain tax reliefs.

ii Franchisee tax liabilities

If the foreign franchisor does not have a permanent establishment or a representative office in Russia, the Russian franchisee acts as a tax agent for the foreign franchisor. Therefore, the Russian franchisee must withhold the corresponding VAT amount from corresponding franchise fees related to trademark and copyright licences set out by the franchise agreement and remit that amount to the state budget.

In addition, the Russian franchisee, acting as a tax agent for the foreign franchisor, shall withhold the corresponding CIT amount from the contracted franchise fees and remit this to the state budget, unless there is a special double-tax treaty in place between Russia and the foreign state where the franchisor resides, as this would provide certain tax reliefs.

Also, the franchisee will be able to deduct the VAT-able amount as well as the amount of franchise fees when paying its own CIT to the government.

iii Tax-efficient structures

In terms of tax-efficient franchising operations, the following best practices can be recommended.

VAT exemption

There should be separation of the underlying IP licence grants, documentation and pricing under the franchise agreement in relation to VAT-able items (i.e., trademarks, copyright) and non-VAT-able items (i.e., patents, industrial designs, know-how, computer programs, databases, mask works).

Double tax treaty

If the foreign franchisor is established in and operates under the laws of a foreign state that has a special and effective double-tax treaty with Russia, a zero or reduced CIT rate may be applied; to enjoy that tax relief, the foreign franchisor must provide the Russian franchisee with valid and certified documentary proof of its tax residency in the relevant foreign state.

Special tax clause

It is possible to include a special tax clause in the franchise agreement related to the calculation of all withholding taxes without affecting the amounts (franchise fees) payable to the foreign franchisor.

Transfer pricing

The amount of contracted franchise fees should be in compliance with the corresponding market price level to avoid additional taxes and penalties.

VI IMPACT OF GENERAL LAW

i Good faith and guarantees

There is a specific provision in Russian law to the effect that contracting parties, while exercising their rights and performing their obligations, should be acting in good faith. There is also a general civil law principle that actions of persons carried out with the sole purpose of causing damage to other persons are prohibited. Hence, abuse of rights and unfair behaviour are prohibited, while the duty of good faith shall always be guaranteed, especially in terms of making transactions. The concepts of good faith and fair dealing are supported and enforced by the Russian courts in contractual disputes, including franchise-related ones.

ii Agency distributor model

Franchise and commercial agency are two different contractual arrangements. Specifically, the functions of the franchisor or franchisee may not be compared with the functions of the principal or agent according to Russian law.

Even though the franchise agreement may sometimes be a 'blended' contract, with many elements incorporated in it, the risk that a franchisor will be treated purely as a principal and the franchisee treated purely as the franchisor's agent is very low.

Usually, agency relations are mixed with distribution, but not with franchising, in Russia. And, importantly, in Russian civil law there is no such contractual model as the distribution contract.

iii Employment law

The franchisor and the franchisee are separate legal or commercial entities operating under the concluded franchise agreement. Therefore, they have their own labour and employment obligations in relation to their own employees, but not in relation to each other. The terms and conditions of the franchise agreement are primarily governed by civil law (i.e., the Russian Civil Code), while the labour and employment relations of entities doing business in Russia are regulated by the Russian Labour Code.

According to the Russian Labour Code, employment relations between the employer and the employee may arise only under a labour agreement. The applicable labour law also stipulates that the conclusion of civil law agreements, which de facto govern the relationship between the employer and the employee, are not allowed.⁵

Therefore, there is no risk or likelihood that the franchisee (or even the employees of the franchisee) will be treated as the employees of the franchisor in Russia.

⁵ Article 15 of the Russian Labour Code.

iv Consumer protection

In Russia, franchisees cannot be treated as consumers under any circumstances. The Russian Law on Protection of Consumers' Rights covers the protection of rights of individual consumers acting as physical persons (not business entities). In other words, the applicable consumer protection law governs business-to-consumer relations, while the franchise relationship may only be created in the business-to-business sphere.

v Competition law

Generally, the applicable law, or competition law, prevents monopolistic (anticompetitive) activities, 'cartels' and abuse of dominance. The law also prohibits unfair competition. In this regard, dissemination of false information or unfair advertising that may damage an operating business entity is not allowed. Passing off and unauthorised IP acquisition and use may be treated as unfair behaviour and, therefore, sanctioned. Importantly, competition law allows 'vertical' contracts, including franchise agreements, whether made between foreign or domestic companies.

According to Russian law, a franchise agreement may impose different obligations and covenants on the franchisee, particularly those listed in Section VI. Theoretically, these covenants, to the extent they are incorporated in the franchise agreement, may be declared invalid by the FAS (or other interested person) if they are found to be contradictory to anti-monopoly laws, subject to the relevant market conditions and economic status of the parties. In practice, the standard contractual restrictions provided in franchise agreements and made in line with relevant provisions of Russian law, including non-compete covenants, are acceptable from the antitrust standpoint.

Importantly, a franchise granted to the franchisee may be sole, exclusive or non-exclusive. If the granted franchise is sole, the franchisor loses its right to use the franchised set of IP rights in the franchised territory on its own and loses the right to offer and sell the same franchises to third parties in the franchised territory. If the granted franchise is exclusive, the franchisor may reserve the right to use the franchised set of IP rights in the franchised territory on its own, but nonetheless loses the right to offer and sell the same franchise to third parties in the franchised territory. If the franchise is granted on a non-exclusive basis, the franchisor is free to franchise the already franchised set of IP rights in the franchised territory to others.

There is no maximum permitted term within which a franchise agreement may be effective. The franchise agreement may be concluded within a definite or indefinite term. If the franchise agreement is made for a definite term, the contract may provide for a specific term (e.g., 10 years), or clearly state that it stays valid during the period of protection of the franchised set of IP rights that has been licensed under the franchise agreement. If the term of the franchise agreement is not defined by contract, the franchise will be regarded as granted and effective for five consecutive years (starting from the corresponding registration date).

As follows from Russian law, the franchisee may be obliged by contract to sell the franchised goods under prices fixed by the franchisor. However, fixing of prices, including minimum resale prices, may fall under the supervision of the FAS. The agency may, within the scope of its competence, tackle any anticompetitive practices if they entail or may entail the fixing or support of prices (tariffs). Therefore, if the Russian Federal Anti-monopoly Service finds the contractual provision on pricing or minimum resale price to be in contravention of anti-monopoly laws, subject to the relevant market conditions and economic status of the parties, the clause may be deemed invalid by the agency.

The franchised territory (region, city, street, address, etc.) may or may not be specified in the contract. If the contract is silent on the territory, the franchise will be regarded as granted and effective in the whole territory of Russia. If the contract specifies certain boundaries or territory, the franchise will be valid in the contracted territory.

vi Restrictive covenants

The franchise agreement may contain different restrictive covenants imposed on the franchisee as allowed under the Russian law.⁶ The scope of the same will usually depend on the parties' negotiations and arrangements.

More specifically, the franchisor may elect for the following covenants to be incorporated into the contract: (1) the franchisee's covenant not to compete with the franchisor in the franchised territory in relation to the franchised business and franchised set of IP rights; (2) the franchisee's refusal to accept analogous rights under franchise agreements from competitors (potential competitors) of the franchisor; (3) the franchisee's covenant to distribute and sell the manufactured or purchased goods, perform works or provide services by using the franchised rights and applying the prices fixed by the franchisor; (4) the franchisee's covenant to refrain from distribution of analogous goods, performing analogous works and providing analogous services using the trademarks or trade names of other franchisors; (5) the franchisee's covenant to sell goods, perform works or provide services exclusively within the boundaries of certain territory; and (6) the franchisee's covenant to obtain approval from the franchisor for the location (as well as the exterior or interior design) of the commercial premises used for implementation of the franchised rights under the contract.

The above restrictive covenants are allowed under relevant provisions of Russian law and may be enforced if not complied with, especially during the term of the franchise agreement. The Russian court system has already tested a few cases in which non-compete covenants were prosecuted in favour of the cases' respective claimants (franchisors).

vii Termination

The franchisor and franchisee are free to use the wording of Article 1037 of the Russian Civil Code to create a valid termination clause in the franchise agreement.

More specifically, according to Russian law, any party may terminate a contract at any time if the franchise agreement has been concluded for an indefinite term. Six months' prior written notice is required in this case, unless the contract indicates a longer term for the advance termination notice. If the contract provides for a specific period of validity, the parties shall be guided by the terms of the franchise agreement.

Either of the parties to the contract concluded for a definite or indefinite term may terminate the franchise agreement by sending a written notice to the other party 30 days in advance. This option will be available only if the contract provides for the release of certain monetary compensation.

The franchisor may terminate the franchise agreement if the franchisee produces goods of inferior quality, or the quality of its services does not correspond to what has been set out in the contract. The franchisor may also repudiate the franchise agreement if the franchisee does not follow the franchisor's instructions and guidance aimed at ensuring compliance with

⁶ Article 1033 (1) of the Russian Civil Code (Part II).

the contractual provisions related to the terms and conditions of use of the franchised set of IP rights. Finally, the franchisor may cancel the franchise agreement if the franchisee fails to settle the franchise fees on the terms set out by the contract.

Termination by the franchisor is available if the franchisee has failed to remedy the breach within a reasonable term, or has committed another breach within a year of receipt of the written notice from the franchisor.

If the franchisor's right to the franchised trademark or franchised trade name (included in the franchised set of IP rights) is lost for any reason, the franchise agreement will be terminated, unless any similar (effective) IP asset is granted (substituted) by the franchisor.

If the franchisor or the franchisee becomes insolvent (bankrupt), the franchise agreement shall be dissolved.

Termination of the franchise agreement is subject to registration with Rospatent. In the absence of registration, the termination will not be effective.

As to post-term restrictions, especially the non-compete covenant, these may be deemed enforceable, provided it is clearly stated in the contract that they survive the termination. Moreover, the franchisee will be regarded as infringer if he or she continues using the franchised set of IP rights following the termination of the franchise agreement.

Although in practice it might be very difficult to take over the franchisee's business, this issue is negotiable and subject to contract. Sale and purchase arrangements, preliminary agreements, call options and conditional instruments are available under Russian law and may be implemented by the parties.

The franchisee's entity may be owned by the franchisor and the latter may corporately restrict any transfer of the ownership interest in the franchisee's entity to a third party.

The sale of shares in the franchisee can only be effectively limited if the franchisor owns some or a majority of the shares in the franchisee's company.

In the context of commercial property, there are no restrictions on foreign companies holding an ownership or lease interest in Russian real estate. Therefore, the question of taking local leases or premises shall be discussed between the parties. Relevant amendments to lease contracts, or the associated assignments, will have to be registered with the Russian State Register of Real Estate Rights and Transactions. Finally, the parties can make the lease agreement conditional on the franchise agreement, hence allowing the lease agreement to be terminated as soon as the franchise agreement is terminated.

viii Anti-corruption and anti-terrorism regulation

Russia is a party to a number of international treaties governing anti-corruption, including the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (dated 1997). There are a few national laws prohibiting terrorism, corruption, money laundering and fraud, namely the Russian Law on Terrorism Resistance (dated 2006), the Russian Law on Combating Corruption (dated 2008) and the Russian Law on Combating the Legalisation of Proceeds of Crime and Terrorist Financing (dated 2001), as well as other local acts and subordinated regulations in this field. The Russian Code on Administrative Offences and the Russian Criminal Code set out strict administrative and criminal liabilities for failure to comply with anti-bribery and anti-money laundering rules, and provide various sanctions for corresponding violations, for entities and individuals. Therefore, potentially susceptible businesses, including those of franchisors and franchisees, are obliged to abide by these laws and the national law enforcement agencies are vigilant in monitoring compliance.

ix Dispute resolution

Generally, franchise-related claims, certain unfair competition conflicts and IP infringement disputes that involve the Russian market, or are targeted at Russia, tend to be litigated through local courts. The system of commercial courts has basically four instances: (1) the first instance courts, (2) the appellate courts, (3) the cassation courts, and (4) the Russian Supreme Court. There is also a special Russian Intellectual Property Court operating as the court of first instance or court of cassation and empowered to hear IP-related cases and unfair-competition disputes. Franchising disputes may fall under the jurisdiction of the Russian IP Court at the cassation stage (third level).

Compared with other jurisdictions, Russia may be a jurisdiction to consider in terms of timing, costs, remedies and enforcement proceedings associated with dispute resolution. For example, it may take about six months for an IP infringement claim or contractual breach matter to reach the stage of the decision of the first instance court and then four months to accomplish the enforcement procedure, if it has not been appealed. Remedies can include preliminary and permanent injunctive reliefs, as well as monetary reliefs (e.g., statutory damages). To obtain statutory damages it is sufficient to prove the fact of the IP infringement having occurred. To obtain lost profits it is necessary to demonstrate: (1) the amount of the damages arising, (2) the method of calculation of the asserted damages, and (3) the nexus between the damages claimed and the illegal activities of the respondent. Cases may be settled at any stage of the civil procedure. Settlement agreement will be approved by the competent court if the agreed provisions do not affect the rights and legitimate interests of third parties. Attorneys' fees may be capped by the clients' respective lawyers and are recoverable from the losing party. If the case is being settled, the parties are free to allocate the attorneys' fees in whatever proportions they want. The general limitation period for the case to be brought to trial is three years and the same period applies for the commencement of the enforcement procedure, when the court decision becomes effective.

There has been rather a large number of noteworthy franchising disputes resolved in front of national courts. A few of them reached the Supreme Court, while many were concluded in the Russian IP Court. These conflicts concerned different issues, including the trademark grant and infringement, contract validity and termination, franchisees' non-compete obligations and non-performance of their financial obligations. In the majority of cases, franchisors prevailed in these civil actions.

Instead of resorting to litigation in local courts, the franchisee and franchisor can contractually agree on arbitration. Arbitration may be conducted in any jurisdiction and in any forum chosen by the parties. If there is no arbitration clause in the contract, the contract may not be submitted to arbitration. Russia is a party to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (dated 1958) (the New York Convention). Hence, an arbitral award received from another jurisdiction that is a signatory to the New York Convention may be enforceable in Russia.

The local courts will also enforce orders granted by foreign courts. Indeed, a court judgment issued by another jurisdiction may be enforceable in Russia, provided that recognition and enforcement of the foreign court judgment is stipulated by the relevant international treaty, and to which Russia is a party, and federal law. Russia is a signatory to many multilateral and bilateral international treaties for recognition and enforcement of foreign judgments.

The Russian Civil (Commercial) Procedure Code provides certain formal or mandatory requirements for recognition and enforcement of foreign judgments. These include, inter alia,

the following significant aspects: (1) effectiveness of the court judgment under the law of the jurisdiction in the territory on which it has been issued; (2) compliance with the statutory three-year term for filing a motion for recognition and enforcement of the foreign court judgment; and (3) consistency of the foreign court judgment with Russian public policy. If these requirements are not met, a Russian court may refuse to recognise and enforce a foreign judgment.

In the absence of a relevant international treaty, a Russian court may recognise and enforce a foreign judgment on the basis of the international principle of reciprocity and comity (*comitas gentium*). Although not in the franchising sphere, there have been at least a couple of successful landmark cases in which foreign judgments were enforced on the basis of the *comitas gentium* principle in Russia.

Mediation is also available as an alternative method of dispute resolution. Franchising conflicts are rarely mediated in Russia.

VII CURRENT DEVELOPMENTS

The business of franchising is growing internationally and apparently will continue to develop, from both an economic and a legal perspective. There are a lot of attractive segments and unexplored areas of the global market where the franchising model will fit perfectly and integrate well, and the Russian market does not represent an exception to this pattern.

Indeed, the Russian legal system has already adapted to the global practice of franchising and currently provides great, legitimate investment opportunities for market participants and their brands, technologies, trade secrets, systems, business reputation and other valuable assets. There have already been several packages of civil law amendments submitted, discussed and implemented by the government to 'close the gaps' in certain areas of national contract law, including franchise law. With these amendments in force, Russia is now welcoming new franchise business entrants to the country.

SAUDI ARABIA

*Melissa Murray*¹

I INTRODUCTION

The Kingdom of Saudi Arabia continues to prove very appealing to franchisors. Among the factors that encourage potential franchisors are its large population, residents' high income, ease of brand recognition and government support.

Saudi Arabia is the most populated country in the Gulf Cooperation Council (GCC) with a population of approximately 32.5 million people. Among those, a significant proportion are under the age of 25. The World Bank Group categorises Saudi Arabia as a 'high-income' state, with a gross national income of US\$20,080 per capita.² According to Trading Economics, Saudi Arabia's gross domestic product at the end of 2017 was over US\$638 billion, which represents 1.1 per cent of the world economy.³ Saudi Arabia's government has incentivised local and foreign investment within the country to facilitate a nation-wide economic shift from reliance on oil revenues to other sources of income.

The food and beverage sector has proven very successful, while the retail sector continues to gain popularity. It must be noted that franchising opportunities within Saudi Arabia are not limited to foreign brands. The past few years have seen an increase in the number of local concepts being franchised within Saudi Arabia and out to the rest of the GCC.

II MARKET ENTRY

i Restrictions

There are a few legal restrictions on local and foreign franchisors in Saudi Arabia. Franchisors, franchisees and developers are subject to foreign investment laws. Pursuant to the Economic Agreement between the GCC states, nationals of other member countries of the GCC⁴ are not considered 'foreign investors' under the law, therefore it is permissible for a foreign brand to be operated by 'GCC nationals' as opposed to 'Saudi nationals'.

For those franchisors looking to set up their own business, or for franchisees looking to trade directly in Saudi, restrictions on foreign investment vary according to how the activity is classified. The Saudi Arabian General Investment Authority's (SAGIA) requirements also depend on the classification. Non-GCC investors wishing to engage in 'service-based'

1 Melissa Murray is a partner at Bird & Bird (MEA) LLP.

2 World Bank Group, 'Doing Business: Ease of Doing Business in Saudi Arabia' (revised in 2018), available at: www.doingbusiness.org/data/exploreeconomies/saudi-arabia/.

3 <https://tradingeconomics.com/saudi-arabia/gdp>.

4 GCC member countries consist of: Saudi Arabia, Qatar, the United Arab Emirates, Bahrain and Oman.

activities have the option of establishing a local branch office or 100 per cent owned limited liability company (LLC). For entities engaged in service-based activities, such as restaurants and maintenance operations, no minimum paid-up capital is imposed by SAGIA. Non-GCC investors wishing to engage in ‘trading-based’ activities have to (1) establish an LLC with at least 25 per cent of the company owned by a Saudi national or company; (2) hire and train Saudi nationals to make up 15 per cent of their employees; and (3) restrict their activity to one store per district. SAGIA imposes a minimum capital requirement of around 27 million Saudi riyals for such companies – 20 million Saudi riyals of which is imposed on the foreign investor as a minimum contribution. This figure is only imposed on the company’s non-Saudi shareholders. Note in mid to late 2015 there were discussions within the Saudi legislature on potentially reducing this 25 per cent figure.

Foreign investors may also set up local manufacturing facilities that manufacture and distribute products to franchisees within Saudi Arabia. SAGIA imposes a minimum share capital requirement of 1 million Saudi riyals for such entities.

Certain activities such as oil exploration, drilling and production, manufacturing civilian explosives and security services are restricted to Saudi nationals.⁵

ii Foreign exchange and tax

Although there is no exchange control in Saudi Arabia, transactions are generally made in Saudi riyals. Saudi Arabia has a corporate tax and *zakat* (Islamic wealth tax), but no individual income tax.

As with most countries, tax depends on the entity’s structure. *Zakat* is set at the flat rate of 20 per cent, and is obligatory for all legal persons who make any payments to foreign individuals. Additionally, a withholding tax of 5 to 20 per cent is imposed on companies engaging in specific activities.

III INTELLECTUAL PROPERTY

i Brand search

Trademark searches, including company name registrations, are made in the trademark office at the Ministry of Commerce and Industry (MOCI).

ii Brand protection

The MOCI allows the registration of distinctive marks that are not contrary to shariah (Islamic) law and are not names of geographic locations. In cases of globally recognised brands, only a rightful owner or their authorised representative can register their trademark in Saudi Arabia. Saudi Arabia operates on a ‘first-to-file’ basis, giving priority and ownership to the first legal person to register the mark.

To register a trademark for a franchise, the owner of the mark or an authorised representative must submit an application that sets out a list of the goods or services and their class, along with a copy of the mark’s foreign registration certificate. Each class of goods and services requires a separate application. The MOCI generally decides whether a trademark is

⁵ SAGIA Business Center list of businesses prohibited for foreign investments, available at: www.sagia.gov.sa/Documents/Download%20center/Business_not_permitted.pdf.

granted within 60 days of filing. The MOCI notifies the applicant if it requires changes to be made to the application. The applicant is then given 90 days to amend the application in accordance with the MOCI's instructions.

If approved, trademark protection is granted for a period of 10 years and may be renewed up to six months after the registration expires.

If the trademark application is not approved, the applicant can appeal the MOCI's decision with the MOCI within 60 days of the rejection date. If the MOCI rejects the appeal, then the applicant may appeal to the Board of Grievances, an independent administrative judicial commission, within 30 days of the date of the rejection being issued.

iii Enforcement

The MOCI and the Board of Grievances have enforcement authority over trademark infringement. Upon receiving evidence of possible counterfeiting activity, the MOCI conducts an investigation and passes its findings on to the Board of Grievances. The latter may then bring both civil and criminal claims against alleged perpetrators. If the trademark owner can prove the existence of an imminent need for protection, the Board has the authority to issue injunctions.

iv Data protection, cybercrime, social media and e-commerce

Privacy rights are protected under the Basic Law of Governance, which is essentially Saudi Arabia's constitution. The Basic Law of Governance generally prohibits the confiscation, delay, eavesdropping and surveillance of communications. Breaches of privacy or confidentiality are punishable offences under the Basic Law of Governance, and the non-breaching party may be awarded compensation for damage caused by such unlawful disclosure. Non-economic punitive measures, such as sanctions, may also be imposed on the breaching party.

Saudi Arabia does not have a specific code tailored towards data protection, but data protection is derived from other codes such as the Anti-Cyber Crime Law. The Anti-Cyber Crime Law protects 'information, commands, messages, voices and images' that are or can be 'saved, processed, transmitted or constructed by computers'.⁶ Breaches of the Anti-Cyber Crime Law can result in fines of over US\$800,000 and prison sentences of up to four years. In the absence of any relevant legislation, courts will apply relevant shariah law principles, which place a high value on privacy.

IV FRANCHISE LAW

i Legislation

Saudi Arabia has recently approved the Commercial Franchise Law (the New Franchise Law).⁷ The New Franchise Law creates a regulatory framework for the relationship between the franchisor and the franchisee on a basis that promotes transparency. The New Franchise Law shall apply to any franchise agreement implemented within Saudi Arabia. The implementing regulations of the New Franchise Law have yet to be released. The New Franchise Law is expected to come into force in April 2020.

⁶ KSA Bureau of Experts at the Council of Ministers, Anti-Cyber Crime Law (August 2010), available at: <https://www.saudiembassy.net/announcement/announcement03260701.aspx>.

⁷ Cabinet Decision No. (122) of 1441 H.

Saudi Arabia previously did not have a law specifically governing franchising, but the Commercial Agencies Law and its Regulations, which govern the principal agent relationship, also cover the relationship between a franchisor and a franchisee. The Commercial Agencies Law Regulations also set out the procedure for registering a franchise in Saudi Arabia, as well as the rights and obligations of all parties involved. The current Commercial Agencies Law regime fails to differentiate between franchise agreements, distribution agreements and agency agreements, and all three may be construed as a commercial agency capable of registration.

Until such time as the New Franchise Law comes into effect, franchises will continue to be governed by the Commercial Agencies Law Regulations. The New Franchise Law specifically excludes ‘agreements or contracts’ subject to the Commercial Agencies Law and it remains to be seen whether an amendment will be made to the Commercial Agencies Law Regulations to exclude franchise agreements.

ii Pre-contractual disclosure

The New Franchise Law requires franchisors to provide the franchisee with a disclosure document at least 14 days prior to the execution of the franchise agreement or before the franchisee pays any funds relating to the franchise (i.e., a deposit). The disclosure document must disclose the main rights, obligations and material risks related to the proposed franchise. The disclosure document and franchise agreement must be translated into Arabic.

Under shariah law, parties must deal in good faith and fully disclose all material facts to each other. This good-faith obligation is now specifically set out in Article 10 of the New Franchise Law. Parties may seek judicial remedies if a party is alleged to have failed to disclose or fraudulently disclosed any pertinent facts and the other party sustained damage from the disclosure or non-disclosure.

iii Registration

The franchise agreement, along with the disclosure document, must be registered with the MOCI. It is not yet clear what supporting documents will also have to be submitted. Under the previous franchise regime, the MOCI required the following documents to register an agreement as a commercial agency, which was required to obtain things such as signage approval:

- a* a standard application;
- b* a certified Arabic translation of the agreement, as well as all other foreign-language documentation;
- c* a copy of the franchisee’s commercial registration and chamber of commerce certificate; and
- d* a declaration, in writing, that the franchisee’s capital is Saudi-owned and its authorised representative is a Saudi national.

We expect to receive further clarification as to the documents required once the implementing regulations have been issued.

iv Mandatory clauses

Under the New Franchise Law, while a franchise agreement does not currently have to follow a specific template, it must include the following elements:

- a* a franchise business description;
- b* the term or period;

- c* the method of amendment;
- d* the geographical scope;
- e* the consideration payable to the franchisor by the franchisee and the method of calculation;
- f* both parties' obligations concerning the training of the franchisee's employees by the franchisor;
- g* the franchisor's obligation to provide technical, marketing and other types of experience required by the nature of the franchise;
- h* the franchisees obligation to adhere to the instructions, marketing method, display and maintenance of the franchise's identity;
- i* the franchisee's rights in relation to intellectual property;
- j* the mechanism of settlement of any dispute;
- k* the franchisee's rights relating to sub-franchising; and
- l* provisions relating to any change of owner of the franchise.

The implementing regulations of the New Franchise Law may set out further requirements for the franchise agreement, including a set form for the agreement.

v Guarantees and protection

Franchise agreements generally include guarantees. Guarantees are enforceable depending on their level of conformity with the elements of shariah law. Guarantees may be enforceable against entities, and personal guarantees may be enforceable against individuals.

V TAX

i Franchisor tax liabilities

Saudi and GCC national franchisors are exempt from corporate tax. Instead, they pay *zakat* at the rate of 2.5 per cent. Non-Saudi and non-GCC nationals must pay a flat corporate tax at the rate of 20 per cent. If a company has GCC national shareholders as well as non-GCC shareholders, the GCC nationals would be responsible for *zakat* at the rate of 2.5 per cent on their interest in the company and non-GCC shareholders would be responsible for a 2 per cent corporate tax on their interest. A franchisor who is a Saudi resident individual or company must declare and pay withholding tax on payments made outside Saudi Arabia. Payments to non-residents are subject to a withholding tax of 5–20 per cent, depending on how they are classified. For payments outside Saudi Arabia, franchisors will be subject to a 5 per cent withholding tax.

ii Franchisee tax liabilities

Individual franchisees are not subject to tax obligations while franchisee entities will be subject to corporate tax or *zakat*. As with franchisors, GCC national franchisees will be subject to a 2.5 per cent *zakat*, while non-GCC franchisees will be subject to a 20 per cent corporate tax. These same flat tax rates apply to companies with GCC national shareholder and non-GCC shareholders respectively.

Franchisees will be subject to a withholding tax of 5 to 20 per cent on payments made to non-residents. Payments to the foreign franchisor, the head office or an affiliated company located outside Saudi Arabia are subject to a 15 per cent withholding tax. The franchisee must declare and pay the withholding taxes.

Saudi Arabia has no personal income tax, so individual franchisees will have no personal tax liability. They will, however, be required to pay *zakat* at the rate of 2.5 per cent.

VAT was implemented in Saudi Arabia on 1 January 2018 at a rate of 5 per cent, with a limited number of exemptions for certain items related to education and healthcare, and basic food items.

iii Tax-efficient structures

The Saudi Arabian government provides tax incentives to companies that establish entities in designated economic areas. Additionally, Saudi Arabia has tax treaties with China, Japan, Russia and the United Kingdom, among others, that may be channelled for tax incentives for foreign franchisors and franchisees.

VI IMPACT OF GENERAL LAW

i Good faith and guarantees

Good faith dealings are deeply rooted in Saudi Arabia's moral code and practices. Saudi courts can hear cases where one or more parties did not behave in good faith. Courts will look to the intent of the party in question to amend or enforce agreements. To avoid allegations of having acted in bad faith, parties must set out their terms, rights and obligations explicitly, clearly and to a full extent. The New Franchise Law specifically provides that all parties shall undertake their obligations in good faith.

ii Agency distributor model

Because at the time of writing, under Saudi law, franchising in Saudi is governed by the Commercial Agencies Law Regulations, it is regarded as a commercial agency. The franchisor–franchisee relationship is treated as a principal agent relationship, with a key difference being that the franchisor is generally not vicariously liable for any torts that the franchisee commits unless the former is shown to have exercised direct control over the franchisee's everyday operations. This will change, however, once the New Franchise Law comes into force in April 2020.

iii Employment law

Saudi law generally does not view a franchisor–franchisee relationship as an employment relationship.

iv Consumer protection

The franchisee cannot claim any consumer protection rights as they are deemed to be the franchisor's agents.

In terms of protecting consumers, Saudi Arabia's Commercial Agencies Law Regulations place an obligation on the franchisee to maintain their products at a reasonable cost, and to ensure that spare parts are available at reasonable prices throughout the term of the franchise agreement and up to one year thereafter. Franchisees must keep stock of integral spare parts, while spare parts that are not in stock must be made available to the consumer within 30 days of the latter's request. The franchisee is held to the same warranty periods that the franchisor provides, therefore the franchisor has an obligation to provide spare parts and necessary support to franchisee for the term of their agreement and for one year thereafter.

The New Franchise Law is concerned with the relationship between franchisor and franchisee and not consumers or customers; however, when released, the implementing regulations of the New Franchise Law may contain some consumer protection provisions.

v Competition law

Saudi Arabia introduced a Competition Law in 2004 to facilitate fair competition and stimulate the economy by preventing the formation of monopolies. The Competition Law allows the market forces to decide prices of goods and services, which essentially gives the consumer more bargaining power.

vi Restrictive covenants

Saudi Arabia recognises restrictive covenants. Courts may enforce covenants, such as non-compete clauses, if they are provided for in the franchise agreement and so long as they represent the parties' intent and are in accordance with shariah law. Parties may restrict each other from conducting substantially the same business with third parties, and may also agree to geographic restrictions. The New Franchise Law does not discuss restrictive covenants therefore there is no express prohibition on the franchise agreement including such clauses.

vii Termination

Currently, in the event of any disputes leading to or following termination, Saudi courts will refer to the agreement, the intent of the parties and whether the clauses are compliant with shariah law and all other relevant regulations. If disputes arise, the MOCI will not permit a new franchisee to register a new franchise agreement with the franchisor until the dispute is settled either by the parties or through the courts. Courts may issue an order to deregister the franchisee from the Commercial Agency Register if they find in favour of the franchisor. The regulations of the New Franchise Law may contain similar provisions. The courts may also award direct damages but are hesitant to award any indirect or consequential damages to either party. The New Franchise Law contains a chapter consisting of three articles that deal with compensation. Both the franchisor and the franchisee have a statutory right to compensation in certain situations.

viii Anti-corruption and anti-terrorism regulation

Corruption, bribery, manipulation, embezzlement, unlawful enrichment and money laundering are criminal offences in Saudi Arabia. Saudi Arabia has elected Nazaha, the National Anti-corruption Commission, whose aim is to eliminate corrupt practices and bribery. Additionally, an Anti-Bribery Law was introduced to combat the making or receiving of bribes.

ix Dispute resolution

Parties are free to select their means of dispute resolution. They can opt for their choice of governing law and jurisdiction. Currently, the Board of Grievances in Saudi has jurisdiction over franchising disputes for those disputes not referred to international or local arbitration.

Traditionally, parties have selected the Board as their redress, but arbitration clauses have become more common given that local arbitration regulations were enacted in 2012. Franchisors may prefer arbitration as an alternative to the Board, as the latter has been known to enforce its subjective interpretation of shariah law. Furthermore, the Board rarely, if ever,

cites precedent cases, meaning the parties lack foresight as to the outcome of a hearing. Another worry for franchisors is that the Board may also exercise protectionism towards Saudi-national franchisees. An issue with arbitration is how or whether the Board will enforce awards. Despite the fact that Saudi Arabia is a party to the New York Convention and the Washington Convention, the Board has broad authority to dismiss arbitral awards. Foreign awards are subject to the same enforcement issues. In general, foreign judgment and arbitral awards may be enforced if the following conditions are met:

- a* jurisdiction: the Saudi courts do not have jurisdiction to hear the original matter decided by the foreign court, and the foreign court has the jurisdiction to adjudicate the matter and issue judgment;
- b* due process: the parties to the litigation are afforded their due process and (1) issue a summons and complaint; (2) are adequately represented; and (3) are able to defend themselves;
- c* reciprocity: there is reciprocity between the foreign jurisdiction that issued the judgment and Saudi Arabia to enforce each other's judgments. This is typically done through a treaty. The absence of such a treaty may not bar an enforcement action;
- d* consistency: the judgment being enforced does not contravene a judgment issued by a Saudi court or other governing body on a similar matter;
- e* finality: the foreign court's decision is final and binding and not subject to further appeal; and
- f* public policy: the judgment does not violate Saudi law or public policy.

The New Franchise Law specifically allows arbitration, mediation and conciliation.

VII CURRENT DEVELOPMENTS

Despite the New Franchise Law being released, until such time as the implementing regulations have been issued, it will be difficult for franchisors to fully understand how to comply with the Law. Under the current regime, franchise agreements are registered as commercial agency agreements and the MOCI registers most commercial agency and distribution agreements as 'non-exclusive', regardless of whether they contain any exclusivity provisions. This is probably because of the the pending implementation of the New Franchise Law and uncertainty as to its application in practice.

There have been recent developments in which the Saudi Food and Drug Authority instructed food facilities in Saudi Arabia to clearly display both the ingredients and the number of calories in food and beverages.

SINGAPORE

Lorraine Anne Tay and Just Wang¹

I INTRODUCTION

Singapore is an attractive market for franchisors as it is an open economy with one of the most liberal trading regimes in the world. As of 2012, Singapore was estimated to have more than 600 franchise concepts and more than 40,000 franchisees, with the majority of them in the food and beverage, retail, business services and health-care industries.

The franchising and licensing industry accounts for 18 per cent of Singapore's total domestic retail sales volume, and generates a turnover of about S\$6 billion. In 2013, its estimated gross domestic product (GDP) contribution was 1.6 per cent of Singapore's GDP, and this is projected to expand rapidly to about 3 per cent by 2017.² In 2013, the nominal value added in these sectors was S\$5.1 billion and S\$3.3 billion respectively, with the franchising industry alone accounting for approximately S\$1 billion.³

The Franchising and Licensing Association of Singapore (FLA) serves as Singapore's national franchise body and seeks to promote and facilitate the growth of franchising both locally and abroad. Companies may choose to become members of the FLA. The FLA has released a Code of Ethics, which is binding only upon FLA's members.

Foreign franchises are warmly welcomed in Singapore and account for the bulk of franchise sales in the country. The United States is the dominant supplier of foreign franchises in Singapore. Australian franchises, as well as Japanese and Taiwanese franchises, primarily in the food and beverage industry, also enjoy a degree of presence in Singapore; however, with support from the local government as well as industry-led efforts, local players have grown rapidly in recent years, particularly in the food and beverage, child-related and training industries. At the Franchising & Licensing Asia forum held in Singapore in October 2019, there were more than 197 brands from over 15 countries around the world present to showcase their products and services.⁴

1 Lorraine Anne Tay is a partner and Just Wang is a senior associate at Bird & Bird ATMD LLP.

2 Speech by Mr Teo Ser Luck, Minister of State for Trade and Industry, at the opening ceremony of Franchising & Licensing Asia 2013, 3 October 2013. See: <http://www.nas.gov.sg/archivesonline/speeches/view.html?filename=20131010002.htm>.

3 Opening address by Mr Teo Ser Luck, Minister of State for Trade and Industry, at the opening ceremony of Franchising & Licensing Asia 2014, 16 October 2014. See: <https://www.mti.gov.sg/Newsroom/Speeches/2014/10/Mr-Teo-Ser-Luck-at-the-Opening-Ceremony-of-Franchising-and-Licensing-Asia-2014>.

4 Opening address by Mr Chee Hong Tat, Senior Minister of State for Trade and Industry, at the opening ceremony of Franchising & Licensing Asia 2019, 24 October 2019. See: <https://www.mti.gov.sg/Newsroom/Speeches/2019/10/Speech-by-SMS-Chee-Hong-Tat-at-the-opening-ceremony-of-Franchising-and-Licensing-Asia-2019>.

II MARKET ENTRY

i Restrictions

Singapore attracts many foreign franchises mainly because of its liberal, pro-business policies and transparent governance. Except in a small number of product areas, Singapore does not generally impose restrictive trade or investment policies on foreign franchises. For example, foreign franchisors are not required to enter into private or official joint ventures, and do not need to relinquish management control to local entities. In addition, Singapore does not restrict foreign ownership of businesses and does not impose foreign exchange controls or taxes on capital gains on foreign franchisors.

ii Foreign exchange and tax

In Singapore, franchisees are not required to comply with any formalities nor seek any approval from any authority when paying royalties to a franchisor. Franchisees are also free to convert royalties to foreign currency for payment to a foreign franchisor, but local franchisees must pay withholding taxes to the Inland Revenue Authority of Singapore (IRAS) on royalties payable to a non-resident franchisor at the prevailing withholding tax rate of 10 per cent subject to variation by virtue of any avoidance of double-taxation agreement (DTA) between Singapore and the home country of the franchisor.

III INTELLECTUAL PROPERTY

i Brand search

Before a franchisor or franchisee enters the local market to seek to establish itself as a brand in Singapore, it should first conduct relevant searches to ensure that there are no conflicts with, or similarities to, existing brands. The following are the most important searches to be conducted.

Trademark searches

To minimise risk of infringement, franchisees should search the local trademark registry, administered by the Intellectual Property Office of Singapore (IPOS), for any existing registered or pending trademarks that could be in conflict with the franchisor's brand; however, such searches are not exhaustive as the local registry only has records of pending or registered trademarks. Unregistered trademarks are not reflected on these records and the owner of an unregistered trademark may be able to lodge an objection with IPOS against the franchisor's application for a trademark if the application mark is similar to the unregistered trademark. Further, unregistered trademarks are protected under the common law in Singapore and the owner of an unregistered trademark may be able to bring a civil action in passing off against any person using a similar trademark.

Business and company name searches

The Accounting and Corporate Regulatory Authority of Singapore (ACRA) maintains a database of businesses and companies registered or incorporated in Singapore. A franchisor or franchisee intending to incorporate a company in Singapore to conduct its franchising business in the country must first reserve with ACRA a valid company name that does not

conflict with an existing company name or any business name prohibited by law. ACRA usually takes two business days to approve a name reservation application, as it conducts its own conflict checks on the proposed company name.

Domain name searches

It is good practice to ensure that the desired domain names are available for registration by conducting domain name searches. Even though a particular domain name may be available for registration, that domain name may nevertheless be similar or identical to an existing registered or unregistered trademark. Cybersquatters often register domain names that are also popular trademarks or variants of popular trademarks. Trademark owners typically seek to enforce their rights against cybersquatters by alleging that those domain names were registered in bad faith. Domain name disputes of this type are usually resolved using the Uniform Domain Name Resolution Policy process developed by the Internet Corporation for Assigned Names and Numbers.

Copyright due diligence

Copyright generally automatically subsists upon creation of a work. There is no requirement for copyright to be registered and no registration system for copyright in Singapore. It is important, therefore, to conduct due diligence checks to ensure that the necessary copyright clearances, licences or assignments have been obtained with respect to any source materials used in the franchise's marketing and promotional materials.

Patent searches

A registered patent grants the patent holder the exclusive right to prevent others from making, using, importing or selling the patent without his or her permission. Therefore, use of a patent without the patent holder's permission could amount to patent infringement. To minimise the risk of infringement, franchisors and franchisees should carry out proper due diligence when engaging in business that involves inventions or new technology. To determine if a particular invention is protected by a patent, franchisors and franchisees can search the local patent registry administered by IPOs, or engage a qualified patent attorney.

ii Brand protection

Trademark registration

There is no time limit for registering any trademark, therefore a trademark may be used by the owner without the need for registration; however, registration of a trademark confers a wider scope of protection on the trademark.

There are a number of advantages in owning a registered trademark. Unless a trademark is registered, the trademark owner cannot bring an action for registered trademark infringement or seek relief under the Trade Marks Act. A claim for infringement of a registered mark is generally easier to establish than a claim under the common law tort of passing off. The registration of the trademark also serves as a notice to the public of the ownership of the 'proprietor' and interest and rights in the trademark, and potential competitors who conduct trademark searches will be alerted that the registered trademark is not available for their use. In addition, using a mark that is registered also serves as a defence against trademark infringement claims from proprietors who may allege that their trademarks are similar to the mark.

The process to apply for registration of a trademark in Singapore is fairly straightforward. An applicant is permitted to file for several classes of goods or services within the same application (i.e., a multi-class application). The applicant may also designate Singapore through the Madrid Protocol (an international registration system of marks administered by the International Bureau of the World Intellectual Property Organization), to which Singapore is a signatory.

Where an earlier claim for the same trademark has already been filed in another Paris Convention country or a World Trade Organization member country, there is a priority claim procedure in place in Singapore. The Singapore application must be filed within six months of the date of the first filing.

Typically, an application will be examined by IPOS within about three to four months of the date that the application is filed. Thereafter, the applicant will be informed whether the application is in order for acceptance and publication, or if there are any objections to the application by third parties.

The trademark registration process is the same for both traditional trademarks such as word marks and logos, and non-traditional marks such as aspects of packaging, sound marks and shape marks. Franchisors may therefore also wish to expand the scope of protection of their brand by applying for the registration of both traditional and non-traditional trademarks, depending on the nature of the marks in question.

Confidential information and trade secrets

Franchisors and franchisees should ensure that all parties who may have or have had access to confidential information or trade secrets have signed and are contractually bound by appropriate non-disclosure agreements that provide a sufficient scope of protection over the information.

iii Enforcement

Franchisees should ensure that they have obtained the necessary licences or assignments of intellectual property rights from the franchisor in accordance with the general intellectual property laws of Singapore. Failure to do so may attract civil or criminal sanctions.

Generally, the owner of the intellectual property may be entitled to take legal action against an infringing party by seeking relief in the form of an injunction to stop the infringing action, obtaining profits gained by the infringing party by virtue of the infringement, or seeking damages or compensation for loss suffered because of the infringement. In the event that an intellectual property infringement is committed deliberately and to a significant extent, this may attract criminal penalties such as a fine or imprisonment.

An exclusive licensee is entitled to bring infringement proceedings against any person in his or her own name, if his or her licence so provides. Where this is the case, the exclusive licensee need not join the proprietor as a plaintiff in the action.⁵ However, for non-exclusive licensees, the right to enforce varies depending on the terms of the licence, as well as the governing law. For example, under the Trade Marks Act, a non-exclusive licensee is also entitled to bring infringement proceedings in his or her own name, unless the licence provides otherwise, but only if he or she has first called on the proprietor to instate infringement proceedings and the proprietor has refused or failed to do so within two months

5 Section 74 Patents Act, S. 45(2) Trade Marks Act and Section 124 Copyright Act.

of being called upon. If this is the case, the non-exclusive licensee must join the proprietor as a plaintiff in the action.⁶ Under the Copyright Act, however, a non-exclusive licensee has no right of action.⁷

iv Data protection, cybercrime, social media and e-commerce

Data protection

The Personal Data Protection Act 2012 (PDPA) came into force on 2 July 2014. While the PDPA regulates how organisations process the personal data of individuals, it is not intended to be overly burdensome.

In general, organisations may collect, use and disclose personal data solely with notice to and the consent of the individual. To obtain valid consent, the organisation must notify the individual of the purposes of the collection, use, or disclosure. The organisation must also limit its collection, use, or disclosure of personal data to purposes that would be considered reasonable in the given circumstances, and that the individual was notified by the organisation. If the organisation wishes to use personal data for new purposes, fresh consent must be obtained in respect of these new purposes.

An organisation may only transfer personal data to another country or territory in accordance with the requirements prescribed under the PDPA. This is to ensure that organisations abroad provide for a standard of protection that is equal or greater than that prescribed by the PDPA.

Under the PDPA, organisations that outsource the processing of data to a third party will be held responsible for the acts of that third party and should ensure that its contract with the third party requires the third party to comply with the requirements of the PDPA, whether locally or abroad.

Franchisees and franchisors have to ensure compliance with the requirements under the PDPA, as failure to comply with the PDPA amounts to an offence.

Cybercrime

On the other hand, there are some specific statutory laws that permit or require organisations to disclose data to law enforcement authorities, particularly where the disclosures relate to an offence. For example, under the Criminal Procedure Code of Singapore, depending on the suspected offence, law enforcement authorities may obtain a warrant to access certain decryption information for the purposes of investigation.

Previously, the Computer Misuse and Cybersecurity Act (CMCA) was in force to protect computers, programs and stored data from unauthorised access, modification, interception and interference. The CMCA was recently amended and split into two separate pieces of legislation.

The Cybersecurity Act 2018 came into force on 31 August 2018. The Cybersecurity Act establishes a framework to oversee and maintain national cybersecurity in Singapore and, most notably, establishes the Cybersecurity Commission. The Act confers upon the Commissioner significant powers to respond to and address cybersecurity threats affecting Singapore. These include powers to seize evidence, examine persons and conduct investigations.

⁶ Section 44 Trade Marks Act.

⁷ *Alliance Entertainment Singapore Pte Ltd v. Sim Kay Teck and another* [2007] SGHC 43.

Similarly, cybercrimes are also governed by the Computer Misuse Act. The Computer Misuse Act mirrors the language found in the previous CMCA (as referenced above). The Computer Misuse Act is not technology-specific and defines 'computer' widely, thereby capturing offences committed in relation to cloud services or online platforms. Under the Computer Misuse Act, an aggrieved company may make a police report, which will then be investigated by the Technology Crime Division.

E-commerce

In relation to commercial communications, the Spam Control Act regulates the sending of unsolicited electronic mail in bulk. This may be relevant where an organisation's advertising or marketing strategy involves the sending of electronic messages in bulk to its recipients. The Spam Control Act prescribes certain requirements that may have to be met when unsolicited commercial electronic messages are sent. These requirements include the inclusion of an unsubscribe facility or opt-out function or mechanism, and labelling of the electronic message with '<ADV>' before the title in the subject field of the electronic message.

E-commerce is also regulated under the Electronic Transactions Act, which closely matches the provisions of the UN Convention on the Use of Electronic Communications in International Contracts signed and ratified by Singapore. The Electronic Transactions Act addresses issues that may arise specifically in the context of digital signatures and contracts that are entered into electronically.

In general, Singapore has well-developed laws that recognise and support electronic transactions, in recognition of the importance of technology and the internet as part of doing business. To keep pace with the developments in involving e-commerce, franchisors or franchisees should keep a lookout for any legal developments in this fast-moving industry.

Social media

While there is no legislation specifically and directly governing social media in Singapore, existing laws relating to data protection, cybercrime and e-commerce, as described above, will apply equally to the use of social media by organisations as part of the brand recognition and marketing strategy for their business.

Organisations would be prudent to take additional care when making use of social media. While the social media space continues to function in the traditional manner as an online phone book, thereby involving potential data protection and privacy issues, social media is also increasingly playing a dual role as a space for users to gather for the purposes of transacting and offering goods or services for sale, thereby effectively hosting an online marketplace where cybercrime and e-commerce issues may arise.

In August 2016, the Advertising Standards Authority of Singapore published the Singapore Code of Advertising Practice, which promotes high standards of ethics in advertising. This now addresses new advertising issues arising from online marketing platforms such as blogs, Facebook, Instagram, Twitter, etc. For instance, marketers cannot boost the user engagement of a website (e.g., the number of 'likes' on Facebook) through fraudulent means. Examples of fraudulent means include the purchase of bulk likes and creation of fake accounts. Marketers were required to have adhered to these guidelines by 29 September 2016.

In May 2019, the Protection from Online Falsehoods and Manipulation Act (POFMA) was passed, giving the Singapore government broad powers to issue directions to counteract

the virality of online falsehoods and ‘fake news’, which are easily spread through chat groups and social media platforms. Although the POFMA is only meant to target falsehoods that threaten the wider ‘public interest’, its effects in relation to social media use should be noted.

IV FRANCHISE LAW

i Legislation

There is no separate jurisprudence or regime that relates specifically and solely to the context of franchising. The general laws of Singapore apply equally to franchise-related issues in Singapore.

The FLA, Singapore’s national franchise association, has provided a Code of Ethics for franchising, binding only on FLA’s members, and which contains provisions on disclosure requirements, contracts regarding existing franchisees, proper selection of franchisees, provision of proper training and business guidance, standards of conduct, notice of breach, rights of termination and dispute resolution, among others.

Additionally, the general laws of Singapore apply to all franchisors and franchisees, regardless of whether they are members of the FLA, and may affect the enforceability of any franchise agreement.

Unfair Contract Terms Act

If any contractual terms are considered unfair under the Unfair Contract Terms Act, they will not be enforceable. Contractual terms are considered unfair if they exclude or restrict liability of any person for death or personal injury resulting from negligence. In the event of other losses or damage, it is also considered unfair if the contractual term provides for an unreasonable exclusion or restriction of liability for such loss or damage.

Misrepresentation under the common law

A franchise agreement may be rendered void on the grounds of misrepresentation under the common law; however, any false statement (whether innocently or fraudulently made) does not, by itself, give rise to a cause of action. It is an actionable misrepresentation only where the false statement has induced the other party to enter into the contract.

ii Pre-contractual disclosure

There are no pre-contractual disclosure regulations relating specifically to the context of franchising.

Apart from the common law rules against misrepresentation described above, which apply equally to franchise-related deals, the FLA’s Code of Ethics also prescribes certain rules relating to pre-contractual disclosure.

For example, under the Code of Ethics, FLA’s members are prohibited from offering, selling or promoting the sale of any franchise, product or service by means of any explicit or implied representation that has a tendency to deceive or mislead prospective purchasers of such a franchise, product or service.

The Code of Ethics also requires the investment requirements of a franchise to be set out in a detailed and specific manner to avoid being misleading. Additionally, the franchisor is required under the Code of Ethics to disclose to the franchisee at least seven days prior

to the execution of the franchise agreement its current operations, the investment required, performance records and any other information reasonably required by the franchisee that is material to the franchise relationship.

iii Registration

Franchises and franchise agreements

There are no requirements in Singapore for franchises or franchise agreements to be registered. However, companies may choose to become registered members of the FLA, in which case they will be required to abide by the FLA's Code of Ethics.

Trademarks used in the franchise

Although there is no mandatory requirement to register any trademarks used in the franchise, it is advisable for the franchisor to do so. The various advantages of obtaining trademark registration have already been discussed (see Section III.ii). More specifically, the trademarks embody the brand in the franchise system, and go a long way in creating the value of the system. Trademarks therefore form one of the key assets of any franchise system and as such would be closely scrutinised by the potential franchisees of the system.

Trademark licences

It is not compulsory for trademark licences to be recorded. However, it may be advantageous for franchisees or licensees to register a trademark licence with IPOS. Such a registration serves as prima facie evidence of the grant of the licence. Additionally, a record of the trademark licence serves to put third parties on notice of the existence of the licence and the licensee's interest in the licensed mark. The Trade Marks Act provides for a presumption such that once a trademark licence is entered in the register, every person is deemed to have notice of it (including 'equity's darling' – the bona fide purchaser without actual notice). This presumption therefore goes a long way towards protecting a franchisee who has registered its licence.

iv Mandatory clauses

Under general Singapore laws, there is no requirement for mandatory clauses to be included in franchise agreements, and parties are free to negotiate the terms of the deal.

The FLA's Code of Ethics, binding only on members of the FLA, contains certain requirements relating to the clauses in the franchise agreement. For example, a franchise agreement may be terminated only if there is a good cause, which includes the failure of a franchise to comply with any lawful requirements of the franchise agreement.

v Guarantees and protection

Guarantees from individuals and companies to the franchisor are generally enforceable. Under such a guarantee, the guarantor's liability is defined as having to procure that the franchisee performs its obligations, as well as having to perform him or herself if the franchisee fails to do so; however, it is not common practice for local franchisors to require a guarantee, except for in exceptional cases where the franchisor may have reservations about the franchisee's finances or ability to operate the franchise.

V TAX

i Franchisor tax liabilities

Franchisors (and franchisees) may choose to operate in any of the following business structures, among others, and must pay income tax as follows:

- a* sole proprietorship: a sole proprietor carries on business on his or her own behalf and is essentially self-employed (sole proprietors must pay income tax on their profits);
- b* partnership: profit and loss will be shared equally among partners and each partner will be taxed at personal income tax rates in each individual partner's name;
- c* limited liability partnership (LLP): each partner will be taxed on his or her share of the income from the LLP (where the partner is an individual or a company, its share of the income from the LLP will be taxed at the personal income tax rate or the tax rate for companies respectively); and
- d* company: regardless of whether it is a local or foreign company, a company is taxed at a flat rate on its chargeable income.

The Singapore government also offers numerous tax incentives and benefits to businesses as part of its pro-business economic strategy. For example, Singapore adopts a flat, single-tier corporate system that is often regarded as one of the most business-friendly in the world. Under the single-tier corporate tax system, tax paid by a company on its chargeable income is the final tax, and all dividends paid by a company are exempt from tax in the hands of the shareholders.

ii Franchisee tax liabilities

In addition to applicable income taxes, local franchisees must pay withholding taxes to the IRAS on royalties payable to a franchisor that is not resident in the country.

The prevailing withholding tax rate is 10 per cent and can be varied depending on the mutual DTAs between Singapore and the home country of the franchisor. Singapore is a party to comprehensive agreements for the avoidance of double taxation with numerous countries worldwide, including China, France, Germany, India, Italy, Japan, the Russian Federation, South Korea, Switzerland, the United Arab Emirates and the United Kingdom; and has limited treaties with countries such as Hong Kong and the United States.

iii Tax-efficient structures

There is no single most tax-efficient structure for a franchisor or franchisee. Much depends on the scope and level of operations of the franchise and, depending on the particular business entity, operational arrangements and corporate or investment structure that the organisation has adopted, the various tax and deductibility rules that the business can utilise to its advantage. Therefore, seeking professional tax advice to properly plan a business's financial and tax structures is recommended.

VI IMPACT OF GENERAL LAW

i Good faith

In Singapore, good faith has no general application in commercial relationships that are governed by the terms of a contractual agreement. Accordingly, franchisors and franchisees do not have an implied duty to act in good faith by virtue of the franchise agreement executed by them.

In the case of *Ng Giap Hon v. Westcomb Securities Pte Ltd*,⁸ the Court of Appeal held that the doctrine of good faith is very much a ‘fledgling doctrine’ in Singapore contract law, and therefore did not endorse an implied duty of good faith in commercial contractual relationships. The Court also found it unnecessary to imply a duty of good faith, on the principle that judges should not rewrite contracts based on their own sense of justice.

However, Singapore courts have upheld contracts that contain an express duty to negotiate in good faith in the recent case of *HSBC Institutional Trust Services (Singapore) Ltd (Trustee of Starhill Global Real Estate Investment Trust) v. Toshin Development Singapore Pte Ltd*.⁹ In so doing, the court also considered the public interest and broader impact of upholding a principle of good faith in contracts, and held:

In our view, there is no good reason why an express agreement between contracting parties that they must negotiate in good faith should not be upheld. . . . Indeed, we think that such ‘negotiate in good faith’ clauses are in the public interest as they promote the consensual disposition of any potential disputes. We note, for instance, that it is fairly common practice for Asian businesses to include similar clauses in their commercial contracts . . . We think that the ‘friendly negotiations’ and ‘confer in good faith’ clauses . . . are consistent with our cultural value of promoting consensus whenever possible. Clearly, it is in the wider public interest in Singapore as well to promote such an approach towards resolving differences.

Therefore, where a franchise agreement governed by Singapore law expressly provides for a duty of good faith to operate, this duty is likely to be upheld and enforced by the Singapore courts. It is worth noting, however, that the Singapore Court of Appeal recently acknowledged in *The One Suites Pte Ltd v. Pacific Motor Credit (Pte) Ltd*¹⁰ that ‘the law in this particular sphere (viz. good faith) continues to be in a state of flux’. After briefly examining recent decisions in other common law jurisdictions, the Court of Appeal stated that ‘the question as to whether or not there is a duty on the part of the parties to cooperate and, if so, what its scope is and what its relationship is to doctrines such as good faith, are all matters that ought best to be decided in a definitive fashion only when they next come directly for decision before the courts’. Therefore, franchisors or franchisees who may be affected should continue to look out for legal developments in this area.

8 [2009] 3 SLR (R) 518.

9 [2012] SGCA 48.

10 [2015] SGCA 21.

ii Agency distributor model

Agency

The general practice in Singapore is for the franchise agreement to expressly state that the parties are independent contractors and are not to be treated as being an agency relationship. Franchisees typically do not operate as agents, as they generally trade in their own name, obtain income for their own account and are ultimately and directly responsible for any goods or services supplied or sold.

Distributorship

Franchising is distinct from a distributorship arrangement because the former does not involve parties being considered the 'seller' or 'buyer' in the business relationship. Typically, franchisees are required to pay royalties for franchising rights. This contrasts with a distributorship relationship, in which the distributor's profits arise from the difference between the cost of manufacturing or obtaining the goods and the price at which the goods are sold.

iii Employment law

There are no reported cases to date where the franchisor–franchisee relationship has been treated as an employment relationship by the courts. However, franchisors may be held liable for the acts of franchisees on the basis of vicarious liability.

Generally, the courts will look at the franchisor's degree of control over the franchisee's business operations, products or supply of services, the extent to which customers are led to believe that the franchisor was responsible for or warrants the quality of the franchisee's goods or services, and the tangible financial or promotional benefits accruing to the franchisor. It would therefore be prudent for franchisors to select their franchisees with care, maintain proper quality controls and provide for such controls in the franchise agreement, obtain appropriate insurance and seek indemnification from the franchisee in the franchise agreement.

iv Consumer protection

The provisions of the Multi-Level Marketing and Pyramid Selling (Prohibition) Act may apply to franchises. This statute was enacted in 1973 to prohibit objectionable features of pyramid selling. However, certain classes of schemes, such as master franchises, are exempted provided they satisfy certain conditions set out in the Multi-Level Marketing and Pyramid Selling (Excluded Schemes and Arrangements) Order.

Examples of these requirements, in relation to a master franchise arrangement or any arrangement where a person is given the right to sub-franchise a franchise, include the following.

- a* The benefits received by any person under the arrangement may not be a result of, or promoted to result from, the introduction or recruitment of other persons to be participants in the arrangement.
- b* Promoters of the arrangement may not knowingly make any misleading representation, omit any material particular relating to the arrangement or engage in conduct that is misleading to any material particular relating to the arrangement, and the promoter may not use fraud, coercion, harassment or other unconscionable means to promote the arrangement.

v Competition law

The Competition Act came into force in 2005 and has retrospective effect, applying equally to all agreements made before the effective date of the Act or the relevant provisions. In general, the Competition Act prohibits any agreement that has the object or effect of preventing, restricting or distorting competition within Singapore. Therefore, a franchise agreement will be rendered void to the extent that the franchise agreement prevents, restricts or distorts such competition.

Practices that may be considered anticompetitive include:

- a* directly or indirectly fixing prices of goods;
- b* limiting or controlling markets, technical development or investment;
- c* imposing different conditions to equivalent transactions with other trading partners such that one partner receives a competitive disadvantage; and
- d* subjecting the conclusion of a contract to supplementary obligations that have no connection with the subject matter of the contract.

The Competition Act provides certain exemptions to and exclusions from the strict application of the provisions in the Competition Act. If a franchise agreement meets all the criteria required for any exemptions or falls within any exclusions, it can be exempted from compliance with the Competition Act requirements.

vi Restrictive covenants

As a general rule, unreasonable restraint of trade clauses are against public policy and therefore void and unenforceable under Singapore law. In determining whether a restraint of trade clause is enforceable, the Singapore court will typically take into consideration the duration, extent, scope and nature of restraint, including the duration and geographical boundary of the restriction compared with the term of the franchise agreement and the territory granted to the franchisee. Franchisors should therefore take extra care and diligence in crafting the parameters of a restrictive covenant to ensure that any restrictive clauses are reasonable and are necessary to protect the legitimate interests of the franchisor so as to avoid falling foul of public policy.

vii Termination

Restrictive covenants that place restrictions on the franchisee upon termination of the franchise agreement are subject to principles similar to those that apply to restrictive covenants in general, as described above.

viii Anti-corruption and anti-terrorism regulation

The general laws of Singapore relating to fraud, anti-corruption and money laundering, such as the statutory prohibitions in the Prevention of Corruption Act and the Penal Code, apply equally in the franchising context. There are no laws specifically relating to franchises.

ix Dispute resolution

Dispute resolution mechanism

The FLA's Code of Ethics provides that a franchisor is required to make every effort to resolve disputes with its franchisees with good faith and goodwill through fair and reasonable direct communications and negotiation. If the franchisor and franchisee are unable to resolve the

dispute by mutual negotiation, the parties shall seek to have the dispute resolved through conciliation, failing which the dispute may be resolved by whatever means agreed between the parties, whether by arbitration or litigation.

Apart from the Code of Ethics, which is binding only on FLA members, parties to franchise deals are free to opt to resolve disputes by voluntary mediation, arbitration or litigation. Where the deals involve foreign entities, arbitration may be a more favourable option depending on the ease of enforcement of arbitral awards in the country in which the foreign entity or its assets are located.

Many franchise agreements include an arbitration clause instead of resorting to court action immediately. From the franchisor's point of view, arbitration proceedings are valuable as they offer parties a private forum to settle disputes while maintaining confidentiality and privacy over any differences that may tarnish the image and goodwill of the franchise or the parties involved. Further, this confidentiality is desirable to the franchisor so that any decision or settlement reached will not form a precedent for future reference by its other franchisees.

Enforcement of foreign arbitral awards in Singapore

Singapore acceded to the New York Convention of 1958 and subsequently re-enacted most of its provisions in Part III of the International Arbitration Act of Singapore. As a result, Singapore is bound by international law to recognise arbitral awards made in countries that are also signatories to the New York Convention.

Additionally, as Singapore belongs to the Commonwealth of Nations, it has enacted the Reciprocal Enforcement of Commonwealth Judgments Act (RECJA). Therefore, Singapore will recognise judgments made in the United Kingdom, jurisdictions that are part of the Commonwealth and other countries with which Singapore has reciprocal arrangements to mutually recognise and enforce judgments. Generally, an arbitral award from each of these countries will be enforceable in Singapore under the RECJA only if the award has become enforceable in that country in the same manner as a judgment given in its own courts.

The Singapore International Commercial Court

The Singapore International Commercial Court (ICC) was launched on 5 January 2015.

The ICC seeks to build on the existing success of Singapore as a global arbitration hub, and further boost Singapore as a leading centre for international commercial dispute resolution. As a specialised commercial court, the ICC offers litigants the option of having their disputes adjudicated by a panel of experienced judges comprising specialist commercial judges from Singapore and international judges from both common law and civil law jurisdictions. The ICC offers a well-designed court-based mechanism that will enable parties to avoid several problems that may be faced in international arbitration proceedings; for instance, the absence of appeals and the inability to join third parties in arbitration. On the whole, the ICC potentially offers franchisors and franchisees a further reliable and reputable option if they are seeking to have their disputes resolved in Singapore.

VII CURRENT DEVELOPMENTS

In July 2014, the FLA launched new membership categories to better meet the needs of current and future franchisees and licensees: franchisee membership, licensee membership and start-up membership. Franchisee and licensee members will have opportunities to attend

educational workshops and networking events, and be exposed to best practices within the industry. Start-up membership will benefit aspiring entrepreneurs (with three business units or fewer) through expert guidance and workshops.

In addition to industry-led efforts, the Singapore government also continues to take a keen interest in promoting franchise development in Singapore, with several government agencies and statutory boards under the Ministry of Trade and Industry playing an active role in franchise development.

One example of this is Enterprise Singapore, which was formed in April 2018 with the merger of Spring Singapore and IE Singapore. Enterprise Singapore administers schemes that provide grants, tax incentives, and other financial assistance to small and medium-sized local enterprises to facilitate growth and enhance innovation and the use of technology within Singapore.

On 25 October 2018, the Enterprise Development Grant (EDG) was introduced (replacing the previous Capability Development Grant) to assist companies in improving business capabilities, innovation and internationalisation. The EDG funds up to 70 per cent of qualifying project costs, such as third-party consultancy fees, software and equipment, and incremental internal manpower costs.

In addition, Enterprise Singapore also assists and supports local companies to franchise their concepts abroad. Enterprise Singapore administers schemes that provide tax deductions to support various overseas growth activities, such as market preparation, market exploration, market promotion and establishing market presence. Enterprise Singapore also provides financial support and funding to companies in areas such as manpower development, market access and capability building. In particular, the Market Readiness Assistance (MRA) grant provides companies with funds to help with up to 70 per cent of costs incurred for overseas market set-up, covering activities such as intellectual property search and applications, drafting of franchising or distributorship agreements, and other advisory or legal expenses. The MRA grant also supports business-matching activities such as third-party costs incurred in identifying potential business partners in licensee or franchisee arrangements.

With the government's support, local franchises have expanded rapidly over the past few years and are expected to continue expanding, particularly in the food and beverage, child-related and private education industries.

SOUTH KOREA

Jason Sangoh Jeon, Jin Woo Hwang and Seung Hyeon Sung¹

I INTRODUCTION

The franchising business in Korea has experienced continued growth in the past few years. According to statistics from the Korea Fair Trade Commission (KFTC), there were 1,009 franchisors and 1,276 brands in 2008. Since then, the market has been on the rise and as at 2018 it boasted 4,882 franchisors and 6,052 brands.²

The franchise business sector in Korea can be broadly categorised into food service business, service business and wholesale–retail business. As at 2018, of the total number of franchisors in the Korean franchise market, 74.1 per cent are involved in the food service business, 19.7 per cent in service business and 6.2 per cent in wholesale–retail business; the food service business share is therefore high.³

Based on the data from 2017, 350 of 4,631 franchisors (7.6 per cent) had entered foreign markets, such as China, the Philippines and Singapore⁴ and overseas expansion by Korean franchisors is anticipated to continue into the future (12.3 per cent of franchisors planned to enter foreign markets in the future).

In 1998, franchisors founded the Korea Franchise Association (KFA) to promote the advancement of franchise businesses in Korea. The KFA performs diverse tasks, such as hosting exhibitions to advance the Korean franchise industry, presenting awards to outstanding companies and franchisees that have contributed to the advancement of the franchise industry, and offering educational programmes to train a professional franchise workforce.

II MARKET ENTRY

i Restrictions

There is no specific regulation of franchising in respect of the entry of foreign franchisors into the Korean market. The Fair Transaction in Franchise Business Act (the Franchise Business Act), which is the framework law applied to franchising businesses in Korea, does not treat foreign franchisors differently from Korean franchisors or provide separate regulations for foreign franchisors. Foreign entities also face no limitations on granting master franchises or development rights to local entities.

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2 See statistics by the KFTC (Korean only, at <http://franchise.ftc.go.kr/main/subIndex/22.do>).

3 See statistics by the KFTC (Korean only, at <http://franchise.ftc.go.kr/main/subIndex/22.do>).

4 Ministry of Trade, Industry and Energy (MOTIE) press release dated 9 April 2019.

Under the Foreign Investment Promotion Act (FIPA), if a foreign investor acquires shares in a Korean company, an *ex ante* or *ex post* report may be required, depending on the method of the relevant stock acquisition. With respect to a foreigner's acquisition of real property, the Foreigner's Land Acquisition Act, the FIPA and the Foreign Exchange Transactions Act (FETA) apply. However, unless the relevant real property requires a government permit, a foreigner may, in principle, acquire real property based on simple reporting pursuant to certain procedures.

According to the FIPA, foreign investments may be prohibited or restricted if the investor or investment (1) threatens national security and public order; (2) causes harm to public health and sanitation or environmental preservation, or goes against Korean morals and customs; or (3) violates any laws or statutes of the Republic of Korea.⁵ However, no such restrictions exist for franchising businesses.

ii Foreign exchange and tax

The framework law applied to foreign exchange issues is the FETA. There is no regulation specific only to franchise businesses with respect to foreign exchange, and there is no tax regulation specific to franchising; these issues will be discussed further in Section V.

III INTELLECTUAL PROPERTY

i Brand search

In Korea, the Fair Transactions in Franchise Business Act (the Franchise Business Act) regulates franchising in Korea, while the government authority in charge of enforcing the relevant statute is the KFTC. The KFTC has launched a separate website that allows the public to access information related to the trademark and business mark of each franchisor and the status of the franchise business of the relevant franchisor.⁶

Moreover, through the website operated by the Korean Intellectual Property Office (KIPO), the public can access information on the specific details of a trademark, such as its shape, to verify the trademark owner of the relevant business mark within Korea.⁷

ii Brand protection

To obtain stable trademark protection in Korea, a franchisor has to register its trademarks with the trademark register. Since Korea is a first-to-file jurisdiction, when two or more applications for trademark registration compete for the same or similar trademarks, the first applicant is granted the registration.⁸

Once the application for trademark registration has been submitted to the trademark office, the examiner reviews whether the application and attached documents prescribed in the regulations for registration have been submitted, whether the documents have been prepared by the trademark owner, and whether the matters stated in the application correspond with those submitted in the trademark register and other attached documents.

⁵ See Article 4 of the FITA.

⁶ See KFTC franchise business search website (Korean only, at <http://franchise.ftc.go.kr/user/extra/main/62/firMst/list/jsp/LayOutPage.do>).

⁷ See KIPO trademark search service website (www.kipris.or.kr/khome/main.jsp).

⁸ See Article 35 of the Trademark Act.

If the documents submitted are accurate and without fault, the examiner must register the trademark. If the documents submitted are faulty yet correctable, the examiner sends instructions for the necessary correction, whereas the examiner rejects the application if the fault is not correctable. In the event that the examiner issues a reason for rejection without providing an opportunity for correction, the applicant is given one month to submit an explanation, which the examiner will review and either process or reject the application.

A registered trademark can be protected under the Trademark Act. Furthermore, any widely known, yet unregistered, trademark and sign can be protected under the Unfair Competition Prevention and Trade Secret Protection Act.

iii Enforcement

Once a trademark is registered, its owner may seek an injunction against a person who infringes or is likely to infringe the owner's rights, requesting the prohibition or prevention of infringement. When seeking an injunction, the trademark owner can request the destruction of the infringing goods, the removal of facilities provided for infringement, or other necessary measures.⁹ Moreover, a trademark owner may make a claim for damages arising from an infringement against a person who has wilfully or negligently infringed on its trademark rights.¹⁰

iv Data protection, cybercrime, social media and e-commerce

With respect to data protection, since the Personal Information Protection Act (PIPA) is enforced in Korea, a franchisor or franchisee has to comply with the PIPA in respect of the handling and protection of personal information in the course of operating a franchise business.

The PIPA imposes the following obligations with respect to the handling and protection of personal information: (1) collection of personal information¹¹ must be limited to the minimum extent necessary to achieve the purpose thereof; (2) the consent of the information subject is necessary for collection, use and third-party provision of the personal information; (3) any use and provision beyond the purpose for which the personal information was obtained is restricted; (4) a personal information manager¹² has to take technical, administrative and physical measures necessary for the safe management of personal information; (5) upon request by, the personal information manager has to inform the information subject of the source of personal information and the purpose of handling that information when the personal information manager handles personal information about the information subject collected from a person other than the information subject; (6) the personal information manager is required to destroy any personal information in its custody without delay when the information becomes unnecessary. Any non-compliance with the foregoing obligations may be subject to criminal liability.

9 See Article 107 of the Trademark Act.

10 See Article 109 of the Trademark Act.

11 The term 'personal information' refers to information that pertains to an individual, including the full name, resident registration number, images, etc. by which the individual in question can be identified (including information that cannot be used alone to identify the individual in question but that can, when combined simply with other information, identify the individual) (Article 2(i) of the PIPA).

12 The term 'personal information manager' refers to a public institution, corporate body, organisation or individual, etc. who manages personal information directly or via another person to administer personal information files as part of his or her duties (Article 2(v) of the PIPA).

The recent increase in the use of social networking sites and social media has resulted in diverse issues, such as defamation of franchisors or brands by malicious posts, causing difficulties for franchisors. With respect to malicious defamation, legal responses, including criminal complaints, may be necessary on a case-by-case basis.

With respect to electronic commerce (e-commerce), the Korean government has enacted the Act on Consumer Protection in Electronic Commerce, Etc. This act provides diverse provisions to protect e-commerce consumers by prohibiting e-commerce entrepreneurs from making false or exaggerated claims, from inducing or trading with consumers by using deceptive means, or from interrupting the withdrawal of subscriptions or termination of contracts.¹³

IV FRANCHISE LAW

i Legislation

In Korea, the Franchise Business Act and its Enforcement Decree regulate matters related to franchise businesses in general.

The Franchise Business Act is composed of six broad Chapters. Chapter I explains the purpose of the Franchise Business Act and provides the definitions of various terms used in the Act. Chapter II presents the fundamental principles of franchise business transactions, while Chapter III prescribes the provisions regarding the registration and provision of information disclosure statement, the franchise fee and franchise agreement and provisions concerning prohibited unfair trade practices. Chapter IV stipulates dispute resolution methods for franchise business transactions and Chapter V includes the provisions regarding the case handling procedure of the KFTC, the enforcement agency for the Franchise Business Act. Finally, Chapter VI prescribes the penalties for violations of the Franchise Business Act.

While Korea's Monopoly Regulation and Fair Trade Act (MRFTA) (the statute that governs fair trade and antitrust issues) applies to all business transactions, the Franchise Business Act only applies to franchise business transactions.¹⁴ Hence, for matters regarding franchise business transactions, where the Franchise Business Act applies, some of the regulations of the MRFTA do not apply (Article 38 of the Franchise Business Act). Moreover, since franchise business transactions can also be viewed as commercial transactions, the Korean Commercial Code may also be applicable.

13 See Article 21 of the Act on the Consumer Protection in Electronic Commerce, Etc.

14 For matters related to the franchising business where the MRFTA applies, Articles 23(1)(i) (unfair refusal to deal); 23(1)(iii) (unfair inducement of competitor's customers); 23(1)(iv); 23(1)(v) (unfair restriction of transacting counterparty's business activities); and 29(1) of the MRFTA shall not apply (Article 38 of the Franchise Business Act).

ii Pre-contractual disclosure

According to Article 6-2(1) of the Franchise Business Act, a franchisor is required to register an information disclosure statement¹⁵ with the KFTC, special metropolitan city mayor, metropolitan city mayor, special self-governing city mayor, *do* governor or special self-governing province governor (city mayor/*do* governor). A registered information disclosure statement subsequently has to be provided to a prospective licensee.¹⁶ When providing a registered information disclosure, a franchisor has to attach the documents stating the trade names, locations and telephone numbers of the 10 franchisees closest to the future store of a prospective franchisee (documents on the status of neighbouring franchisees). Unless 14 days have elapsed since the provision of a registered information disclosure statement and the documents on the status of neighbouring franchisees, the relevant franchisor cannot execute a franchise agreement with a prospective franchisee.¹⁷

Moreover, when providing information to prospective franchisees or franchisees, franchisors are prohibited from engaging in the following acts: (1) providing information different from the facts, or exaggerated information, and (2) providing information by suppressing or reducing facts that have a material impact on the execution or maintenance of a contract. Additionally, franchisors are obligated to provide information about the past profits or the expected future profits to the prospective franchisees and franchisees in writing.¹⁸ If a franchisor provides false, exaggerated or deceptive information to its prospective franchisees or franchisees in violation of the above, it may be subject to corrective measures or surcharges by the KFTC. In addition, the relevant franchisor could also bear damages liability or criminal liability.¹⁹

iii Registration

Other than the registration of the information disclosure statement discussed in Section IV.ii, no separate specific registration process is required for a franchisor or for a franchisee.²⁰

15 The term 'information disclosure statement' refers to a document that includes the general status of a franchisor; the current status of the franchise business of a franchisor; history of violations of the law by the franchisor and its executive officers; franchisee charges; conditions of and limitations on business activities; detailed procedures for the commencement of the franchise business and the duration required for the commencement of business; explanation of the management role of a franchisor; and support, education and training in relation to business activities (Article 2(x) of the Franchise Business Act and [Appendix 1] of Article 4(1) of the Enforcement Decree of the Franchise Business Act) by a franchisor or its executive.

16 To partially change the contents of a registered information disclosure statement, the relevant franchisor has to register with or (for minor changes) report to the KFTC or the city mayor/*do* governor, depending on the importance of the matters changed.

17 See Article 7 of the Franchise Business Act; a violation may be sanctioned by imprisonment of up to two years and a criminal fine of up to 50 million South Korean won.

18 See Article 9 of the Franchise Business Act.

19 Violation of Article 41(1) or 9(1) of the Franchise Business Act is punishable by imprisonment of no more than five years or by a fine of no more than 300 million won.

20 See Article 6-2(1) of the Franchise Business Act.

iv Mandatory clauses

According to Article 11(2) of the Franchise Business Act, a franchise agreement must cover each of the following matters:

- a* grant of licence for business marks;
- b* terms and conditions of the business activities of the franchisee;
- c* education, training and business guidance for the franchisee;
- d* payment of franchise and other fees;
- e* demarcation of business territory;
- f* term of the agreement;
- g* transfer of business;
- h* grounds for termination of the agreement;
- i* the fact that a franchise deposit shall be deposited in the depository for two months from the date on which the prospective franchisee or franchisee executes a franchise agreement;
- j* if the prospective franchisee has consulted an attorney or a franchise trader with regard to the information disclosure statement, the fact that it has done so;
- k* the obligation to compensate franchisees for loss arising from an act committed by the franchisor or any executive officer of the franchisor in contravention of social norms, such as committing an illegal act or impairing the reputation or credibility of the franchise business; and
- l* other matters specified by Presidential Decree concerning the rights and obligations of parties to a franchise business.²¹

v Guarantees and protection

Typically, guarantees from individuals and companies to the franchisor are enforceable. It is generally a common practice for local franchisors to require a franchisee to guarantee the franchisee's obligations under the franchise agreement.

V TAX

i Franchisor tax liabilities

As mentioned above, with respect to tax issues, the Korean Tax Code applies, with no specially applied regulation for franchises. The primary taxes relevant to business entrepreneurs in Korea are corporate tax, value added tax, individual income tax, customs duties and inhabitant tax levied on corporate tax, income tax and other taxes.

21 Article 12 of the Enforcement Decree of the Franchise Business Act mentions the following as the 'matters prescribed by Presidential Decree': (1) conditions regarding the return of funds, such as franchisee fees; (2) installation of equipment and fixtures, etc. for the business of a franchisee and the maintenance and repair thereof, and the bearing of these expenses; (3) measures to be taken according to the expiration and termination of a franchise agreement; (4) just cause by which a franchisor may refuse to renew a franchise agreement; (5) franchisor trade secrets; (6) compensation for loss because of violation of a franchise agreement; (7) procedures for the resolution of disputes between franchisors and franchisees; (8) in the event of transfer by a franchisor of a franchise to another franchisee, the franchise agreement with the former franchisee; and (9) measures to be taken at the expiration of the term of validity of a franchisor's intellectual property rights.

If a franchisor is a corporation, a Korean company has the duty to pay corporate tax on all income generated in and outside Korea, while a foreign company has a duty to pay this tax only on domestic-sourced income. Company income in each fiscal year is charged with a 'corporate tax on income from each fiscal year', and if the company transfers land and buildings, housing and adjacent land located in a specific area, or non-business-purpose land, it is subject to a 'corporate tax on income from transfer of land and other real properties'. If a domestic company is dissolved, 'corporate tax on income from liquidation' is levied; however, a foreign company is not subject to the duty to pay tax on income from liquidation.

ii Franchisee tax liabilities

If a franchisee is a corporation, the same tax rule applies as in Section V.i. However, if a franchisee is a natural person, the main tax issue would be the income tax levied on the business income in lieu of corporate tax. While a resident bears the duty to pay income tax on all income generated in and outside Korea, a non-resident, conversely, only has the obligation to pay income tax on domestic-sourced income. However, if a non-resident becomes a resident, such as through the method of dwelling in Korea for at least one year, income tax is imposed only on the domestic-sourced income generated up to the day before the non-resident's transition to resident and any income, both foreign or domestic, generated from the date of residency will be subject to income tax.

iii Tax-efficient structures

While there are both advantages and disadvantages depending on the business entity and the business structure, no single, optimal tax-efficient structure exists specially for franchise businesses.

VI IMPACT OF GENERAL LAW

i Good faith and guarantees

In Chapter (II), as a fundamental principle of the franchise business transaction, the Franchise Business Act requires the parties engaged in the franchise business to carry out each of their duties in good faith.²² By specifying this fundamental principle, the Franchise Business Act prescribes the obligations of the franchisors (Article 5) and those of the franchisees (Article 6). However, the Franchise Business Act does not separately prescribe sanctions for violations of the above fundamental principle and the obligations of the franchisors and of the franchisees. Therefore, these provisions can be viewed to have significance as best-practice standards rather than as mandatory rules. However, under the Franchise Business Act, any breach of these obligations may be regulated under other provisions within the Franchise Business Act. Hence, it is worth noting that any breach of the above obligations may trigger civil or criminal liabilities.

ii Agency distributor model

In principle, a franchisee governed by the Franchise Business Act and an agency distributor are distinguished pursuant to the actual details of the business, regardless of the term used. However, since in many respects a franchisee and an agency distributor engage in similar

22 See Article 4 of the Franchise Business Act.

transactions, distinguishing between the two business models is not easy. This is because an agency distributor, like a franchisee, also pays contract fees or deposits, and purchases various types of products or goods to resell them to end customers.

The actual standard for distinguishing a franchisee governed by the Franchise Business Act from an agency distributor is the 'payment of compensation for use of business marks and assistance or training for business activities'. In other words, if compensation for use of business marks and assistance or training for business activities (e.g., compensation that exceeds the reasonable wholesale price of supplies, such as for application fees, royalties, product and equipment) is paid separately, the business operator should be viewed, reasonably, as a franchisee. Conversely, if such compensation is not paid, but rather only deposits or performance bonds are paid to engage in business, the business operator should be termed, reasonably, an agency distributor. Although the Franchise Business Act is not applicable to dealings with an agency distributor,²³ the MRFTA remains applicable.²⁴

iii Employment law

The term 'worker' refers to a person, regardless of the occupational type, who offers labour to a business or workplace for the purpose of earning wages.²⁵

The Supreme Court determines whether a person falls within the definition of a worker under the Labour Standards Act based on whether the person has actually provided labour to an employer under a subordinate relationship at a business or workplace for the purpose of earning wages. In this context, whether a subordinate relationship exists is determined by comprehensively considering factors including the employer's decision-making as to the details of the work and the principal direction and supervision of the person while subject to the applicable rules of employment or code of conduct (personnel policy); the employer's decision-making as to the time and place of labour by which the person is bound; the person's ownership of the equipment or working tools, or ability to independently determine the method of operation of the business, such as hiring a third party to perform the work as an agent; the person's liability for the risks, such as profits or losses, that arise from the provision of labour; the compensatory nature of the payments for the labour provided; salary-related matters, such as the existence of base salary or fixed salary, and withholding of earned income tax; continuity of the relationship of providing labour under the exclusive control of the employer; and various economic or social conditions, such as recognition of 'worker' status under statutes related to the social security system.²⁶

Since a franchisee independently engages in a business upon its own initiative and bears the risks itself, and because the franchisee obtains a separate business licence for tax return purposes under the actual business practice, a franchisee is not viewed as a worker. Rather, a franchisee is generally treated as a separate, independent entrepreneur.

23 See the KFTC's Answers to Questions (6 February 2017) (<http://www.ftc.go.kr/www/qnaView.do?key=304>).

24 See Article 4 of the Fair Agency Transactions Act.

25 See Article 2(1)(i) of the Labour Standards Act.

26 See Supreme Court Decision No. 2011Da44276 rendered on 27 June 2013.

iv Consumer protection

According to the Framework Act on Consumers, the term ‘consumers’ refers to those who use goods or services provided by entrepreneurs for their daily consumption or for their production activities as designated by Presidential Decree.²⁷ With respect to the scope of those who use goods or services for production activities, the Presidential Decree stipulates the following: (1) an end consumer of the goods or services provided (provided that those who use the furnished goods, etc. as raw materials, capital goods or other equivalents for production activities are excluded), and (2) a person who uses furnished goods, etc. for agricultural activities (including in the livestock industry) and fishery activities (excluding those engaged in deep-sea fishing).²⁸

Since franchisees are not end consumers of the goods furnished by the franchisor, but rather persons that use the furnished goods, etc. as raw materials, capital goods or other equivalents, they are difficult to treat as consumers.

v Competition law

The Franchise Business Act prohibits a franchisor from engaging in, or causing any other business entity to engage in, acts that are likely to impede fair franchise business transactions and enumerates the following five types of prohibited acts:²⁹

- a* suspending or refusing the supply of goods or services or business assistance to a franchisee or placing significant limitations thereon;
- b* imposing unreasonable restraints or limitations on the prices of goods or services that a franchisee handles, its transacting counterparty, transacting territory or the business activities of a franchisee;
- c* imposing unreasonable disadvantages on a franchisee by abusing a franchisor’s superior trading position;
- d* imposing on a franchisee unreasonable obligations to pay damages, such as imposition of penalties that are excessive in relation to the object and content of the contract, the size of the potential damages, the existence and extent of the faults between the parties and the normal trade practice in that type of business; and
- e* any act that does not fall under (a) to (d) above that is likely to interfere with fair franchise business transactions, such as the franchisor unreasonably inducing the franchisees of a competing franchisor to conduct transactions with it instead.

Moreover, the Franchise Business Act prohibits the franchisor from providing false or exaggerated information to franchisees, unreasonably pressuring franchisees to improve store environments, unreasonably restricting business hours, unreasonably infringing on the franchisees’ sales territory and taking retaliatory measures.³⁰

As the Franchise Business Act is a special law of the MRFTA, governing fair trade and antitrust issues, any area where the Franchise Business Act is inapplicable may be governed by the provisions of the MRFTA on unreasonable collaborative conduct and unfair trade practices (including unfair discriminatory treatment of transacting counterparties, unfair exclusion of competing enterprises, and tie-in sales).

27 See Article 2(i) of the Framework Act on Consumers.

28 See Article 2 of the Enforcement Decree of the Framework Act on Consumers.

29 See Article 12(1) of the Franchise Business Act.

30 See Articles 9, 12-2, 12-3 and 12-4 of the Franchise Business Act.

vi Restrictive covenants

A franchisor is permitted to include a provision in the franchise agreement that prohibits its franchisee from engaging in a business that competes with the franchise business during the term of the franchise agreement under the franchisee's own name or the name of a third party without the consent of the franchisor. For reference, the standard form franchise agreement distributed by the KFTC via its website also includes such a non-compete clause. In the event of a franchisee's breach of the non-compete clause, a franchisor can seek an injunction against the breaching franchisee requesting the suspension of business, and further the franchisor can claim any damages arising from the breach.

There is no clear consensus on whether a non-compete duty can be held to be binding even after the expiration of the franchise agreement. However, when the KFTC previously investigated whether a franchise agreement used by chicken and pizza franchisors violated the Act on the Regulation of Terms and Conditions, it held that a non-compete clause has to be reviewed by comparing and balancing the franchisor's interests in protecting its trade secrets against the franchisee's freedom of occupation choice. Based on this premise, the KFTC decided that, since chicken and pizza franchises can be opened without particularly special know-how from the franchisors, chicken and pizza franchisors cannot be found to have significant interests in protecting their trade secrets, if any. Accordingly, the KFTC ordered the non-compete clause in the franchise agreement to be removed or substituted with a clause that specifically protects trade secrets.³¹ In addition, in another case, when a porridge restaurant franchisor seeking to prohibit competitive business filed an injunction against a franchisee for breaching the duty not to compete for a year after termination of the franchise agreement, the district court held that although the non-compete clause was, in principle, valid because the franchisor gained benefit from the prohibition of competitive business, the non-compete clause was deemed ineffective because the franchise agreement was terminated for causes attributable to the franchisor. The court reasoned that the validity of a non-compete clause depended on whether the franchisor gains any benefit that is valuable enough to enforce the non-compete clause. The court comprehensively takes into consideration factors, such as the type of franchise business, the role and weight of the role of the franchisor in the business operation process, and the risk of disclosure of trade secrets or misappropriation of trade rights by franchisees post-termination of the franchise agreement, even when the non-compete period is provided in the franchise agreement, because inclusion of a non-compete clause in a franchise agreement limits the franchisee's freedom and right to choose an occupation.³² In light of the foregoing standard presented by the KFTC and the district court case, if transfer of special know-how in a franchise business is substantiated by the need to protect trade secrets of the franchisor and the cause of termination of the franchise agreement is not attributable to the franchisor, a short-term non-compete obligation may be extended beyond the expiration of the contract term.

In connection with the confidential clauses in franchise agreements, a franchisor can include a clause that prohibits a franchisee from disclosing to a third party a franchisor's trade secrets acquired in the process of executing the franchise agreement and of operating a franchise business. If a franchisee breaches the clause, a franchisor can apply for an injunction against the breaching franchisee barring the infringement of trade secrets, and can claim compensation for damage that the franchisor incurred because of the infringement.

31 See KFTC, Press Release Dated 15 September 2009.

32 See Seoul Central District Court, Decision No. 2010KaHab1692 rendered on 2 December 2010.

vii Termination

Where a franchisee requests to renew the franchise agreement during the period from 180 days to 90 days prior to the expiration of the franchise agreement, a franchisor cannot reject the request without justifiable reasons. A franchisee's right to request the renewal of the agreement may be exercised only when the total term of the franchise agreement, including the initial term, does not exceed 10 years.³³

Furthermore, apart from the exceptional grounds for immediate termination³⁴ prescribed by the Franchise Business Act, if a franchisor seeks to terminate the franchise agreement, it must clearly state the fact of the franchisee's breach during the grace period of not less than two months, and give a written notice at least twice indicating its intent to terminate the agreement unless the breach is corrected during the grace period. If this procedure is not complied with, the termination of the franchise agreement is not effective.³⁵

After the expiration of the franchise agreement, the shares, assets or business of franchisees can be acquired by the franchisor pursuant to the agreement between the parties; the Franchise Business Act does not provide specific regulation of such transfers.

viii Anti-corruption and anti-terrorism regulation

With respect to anti-corruption and anti-terrorism regulations, there is no regulation specifically applicable to franchising. Generally, the relevant laws that govern the bribery of domestic government officials include (1) the Korean Criminal Code, (2) the Act Concerning Aggravated Punishment of Specific Crimes, and (3) the Act on the Prohibition of Improper Solicitation and Provision or Receipt of Money and Valuables. In connection with the issue of bribery of foreign public officials, based on the OECD Convention, Korea enacted the Act on Prevention of Bribery to Foreign Public Officials in International Business Transactions.

ix Dispute resolution

In principle, a franchise agreement can designate a foreign court as the applicable jurisdictional court. However, an exclusive jurisdiction agreement, excluding the jurisdiction of the Korean court and recognising only the jurisdiction of a foreign court, is valid if the relevant case does not come under the exclusive jurisdiction of the Korean court and the jurisdiction of the designated foreign court can be established in addition to the existence of a reasonable connection between the relevant case and the designated foreign court. Furthermore, the exclusive jurisdiction agreement should not constitute a legal act that is significantly unreasonable and unfair to the extent that it is adverse to public order and good morals.³⁶ Moreover, any agreement that sets a foreign law as the governing law is valid, unless there is a justifiable basis for the claim that the agreement causes a significantly unreasonable or unfair consequence.³⁷

Most franchise disputes are addressed or resolved before the courts, or through mediation or arbitration, like most other commercial disputes in Korea. However, Korea has also established the Franchise Business Dispute Mediation Council under the Korea Fair

33 See Article 13-2 of the Franchise Business Act.

34 See proviso of Article 14 of the Franchise Business Act and Article 15 of the Enforcement Decree of the Franchise Business Act.

35 See Article 14 of the Franchise Business Act.

36 See Supreme Court, Decision No. 96Da20093 rendered on 9 September 1997.

37 See Supreme Court, Decision No. 2010Da28185 rendered on 27 May 2010.

Trade Mediation Agency as an agency in charge of mediating disputes related to franchise businesses. In a special metropolitan city, metropolitan city, special self-governing city, *do* or special self-governing province (city/*do*),³⁸ a city mayor/*do* governor may establish a franchise business dispute mediation council. Both parties to a dispute can apply for mediation in cases involving franchise business disputes. Also, the KFTC can request mediation in cases that it is handling or investigating. In the event that each party to a dispute separately applies for mediation at different mediation councils or the parties apply for mediation for the same dispute at more than one mediation council, a council selected by the franchisee from the councils established by the city/*do* at the location of the franchisor's main business site shall handle the dispute.³⁹ If the mediation by the mediation council is successful, a settlement agreement must be prepared. The parties to the dispute must carry out the actions agreed to in the settlement agreement and submit the results to the KFTC. The KFTC will not require corrective action or recommend correction if these obligations are satisfied. The settlement agreement has the same effect as a settlement in litigation.⁴⁰

As discussed earlier, if a franchisee breaches the non-compete clause during the term of the franchise agreement or if a former franchisee uses the franchisor's trademarks even after the expiration of the franchise agreement or breaches the confidentiality clauses in connection with the franchisor's trade secrets, the franchisor can file a motion for injunctive relief against the infringements and claim compensation for any damage suffered. In Korea, property damages arising from tortious acts are calculated based on proprietary disadvantages suffered because of the harmful act (i.e., the discrepancy between the financial condition in the absence of the tortious act and the financial condition after the tortious act).⁴¹

With respect to recognition and enforcement of foreign arbitral awards, Korea recognises or enforces any domestic arbitral award made in Korea pursuant to the Arbitration Act. Any foreign arbitral award made in jurisdictions other than Korea is recognised and enforced pursuant to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention).⁴²

VII CURRENT DEVELOPMENTS

An amendment to the Franchise Business Act in 2018 introduced the system of punitive damages (treble damages).

In principle, if a franchisor harms a franchisee by violating the Franchise Business Act, the franchisor is liable to the franchisee for damages. However, if the franchisor were to successfully prove that it lacked intent or negligence, the liability would not be established. Nonetheless, (1) provision of false and exaggerated information, (2) unreasonable refusal to deal (i.e., unreasonable refusal to renew the underlying franchise agreement, or termination of the agreement, etc.) by the franchisor, and (3) retaliatory measures such as discontinuing any transactions or otherwise disadvantaging the franchisee are deemed to show significant malevolent intent and to cause harm through loss of considerable sums in investment and the potential exit of the franchisee from the market. The punitive damages system was introduced

38 See Article 16 of the Franchise Business Act.

39 See Article 22 of the Franchise Business Act.

40 See Article 24 of the Franchise Business Act.

41 See Supreme Court en banc Decision No. 91Da33070 rendered on 23 June 1992.

42 See Articles 38 and 39 of the Arbitration Act.

to sanction behaviour deemed to be of malicious intent, and the effects of such behaviour, by imposing on the franchisor liability for damages of up to treble the amount of the costs incurred as a result of the damage suffered by the franchisee.⁴³

Previously, a franchisee who suffered harm, such as a sharp drop in sales, because of damage to the brand reputation caused by unlawful or unethical acts by an executive of the franchisor had difficulty in holding the franchisor liable. The amendment to the Franchise Business Act of 16 October 2018 mandates that franchise agreements now include a provision stating that the franchisor will compensate the franchisee for any harm caused by unlawful acts by the franchisor or its executives, or acts by them that go against the rules of society and that cause damage to the reputation or credit of the franchise business.⁴⁴

For reference, the amended Enforcement Decree of the Franchise Business Act requires that compensation made to the franchisor by the franchisee in excess of the wholesale price be recorded in the information disclosure statement for items supplied by the franchisor or a party designated by the franchisor and upon the franchisor's direction or recommendation (Article 5(b)(2) of Appendix 1 of Enforcement Decree of the Franchise Business Act). With regard to the foregoing, the Korea Franchise Association has filed a constitutional appeal, claiming that such a regulation violates the Constitution, which guarantees freedom of business activities as, in effect, it requires disclosure of trade secrets, such as production costs. The Constitutional Court has yet to render its decision.

TAIWAN

Wen-Yueh Chung, Jane Wang and Charles Chen¹

I INTRODUCTION

Franchising in Taiwan has continued growing in the past few years, especially in the food service business and in retail business. International franchise brands have developed steadily, such as Starbucks, Pizza Hut, McDonald's, MOS Burger, Watsons and World Gym. Local franchisors have also endeavoured to scale up their brands, such as Chatime, TKK, Louisa Coffee, 85°C Bakery Cafe, COSMED, while mainly focusing on developing in the Asian markets.

According to statistics from the Taiwanese Chain Stores and Franchise Association (TCFA),² which was founded in 1987 by franchisors, the total number of food service brands increased to 970 in 2017, and the total number of stores increased from 28,880 to 32,810; of this increase of 3,930 stores, 1,737 were general restaurants, 886 were fast food restaurants, 763 were beverage stores and 544 were coffee shops. Additionally, according to statistics from the Taiwan Fair Trade Commission (FTC), the total number of franchising convenience stores increased to 10,905 in 2017, with over 75 per cent of these constituted by three brands: 7-Eleven, FamilyMart and Hi-Life.³

In addition to the TCFA, franchisors also founded the Association of Chain and Franchise Promotion, Taiwan (ACFPT) in 1995, and both of these associations aim to promote franchising in Taiwan. The TCFA and ACFPT provide varied functional services, such as hosting exhibitions to boost the Taiwan franchise industry, offering educational training programmes for franchisees and franchisors, and acting as an information exchange platform.

II MARKET ENTRY

i Restrictions

With respect to the principle of freedom of contract and with the intention of attracting foreign investment, Taiwan generally imposes no restrictions on foreign franchisors entering the Taiwan market, although if a foreign investor (including investors from China, Hong Kong or Macau) acquires shares in a Taiwanese company or establishes an entity in Taiwan,

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2 See statistics from the TCFA, quoted by the Taiwan Ministry of Economic Affairs, https://www.moea.gov.tw/mns/dos/bulletin/Bulletin.aspx?kind=9&html=1&menu_id=18808&bull_id=5345.

3 See statistics from the FTC, <https://www.ftc.gov.tw/internet/main/doc/docDetail.aspx?uid=126&docid=16025>.

advance approval of the foreign investment is required.⁴ To franchise in Taiwan, foreign franchisors are neither required to establish joint ventures nor give management power to Taiwanese citizens. Other than the basic law governing business in Taiwan, including the Civil Code, the Company Act and the Tax Code, there is no specific law regulating franchise businesses, except for the Fair Trade Commission Disposal Directions on the Business Practices of Franchisers (the FTC Directions). The FTC Directions primarily regulate disclosure obligations and other behaviours in an attempt to prevent unfair competition.

ii Foreign exchange and tax

There is no regulation specific to franchise businesses with respect to foreign exchange, and there are no tax regulations specific to franchising. A foreign investor may apply for exchange settlement against the annual interest accrued or the profit surplus distributed from his or her investment. Further, when the investor is approved to transfer his or her shares, or to withdraw or decrease his or her investment, or when he or she obtains the capital gain realised from his or her investment, a foreign investor may also apply for exchange settlement in a lump sum against the total amount of his or her investment as approved.⁵ The same rule applies to investment in Taiwan by a Chinese investor or a company funded by a Chinese, Hong Kong or Macau investor.⁶

There are no tax regulations specific to franchise businesses either, therefore further tax issues will be discussed in Section V.

III INTELLECTUAL PROPERTY

i Brand search

There is no governmental institution that is specifically responsible for gathering information regarding franchise businesses in Taiwan. Notwithstanding this, trademark search is a useful tool for obtaining an understanding of brand activity in Taiwan. The Taiwan Intellectual Property Office (TIPO) maintains and provides an online database with a very functional search tool for public use. Through the TIPO website Trademark Search system,⁷ the public can find comprehensive information for a registered trademark in Taiwan using keyword searches; for example, through searching for the identity of an applicant for a trademark, the words used in a trademark and the status of pending or granted (registered) trademarks.

ii Brand protection

Taiwan's trademark registration system is based on the first-to-file principle. According to the Taiwan Trademark Act, any person who wishes to obtain trademark rights may apply for registration.⁸ An application must be submitted to TIPO containing the applicant's information, a reproduction of the trademark and a list of identified goods or services for the registration. By obtaining a registration, an applicant will have the exclusive right to the use

⁴ See Articles 2, 3, 4 and 8 of the Statute for Investment by Foreign Nationals.

⁵ See Article 12 of the Statute for Investment By Foreign Nationals.

⁶ See Article 12 of the Regulations Governing Permission of Investment in Taiwan from the Mainland Area.

⁷ See the Trademark Search system page of the website of the Intellectual Property Office of Taiwan: https://twtmsearch.tipo.gov.tw/OS0/OS0302.jsp?lg=zh_TW&isReadBulletin_US=&isReadBulletinzh_TW=true.

⁸ See Article 2 of the Trademark Act.

of the trademark from the date of publication of registration for a period of 10 years,⁹ and the registration can be renewed to extend the protection period, as long as the business continues and the trademark is used on or with the goods or services identified in the registration for the trademark. Furthermore, applications to register intangibles such as sounds or smells as trademarks can be filed to obtain protection under Taiwanese law.

Taiwan's Trademark Act also emphasises the protection of famous trademarks and seeks to prevent trademark 'squatting'. The existence of a well-known unregistered mark precludes later registration of identical or similar marks without the permission of the owner of the well-known mark¹⁰ where a likelihood of confusion with respect to the relevant public or a likelihood of dilution of the distinctiveness or reputation of the well-known mark would arise should the later identical or similar mark be registered or used. Well-known unregistered marks are also protected under Taiwan's Fair Trade Act. No enterprise may use a commonly known trademark in the same or a similar manner for the same or a similar category of merchandise or services.¹¹

The main actions available to brand owners to prevent trademark squatting are invalidation or opposition procedures against the squatter at TIPO to revoke the offending registration. The Trademark Act clearly identifies the conditions for registration and prohibits an applicant from registering a mark where the applicant intends to imitate an earlier used trademark and is aware of the existence of the earlier used trademark through contractual, regional or business connections, or any other relationship with the proprietor of the earlier used trademark. The statute of limitations for invoking these administrative remedies is five years from the publication of the trademark. Where well-known marks are squatted in bad faith, this time limitation is waived.

iii Enforcement

Taiwan continues to strengthen protection for intellectual property (IP) rights. Taiwan has an IP court and IP police, both of which assist in enforcing IP rights, especially for trademarks and patents. If a registered trademark is infringed, the trademark owner is entitled to demand that the infringer cease the infringement or prevent the infringement, and to obtain compensation for damage.¹² The trademark owner can also demand the destruction of infringing articles and the materials or implements used in infringing the trademark under the Trademark Act.¹³ The infringer will also be subject to imprisonment for a period not exceeding three years or a fine not exceeding NT\$200,000, or both of these penalties.¹⁴ Additionally, the owner of a well-known or famous but unregistered trademark can seek civil relief under the Fair Trade Act in Taiwan.¹⁵

9 See Article 33 of the Trademark Act.

10 See Article 30.1.11 of the Trademark Act.

11 See Article 22 of the Fair Trade Act.

12 See Article 69 of the Trademark Act.

13 See Article 69 of the Trademark Act.

14 See Article 95 of the Trademark Act.

15 See Articles 22, and 29 to 33 of the Fair Trade Act.

iv Data protection, cybercrime, social media and e-commerce

Enacted in 2010, the Personal Data Protection Act (PDPA) is the statute regulating data protection issues in Taiwan. According to the PDPA, 'personal data' refers to a natural person's name, date of birth, ID card number, passport number, features, fingerprints, marital status, family information, educational background, occupation, medical records, healthcare data, genetic data, data concerning the person's sexual life, records of physical examinations, criminal records, contact information, financial records, data concerning the person's social activities, and any other information that may be used to directly or indirectly identify that natural person.¹⁶ The PDPA regulates the collection, processing and use of personal data. Any non-compliance with the obligations set out in the PDPA is subject to civil and criminal liability.

In the course of dealing with legal issues in relation to cybercrime in Taiwan, the Criminal Code, Trademark Act, Copyright Act and PDPA and related legislation can be applied. To prevent cybercrime, the Criminal Code provides a specific chapter on illegal acts that harm or attack computer security, such as illegally accessing others' accounts and obtaining or deleting records held in magnetic storage on computers.¹⁷

With respect to e-commerce, the Taiwanese government has enacted specific legislation such as the Act Governing Electronic Payment Institutions, and the Electronic Signatures Act, to deal with related issues.

IV FRANCHISE LAW

i Legislation

There is no law that specifically regulates franchising in Taiwan (see, however, Section IV.ii on pre-contractual disclosure and the FTC Directions). Taiwan's civil law greatly respects the principle of freedom of contract and this principle also applies to franchise contracts, and Taiwan courts will consider the nature of a franchise contract, and its provisions, when deciding on the application of the regulations of the Civil Code to a particular franchise contract.

ii Pre-contractual disclosure

According to the FTC Directions, franchisors must provide their trading counterparts with the following important franchise information in writing at least 10 days prior to entering into the franchise operation relationship, or within a reasonably determined time frame in a specific case, or within a time agreed upon by both parties:

- a* startup costs;
- b* operating expenses;
- c* the contents, periods of validity, extent of authorisation and corresponding restrictions of relevant trademarks, patents and copyrights;
- d* contents and methods of operational assistance, training and guidance;
- e* plans for setting up other franchisees in the same franchise system in a franchisee's existing area of operation;
- f* restrictions applied to the franchise relationship during the contract period; and

16 See Article 2 of the Personal Data Protection Act.

17 See Articles 358 to 363 of the Criminal Code.

- g* conditions and ways of handling the alteration, termination and cancellation of a franchise contract.¹⁸

However, those who withhold important information with justification can be exempted from these obligations; justifications include:

- a* the continuation or expansion of an existing franchise operation relationship;
- b* the franchisor actually lacks the information concerned; or
- c* other circumstances where there is no information asymmetry between the franchisors and the trading counterparties.¹⁹

iii Registration

There is no requirement to register the franchise agreement or the disclosure document in Taiwan. Corporate registration and tax registration are required if the franchisor establishes an establishment or entity such as a representative office, a branch or a subsidiary in Taiwan.

iv Mandatory clauses

There are no prescribed clauses that must be included in franchise agreements. However, the FTC Directions require the franchisor to disclose important business information and terms before entering into a franchise relationship. According to the FTC Directions, when entering into franchise contracts, franchisors shall not engage in obviously unfair acts such as the following:

- a* prior to entering into a written contract regarding a franchise operation, the franchisor fails to provide at least five days, or a reasonable time frame determined in line with each specific case, for the trading counterparty to review the contract; or
- b* the contract document is not given to the trading counterparty at least 30 days before the contract is signed (unless the delay is caused by circumstances not attributable to the franchisor).²⁰

v Guarantees and protection

In a franchise contract, franchisors usually require franchisees to (1) guarantee the confidentiality of the information provided and (2) refrain from using the information for purposes other than those set out in the franchise contract. These guarantees from franchisees are enforceable as they are not deemed to constitute obviously unfair practices. There are several articles in the Civil Code regarding the good-faith principle and the effect of standard form contracts and these will be applied by the courts when determining the effect of these types of guarantee clauses (see Section VI.i for more information).

18 See Article 3.1 of the Fair Trade Commission Disposal Directions on the Business Practices of Franchisors (the FTC Directions).

19 See Article 3 Section 3 of the FTC Directions.

20 See Article 4.3 of the FTC Directions.

V TAX

i Franchisor tax liabilities

The primary taxes relevant to business entrepreneurs in Taiwan are the profit-seeking enterprise income tax (PSE income tax), value added business tax (VAT), individual income tax, and customs duties.

Company income is charged with PSE income tax on income from each fiscal year.²¹ If a franchisor is a Taiwanese company, it has a duty to pay PSE income tax on all income generated in and outside Taiwan, while a foreign company franchisor only has to pay this tax on domestic-sourced income.²²

VAT is levied on the sale of goods or services in Taiwan and on the import of goods by the Value-Added and Non-Value-Added Business Tax Act.²³ If services are provided by a foreign company that has no fixed place of business in Taiwan, service purchasers from Taiwan are required to pay VAT;²⁴ if the services are electronic, the foreign company is the taxpayer.²⁵

ii Franchisee tax liabilities

If a franchisee is a company, the tax rule indicated in Section V.i applies. Otherwise, if a franchisee is a natural person, the main tax issue will be income tax levied on the person's business income. A resident or a foreign national who has no domicile but resides in Taiwan for over 183 days during a taxable year must pay income tax on all income generated in and outside Taiwan.²⁶ A non-resident must pay income tax on domestic-sourced income,²⁷ such as salaries paid in Taiwan²⁸ and the income from buildings and land transactions in Taiwan.²⁹

iii Tax-efficient structures

There is no optimal tax-efficient structure existing specifically for franchise businesses, as the pros and cons depend on the particular business entity and business structure.

VI IMPACT OF GENERAL LAW

i Good faith and guarantees

The Civil Code stipulates that a right shall be exercised and a duty shall be performed in accordance with the principle of good faith.³⁰ Further, a party is obliged not to harm the economic interests of the other party during negotiations and the victim can claim compensation for damage caused by a misplaced reliance on the good faith of the other party. The Civil Code also stipulates that even where the contract is not concluded, one of the

21 See Article 24 of the Income Tax Act.

22 See Article 3 of the Income Tax Act.

23 See Article 1 of the Value-Added and Non-Value-Added Business Tax Act.

24 See first sentence in Article 2.3 of the Value-Added and Non-Value-Added Business Tax Act.

25 See Article 2-1 of the Value-Added and Non-Value-Added Business Tax Act.

26 See Article 2 and 7 of the Income Tax Act.

27 See Article 2 and 7 of the Income Tax Act.

28 See Article 8 of the Income Tax Act.

29 See Article 14-4 of the Income Tax Act.

30 See Article 148 of the Civil Code.

parties is responsible for injury caused to the counterparty who, without negligence, believed the contract to be concluded, when, to prepare or negotiate for the contract, the party has done any of the following:³¹

- a* hidden in bad faith or dishonestly explained an extremely relevant matter of the contract when the other party enquired of it;
- b* intentionally or through gross negligence disclosed a secret of the counterparty known or held by the party, and which the counterparty had explicitly requested be kept secret; or
- c* any other matter obviously against good faith, although there is no specific regulation that addresses good faith in commercial relationships governed by the terms of a contractual agreement. Accordingly, franchisors and franchisees do not have an implied duty to act in good faith by virtue of the franchise agreement executed by them.

In Taiwan, most franchise agreements are standard form contracts. Where there is any ambiguity regarding the terms and conditions, interpretations are made in favour of the other party (i.e., the franchisees). The effect of the clauses in standard form contracts is regulated by the Civil Code, which stipulates that agreements that include provisions with the following purposes, and that are obviously unfair under the given circumstances, are void:³²

- a* to release or to reduce the responsibility of the party who prepared the entries of the contract;
- b* to increase the responsibility of the other party;
- c* to make the other party waive his or her right or to restrict the exercise of his or her right; and
- d* other matters gravely disadvantageous to the other party.

A non-compete clause in a franchise agreement might be deemed unfair and invalid depending upon the specific facts of the case (see Section VI.vi for additional information).

ii Agency distributor model

According to the FTC Directions, the term ‘franchise relationship’ refers to an ongoing relationship in which a franchisor licenses a franchisee through a contract to use its trademarks or operational techniques, and assists or counsels the franchisee to manage the business, while the franchisee pays the corresponding charges for these services. The purchase of products or services at wholesale or lower rates for resale or leasing is not included under this arrangement.³³

According to this definition, the FTC does not limit the business model of the franchise but excludes the application of the pure resale or rental model. Thus, both the agency model and the distributor model exist in Taiwan, and franchisors and franchisees may freely contract into an agency or distributor business model. In an agency model, the franchisees sell the franchisor’s products to customers on behalf of the franchisors, and the product ownership remains with the franchisors. In contrast, in a distributor model, the franchisees operate the business for themselves after purchasing the products from and being licensed by the franchisors.

31 See Article 245-1 of the Civil Code.

32 See Article 247-1 of the Civil Code.

33 See Article 2.3 of the FTC Directions.

iii Employment law

According to the Taiwan Labor Standards Act (LSA), a worker is defined as a person who is hired by an employer to work for wages. All employee–employer relationships are mandatorily regulated by the LSA. However, a ‘franchisee’ may not have an employment relationship and as such the LSA will not apply to a franchisee who merely uses the trademarks or operational techniques licensed by the franchisor, or who receives assistance or counsel from the franchisor and pays the franchisor the corresponding charges for those services.

As a side note, there are some judgments that also clearly declare that only natural persons can be viewed as a worker or labourer, and legal persons cannot.³⁴

iv Consumer protection

According to Taiwan’s Consumer Protection Act, a consumer is any person who is acting for the purposes of consumption to make transactions in exchange for goods or services in relation to a commercial practice, and a consumer relationship is the legal relationship arising between consumers and traders for the sale of goods or the provision of services.³⁵

The Supreme Court in a judgment has emphasised that the purpose of the Consumer Protection Act is to protect the interests of unspecified consumers in society, rather than to regulate the trading activities between traders, and therefore only end consumers fall under the protection of the Act.³⁶ A franchisee may be deemed a trader who intends to conduct business with consumers and the Act cannot be applied to the franchise agreement.³⁷

v Competition law

According to the FTC Directions, the following four types of acts are prohibited in a franchise relationship:

- a* to cause another enterprise to discontinue supply, purchase or other business transactions with a particular enterprise for the purpose of injuring that particular enterprise;³⁸
- b* to treat another enterprise discriminatorily without justification;³⁹
- c* to make or use false or misleading representations or symbols in relation to goods and do so sufficiently to affect trading decisions on goods or in advertisements, or in any other way make these known to the public;⁴⁰ and
- d* to engage in any deceptive or obviously unfair conduct that can affect the trading order.⁴¹

The FTC may order any enterprise that engages in any of the above acts to cease the acts, rectify its conduct or take necessary corrective action within a specified time; in addition,

34 See Taoyuan District Court Judgment 2014 Su Zi No. 688; Taoyuan District Court Judgment 2011 Zong Su Zi No. 45; Pingtung District Court Judgment 2010 Jian Zi No. 5.

35 See Article 2 of the Consumer Protection Act.

36 See Supreme Court Judgment 2002 Tai Shang Zi No. 1001.

37 See High Court Civil Judgment 2012 Zhong Shang Zi No. 128

38 See Article 20 of the Fair Trade Act.

39 See Article 20 of the Fair Trade Act.

40 See Article 21.1 of the Fair Trade Act.

41 See Article 25 of the Fair Trade Act.

the FTC may impose upon such enterprises an administrative penalty with a fine of up to NT\$50 million, depending on the nature of the violation⁴² (see also the discussion of the Fair Trade Act in Section IV).

vi Restrictive covenants

There is no law expressly regulating whether a non-compete clause can be included as part of a franchise relationship. According to the principle of freedom of contract, there are court precedents admitting that franchisors may prohibit franchisees from engaging in the same or similar business during or after the contract period.⁴³ Further, franchisors may also forbid franchisees from recruiting other franchisees within a certain geographic range of the original business location.⁴⁴

However, as indicated in Section VI.i, a non-compete clause cannot violate the principle of public order and good morals.⁴⁵ The courts usually consider several factors, including whether the franchisors have a legitimate interest to be protected, such as special knowledge or trade secrets, whether the restricted period is too long, whether the restricted area and the scope of business are too broad, and whether the franchisee's right to work is seriously harmed.⁴⁶

To prevent franchisees from circumventing their non-competition obligations, it may be regarded as a breach of contract if the franchisee's spouse or representative engages in the restricted competing business.⁴⁷

vii Termination

As there is no special law governing franchises in Taiwan, the termination of a contract will be regulated by the Civil Code.

In response to a breach of a non-compete obligation, a franchisor may file a lawsuit to request liquidated damages or performance of the obligation from the franchisee concerned.⁴⁸ Further, according to the Code of Civil Procedure, to prevent more damage, a franchisor may file for an 'injunction maintaining a temporary status quo'⁴⁹ (i.e., injunctive relief) before filing such a lawsuit.

Whether a franchisor can take back or take over a franchisee's business will be determined by the particular contract, and provisions to this or similar effect have been permitted by several judgments.⁵⁰

42 See Articles 40 and 42 of the Fair Trade Act.

43 See Taoyuan District Court Judgment 2018 Su Zi No. 2106.

44 See High Court Kaohsiung Branch Court Civil Judgment 2017 Shang Yi Zi No. 2106.

45 See Articles 72 and 247-1 of the Civil Code.

46 See Taichung District Court Civil Judgment 2017 Su Zi No. 1377.

47 See High Court Tainan Branch Court Civil Judgment 2010 Shang Yi Zi No. 196.

48 See IP Court Civil Judgment 2014 Min Ying Shang Zi No. 4; Taipei District Court Civil Judgment 2002 Su Zi No. 3472.

49 See High Court Civil Ruling 2007 Kang Zi No. 81.

50 See High Court Civil Judgment 2014 Shang Yi Zi No. 267; Taipei District Court Civil Judgment 2018 Su Zi No. 1416; Shilin District Court Civil Judgment 2013 Su Zi No. 1012.

viii Anti-corruption and anti-terrorism regulation

In Taiwan, as there are no regulations specifically applicable to franchises, in general, relevant regulations that may be applicable to certain situations include the Criminal Code, the Money Laundering Control Act and the Anti-Corruption Act.

ix Dispute resolution

At present, there is no exclusive dispute resolution mechanism adapted specifically for franchising disputes under Taiwan law. Generally, mediation, arbitration and litigation exist and are used to resolve disputes, and they have the same effect. The law does not mandate that a franchise dispute be preceded by a mediation procedure,⁵¹ therefore the parties may choose which dispute resolution mechanism they want to adopt in their contracts. In 2016, ACFPT began offering a method similar to mediation by establishing a 'chain and franchise mediation committee'. In our experience, the parties to a franchise agreement tend to resolve disputes by litigation.

Pursuant to the Civil Code, compensation is limited to the injury actually suffered and the interests that have been lost.⁵² However, liquidated damages as a penalty are usually requested and, after considering the actual cost of the damage, the social economy, the seriousness of the breach of contract and other factors, the court may reduce the liquidated damages penalty to a reasonable amount. For violations of the non-compete clause or violations of trademark rights or other intellectual property rights, franchisors are entitled to file for injunctive relief.⁵³

Once a lawsuit has been filed, a plaintiff first has to pay the court fee. After the judgment has been issued, the court may order the court fee to be borne by one party or by both parties in certain proportions. The court fee is calculated according to the ratio of the alleged claims, and therefore there is no upper limit. If the amount of the claim exceeds NT\$1.5 million,⁵⁴ the judgment may be appealed through three levels of courts.

Taiwan is not a signatory to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (known as the New York Convention); however, unless the country where the arbitral award is made or whose laws govern the arbitral award clearly states that it does not recognise Taiwan's arbitral awards,⁵⁵ a foreign arbitral award will be binding and enforceable on the parties after an application for recognition has been granted by the courts, and it will have the same force as a final judgment of a court.⁵⁶ Further, if the parties explicitly agree to select a foreign court as the exclusive international court, the jurisdiction of the court in Taiwan may be excluded.⁵⁷ In addition, the applicable law regarding the formation and effect of a juridical act (e.g., a contract) can be determined by the intention of the parties.⁵⁸

51 See Article 403 of the Taiwan Code of Civil Procedure.

52 See Article 216 of the Civil Code.

53 See High Court Civil Ruling 2014 Kang Zi No. 1009; High Court Ruling 2007 Kang Zi No. 81.

54 See Article 466 of the Code of Civil Procedure.

55 See Supreme Court Civil Judgment 2004 Tai Shang Zi No. 1943; Supreme Court Civil Ruling 1986 Tai Kang Zi No. 335.

56 See Article 49.1 of the Arbitration Law.

57 See Supreme Court Civil Ruling 2019 Tai Kang Zi No. 373.

58 See Article 20 of the Act Governing the Choice of Law in Civil Matters Involving Foreign Elements.

Taiwan's courts have different opinions as to whether franchisors undertake joint liability for wrongful acts committed by the employees of their franchisees. This legal issue is determined according to whether an employee of a franchisee and the franchisor are in a 'de facto employment relationship'.⁵⁹ In 2015, a High Court judgment declared that even if the franchisor had the right of audit and examination of the franchisee, as long as the employee is not objectively supervised in the commission of his or her labour service, the franchisor did not have to undertake joint liability.⁶⁰ However, a district court judgment expressed a different opinion in 2017.⁶¹ As such, this issue has not been clearly decided and requires more observation.

VII CURRENT DEVELOPMENTS

According to the data from the Directorate General of Budgets, Accounting and Statistics, of the Executive Yuan, the ratio of the output value of Taiwan's service businesses to the national gross domestic product was 63.5 per cent,⁶² indicating that service businesses are of great importance to Taiwan's economic development. In recent years, the domestic franchise industries have grown rapidly, which has resulted not only in a change of the business model of Taiwan's service businesses, but also in franchising becoming the primary mode of Taiwan's modern commercial operations.

Many franchise businesses have developed overseas. As to the overseas distribution of brands, the huge Chinese market is still a most coveted region. According to ACFPT statistics on food-industry members, 26 Taiwanese brands are currently established in China and 12 in the United States and Canada.⁶³

Recently, the Taiwanese government has promoted the 'New Southbound Policy', enhancing and encouraging economic investment in and exchanges with South East Asian countries, which have enticed many Taiwanese food-service franchising businesses to develop southward. In some South East Asian countries, there is a significantly large population of Chinese ethnic groups, which has facilitated acceptance of Taiwanese brands. For instance, the Chinese ethnic group accounts for more than 20 per cent of the population in Malaysia, and 12 ACFPT-established store brands exist in Malaysia, in Macau there are seven brands, and in Hong Kong there are six Taiwanese brands.⁶⁴

Through long-term development, the Taiwanese franchise industry has evolved into a fairly mature business model. As long as the raw materials overseas are properly controlled, other planning for the establishment of stores can be copied and spread rapidly in a standardised manner. However, among the potential brands planned for development overseas, there are a few small and medium-sized enterprises that lack the necessary funds and professional support. These franchise businesses still need support from the government or the private sector to operate successfully overseas.

59 See Supreme Court Civil Judgment 2000 Tai Shang Zi No.1165; Supreme Court Civil Judgment 1956 Tai Shang Zi No. 1599; Article 188 of the Civil Code.

60 See High Court Civil Judgment 2015 Shang Zi No. 567.

61 See Kaohsiung District Court Civil Judgment 2016 Su Zi No. 1699.

62 See <https://www.chinatimes.com/newspapers/20170524000305-260210?chdtv>.

63 See statistics from ACFPT, quoted by foodNEXT, <https://www.foodnext.net/news/newstrack/paper/5975323036>.

64 See statistics from ACFPT, quoted by foodNEXT, <https://www.foodnext.net/news/newstrack/paper/5975323036>.

Last but not least, many franchise businesses have flourished in this era of globalisation and accelerated technological development, with emerging technologies such as big data, the internet of things and artificial intelligence, and they will have to face head on the challenge of keeping up with these modern trends and developing their own characteristics in their future operations.

UKRAINE

Volodymyr Yakubovskyy and Graeme Payne¹

I INTRODUCTION

Franchising is still in the process of development in Ukraine. It remains a relatively new notion for the Ukrainian business community as it only appeared after the collapse of the Soviet Union in the early 1990s and had no legal framework for the following decade, until the Civil Code and the Commercial Code were adopted in 2003. Moreover, even though the Civil Code and the Commercial Code established a necessary platform, for another decade franchising regulation still lacked several important elements necessary for it to function properly. Ukrainian law still has a rather limited framework and the case law does not yet fully compensate for the missing components. Self-regulated non-governmental associations try to fill the void, particularly given that there has been no special governmental agency to regulate the offer and sale of franchises in Ukraine.

Despite the gaps and inconsistencies of the Ukrainian legal system, international and local franchise businesses have managed to find enforceable franchising structures or employed alternative arrangements to develop their business in Ukraine. For quite some time now, many international brands have successfully operated their franchise businesses, including, among others, McDonald's, Papa John's, KFC, GAP and InterContinental, along with a variety of local franchises in food, retail, services and other industries. The market continues to grow. The Ukrainian Franchise Association publicised information that more than 2,300 franchising companies are now members of the Association.

The recent necessary changes in applicable laws and the new Ukrainian government's general trend of reform towards a competitive and market-based economy give hope for further, even extensive, development of the franchising industry in Ukraine.

II MARKET ENTRY

i Forms of business entities

A foreign business would usually incorporate in Ukraine to operate a substantial business in the country. A foreign franchisor, however, may choose not to do so if it only licenses its franchise to franchisees in Ukraine.

The typical franchisor would incorporate as a limited liability company (LLC), like most businesses in Ukraine. There are other forms of business entity available, such as

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a private enterprise or a joint-stock company. However, those other corporate forms are either under-regulated or over-regulated, while the LLC strikes a proper balance. A single-person franchisor may also register as an individual entrepreneur.

ii Requirements

The Civil Code, the Commercial Code, the Law on Companies, the Law on Limited Liability Companies (enacted in 2018) and the Law on State Registration of Legal Entities and Individual Entrepreneurs govern the formation of business entities. Between them, these laws set a number of requirements for forming and maintaining a business entity.

The first step in establishing a legally formed entity in Ukraine is to file a registration form (which includes a statement of beneficial ownership), founding resolution and statutory documents, and to apply for registration of the company with a local state registrar. Currently, state registration of legal entities is free of charge.

Ukrainian law envisages some capital formation and maintenance rules for companies. In particular, a joint-stock company must have a minimum capital of not less than 5.9 million hryvnas² at its formation. There are also restrictive rules regarding consideration paid for the issue of shares of joint-stock companies. There is no minimum capital requirement for registration of an LLC and capital formation rules are generally less restrictive for LLCs.

A company must have a distinctive name that also contains an indication of its corporate form. Each business entity must have an office located in Ukraine. A company must have at least one responsible director, who must be a natural person.

Business entities must all be registered with tax and statistic authorities, and with the Pension Fund of Ukraine. They are required to keep accounting records and file returns on a monthly, quarterly and annual basis.

iii Restrictions

Foreign business and foreign investment are generally subject to the national regime in Ukraine, which basically implies the same rights and possibilities as apply to local residents. Moreover, foreign investors have certain statutory guarantees under Ukrainian law and bilateral or multilateral treaties that protect their investment, such as a guarantee of profit repatriation and compensation of losses, a guarantee against nationalisation and a guarantee against changes in the law. However, because of strict currency control regulations, severe restrictions existed until recently with regard to the repatriation of investment and profits. With the enactment of the new Law on Currency in February 2019, currency restrictions were lifted. Nevertheless, the National Bank of Ukraine still reserves the right to temporarily re-introduce them to stabilise the national financial market.

Furthermore, certain limitations and restrictions do naturally apply to foreign businesses and foreign investment and these are mostly related to national security and strategic interests in certain important industries (e.g., financial services, railway, mining, agriculture, publishing and media). Since franchising is usually not related to the above-mentioned strategic industries, it typically does not raise any purely foreign investment restriction issues. It should also be borne in mind that the Ukrainian government currently pursues a sanctions

2 As of 1 January 2020. The amount is equal to 1,250 minimum statutory wages and therefore increases with the adjustment of that figure (as a rule, every year).

policy in relation to Russia because of the backing of the insurgency in eastern Ukraine and the annexation of Crimea. Accordingly, a number of Russian companies and individuals are under sanctions, which would render their franchising activities in Ukraine impossible.

iv Real estate

The Ukrainian real estate market is structured and fairly well developed. Commercial real estate is rapidly expanding, and this is especially true for metropolitan areas. However, the development level still remains much lower than the usual level or trading area per capita found in Europe or the United States.

Real estate is normally leased or, less often, bought for franchising purposes. From a procedural point of view, real property sale and purchase transactions must be certified by a notary and rights to real estate registered with the relevant state register. Long-term lease agreements of three years and longer must also be notarised, and lease rights thereunder must be registered. This implies additional costs, but it also provides for greater certainty and protection. To avoid notarisation costs, lease agreements are often concluded for two years and 11 months with a pre-emptive right to renew the lease.

Lease agreements must contain certain mandatory provisions (e.g., lease object description, its value with indexation, rent with indexation, lease term and renovations), but, in general, the parties are largely free to determine specific terms and conditions.

III INTELLECTUAL PROPERTY

i Trademark protection

Ukraine has a number of laws that regulate protection of intellectual property. In addition, the state is a member of international organisations and international agreements (e.g., World Intellectual Property Organization, the Berne Convention and the Paris Convention).

As for trademarks, they are subject to the territorial principle of protection and must be registered to enjoy protection. To safeguard a trademark in Ukraine, the foreign franchisor should either register the trademark in Ukraine directly with the Ukrainian patent office or apply for international registration to the WIPO through the Madrid System. The trademark registration is normally valid for 10 years and may then be extended further.

Some trademarks may qualify as well-known brands, which implies a stronger protection for the trademark holder. For this, a trademark must meet certain stringent criteria of identity and public awareness. To formalise such protection, the trademark holder must file an application with the State Intellectual Property Service of Ukraine, supporting it with substantive evidence, or obtain a court judgment in respect of a trademark dispute.

ii Know-how protection

Know-how is a novel and rather problematic notion for the Ukrainian legal system. Ukrainian law defines know-how as information obtained through experience and tests and that is:

- a* not public or easily accessible;
- b* substantive (i.e., important and useful for producing goods and rendering services); and
- c* defined (i.e., it is properly described in writing in sufficient detail such that it is possible to verify that it meets the criteria of being non-public and substantive).

In court practice, know-how is further defined as technical knowledge, experience, production secrets and information necessary for solving tasks of a technical or other nature. Know-how

is understood to be the result of technical creation, technical or other information, necessary for the production of certain products, or a technical decision, performed as an invention, which is not duly patented. Know-how is often associated to commercial and trade secrets, and is therefore similarly protected. There are no formal filings required to receive legal protection. However, some franchisors also employ patent filings to protect some aspects of their franchise other than trademarks.

iii Data protection

Ukraine has rules governing the collection, use, processing and transfer of personal data. Pursuant to the changes in the personal data protection laws of Ukraine, there is no longer a requirement to register personal databases. According to the new rules effective as of the beginning of 2014, the processor of personal data is obliged to notify the Ukrainian Parliament Commissioner for Human Rights only if the processing refers to information related to a particular area of risk (e.g., data on race, political views, health status, sex life, biometric data or movement tracking). In any case, the data controller must ensure an adequate level of protection of personal data it uses and processes.

A company is normally required to obtain consent from an individual to collect and process his or her personal data, with some statutory exemptions. In particular, a company is not required to obtain a consent when it collects and uses basic personal information necessary for a transaction with a consumer or when the law specifically requires the company to collect and retain some personal information (e.g., for the purpose of employment).

When individual consent is required, it must be obtained in either written or electronic form that shows it has been explicitly granted. The company must then retain this confirmation document (information) during the whole time of processing.

With the entry into force of the EU General Data Protection Regulation in 2018, many Ukrainian companies maintaining business ties with the EU and EEA undertake to adjust their data protection policies to the legal requirements of that Regulation.

IV FRANCHISE LAW

i Legislation

The Civil and Commercial Codes of Ukraine provide specific regulation of the ongoing relationship between franchisor and franchisee. In particular, these laws set forth some default ongoing franchisor obligations, which may be varied in the franchise contract. Namely, the franchisor is obliged to control the quality of goods produced by the franchisee and to regularly provide technical and consultancy support and training for the franchisee's personnel.

Competition law has to be taken into consideration and may substantially affect the franchise relationship. Specifically, Ukrainian competition law prohibits concerted actions that impose prices or other hardcore restrictions such as limitation of production or technical development, territorial markets and supplier allocation, and tying. The franchise agreement requires careful consideration in this regard, and further relations between the franchisor and franchisee must be constantly controlled for compliance.

When providing payments to a foreign franchisor in foreign currency, currency control laws must be under constant consideration.

ii Definition of a franchise

Ukrainian law does not use the term ‘franchise’; instead it provides a definition for a ‘commercial concession agreement’, which is the equivalent of a franchise agreement in Ukraine. It may be logically inferred that a franchise is a legal relationship based on an agreement under which one party (title-holder) undertakes an obligation to grant for remuneration to the other party (user) the right to use a set of rights of the title-holder with the purpose of production or sale of certain goods and services. Pursuant to further provisions of Ukrainian law, the franchise agreement implies the use of a title-holder’s rights, business reputation and commercial experience in the agreed scope, with or without reference to the territory and to particular areas of commercial activities.

iii Pre-contractual disclosure

Ukrainian law does not require formal pre-contractual disclosure in a franchise transaction. The parties decide on the information to present to each other and are not obliged to follow any particular procedure.

A franchisor does have to provide a copy of the technical and commercial documentation and other information necessary for performance of the franchisee’s rights under the commercial concession agreement. However, this obligation only arises after the contract has been concluded.

iv Registration

Registration of franchise agreements is no longer required under Ukrainian law. The statutory registration requirement was abolished as of 5 April 2015, in the wake of the business deregulation policy pursued by Ukrainian government.

Nevertheless, to ensure better legal protection, the franchisee may (but is not obliged to) apply for and procure registration of the assignment or transfer of the trademark rights assigned to the franchisee by the franchisor under a franchise or trademark licence agreement. Such an assignment of trademark rights is registered with the State Trademarks Register of Ukraine and the franchisee is issued a registration certificate.

v Mandatory clauses

In general, provisions in franchise contracts should not contradict the statutory provisions of Ukrainian civil and commercial law. Even though some deviation from statutory provisions is generally allowed according to the principle of freedom of contract, this should not be a substantial deviation. Otherwise, there is a risk that the court would render a deviating contractual clause unenforceable and choose to apply a statutory provision instead.

vi Termination of the franchise agreement

If a franchise contract is conducted for an indefinite period, both parties are entitled to its unilateral termination upon a six-month notice unless the contract envisages a longer notice period.

If a franchise contract is conducted for a defined period, termination is only possible upon mutual consent of the parties or on the basis of a court decision. Court ability to terminate the franchise relationship is limited to the general restrictions available in the laws on contract termination. In particular, the court may terminate the franchise contract if

the franchisor proves a substantial breach on the part of the franchisee. In some limited circumstances, the franchisor may also claim a substantial change due to unforeseen and irremediable circumstances.

The franchise contract also terminates under operation of law in the following cases: when a franchisor loses its title to the trademark, without substitution; or in the case of the bankruptcy (insolvency) of the franchisor.

vii Guarantees and protection

Guarantees are often necessary to protect the foreign franchisor against the lack of adequate creditor protection rules in Ukraine. Foreign franchisors usually request a surety from beneficial owners or affiliated business entities or, less often, a bank guarantee to secure financial obligations. It should be taken into account, however, that Ukrainian currency regulations may have specific regulatory requirements for the outbound payment under the surety agreement by an individual resident or a Ukrainian legal entity (other than a bank) in foreign currency, which may turn out to be rather problematic.

V TAX

i Franchisor tax liabilities

A Ukrainian franchisor is subject to corporate profit tax. The general corporate profit rate is currently 18 per cent. There are some simple taxation systems available for small and medium-sized businesses that do not have a substantial turnover.

For tax purposes, franchise fees shall fall within the definition of royalties under Ukrainian tax law. As a general rule, Ukraine charges a 15 per cent withholding tax on outbound royalty payments. Withholding tax is usually withheld and then paid into the state budget by a local franchisee. Where there is a double-tax treaty between Ukraine and the country in which the franchisor is domiciled for tax purposes, the applicable withholding tax may be lower (e.g., 10 per cent, 5 per cent or even zero per cent). Such treaties have priority over Ukrainian domestic legislation. The franchisor must, however, provide certificated confirmation of its place of residence.

Generally, royalties are not subject to VAT. Normally, however, supply transactions of goods (including their import) and services are subject to VAT at the rate of 20 per cent in Ukraine.

Foreign franchisors must be careful not to create a permanent establishment on the territory of Ukraine, as a permanent establishment would be subject to general corporate taxes in Ukraine.

ii Franchisee tax liabilities

Ukraine tax law limits deductibility of royalty payments made by Ukraine-resident companies to non-residents (including those having offshore status) to an amount not exceeding 4 per cent of income (revenues) received from the sale of products (goods, works and services) during the year that precedes the reporting year (see Section 140.5.6 of the Tax Code of Ukraine). Payment of royalties exceeding 4 per cent of the previous year's turnover would just add to the Ukrainian franchisee's tax burden, unless it can prove that the arm's-length principle applies to the royalties.

The Tax Code of Ukraine provides for further specific restrictions on the deductibility of royalty payments in addition to the above-mentioned turnover limitation. In particular, royalty payments made to non-residents will not be deductible at all where:

- a* a non-resident receiving such payments is not a beneficiary of the royalty payments (except in cases where the beneficiary has granted the right to receive the payments to the said non-resident);
- b* royalties are paid in respect of intellectual property that initially belonged to a Ukrainian resident (i.e., if the rights to the intellectual property were first owned by a Ukrainian resident, then transferred to a non-resident and then licensed to a Ukrainian resident); or
- c* a non-resident receiving royalty payments is not subject to taxation in respect of the royalties in its country of residency.

If the franchisee is a company, it will pay corporate profit tax unless it opts in to the simplified taxation regime. In addition, VAT is likely to apply to supply transactions of goods and services (including the transfer or assignment of intellectual property rights to the franchisor under licence, franchise or other agreement) conducted by the franchisee as a franchise business is always presumed to involve a trading business. Alternatively, in certain cases for small and medium-sized businesses, the franchisee may choose to pay a 'unified' tax (if it opts in to the simplified taxation regime), which can substitute for corporate profit tax and VAT.

Transfer pricing may also be a factor if:

- a* the foreign franchisor and the Ukrainian franchisee are related persons;
- b* the foreign franchisor is incorporated or is tax resident in a country (territory) that is classified as an offshore zone by the Cabinet of Ministers of Ukraine, namely that corresponds at least to one of the following criteria:
 - the rate of corporation tax in the franchisor's home jurisdiction is more than 5 per cent lower than the Ukrainian rate, or the franchisor's home jurisdiction provides for a preferential taxation regime, or the franchisor does not in fact pay any corporation tax;
 - the franchisor's home jurisdiction does not have an information-exchange agreement with Ukraine; or
 - the franchisor's home jurisdiction does not ensure an exchange of tax information on request by the Ukrainian tax authorities;
- c* the foreign franchisor does not pay any corporation tax or is not tax resident in the country of its incorporation (pursuant to a list of legal entity forms approved by the Cabinet of Ministers of Ukraine);
- d* the franchisee's annual income in the relevant tax year, according to accounting standards, exceeds 150 million hryvnas; and
- e* the value of all transactions between the foreign franchisor and the Ukrainian franchisee in the relevant tax year exceeds 10 million hryvnas.

Ukrainian tax legislation undergoes frequent changes, even following its substantial revision and codification in 2011. Moreover, the new government intends further reform of the tax system to facilitate easy tax administration.

VI IMPACT OF GENERAL LAW

i Competition law

The franchisor should bear in mind aspects of competition law that prohibit the imposition of certain vertical restraints on the franchisee in the franchise agreement. In particular, the franchisor should be careful regarding restrictions imposed on the franchisee that may affect competition. In practice, competition is considered to be substantially restricted when the undertakings involved approach a dominant position, separately or collectively. The imposition of such restrictions on the franchisee may also fall under certain market-based exemptions and the block exemption for intellectual property rights transfer. If none of these exemptions applies, the provisions may still be cleared by an approval from the Anti-Monopoly Committee of Ukraine (AMC).

The Law on Protection Against Unfair Competition is also relevant to the typical franchisor. As mentioned above, a franchisor may be held accountable for any deceptive or misleading statements about its franchise to potential franchisees. Besides that, on the other hand, the law provides certain protection to the franchisor against dishonest franchisees or third-party competitors in relation to passing off, infringement of trademarks and other intellectual property, trade libel, unlawful collection, misappropriation and unauthorised disclosure of trade secrets.

To enforce the provisions of unfair competition laws, the franchisor may file a lawsuit directly with the court and argue under general competition principles on the basis of the evidence it has collected. Alternatively, the franchisor may file a complaint with the AMC, or its local division, which would take up some of the burden of collecting evidence against a breaching party. As a result of its investigation, the AMC may order the cessation of any violation and impose a substantial fine. Moreover, once the violation is confirmed, the franchisor may then, on the basis of that established fact, apply to the court for damages. There are, however, drawbacks to the AMC investigation process for the franchisor. First, because of bureaucracy, it takes an overly long time for the AMC to conclude the process. Second, the franchisor has no access to the information collected by the AMC during its investigation proceedings and, therefore, the franchisor has little influence on the course of such an investigation.

ii Product liability

A franchisor bears subsidiary liability with franchisees for consumers' claims in relation to the quality of products manufactured by the franchisor and further resold by the franchisee (i.e., a consumer is entitled to bring a claim against the franchisor only after the franchisee has been found unable to satisfy the claim in full).

At the same time, if the franchisee manufactures the products under the technology and the standards granted under the franchise agreement, the franchisor and the franchisee shall be jointly liable. Note, however, that currently there is no case law addressing the issue of product liability under the relevant provisions of Ukrainian law. Furthermore, in general, product liability cases are not often tried in Ukrainian courts.

Ukraine has recently updated its law on product liability. The new law defines that consumers are entitled to bring claims in respect of the following:

- a* against an actual producer and any person that is the brand holder of a product (i.e., this can actually be the franchisor or its related companies);

- b* against any importer of a product for sale, hire, leasing or any form of distribution as a producer (i.e., usually the franchisee or its related companies); and
- c* where a producer cannot be identified, each supplier (i.e., the franchisee or its related companies) shall be liable as a producer unless they inform an injured person of a producer or an importer within 30 days. Moreover, under the new law if several persons are liable for damages (e.g, a producer and an importer, in the case of imported products), an injured person is entitled to address its claims either to all liable persons jointly or to one of them separately.

At present, there is no comprehensive case law or official interpretation of the new product liability law. It is difficult to predict how most of its provisions will apply in practice. It is especially unclear how new rules will correlate with existing civil and consumer protection law.

Under Ukrainian conflict-of-laws rules, Ukrainian consumer protection laws apply mandatorily if the consumer claims derive from products sold in Ukraine. However, there is an exception if the goods are not produced in Ukraine (and merely available on its territory). In this case, a claimant has a right to choose the law of the country of manufacture to be applied as well.

iii Dispute resolution

Most disputes concerning franchising matters are heard by the courts of either civil or commercial jurisdiction (depending on the parties), including contractual and non-contractual matters. Whenever a public act or failure to act is challenged, the case is resolved by the courts of administrative jurisdiction. The criminal proceedings in public prosecutions are overseen by the courts of criminal justice. As regards franchise matters, a criminal prosecution may be initiated for intellectual property infringement. Under the judicial reform enacted at the end of 2017, the establishment of a new High Court for Intellectual Property is envisaged. This Court will have jurisdiction over all disputes related to intellectual property, including those arising out of franchise agreements.

Besides the system of state courts, parties can choose to submit their dispute to an arbitration tribunal. Although binding on the parties, decisions of arbitration tribunals can be appealed to the courts.

Foreign courts may also be used as an alternative. To enforce the decision of a foreign court in Ukraine, however, the courts of both jurisdictions should have established mutual recognition of judgments. A significant disadvantage is the burdensome and time-consuming notification process under the Hague Service Convention.

Dispute resolution in international arbitration tribunals is allowed and enforceable in Ukraine. Ukraine is a party to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards and Ukrainian courts respect and frequently enforce arbitral awards. There is an established international tribunal at the Ukrainian Chamber of Commerce.

The major advantage of international tribunals is that the case is heard by either a sole professional international practitioner or a bench of such arbiters selected in the manner agreed by the parties. This provides greater certainty of a fair and just award being made in the case. The Ukrainian courts may, however, refuse to enforce an arbitration award on the grounds set forth by the New York Convention. The most common grounds for such a refusal is that of public policy. The other disadvantage is that injunctions in support of arbitration procedures are not currently practicable in the Ukrainian courts.

VII CURRENT DEVELOPMENTS

The major development, as mentioned above, is the abolition of the state registration requirement for franchise agreements, which had been one of the most controversial issues in franchise law in Ukraine. With the adoption of the Commercial and Civil Codes in 2003, Ukrainian private law introduced a registration requirement for franchise agreements; the problem was that Ukrainian public law did not envisage any procedure for registrars to perform such a registration. For this reason, the state registrars in Ukraine refused to perform registrations of franchise agreements altogether. This posed a serious risk to the enforceability of such agreements in the Ukrainian courts and there was no completely safe means of complying with the registration requirement under Ukrainian law.

Another essential step towards liberalising business and trade relations in Ukraine is the adoption of the new E-Commerce Act, which came into force on 30 September 2015. This Act will certainly influence the franchising sphere, since it provides for the execution of electronic transactions, including franchise agreements. Thus, the parties of a franchise agreement may choose to execute it in an electronic form. According to the Act, an electronic transaction shall have legal force and consequences equal to those of any other valid legal transaction, in particular, an agreement in written (paper) form. Importantly, this principle applies only to electronic transactions signed by the parties concerned in one of the following ways:

- a* by a certified digital signature;
- b* by a digital signature provided by the seller to the customer in the form of a one-time identifier (a combination of numbers and letters); or
- c* using an analogue of the handwritten signature, such as a facsimile, provided the parties agree to this in writing and the agreement shall contain samples of the parties' respective signature analogues.

Despite the progressive character of the Act, and given that even after several years there is a lack of comprehensive practice in this regard, it remains to be seen how it will be received by traditional business and how, in light of the conservative nature of administrative and court practice, it will actually be applied (in particular, to cross-border contracts, including franchise agreements). Certainly, practical issues will emerge, necessitating adjustments of the Act and concurrent legislation.

In November 2016, the Ukrainian parliament approved progressive legislative changes removing a number of formalities pertaining to cross-border contracts. In particular, the changes explicitly provide for the option to execute such contracts in an electronic form. As regards contracts for the export of services, an exchange of emails, issuance of an invoice, including an electronic one, and the acceptance of a public offer will be considered to be as valid and binding a contract as a standard paper-form agreement. These changes to the law should simplify cross-border business relations between franchisors and franchisees.

In 2018, the new Law on Limited Liability Companies became effective. It provides detailed regulations on this most widely used form of legal entity, and it gives those concerned the flexibility to govern certain limited issues in the company charter or their shareholders' agreement differently from the Law itself.

With the entry into force of the GDPR in 2018, many Ukrainian companies maintaining business ties with the EU and EEA undertake to adjust their data protection policies to the legal requirements of that Regulation.

Finally, the new High Court for Intellectual Property is expected to commence its work shortly. The Court shall assume jurisdiction over all disputes related to intellectual property, including those arising out of franchise agreements.

UNITED KINGDOM

*Graeme Payne*¹

I INTRODUCTION

The United Kingdom is one of the more ‘mature’ franchise markets of all the nations that have embraced franchising as a vehicle for business growth. At the time of writing, the latest published NatWest/British Franchise Association Franchise Survey (the Survey) was the 2018 Survey. The 2018 Survey reported a total of 935 franchise systems in the United Kingdom. The Survey also reported that the overall contribution of franchising to the UK economy was in excess of £17 billion, an increase of over £2 billion since the previous survey in 2015.

The Survey reports that between them, the franchise systems in the United Kingdom operate an estimated total of 48,600 franchised units, which is the highest number ever reported, and nearly two times more than 25 years ago. On average, these businesses are becoming larger as the sector matures, with 60 per cent of those surveyed claiming a turnover in excess of £250,000.

The majority (80 per cent) of franchise systems in the United Kingdom are UK-owned, which is a huge contrast to 25 years ago, when the majority of systems were imported from the United States. One in three systems has operations outside the United Kingdom and, for those franchisors that do not currently operate internationally, 4 per cent have a definite business plan to do so, and a further 30 per cent are considering it as a future option. The number of franchisees operating multiple units is continuing to rise, with 36 per cent of respondents to the Survey owning more than one unit, up from 29 per cent in 2015, and 25 per cent in 2013. The Survey comments on how the bargaining power between franchisor and franchisee will likely start to change with the increase in multi-unit franchisees, often increasing the bargaining power of the franchisee.

Sectorally, the Survey concludes that while more systems were added in every category, the largest growth was seen in hotel and catering, and personal services. These two sectors now account for over 60 per cent of the UK franchising market by unit number, up from 40 per cent in 2008. While growth in the store retailing sector appears to have been relatively flat over time, the Survey reminds us that this should be viewed in the context of a highly challenging retail business environment, and as such the growth that there has been is a positive indication of the state of the UK franchising market. Furthermore, 93 per cent of franchisee-owned units reported profitability, and closure of a unit due to commercial failure was reported at less than 1 per cent – low when compared with failure rates for small and medium-sized enterprises generally.

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The Survey also comments on changes to those entering the UK franchise market. While it found that 70 per cent of franchisees are male, the Survey reports that more females are becoming franchisees, with a 20 per cent jump since the previous survey in 2015. More under 30s are also becoming franchise owners, with 18 per cent of all franchisees now under the age of 30. The industry has also embraced the agile working trend, reporting that nearly four in 10 franchise systems can be operated from a home office.

The United Kingdom's national franchise association is the British Franchise Association (BFA), which was formed in 1977. The BFA is a voluntary self-regulating body whose stated aim is 'to promote ethical franchising practice in the United Kingdom and help the industry develop credibility, influence and favourable circumstances for growth'.

II MARKET ENTRY

i Restrictions

Typically, there are no restrictions faced by foreign franchisors in terms of the granting of master franchises or development rights to a local entity in the United Kingdom. The United Kingdom is generally considered to be a relatively easy and regulation light place in which to do business. Foreign ownership and investment in the United Kingdom – in terms of foreign franchisors owning equity in a local business or owning commercial or residential property (or other assets) – is subject to very few regulations. With relatively benign immigration laws (subject to the impact of the United Kingdom leaving the European Union, which is due to take place on 29 March 2019) and no mandatory approval conditions, there is little by way of legal barriers to, or restrictions on, foreign franchisors entering the UK market.

ii Foreign exchange and tax

There are no foreign exchange controls or restrictions on foreign currency payments that are applicable to cross-border franchising in the United Kingdom. It is, however, important that the franchise agreement expressly details the choice of payment currency, together with the rate and time of the conversion for payments where applicable. For information regarding tax, refer to Section V.

III INTELLECTUAL PROPERTY

i Brand search

The key intellectual property rights that will form part of a franchise business concept are trademarks; domain names; copyright – particularly in respect of materials such as the operations manuals, website and social media text and advertising, marketing and promotional literature – and database rights. To a lesser extent patents, design rights and image rights may play a role in the franchise business concept.

As copyright is a non-registrable right the key registered (or registrable) right is the trademark, or the franchisor's brand rights as they are commonly referred to. For the franchisor looking to register its trademarks in the United Kingdom and the EU, the recommended searches are, with respect to registered trademarks, the centralised systems offered on the trademarks section of the UK Intellectual Property website and the trademarks section of the European Union Intellectual Property Office (EUIPO) website (for European Union trademarks, or EUTMs).

Searches should be carried out for both identical and similar marks and consideration given as to whether the trademarks are being used against identical or similar goods and services to those of the franchisor.

It is also recommended that general internet searches be carried out to check what trademarks are being used in the public domain, particularly those that are not registered and thus not identifiable on the trademark registers but that could still pose a threat to the franchisor's trademarks because of their use in the public domain.

If the franchisor's trademark is not registered and there are no registered trademarks identified through the searches that are identical or similar to that of the franchisor's trademark, an application for registration should be made as quickly as possible. If, however, searches identify that there are already registered trademarks identical or similar to that of the franchisor, the franchisor could be at risk of having infringement proceedings brought against it for the use of its trademark and should therefore stop all use of its trademark and consider what changes could be made to its trademark so that the mark cannot be deemed identical or similar to any others currently registered. The new trademark should then be registered to ensure it is protected going forwards.

In addition to carrying out regular trademark searches, it is advisable – particularly so that expensive opposition, invalidity or infringement proceedings can be avoided – that a trademark-watching service be set up to ensure that the franchisor or franchisee is continually notified of any potentially conflicting trademarks that other parties are applying to have registered with one of the trademark registries. The costs of such a service varies depending on the search criteria, in particular the number of trademarks required to be watched and what trademark classes need to be covered.

With regard to domain name searches, there is no centralised system as there is for trademarks. It is, however, possible to check whether a domain name has been registered using a WHOIS service.

ii Brand protection

To protect the franchisor's brand it is important that the franchisor's trademarks and domain names are correctly registered.

For UK trademarks, applications are made to the UK Intellectual Property Office (UKIPO). For franchisors looking at additional expansion in Europe it is advisable to obtain (depending on the precise European markets that a franchisor is looking to promote and provide its goods and services in an EUTM, which provides trademark protection in each Member State of the EU. An EUTM application is made to the EUIPO in Alicante, Spain. Alternatively, an international registration can be applied for (specifying the individual countries in which it is desired to protect the trademarks) through the World Intellectual Property Organisation (WIPO) under the Madrid Protocol.

The franchisor will need to determine which of its goods and services should be subject to registered trademark rights for the purposes of the franchise business and provide a description of each. It is often advisable to seek the advice of a specialist trademark solicitor when preparing the trademark application, in particular which goods and services should be included in the trademark specification. For UK and EU trademarks registered with the UKIPO and the EUIPO respectively, the classification system is divided into different classes, with goods in classes 1 to 34 and services in classes 35 to 45.

It is important to ensure that the franchisor's registered trademark specifications are sufficiently broad to cover all the goods and services currently offered by the franchise

business to ensure that no other entity can use identical or similar trademarks in relation to identical or similar goods and services, thus causing the consumers of the franchise business to be confused as to the origin of the goods and services being offered to them. The trademark specification should also cover goods and services that the franchise business might be looking to expand into in the future and thus not limit the direction of the franchise business.

In relation to domain names, as with the searches, there is no centralised system for domain name registration, therefore registration of a domain name is carried out through a registrar. There are a large number of registrars and the choice of registrar will be determined by price, reputation for reliability and other services offered such as website hosting, and domain name portfolio management. A domain name is registered for a set period (for example, two years) and will have to be renewed once that period is up.

iii Enforcement

There is an array of potential protection techniques enforcing intellectual property rights (IPRs), as well as protection in the event that a franchisor's franchisee (or master or developer) infringes the franchisor's IPRs. A number of IPR enforcement strategies are, however, equally applicable to the scenario in which an independent third party infringes the franchisor's IPRs.

Part of an effective strategy is to ensure that the franchisor's IPRs are correctly protected in the first place.

Contractual provisions

In addition to formal or registered protection for IPRs such as trademarks, domain names, patents and designs (as discussed above) a well-drafted franchise agreement should provide the franchisor (at least in terms of its franchise network) with contractual protection against infringement of its IPRs by franchisees.

As a minimum, the franchise agreement should include:

- a* an appropriately worded grant of rights clause defining the extent and limits of the franchisee's right to use the franchisor's IPRs;
- b* confidentiality provisions obliging the franchisee to only use and disseminate the franchisor's IPRs, know-how and confidential information to the extent necessary for the operation of the business;
- c* IPRs clauses regarding the franchisee's permitted uses of the franchisor's IPRs, together with express provisions regarding non-infringing use of the IPRs and how infringement actions are to be dealt with; and
- d* provisions regarding the collection, use and sharing of data and related database rights.

In addition to the above in-term provisions regarding the appropriate use of IPRs and materials featuring IPRs, it is important that the franchise agreement expressly details appropriate post-termination or expiration provisions regarding a terminated or expired franchisee's non-use of the franchisor's IPRs, including debranding obligations and time lines for so doing.

Operational and organisational methods

Closely tied in with and backed up by contractual provisions should be certain operational and organisational measures, including:

- a* initial and ongoing training emphasising key messages regarding the use of IPRs, know-how and confidential information;

- b* appropriate confidentiality, copyright and no copying notices on key operational documentation, including the manual – as well as technical and IT safeguards for such operational information as the franchisor makes available online;
- c* template stationery and promotional materials provided by the franchisor to ensure that the franchisor's IPRs are used in the correct manner; and
- d* appropriate policies and training regarding the franchisee's use of branded email accounts and branded social media.

Legal enforcement

With regard to enforcement for registered trademarks, if cease-and-desist-style letters fail to resolve the issue, then a franchisor can seek injunctive relief to stop the infringing use by the franchisee (or third party) together with a claim for damages or an account of profits unlawfully made by the franchisee. In determining whether injunctive relief should be granted the court will have regard to the balance of convenience between the parties' interests and the prospect of unquantifiable or irreversible harm (or both).

With unregistered trademarks, a claim can be brought under the common law for the tort of passing off. The franchisor will be required to establish that:

- a* it has goodwill in its unregistered marks;
- b* that the franchisee has made misrepresentations to customers or prospective customers that amount to a false imitation of the franchisor's branded goods or services; and
- c* that as a consequence of the franchisee's actions, the franchisor has suffered loss (i.e., loss or diversion of business).

As passing-off actions tend to be more complex and costly as compared with relatively simple trademark infringement actions, well-advised franchisors tend to invest in a brand protection (including searches) and registration programme at the outset.

In respect of domain name actions, proceedings can be initiated against cybersquatters and others infringing trademarks through use of a domain name. The relevant rules and procedure differ depending on the type of domain name. For example, disputes over .com, .net and .org domain names are governed by the ICANN Uniform Domain Name Dispute Resolution Policy (UDRP)² and .co.uk by the Nominet Dispute Resolution Service policy.³ Disputes under the UDRP are heard by a number of tribunals, for example, WIPO.⁴

Disputes in relation to UK domain names are heard by the Nominet Dispute Resolution Service. Domain name dispute resolution proceedings are generally simple and low cost. Proceedings are conducted on paper and hearings are extremely rare.

With regard to the protection of IPRs such as copyright and items such as know-how and confidential information, much like with trademarks, the franchisor's enforcement options will initially start with correspondence between the franchisor's and franchisee's legal advisers, which, if unsuccessful, may result in an application for an injunction by the franchisor and depending on the nature of the franchisee's conduct, a subsequent court-based trial to determine the franchisor's possible remedies.

² www.icann.org/en/help/dndr/udrp.

³ www.nominet.org.uk/disputes/when-use-drs/policy-and-procedure/drs-policy.

⁴ www.wipo.int/amc/en/domains/.

iv Data protection, cybercrime, social media and e-commerce

After a period of incremental development, the laws that regulate data protection, privacy and security in Europe have undergone considerable change.

For many years the key pieces of data protection and privacy legislation in the EU were Data Protection Directive 95/46/EC (the Data Protection Directive) and Privacy and Electronic Communications Directive 2002/58 EC (the ePrivacy Directive). The former regulated all personal data processing, the latter electronic and telephone direct marketing, the use of online tracking technologies such as cookies and a number of other communications issues.

In May 2018, the Data Protection Directive was replaced by Regulation (EU) 2016/679 – the General Data Protection Regulation (GDPR). While the GDPR did not have to be implemented by domestic legislation in EU Member States, it affords a significant degree of leeway for Member States to supplement, and derogate from, various provisions. The United Kingdom has implemented this by passing the Data Protection Act 2018 (DPA 2018).

A pan-EU replacement for the ePrivacy Directive has been expected for some time; however, at the time of writing, its progress through the legislative process has been slow. It is increasingly unlikely that it will be passed before the United Kingdom is scheduled to leave the EU in March 2019. It therefore remains to be seen how the UK Privacy and Electronic Communications (EC Directive) Regulations 2003 (which currently implement the ePrivacy Directive) will be updated once the EU's replacement for the ePrivacy Directive has been finalised.

An introduction to current obligations under the GDPR and DPA 2018

The GDPR and DPA 2018 impose obligations upon franchisors and franchisees with respect to any personal data that is processed by them or on their behalf. They also grant data subjects rights in respect of their personal data.

Personal data is information that relates to an identified or identifiable living person, such as a customer, member of staff or a supplier. The laws impose obligations on data controllers (those who alone or jointly determine the purposes and means of processing personal data), and data processors (those who process personal data on behalf of data controllers, such as their suppliers). In many situations, franchisors and their franchisees will each process personal data as a data controller, but the specifics of data processing arrangements will need to be reviewed to determine the precise role of each.

The GDPR has introduced significant new obligations and much higher fines than were previously imposed under the Data Protection Directive – the maximum fine that can be imposed under the GDPR is a figure equivalent to the greater of 4 per cent of the non-compliant data controller or processor's worldwide turnover or €20 million.

Franchisors and franchisees will have to notify the UK Information Commissioner's Office of their data processing activities and pay an annual registration fee, which is calculated with respect to their annual turnover.

Other obligations include the requirement to abide by the data protection principles. For instance, this will mean ensuring that notice is given to relevant individuals about what data will be collected, with whom the data will be shared and how the data will be used. Also, data controllers must ensure that they can point to a lawful basis for their personal data processing activities, such as: for the purposes of fulfilling a contract; the legitimate interest of the controllers or a third party; or because the data subject's consent has been obtained. The

data should not be used in any other way that is incompatible with the specified purposes, and appropriate steps should be taken to ensure data is accurate, kept secure and only for as long as necessary and that it does not go beyond what is necessary to meet the purpose.

Individuals will obtain significant new rights under the GDPR and DPA 2018, including the right to demand, in certain circumstances, that their personal data is transferred to a replacement service provider (the 'right to data portability'), rights in respect of automated decisions and the right to demand erasure (the 'right to be forgotten').

The GDPR and DPA 2018 have also introduced a requirement for data breaches to be proactively notified to regulators and to individuals affected by the breach. The terms of this notification are onerous with controllers obliged to notify the regulator without undue delay and, in any event, within 72 hours of the controller having become aware of a breach.

New accountability or data governance measures will also have to be implemented by data controllers and data processors, including running data protection impact assessments, audits, policy reviews, activity records and (in certain prescribed circumstances) the obligation to appoint a data protection officer. Where a data processor is engaged to process personal data, a long list of provisions set out in the GDPR must be agreed in writing in favour of relevant data controllers. Where two or more data controllers act jointly to agree processing activities, they must enter a written agreement confirming their respective responsibilities for meeting the obligations imposed by the GDPR and the DPA 2018.

Another significant requirement of the GDPR and DPA 2018 relates to international transfers of personal data. If such data is being made available from the United Kingdom to a third party located outside the EEA, then the UK organisation (i.e., most typically a UK master franchisee or developer) will have to consider the data transfer restrictions, which only allow transfers to a country that ensures adequate data protection for the rights of data subjects (measured against the protections offered under EU data protection laws). Transfer adequacy mechanisms such as standard contractual clauses or certification schemes (e.g., the US–EU Privacy Shield) approved by the European Commission are options.

Taking all the above points together, franchisors and franchisees would be well advised to review their contractual and operational procedures to ensure that they have appropriately amended these to comply with the changes that Europe's new data protection laws have brought.

Cybercrime

On 19 July 2016, the European Parliament published its Directive on network and information security across the EU (the Cybersecurity Directive). The Cybersecurity Directive is the first comprehensive piece of EU legislation addressing the area of cybersecurity risk. Its objective is to achieve a high level of commonality of approach in the way that Member States address the urgent need to improve security in networks and information systems. Following the publication of the Cybersecurity Directive, Member States had until 9 May 2018 to implement the Directive in national law, and a further six months thereafter to declare for their jurisdiction the identities of 'operators of essential services'. In the United Kingdom, the Directive was implemented on 10 May 2018 in the form of the Network and Information Systems Regulations 2018 (NISRs).

The NISRs apply principally to two categories of organisation: (1) operators of essential services (OES) and (2) relevant digital service providers (RDSP). The United Kingdom's

enactment of the Directive includes a number of compliance obligations and carries material sanctions for non-observance. It is therefore important for businesses to determine whether they qualify as an OES or a RDSP, or both.

A RDSP is an operator that provides (1) an online search engine, (2) cloud computing service, or (3) an online marketplace. It should be noted that the NISRs do not apply to RDSPs that are considered small or micro businesses, which are companies employing fewer than 50 people and with an annual turnover or balance sheet total below €10 million. The operator must also offer its services within the EU and be headquartered in the United Kingdom or have nominated a UK-based representative.

The NISRs detail the sectors in which OESs are identified by the UK government, which include energy, transport, health, drinking water supply and distribution, and digital infrastructure where the relevant entity provides a service that is essential for the maintenance of critical societal or economic activities; the provision of the service is dependent on network and information systems; and an incident affecting the network and information systems of that service would have significant disruptive effects on its provision. The NISRs also provide detailed thresholds to ensure they apply only to material operators.

The requirements of the NISRs for RDSPs and OESs include the need to take appropriate and proportionate technical and organisational measures to manage risks to network and information systems. They also require the relevant entities to take appropriate and proportionate measures to prevent and minimise the impact of incidents that affect security of the networks and information systems used, with a view to ensuring continuity of those services.

The NISRs impose reporting obligations requiring RDSPs to report 'any incident having a substantial impact on the provision of any of the [relevant] digital services'. Similarly, OESs are required to report any incident that 'has a significant impact on the continuity of the essential service which that OES provides'. In each case, organisations must report the incident to the competent authority within 72 hours of the incident occurring.

While the legislation focuses on RDSPs and OESs, it is inevitable that suppliers to those entities will be contractually drawn into compliance as the entities pass down their own compliance obligations to their supply chains.

The sanctions regime for breach is significant, with competent authorities having rights to serve information notices, conduct inspections, and serve enforcement and penalty notices. The ultimate fine available under the NISRs is £17 million for a 'material contravention which the enforcement authority determines has caused, or could cause, an incident resulting in immediate threat to life or significant adverse impact on the United Kingdom economy'.

Whether franchisors will be affected or not by the NISRs, what should they be doing now?

Key concepts:

- a* accept that a cybersecurity incident is a matter of 'when', not 'if';
- b* stop regarding cybersecurity as solely an IT issue;
- c* balance your approach between prevention and preparation for when an incident occurs;
- d* adopt a multidisciplinary approach, including: IT and IT forensics, legal and compliance, and PR; and
- e* do not seek to address cybersecurity resilience without simultaneously looking at compliance with the requirements of the GDPR, and vice versa.

Action points:

- a* establish your cybersecurity team – with senior board engagement;
- b* review your current cybersecurity technology and, if necessary, implement data monitoring and behaviourally based detection systems;
- c* prepare a cyber-response strategy – cyber-response plan, cyber-response teams and reporting mechanisms;
- d* train and test; and
- e* review cybersecurity-related insurances.

Social media

When the franchisor or franchisee posts personal data on a social networking site, message board or blog, or downloads personal data from one of these sites, they must ensure they have complied with the GDPR (and, for marketing materials, the CAP code). Anyone running an online forum or downloading personal data for business purposes should take the following steps:

- a* have clear acceptable-use policies;
- b* clearly inform individuals (by way of a privacy notice) how their personal data will be used. Where an intended practice is unusual, unexpected or particularly invasive, it may be necessary to draw specific attention to this use – such as through the use of pop-ups and other more active notices;
- c* consider whether you require consent – and whose consent to get. For example, posting sensitive information (such as data concerning health, race, ethnicity, political or religious views, criminal activity or sexual orientation) or any information that is particularly embarrassing is likely to need prior consent. You may also need consent if you use an individual's name or likeness for promotional purposes. Where posts or data relate to children, parental consent may be required;
- d* give individuals the opportunity to opt out or correct inaccurate information. Individuals must have access to easy-to-find procedures to dispute the accuracy of posts and ask for them to be removed. Organisations must respond to such requests quickly (and at the latest within one month) and have procedures to remove or suspend access to content at least until any disputes have been settled; and
- e* before downloading information from a third-party website, check that site's terms of use. Many websites have anti-scraping policies that prohibit the collection and re-use of information from their sites. Where the information contains personal data, the risk is not just that there could be a commercial claim; violating a third-party's terms of use could cause the franchisor or franchisee to run afoul of the GDPR.

Franchisors should also consider whether they want to manage social media platforms on behalf of their franchisees or place restrictions on franchisees' use of social media (such as requiring prior approval of the platforms, profiles and any trademarks or brand logos being used; ensuring compliance with all laws and relevant codes of practice, including the GDPR, relevant laws and codes on advertising such as the CAP code; mechanisms to take down content at the franchisor's request or following a third-party complaint; and obligations to comply with the franchisor's social media policy). The level of control a franchisor wishes to exert – which to a large extent will depend on the franchisor's level of resources – will thereby determine the level of brand consistency for the franchise business across the internet, including on social media.

IV FRANCHISE LAW

i Legislation

There are no specific franchise laws in the United Kingdom. The franchisor–franchisee relationship is governed by contract law with a number of statutes, voluntary codes and case law affecting both the franchisor–franchisee relationship and the franchise agreement itself. Franchisors who are members of the BFA are obliged to comply and ensure that their franchise agreements conform with the BFA Code of Ethics (the BFA Code) (see below).

The Trading Schemes Act 1996 governs pyramid-selling schemes, and brands seeking to franchise in the United Kingdom should structure their franchising arrangements to fall outside the scope of this act. To be exempt by virtue of the Trading Schemes (Exclusion) Regulation 1997, parties should ensure that: (1) the franchise is a single-tier trading scheme (with a single level of franchisees beneath the franchisor), or (2) the franchisor and all franchisees are registered for VAT, or both of these.

ii Pre-contractual disclosure

As a starting point there is no mandatory pre-contractual disclosure requirement in the United Kingdom. This statement, however, is not particularly helpful for ethical franchisors or franchisors wishing to adopt best practice. The BFA Code to some extent enshrines best and recommended practice in relation to pre-contractual disclosure requirements. Members of the BFA are required to disclose certain information in writing to prospective franchisees within a reasonable (not defined) period prior to signature of the franchise agreement. This information includes:

- a* the business and financial position of the franchisor;
- b* the main officers of the franchisor;
- c* details of the franchise business;
- d* details regarding the franchise network and franchisees;
- e* any financial projections or historical financial performance data; and
- f* key terms of the franchise agreement.

With the exception of the BFA requirements there is no statutory or other pre-contractual obligation on franchisors to disclose relevant facts. Generally the principle of caveat emptor, or ‘buyer beware’, applies to the pre-contractual phase of the franchisor–franchisee relationship. The laws of misrepresentation, however, apply to the pre-contractual phase of the franchisor–franchisee relationship. The concept of misrepresentation is enshrined both in the Misrepresentation Act 1967 and common law.

There are two main types of misrepresentation claims relevant to pre-contractual disclosure, which vary according to the level of belief held by the franchisor in the truth of the statement. If the franchisor makes a false statement knowingly, or without belief in its truth, or recklessly as to its truth, then they may be liable for fraudulent misrepresentation. If, however, the franchisor only made the statement carelessly, or without objectively reasonable belief in its truth, then the franchisor may be liable for negligent misrepresentation.

If a franchisee can demonstrate that the franchisor’s misrepresentations were statements of fact that induced the franchisee to enter the franchise agreement, as a result of which the franchisee suffered loss, the franchisee will be entitled to seek compensation for the loss. The

franchisee may also be entitled to rescind the franchise agreement. Recent case law has shown that the courts are increasingly willing to award substantial damages for misrepresentation by franchisors.

In *Peart Stevenson Associates Ltd v. Holland*,⁵ the franchisor was awarded £20,000 for a breach of contract by the franchisee in relation to overdue payments and post-termination restrictions. The franchisee counterclaimed, however, stating that a number of representations, including those relating to projected turnover and profit, had induced it to enter the agreement and it transpired that the statements had been misleading. The court agreed with the franchisee and awarded £170,000 in damages, vastly offsetting the sum awarded to the franchisor.

Many franchisors use a 'non-reliance' clause in their franchise agreements, which involves either a warranty, undertaking or contractual obligation by the franchisee that no statement has been relied upon other than those contained in the written agreement. Such a clause is stronger if the franchisee is allowed an express opportunity to attach any relied-upon pre-contractual statements to the franchise agreement. It is important to note that non-reliance clauses cannot protect a franchisor against fraudulent misrepresentation, only negligent misrepresentation. Any clause that attempts to exclude liability for fraudulent misrepresentation will be unenforceable under common law as a matter of public policy. In principle, non-reliance clauses in business-to-business dealings are legitimate, but any clause that attempts to limit or exclude liability for misrepresentation or excludes any remedy for misrepresentation is enforceable only to the extent that it satisfies the test of reasonableness under the Unfair Contract Terms Act 1977 (UCTA) (by virtue of Section 3 of the Misrepresentation Act 1967). Whether a particular clause is, in fact, enforceable will be subject to the facts of each case. This is highlighted in the cases of *Henry Boot v. Foodco*⁶ and *Papa Johns (GB) Limited v. Elsada Doyley*.⁷

The court in *Papa Johns v. Doyley* (a case involving the provision of financial information and financial performance projections by the franchisor to the franchisee during the recruitment process) examined a number of relatively typical and common boiler-plate provisions in the franchise agreement that are normally designed to protect the franchisor against misrepresentation claims.

Despite case law having largely upheld such clauses in commercial contracts, the court in *Papa Johns* held the entire agreement and non-reliance clauses to be unenforceable as they failed to satisfy the reasonableness tests under the Misrepresentation Act 1967 and UCTA. The court's findings were largely based on:

- a* the inequality of bargaining power between the parties;
- b* Papa Johns' insistence that the agreement was non-negotiable; and
- c* the standard boiler plate clauses in the franchise agreement had not been brought to Ms Doyley's attention.

In contrast, in the case of *Henry Boot v. Foodco* (a case that involved performance projections provided by a landlord to franchisee tenants regarding motorway service stations) the bargaining power between the parties was more equal than in comparison with *Papa Johns*.

5 [2008] EWHC 1868.

6 [2010] EWHC 358 (High Court).

7 [2011] EWHC 2621 (QB).

The court held that the non-reliance clause was enforceable. In this specific dispute the court held that there was ‘no doubt’ that the clause was reasonable after considering the following factors under UCTA:

- a* certainty is desirable;
- b* there was no substantial imbalance of bargaining power between the parties;
- c* each of the tenants were advised by solicitors;
- d* the non-reliance provision was open to negotiation; and
- e* the clause permitted reliance by the tenants upon any replies given to them by Henry Boot’s solicitors.

In *Lloyd v. Browning*,⁸ the Court of Appeal endorsed the *Henry Boot* reasoning under UCTA and stated that the general purpose of a non-reliance clause is to achieve certainty and forestall disputes, and that *Henry Boot* ‘set out the features which are relevant to the assessment of reasonableness’ and the approach of the courts in *Henry Boot* was to be ‘endorsed’.

Despite the contrast in outcomes between *Henry Boot* and *Papa Johns* it is advisable for international franchisors looking to enter the United Kingdom to ensure that any financial projections regarding the franchisee’s business provided in the pre-contractual recruitment phase are not only capable of objective substantiation but are provided in writing with appropriate background information and health warnings. Express non-reliance clauses are important for franchisors’ risk management but franchisors must be aware that their enforceability is not always guaranteed, especially in circumstances where the franchisee is an individual or small business inexperienced in commercial matters.

In 2018, the High Court considered statements made by the franchisor’s development manager in a franchise arrangement structured through joint-venture agreements in *Ali v. Abbeyfield VE Ltd.*⁹ Representations made by the development manager concerning the suitability of a location, anticipated business projections and success rates of the franchisee businesses were found to be fraudulent misrepresentations in that the defendant, through its development manager, either knew, or was reckless as to whether or not, the representations were false. While this judgment does not change the law in this area, it is a reminder to franchisors to ensure their employees and representatives carefully consider any assurances they give to potential franchisees.

iii Registration

There are no registration requirements in the United Kingdom that impact on the franchisor–franchisee relationship or with regard to the franchise agreement itself. There is no requirement to register either the franchise agreement or the trademark licensing provisions as a registered trademark licence agreement.

iv Mandatory clauses

There are no mandatory clauses prescribed by statute or case law. Franchisors who are BFA members will need to ensure that their contracts comply with the BFA Code as well as the BFA’s Extension and Interpretation of the Code. While the BFA Code does not specify mandatory clauses it does contain a list of terms to be contained in the franchise agreement.

⁸ November 2013.

⁹ [2018] EWHC 669 (Ch).

It is therefore important that a UK franchisor or an international business franchising in the United Kingdom who wishes its master or developer to become a member of the BFA has its franchise documentation drafted by advisers familiar with the BFA Code.

v Guarantees and protection

In the event that a franchisor contracts with a sole trader then the sole trader franchisee will be personally liable for its performance and payment obligations and therefore a guarantee would not be required. In the event, however, that a franchisor contracts with a partnership or limited liability company franchisee, it is certainly advisable that a franchisor obtains a contractual guarantee from either the primary director or shareholder or partner as the case may be – or more than one key individual if commercially appropriate.

Where the franchise business involves an element of product supply by the franchisor to the franchisee it may also be prudent for the franchisor to request that the franchisee provides a letter of credit from a bank acceptable to the franchisor to cover payment defaults by the franchisee.

Provided that the contractual guarantee agreement is not unreasonable to the extent that it is legally unenforceable, then guarantees from individuals and companies to the franchisor are enforceable.

V TAX

i Franchisor tax liabilities

UK tax-resident companies carrying on a franchising trade (which will generally include UK-incorporated companies unless ‘treaty non-resident’), or companies carrying on a franchising trade in the United Kingdom through a permanent establishment, will be subject to UK corporation tax on the profits of that trade. For corporation tax purposes the main acts are the Corporation Tax Act 2009, Corporation Tax Act 2010 and Taxation (International and Other Provisions) Act 2010. Although less common, UK resident individuals carrying on a franchising trade will be subject to income tax in accordance with the provisions of the Income Tax Act 2007 and the Income Tax (Trading and Other Income) Act 2005.

Individual shareholders receiving dividends will, if UK tax resident, generally be subject to income tax on any dividends received in accordance with the provisions set out in Part 4 of the Income Tax (Trading and Other Income) Act 2005. In general, UK resident corporate shareholders should be able to rely on one of the exemptions from corporation tax on the dividends they receive. If the supply of IPRs by the franchisor is segregated and a royalty is paid to a non-UK resident corporate franchisor that is not trading in the United Kingdom, there may be withholding tax on the royalty payment subject to relevant treaty (or other) relief; however, if the other provisions of the franchising agreement are supplied by the same company as the intellectual property, then it is possible that the non-UK resident corporate franchisor may itself be trading in the United Kingdom as a result of the franchising arrangement. From April 2019, the United Kingdom will impose an income tax charge on the gross revenues of non-resident entities that have intangible property that is used to make supplies to UK customers. Although this is targeted at multinational groups, it could also affect franchisors, as the provisions extend to indirect, but substantial, exploitation of that intangible property in the UK market through unrelated parties.

The franchisor may need to register for and account for VAT on supplies to the franchisee. If the franchisor is not based in the United Kingdom, it is likely that the VAT on such supplies would be accounted for by the franchisee under the 'reverse charge'.

ii Franchisee tax liabilities

If the franchisee is a UK-incorporated company, then consistent with the main tax liabilities faced by franchisors discussed above, the franchisee company's profits will also be subject to corporation tax. If the franchisee is a partnership or sole trader then the partners' or individual's income will be taxed under income tax rules and corporate partners will be taxed under corporation tax rules as per the above. Individual sole traders (and partners) will also be subject to National Insurance contributions – albeit at fairly low rates.

Withholding tax may also be payable – as also specified above. If there is a gross-up provision in the franchise agreement or IP licence then the liability for this could fall on the franchisee.

Subject to the nature of the goods and services sold or provided by the franchisee and supplied by the franchisor, the supply may be subject to VAT, which is governed by the Value Added Tax Act 1994. If the franchisee carries out an exempt (or partially exempt) business, then it may not be able to recover VAT (in full or in part) on the supplies made to it, including those of the franchisor.

iii Commonly used structures

Under modern tax regimes, it is very difficult to put in place 'tax-efficient structures'. However, steps can be taken to ensure that structures are not tax inefficient. For example, if both franchisor and franchisee are UK entities, VAT registration for both parties is recommended to ensure that VAT is not a cost for either business.

For both tax reasons and contractual ring-fencing, franchisors may wish to consider which of their group companies should be the contracting entity in respect of each supply (intellectual property, products, services to the franchisees, etc.).

Franchisors may wish to hold valuable functions (e.g., intellectual property) in a tax-friendly offshore jurisdiction to accrue income and potentially realise gains at lower tax rates. However, this is likely to require a presence in that jurisdiction and may also require transferring valuable rights to that jurisdiction, which may trigger exit taxes. The UK government discourages the holding of intellectual property in low-tax jurisdictions. If such a structure were to be used, consideration would have to be given to the UK's diverted-profits tax and the new offshore-receipts rules, which are targeted at offshore companies holding intellectual property exploited in the United Kingdom. Where the company holding the intellectual property is a subsidiary, the 'controlled foreign company' or other anti-avoidance rules for the parent company will also have to be considered.

For overseas-based franchisors receiving royalties from UK franchisees, the royalties may be subject to withholding tax and may be mitigated by treaty relief. Such treaty relief typically reduces the rate of royalty withholding taxes to a lower (or zero) rate but may require clearance from the relevant tax authority before payments can be made at the lower rate.

The structure of the fee arrangements may have a positive or negative effect on the tax treatment of both franchisor and franchisee, so careful drafting in the franchise agreement will be required. A franchisee will wish to maximise its tax deductions and the franchisor will wish to minimise its taxable income.

VI IMPACT OF GENERAL LAW

i Good faith and guarantees

The traditional and long-standing position under English law was that a good-faith clause was not ordinarily binding, or capable of being enforced. Franchise purists historically have claimed that there is no overarching duty of good faith that can be implied into a franchisor–franchisee relationship under English law.

The idea, however, that good faith is not part of English law business-to-business contracting is now outdated. It remains broadly correct in relation to the pre-contract phase, but it is now clear that an implied concept of good faith is steadily gaining recognition as a legally binding concept during the performance phase of contracts particularly long-term ‘relational agreements’ such as franchise agreements.

Prior to the recent, and some would say ground-breaking good-faith case of *Yam Seng Limited v. International Trade Corporation Limited*,¹⁰ two franchise cases provided examples of where the English courts inferred a position equivalent to good faith into a franchise agreement. In *MGB Printing v. KallKwik*,¹¹ the court implied an obligation on the franchisor to ensure that it provided services to the franchisee using reasonable skill and care on the basis of ‘business efficacy’. In *Stream Healthcare v. Pitman*,¹² the court ruled that services should be provided to the franchisee by the franchisor where reasonably required or requested.

In the *Yam Seng* case, Leggatt L J (as he is now) analysed whether English law should impose an obligation of good faith in a distribution agreement. Leggatt L J’s judgment drew together the pre-existing, disparate strands of English case law on the issue of good faith in commercial contracts and explained the importance of implied good faith in what he called ‘relational’ agreements, which are long-term agreements requiring extensive cooperation, a high degree of communication, mutual trust and confidence and expectations of loyalty. The judgment referred expressly to franchise agreements, long-term distribution agreements and joint venture agreements as examples of these relational agreements.

While arguably Leggatt L J’s conclusion in the *Yam Seng* case that an implied duty of good faith did exist was potentially based on the facts of the particular case, including the fact that there was clear evidence of bad faith on the distributor’s behalf, his judgment does clearly imply an objective duty of good faith between parties in long-term relational contracts. The fact that franchising was specifically referenced as one of these forms of relational agreements highlights its relevance to the performance phase of a franchisor–franchisee relationship.

In the July 2014 decision of *Bristol Groundschool v. IDC*,¹³ the High Court ruled that a duty of good faith should be implied into a relational contract for the production and distribution of training materials for pilots. The judge said that it is clear from the *Yam Seng* decision that ‘good faith extends beyond, but at the very least includes, the requirement of honesty’ and ‘[t]he relevant test is that of conduct which would be regarded as “commercially unacceptable” by reasonable and honest people in the particular context involved’.

10 [2013] EWHC 111.

11 *MGB Printing and Design Limited v. Kall Kwik UK Limited*, High Court of Justice Queen’s Bench Division [2010] EWHC 624 (QB).

12 *Stream Healthcare (London) Ltd v. Pitman Education & Training Ltd*, High Court of Justice Chancery Division [2010] EWHC 216 (Ch).

13 *Bristol Groundschool Ltd v. Intelligent Data Capture Ltd* [2014] EWHC 2145 (Ch).

However, these cases can be contrasted with the July 2014 High Court decision in *Carewatch Services Ltd v. Focus Caring Services Ltd & Others*¹⁴ in which the defendant franchisee tried unsuccessfully to argue that (among other alleged implied terms) the franchise agreement contained an implied term that the parties would conduct themselves in ‘good faith and/or deal with each other fairly and in particular not in a manner that would damage each other’s business interests’. The judge in *Carewatch* agreed with the reasoning of the judge in the case of *Hamsard v. Boots*¹⁵ (which concerned the termination of a supply agreement between the parties for the supply of children’s clothes to Boots stores), who said that he did not regard the *Yam Seng* case as authority for the proposition that there is a general obligation of good faith implied into all commercial agreements or that there is some sort of positive obligation implied that a party to a contract should subordinate its own commercial interests (in this judgment, the franchisor’s) to those of the other contracting party.

More recently, in the 2016 case of *Apollo Window Blinds Ltd v. Mr McNeil & Mr Taylor*, the franchisees argued that there was an implied obligation of good faith that obliged the franchisor to remind the franchisees of an obligation in the franchise agreement to give the franchisor notice that they wished to renew between six and nine months prior to the expiry date. While the judge did not discount the possibility that there may be an implied obligation of good faith in relation to some parts of the agreement, the judge said that he could not see a court implying a term that imposes a duty on one party to tell the other of its contractual rights. As the giving of notice was a requirement of a right to renew, the judge took the view that the franchisees had no automatic right of renewal, as they had failed to give the requisite notice.

Even more recently, the Court of Appeal has commented (obiter) that parties to a long-term contract, classified as a relational contract, of ‘massive length, containing many infelicities and oddities’ should not latch onto such oddities to disrupt the contractual project and maximise their own gain.¹⁶ Interestingly, Leggatt L J has also recently commented on his decision in *Yam Seng* in the High Court case of *Al Nehayan v. Kent*.¹⁷ Acknowledging that his observations made in *Yam Seng* ‘have provoked divergent reactions’, he proceeded to comment that ‘there appears to be a growing recognition that such a duty may be readily implied in a relational contract’ before concluding that the long-term joint venture to develop hotels and associated travel businesses before him was a relational contract and was therefore subject to an implied duty of good faith.

For BFA-registered franchisors, a failure to act in good faith may constitute a breach of the BFA Code and therefore such challenges from unhappy franchisees may well increase. A standard of good faith is taking shape under English commercial contract law as seen in the *Yam Seng* and *Bristol Groundschool* decisions, and in judgments from the past year. By contrast, the *Carewatch* and *Apollo Window Blinds* decisions illustrate that the concept of good faith has its limitations and courts will not allow franchisees who are treated roughly, but commercially fairly, to use the concept to benefit from rights and protections that the written agreement did not give them.

14 [2014] EWHC 2313 (Ch), 2014 WL 3002765.

15 [2013] EWHC 3251 (Pat), *Hamsard 3147 Limited Trading as ‘Mini Mode Childrenswear’, JS Childrenswear Limited (in liquidation) v. Boots UK Ltd* 2013 WL 5826153.

16 *Amey Birmingham Highways Ltd v. Birmingham City Council* [2018] EWCA Civ 264.

17 [2018] EWHC 333 (Comm).

ii Agency distributor model

In the United Kingdom, a genuine franchisor–franchisee relationship will not be treated as one of principal and agent or manufacturer and distributor. It is, nevertheless, advisable to have an express provision in the franchise agreement confirming that the franchise relationship will not be construed as one of employer and employee (see below), or principal and agent or manufacturer and distributor.

iii Employment law

In a genuine franchisor–franchisee relationship, franchisees are not and cannot be treated by the courts as employees.

iv Consumer protection

Franchisees are not generally treated as consumers under English law and therefore are not afforded consumer protection rights.

Notwithstanding this, it is important for franchisors to be fully aware of consumer-facing laws as these will nevertheless have an impact on the franchisor, whether dealing with consumers directly or through its franchisees. A franchisor will need to ensure there are suitable provisions in the franchise agreement requiring its franchisees to comply with all consumer protection legislation.

The Consumer Contracts (Information, Cancellation and Additional Charges) Regulations 2013 (the Consumer Contracts Regulations) contain provisions that will be relevant to all franchisors and franchisees who deal with consumers (referred to in the legislation as ‘traders’), but will have a particular effect on the protections available to consumers when they purchase goods or services using a means of distance communication such as the internet. The Consumer Contracts Regulations require all traders to provide consumers with certain specific pre-contractual information prior to entering into any contract (e.g., on the total costs of the relevant products or services, and the arrangements for payment and delivery). Where orders are placed using the internet or other electronic means, the trader must clearly label the order button to indicate that placing the order entails an obligation to pay (e.g., by using words such as ‘order with obligation to pay’). For distance contracts, traders in most circumstances must also offer consumers a period of 14 calendar days in which they can cancel the contract. The Consumer Contracts Regulations also contain specific provisions governing refunds, returning goods, delivery and risk, inertia selling and help-line charges, and introduced specific new rules regarding the supply of digital content.

A large proportion of domestic consumer law was codified under the Consumer Rights Act 2015 (CRA). The CRA is a complex piece of legislation but key provisions include: (1) a fairness test applicable to most terms of business-to-consumer (B2C) contracts, which, if failed, results in the infringing term being unenforceable against the consumer; (2) a transparency test that requires all terms of B2C contracts to be in plain and intelligible language, failing which a court will take the most consumer-friendly interpretation of the term at issue; and (3) implied warranties in all B2C contracts that vary depending on whether the subject matter of the contract is the provision of goods, services or digital content, and implied remedies available to a consumer for breach of contract by a business.

Other important consumer laws include the Consumer Protection from Unfair Trading Regulations 2008, which prohibit various unfair commercial practices by traders, such as providing misleading information or omitting material information, and include a blacklist

of commercial practices that are automatically prohibited (e.g., ‘bait advertising’), and the E-Commerce Regulations 2002, which require website operators to provide additional specific information about themselves and their services.

v Competition law

The BFA Code does not provide a minimum term for a UK franchise agreement. Instead, it states that, as a minimum, the agreement should be long enough for the franchisee to amortise its initial investment. Franchise agreements in the United Kingdom are typically granted for an initial term of five years. This is often supplemented in the agreement by providing for two further five-year periods subject to the franchisor’s approval and certain renewal criteria being met at the end of each period.

The five-year term approach in the United Kingdom is mainly a response to European competition law (as further discussed below), and in particular Article 101 of the Treaty for the Functioning of the European Union (Article 101 TFEU). If an agreement is found to be contrary to Article 101 TFEU, then either the prohibited provision – or in some circumstances the entire agreement – will be declared void and the relevant parties may be liable to fines. Chapter 1 of the UK Competition Act 1998 (the 1998 Act) largely replicates the key provisions of Article 101 TFEU.

In-term non-compete provisions, including product ties or an obligation on the franchisee not to be involved in a similar business, are common in franchise agreements, which means that franchise agreements are typically regarded as having the potential to affect competition – contrary to the principles of Article 101 TFEU and the 1998 Act. In-term non-compete provisions are those that provide that, for the duration of the franchise agreement, the franchisee must not sell products or services that are in competition with those of the franchisor. Product ties are those provisions that restrict the franchisee to buying specified products, including those that the franchisee will sell on to customers, from the franchisor or its nominated supplier only.

As franchise agreements are classified as ‘vertical agreements’ (in that the franchisor and franchisee operate at different levels in the production or supply chain), subject to meeting certain conditions regarding market shares, they receive the benefit of an exemption found in the Vertical Block Exemption (VBE)¹⁸ and the European Commission’s accompanying guidelines (the Guidelines). The VBE guarantees that the whole agreement does not infringe competition law provided it does not contain certain prohibited restrictions (called ‘hardcore’ restrictions).

A number of other provisions are ‘excluded’ under the VBE. Although these excluded restrictions cannot receive the benefit of the VBE themselves, and must therefore be assessed separately to understand if they infringe competition law, the remainder of the agreement will continue to benefit from the VBE. One such excluded restriction is a non-compete obligation that lasts indefinitely or for longer than five years. As mentioned previously, most franchise agreements in the United Kingdom therefore adopt a five-year term.

Nonetheless, there is an exception to the five-year duration rule under the Guidelines,¹⁹ which is applicable to franchises. This states that a non-compete obligation on the products or services purchased by the franchisee may not be contrary to Article 101 TFEU if it is necessary to maintain the common identity and reputation of the franchised network. If

18 Commission Regulation (EU) No. 330/2010.

19 Paragraph 190(b).

this exception applies, the duration of the non-compete obligation is immaterial, and can be indefinite, provided that the obligation does not survive beyond the duration of the agreement itself. A very limited (no more than one year) post-term non-compete may be lawful if it is necessary to protect know-how and relates to the same premises that the franchisee used during the lifetime of the franchise agreement.

Price-fixing or resale price maintenance is classified as a hardcore restriction. Franchisors should not set a fixed price, a minimum price or a maximum discount. However, franchisors are permitted to set a maximum price or recommend a pricing structure for their franchisees but cannot take steps (contractual or otherwise) to enforce those recommended resale prices.

E-commerce has been one of the more topical and contentious areas. The European Commission carried out an EU-wide investigation into e-commerce, which culminated in a final report in May 2017. Internet or web-based sales are generally classified as ‘passive’ sales by the European Commission and cannot be prohibited by franchisors. Passive sales are typically reactive sales by a franchisee (i.e., where the customer seeks out the franchisee rather than the other way round). Franchisors can, however, prohibit a franchisee from making active sales (whether internet-based or otherwise) into any territory exclusively reserved for the franchisor or another of its franchisees.

Franchisors cannot prevent franchisees from operating their own websites, although franchisors can impose quality standards, particularly in relation to representations of the brand and the general look, feel and content of the website. Franchisors cannot prevent the franchisee setting up a website in a language other than that (or those) of the territories it is allocated; the European Commission considers that to be passive selling. Price-comparison-tool restrictions imposed on franchisees will most likely be treated as hardcore restrictions by the European Commission. However, following the *Coty* judgment,²⁰ sales via online marketplaces can be restricted in the context of the distribution of luxury products through a selective distribution network.

The European Commission indicated in the Final Report on the E-commerce Sector Inquiry that bans on using price comparison tools are likely to amount to hardcore restrictions. Of particular relevance to franchise arrangements, the European Commission highlighted concerns relating to information flows between a supplier and its retailers where the supplier competes with the retailer. This is highly likely to occur in the context of franchising and adequate information barriers should be set up to prevent exchange of commercially sensitive information.

vi Restrictive covenants

Non-compete and other restrictive covenants will typically be caught by competition or antitrust law principles (see Section VI.v on competition law, above).

In terms of enforcement, if a franchisee is in breach of in term non-compete or restrictive covenants, the franchisor’s initial course of action may be to terminate the franchise agreement. Following termination, the franchisor will either bring a claim against the franchisee for breach of contract or, depending on the nature of the franchisee’s breach, apply for an injunction to compel the franchisee to either cease their infringing conduct or to comply with their obligations, if appropriate. The criteria for the grant of an injunction by the court are discussed elsewhere in this chapter. If the franchisor is successful in a contractual

20 *Coty Germany GmbH v. Parfümerie Akzente GmbH* Case C-230/16.

claim, the likely remedies include damages to compensate the franchisor for any losses it has suffered and potentially an account of profits that the franchisee has made from the competing business.

vii Termination

Termination of a franchise agreement is dealt with under common law principles. It is therefore crucial that the termination provisions in the franchise agreement be not only clear but also significantly flexible so as not to limit or restrict the franchisor's ability to terminate.

Best practice dictates that the grounds for termination are clearly stated in the franchise agreement with a clear distinction between conduct that will result in immediate termination and conduct that is potentially remediable and therefore not damaging to the long-term or overall relationship.

The BFA Code dictates that franchisees must be notified of any breaches the franchisor claims have been committed and be given a reasonable time period to remedy the breach.

Under competition law principles, post-termination non-compete provisions are prohibited unless the provisions are necessary to protect the franchisor's know-how, which may be difficult for franchisors to prove. If the know-how is deemed secret (and therefore requires protection), then the VBE recognises the right for franchisors to impose a limited 12-month non-compete restriction from the premises at which the franchisee operated its business.

Fortunately, case law has taken a more sensible approach than that set out in the VBE, recognising that a wider post-termination geographical restriction may be permitted provided the aim of the provision is to prevent the franchisor's know-how being used by competitors.

Enforcement of post-termination restrictive covenants will typically involve the franchisor applying to the court for an order injunctioning the former franchisee (i.e., preventing it from trading or otherwise acting in breach of its covenants).

Post-termination restrictive covenants will only be upheld if the court considers them reasonable. Typically, the court will look at the geographical width of the restriction and the duration. A 12-month restriction not to operate a competing business in the franchisee's former territory is likely to be enforceable, whereas a 24-month restriction for the whole of the United Kingdom is likely to constitute an unlawful restraint of the former franchisee's right to trade. Each case will, however, be examined on its own facts.

In the case of *Carewatch Care Services Limited v. Focus Caring Services Limited and others*, the High Court held and reaffirmed the position that restrictive covenants may be enforceable if it can be proven that they were designed to protect the company's legitimate business interests and went no further than necessary to achieve that purpose.

In the case of *Apollo Window Blinds* referred to above, the franchisees, who had 45 years of experience in the window blinds business, successfully defended the franchisor's application for an injunction against them on the basis that the restrictive covenants were not justified as the franchisees received no training and no goodwill; the franchisor was purely used by them as a source of good quality products.

viii Anti-corruption and anti-terrorism regulation

Within a contractual context, a franchisor's liability for fraud will largely be related to fraudulent misrepresentation as detailed above. In the event that the franchisee or principal shareholder or director commits an act or omits to act in circumstances that amount to fraud, it will often constitute an express ground for termination of the franchise agreement by the franchisor.

The UK Bribery Act 2010 (the 2010 Act) sets out a range of offences relating to bribery that may apply to the franchise relationship. The 2010 Act targets the payment or receipt of a bribe (which is not restricted to providing someone with a financial advantage) to a person when the bribe is made with the intention of persuading that person to perform a function or activity improperly. The 2010 Act covers bribes paid and received by UK citizens, and also extends to bribes paid by UK citizens to foreign public officials.

The Money Laundering Regulations 2007 (the Regulations) aims to prevent money or assets that were obtained by criminal means, including money raised for the purposes of terrorism, being exchanged for money or assets that were legitimately obtained. Franchisors should ensure compliance with the Regulations by putting in place strict controls to verify the identity of their business partners and the sources of their wealth, along with having a clear reporting procedure for any suspicious activity.

Along with ensuring their own internal compliance, franchisors should have clear anti-bribery, anti-corruption and money-laundering policies in place for their franchisees. These policies should form part of the operating manual, as well as being part of the initial and ongoing training provided by the franchisor. The policies themselves, and any guidance given on them, should include key messages for the franchisees and practical considerations that flow from them. This should then be backed up by express contractual provisions in the franchise agreement so that a breach of any of the policies triggers a breach of the franchise agreement.

ix Dispute resolution

In domestic franchise disputes depending on the nature of the franchisee's conduct or breach a franchisor may seek an injunction to either stop or compel certain conduct by the franchisee. For most breach of contract claims litigation as opposed to arbitration is the typical form of dispute resolution in the United Kingdom. While mediation is a recognised form of alternative dispute resolution and actively encouraged by the Civil Procedures Rules, it is not mandatory. However, the parties can incorporate a mandatory mediation process in the dispute resolution clause in the franchise agreement, which is likely to be upheld by the courts in the United Kingdom.

For international franchisors, the English courts will recognise and uphold foreign choice of law and jurisdiction clauses. It is, however, advisable to ensure that a franchise agreement is reviewed by an English law expert in franchising to ensure that there are no clauses that would be unenforceable or contrary to public policy.

There is no specific procedure for franchise disputes in the United Kingdom – most are settled before reaching formal alternative dispute resolution methods or court-based litigation. The BFA offers both a mediation and arbitration scheme although the latter has not experienced a significant take-up rate. Certainly, for international franchisors and more sophisticated disputes, it is probably advisable to use one of the more experienced international arbitral bodies such as the London Court of International Arbitration. Before

the parties engage in mediation or arbitration, the BFA also offers an informal conciliation scheme, aimed at facilitating an amicable discussion between the parties and allowing each of the parties to make representations about their case.

The English litigation procedure, as governed by the Civil Procedure Rules, is a world leader. The rules of full and frank disclosure are particularly appealing to claimants, and a compelling reason to elect for disputes (contractual or otherwise) to be settled by the English courts. Commencing in January 2019, a mandatory disclosure pilot scheme will run for two years in the Business and Property Courts, which will have an effect on the disclosure process for new claims (and certain existing claims) heard in these courts. Franchisors or franchisees party to disputes heard in these courts should be mindful of the new requirements under the scheme.

Where a franchisor seeks an injunction against a franchisee, the reasons for which may include, for example, a former franchisee continuing to trade in breach of a non-compete provision or using the franchisor's trademarks or other IPRs, once the application is issued it may be heard on a without notice preliminary basis within one to three days or on notice with three clear days' notice to the opposing party. The courts will normally only grant an interim injunction on a without notice basis if there is a real risk that the franchisor will suffer severe harm if the franchisee is given notice of the application or it is extremely urgent. It is more common for an application to be made on notice in order that the franchisee has time to prepare for and be represented at the hearing.

The court's decision to award an injunction will be based on a consideration of the balance of harm to the franchisor caused by allowing the franchisee to continue to trade or use the IPRs against the harm caused to the franchisor by requiring the cessation of the conduct. If monetary compensation is deemed to be an adequate remedy for the franchisor, the court will not grant an injunction.

An interim injunction will be granted until trial or the end of the contractual period of restrictions, whichever is sooner.

It may take between 12 and 18 months before a dispute reaches full trial. By this point the restrictive covenants (and the injunction) will most likely have expired and the dispute will primarily focus on the level of harm suffered by the franchisor and the level of damages to which the franchisor (if successful) is entitled.

If a franchisor is successful in a breach of contract claim against a franchisee, it will be entitled to damages to put it in the position it would have been in had the contract been performed correctly by the franchisee. There are two limbs to the damages that can be claimed: those that flow directly and naturally from the breach and those that are indirect but that were in the reasonable contemplation of the parties at the time that the agreement was entered into. The types of losses that may be recoverable could include the franchisor's profit on the royalty fees for the remaining term of the agreement or until the franchisor could reasonably be expected to appoint a new franchisee; the costs of appointing a new franchisee; loss of profit on product sales that the franchisee would have bought; damage to the franchisor's goodwill or reputation (although this can be very hard to quantify); the costs of taking over and running the franchisee's territory until it can be refranchised. The heads of loss available to a party will be dependent on how the underlying agreement has been drafted, so it is essential, as the first port of call in any dispute, to consider the limitations on liability that have been included in that agreement (both in terms of quantum and the types of loss that can be recovered).

As stated above, in the event that a party is looking to terminate an agreement by reason of the other party's failings, this can potentially be achieved under either the provisions of the contract or common law. A well-drafted contract should contain specific termination provisions, which may provide for termination in the event of material breach. This term 'material breach' is a nebulous concept with no specific definition under English law, so unless specifically defined in the contract in question, a party looking to terminate should be careful as to whether a material breach has been committed, which will be determined by the facts and circumstances of the contract. Where a breach is so severe that it goes to the root of the contract, it would be considered repudiatory under common law, giving the injured party the right to terminate and claim the full value of the contract. Where a repudiation has happened under common law, the injured party has the right to terminate or affirm (that is continue with) the contract; such an election need not be taken immediately. However, an injured party would be advised to elect within a reasonable period, as otherwise the law may intervene and treat the contract as affirmed (damages would still be available in either scenario).

If a franchisee is successful in a claim for negligent or fraudulent misrepresentation, it could be entitled to rescind the agreement (i.e., treat it as set aside) and damages to put it in the position that it would have been in had the agreement not been entered into. This could entitle the franchisee to claim a refund of the initial and all other franchise fees paid; refund of all set up and running costs (minus any profits made); a refund of the costs of any bank lending; and compensation for lost opportunity based on what the franchisee would or could have done had it not entered into the franchise agreement. The damages can therefore be substantial.

As a general rule, the successful party to litigation will be entitled to an order that the losing party pays its legal costs; however, the costs are always at the discretion of the court and unreasonable conduct by the successful party, such as issuing a claim without going through the appropriate pre-action protocols, refusing to enter into alternative dispute resolution or informal negotiations, or refusing to accept a without prejudice offer that it then failed to beat at the final hearing could result in it only recovering a proportion of its costs or even being ordered to pay the other side's costs. Costs are also subject to assessment by the court to ensure they are reasonable and proportionate and, as a general rule of thumb, a party can expect to receive around 70 per cent of its costs under assessment.

For claims over £25,000, the costs will not be capped (although they are subject to assessment, as explained above). For claims between £10,000 and £25,000 the costs will be capped and for claims below £10,000 (small claims) the successful party will not be able to claim any costs from the losing party other than court fees.

Brexit means a certain degree of uncertainty when it comes to the enforcement of agreements within the EU. As regards where disputes will be heard (i.e., jurisdiction), because the United Kingdom is currently an EU Member State, the UK courts recognise and enforce court judgments from other EU Member States by virtue of the Recast Brussels Regulation and Lugano Convention. The problem post-Brexit is that both these Conventions require reciprocity to be effective, therefore they cannot simply be incorporated into UK law upon the country leaving the EU, because the United Kingdom will not be recognised by the other signatories to the Conventions. The United Kingdom is set to sign up to the Hague Convention on Choice of Court Agreements, which means that where a contract confers exclusive jurisdiction on the English courts, that choice shall be honoured; however, this will not extend to non-exclusive or asymmetric clauses. What will happen in the event of

a 'no-deal' Brexit remains unclear at present, but parties would be well advised to make any choice of jurisdiction exclusive. Domestic disputes and international disputes without an EU element should not be affected.

Furthermore, it is important for international franchisors to note that the United Kingdom is a signatory to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitration Awards (the New York Convention) and the English Courts will readily recognise and enforce foreign arbitral awards from other Convention countries. This will remain the same post-Brexit, and we may see a marked increase in the adoption of arbitration clauses as a means of resolving disputes.

Governing law clauses will be unaffected by Brexit, as the EU Rome Convention on governing law will honour express choices of governing law without the same need for reciprocity, and is set to be incorporated into English Law post-Brexit.

VII CURRENT DEVELOPMENTS

In terms of specific legislation and case law that deals directly with franchising, 2018 has produced little that impacts significantly on either domestic franchise arrangements or relationships between an international franchisor and a UK developer, master or unit franchisee. There have, however, been other notable legal developments that will impact on the franchisor–franchisee legal arrangements and on both the franchisor's and franchisee's relationship with the ultimate consumer.

Following the implementation of the GDPR and the DPA 2018, most franchisors should have reviewed (or if not, should review now as a matter of urgency) not only the data protection provisions in their franchise agreements, but also more importantly the policies, processes and data handling training that these organisations provide to both their franchisees and employees.

The Supreme Court has ruled decisively on whether parties can vary a contract orally despite the presence of a valid 'no oral modifications' (NOM) clause in a contract in the case of *Rock Advertising v. MWB*.²¹ Previous decisions of the Court of Appeal suggested it would be possible to enter into a legally binding oral variation, despite the existence of a NOM clause, as freedom of contract would prevail.²² However, the Supreme Court rejected this argument as a 'fallacy', instead finding that NOM clauses (1) prevented attempts to undermine a written contract by informal means; (2) avoided disputes regarding variations; and (3) provided formality in recording variations, enabling contracting parties to restrict those that can vary their contractual relations. The Court agreed that all of these were legitimate commercial reasons for using a NOM clause, which should not simply be overridden. This ruling has largely been welcomed for bringing greater certainty to long-term commercial arrangements; however, parties to contracts should now carefully consider their record-keeping and contracting procedures to ensure that any oral variations made to commercial arrangements are properly documented and that they are enforceable. The Supreme Court did acknowledge the risk that a party to a contract could act on the contract as orally varied and then find itself unable to enforce it; however, this risk can be partially offset by the principle of estoppel.

In the wider commercial context, UK franchisors continue to make considerable investments in technology, not only as a means for improving business efficiency, but also

21 [2018] UKSC 24.

22 See for example, *TRW Lucas Verity v. Globe Motors* [2016] EWCA 396 (Court of Appeal).

to enable their franchisees to offer a uniform digital marketing platform and integrated e-commerce channel. The twin issues of investment in technology and the evolving landscape around handling, storing, processing and protecting data are likely to continue as trends and developments in 2019.

Finally, it is impossible to ignore the seismic political decision of the United Kingdom to leave the European Union, which has both wide-reaching legal and commercial implications for franchisors, master franchisees, developers and franchisees. While at the time of writing the full extent of Brexit is still unknown, the possibility of a no-deal exit from the EU cannot be discounted, and franchisors should be reviewing their brand protection strategies, their franchisees' employment policies, and the constitution of their employee workforce, as these are areas that will have to be addressed whatever the outcome of the discussions between the UK government and the EU. In addition to free-movement-of-labour issues, key considerations for international franchisors looking at entering the United Kingdom will focus on currency and import-versus-export prices, and the potential impact of enhanced customs checks of goods at borders with EU Member States.

UNITED STATES

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I INTRODUCTION

The franchising industry in the United States is vibrant and shows no signs of slowing down. The United States has the largest franchise market in the world, with 2,500 franchise systems that operate 800,000 franchised establishments in 300 different industries. These franchised businesses support over 7.6 million direct jobs, US\$674 billion in direct economic output for the US economy and 2.5 per cent of the US gross domestic product. It is estimated that franchising accounts for 50 per cent of all retail sales in the United States.

The 10 largest franchise systems in terms of worldwide sales are based in the United States: McDonald's, 7-Eleven, KFC, Burger King, Ace Hardware, Subway, Domino's, Pizza Hut, Marriott Hotels & Resorts and Taco Bell. These franchise systems account for more than US\$300 billion in annual sales. Much of the growth in the United States franchise industry is attributable to multi-unit ownership, which constitutes 55 per cent of all franchise locations in the United States. While most well-established franchise brands are growing, much of the growth during the past 10 years is due to the expansion of new and emerging concepts.

The International Franchise Association (IFA), based in Washington, DC, is the oldest and largest organisation representing franchising worldwide. The IFA works through its government relations, public policy, media relations and educational professionals to protect and enhance the franchise business model. The outlook for the franchise sector remains strong, despite a variety of regulatory issues, legislative proposals and economic challenges.

II MARKET ENTRY

i Restrictions

The decision to begin franchising in the United States should not be taken lightly. Such a decision should be strategic, as it will require a significant commitment of resources by the franchisor. Franchisors planning to enter the US market must satisfy several legal requirements and will incur a variety of compliance costs. Most importantly, the franchisor will have to register and protect its trademarks in the United States and adapt its franchise agreement as necessary to account for local laws, language, currency and the US market. There is also a requirement under the Federal Trade Commission (FTC) Franchise Rule to provide pre-contractual disclosures to a prospective franchisee by providing a franchise disclosure

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document (FDD). The FDD will have to satisfy a variety of state franchise disclosure laws in addition to the FTC Franchise Rule. Moreover, 15 states require that franchisors register their FDDs (and an additional seven states require a filing) prior to offering or selling franchises in those states. The disclosure and registration requirements are intended to protect franchisees and prospective franchisees.

The cost of providing support and assistance in the United States is likely to be higher than in many other countries. This is due to a variety of factors, such as the need for greater training and assistance, the introduction of a new concept in a foreign market and adaptation of the franchised concept to the US market. In addition, a key to the successful launch of a brand in the United States is the development of a secure, high-quality supply chain. It will be necessary for the franchisor to determine whether products and supplies must be imported from the home country into the United States – with the added expense of transportation and logistics services and the payment of customs duties – or whether proper suppliers and manufacturers can be located in the United States. Inevitably, a franchisor's personnel will need to travel to the United States to identify suppliers and franchise prospects, train personnel, inspect proposed sites, provide operational assistance and monitor franchisees' operations to ensure that they are operating in accordance with system requirements. The methodical franchisor should seek to budget for these expenses and should structure both its initial and ongoing fees accordingly. Of course, the size of the US market makes franchising attractive, even though the cost of doing business is substantial.

ii Foreign exchange and tax

Foreign-based franchisors do not face any significant barriers in obtaining payment of royalties and other fees and payments from US franchise operations. The US government does not restrict franchisees in the United States from remitting royalty payments abroad, although cash payments may be subject to anti-money laundering rules. Foreign exchange risks involving the US dollar historically have been equally low.

A franchisor entering the United States should seek tax advice to determine whether any special taxes will affect the financial terms of the franchise relationship. The US tax implications of a franchisor entering the US market depend upon the ownership structure of the franchise. Foreign franchisors may enter the US market by either entering into a franchise agreement, area development agreement, or master franchise agreement directly with an unrelated party; or by forming a US subsidiary to serve as a base of operations in the United States or as a joint venture partner. Each structure will have different tax implications, so it is advisable to seek advice from a qualified accountant or tax lawyer to create a tax-efficient structure. In addition, the effect of tax treaties must be considered.

III INTELLECTUAL PROPERTY

i Brand search

While a proven business model with clearly defined procedures and operating guidelines is an important factor for evaluating a franchise, the cornerstone of most franchise systems is the power of the franchisor's brand. A franchisor's brand is itself composed of intellectual property – which is an intangible asset that has a major impact on the franchise system's likelihood of success. A franchisor's intellectual property, including its trademarks, trade

names, patents and trade dress, has a critical influence on how customers perceive, identify and choose the franchisor's goods or services over those of another brand. Not surprisingly, brand identification is one of the most important aspects of building a successful franchise.

Unlike in many countries, trademark rights in the United States are based on use under common law rather than arising from trademark registration. This means that from the moment that an owner begins to use a trademark on or in connection with a good or service, the owner owns rights in the mark and it generates associated goodwill. This is true regardless of whether the owner has applied for a federal registration of the trademark with the US Patent and Trademark Office (USPTO) or state trademark authority. As a result, trademark counsel will routinely recommend that a franchisor run a full trademark clearance search to ascertain whether any third parties are using marks that are the same or confusingly similar to the franchisor's mark. A full clearance search typically includes a search of all federal and state trademark registers and common law uses, which can be found through internet searches and other publicly available materials. Trademark counsel analyse the search results on the basis of likelihood of confusion of the proposed mark with marks disclosed in the search.

Likelihood of confusion is based on balancing a series of factors. Among the more important factors widely recognised by the USPTO and the courts are: the similarity of the two marks in appearance, sound and meaning; the similarity and relatedness of the respective goods or services and their channels of trade; the strength or distinctiveness of the marks; the price of the goods or services and degree of likely consumer care in the purchase process; and any evidence of any actual confusion. A search will also assist in ascertaining the distinctiveness and, hence, the scope of protection that may be accorded the franchisor's mark. For example, if the search reveals several similar marks for related goods or services exist, it is likely that the franchisor's mark will be considered a 'weak' mark and afforded a narrow scope of protection. As another example, if the mark is a word that has been 'disclaimed' in registrations for similar goods or services offered by the franchisor, it will likely be difficult to obtain a registration for that word as a mark. In that instance, trademark counsel may recommend using the word in combination with other words or in a stylised form, which may render the mark distinctive enough that a registration can be obtained.

While trademark conflicts do arise, registration with the USPTO can significantly minimise risk. Since common law usage grants a trademark holder common law rights, the first person in time to utilise a mark generally has superior rights to all others. Such rights are limited, however; including being limited by geographic area and by the industry in which the mark is utilised. Once established, federally registered trademarks provide for national usage and clear protection for the marks 'as registered'. Further, once registered, the federal mark holder has a presumptive argument that it was first in time as of the date of its registration and, if the mark has been granted registration, it is very difficult for a common law mark holder to overcome the presumptions in favour of the federal registrant.

ii Brand protection

In the United States, common law trademark rights are limited to the geographical locations in which the mark is used, but federal registration of a mark affords nationwide rights in the mark regardless of where it is being used. Such registration confers nationwide priority as of the application filing date, contingent on the successful registration of the trademark.

Because trademark rights are based on priority of use, the franchisor's nationwide rights are limited to the extent that a third party can establish common law rights through prior use of the same or similar mark on, or in connection with, similar or related goods or services.

A federal registration, however, would restrict those third-party rights to the areas of use as of the application filing date of the franchisor's mark. A franchisor can file an application following use of the trademark in commerce, or prior to use, as long as the applicant declares (under penalty of perjury) a bona fide intent to use the trademark in commerce. Where there is only a bona fide intent to use the mark, the registration will not be issued until the franchisor establishes use in commerce and the franchisor files a statement of use with a specimen of the trademark as used. The benefit of filing an intent-to-use application is that once the registration is issued, the effective date of the registration is the filing date of the application rather than of its first use in commerce. One exception to this rule is that an application trademark may be based on a pre-existing foreign registration or application under the Paris Convention or the Madrid Protocol.

Images, designs, software and other works protectable under copyright can attain protection from the moment of creation. As such, in addition to trademark protection, franchisors should consider obtaining copyright protection under the US Copyright Act by registering the copyright with the US Copyright Office. If a franchisor wishes to protect an invention or unique process it has developed, it may apply for a patent with the USPTO. Patents are generally more difficult to obtain than trademark and copyright registration, and the categories of inventions or processes that rise to the level of warranting patent protection are limited.

iii Enforcement

In addition to a franchisor using its mark, a franchisor must also enforce its mark against infringement. If a franchisor does not take steps to enforce its trademark rights, its rights in the mark may weaken and – in extreme cases – be forfeited. Enforcement of a trademark is imperative to maintain a strong and distinctive mark. A trademark enforcement strategy often begins with retaining a trademark watch service. Depending upon available resources, the watch service could cover filed federal applications, published applications, use of similar trademarks or names in commerce, and domain name registrations. Infringing uses are also often identified by internet searches and advertisements, and through the franchisor's franchisees, contacts or customers. An effective enforcement strategy typically entails a cease-and-desist letter, which identifies the franchisor's trademark rights, including identification of any federally registered marks, and demands that the infringer cease all use of the infringing mark.

In the event that a cease-and-desist letter does not resolve the infringement, the franchisor may decide to file a trademark infringement action. A trademark infringement suit can be commenced in either federal or state court, although federal court is usually preferred because of the greater familiarity of federal judges with trademark law. The same is true of suits alleging unfair competition or false designation of origin. A trademark owner does not have to hold a trademark registration to sue for trademark infringement. A trademark infringement action can be based on common law trademark rights.

To the extent trademark infringement arises from unauthorised use of a trademark in a website domain name, the franchisor owner may opt for a streamlined mechanism under the Uniform Dispute Resolution Policy. This policy, administered through the World Intellectual Property Organization, the National Arbitration Forum and others, offers limited relief (the cancellation or transfer of an offending domain name) to the extent that the franchisor can demonstrate bad-faith registration of a domain name that incorporates the franchisor's mark or a confusingly similar variation thereof. Use of this mechanism may be preferable to

attempting to obtain the same relief in court if the only offending infringement is usage of a domain name, or where the loss of the domain name will result in the elimination of the infringing activity.

Additionally, franchisors should enforce their marks with the USPTO by preventing third parties from applying to register, or maintaining a registration for, the same or similar marks for use on or in connection with similar or related goods and services. The franchisor can do this by filing an opposition proceeding (commenced after an application for an infringing mark is published) or a cancellation proceeding (commenced after an infringing trademark is registered).

iv Data protection, cybercrime and e-commerce

In the age of e-commerce, franchisors and franchisees must also be ever vigilant regarding the protection and security of customer information exchanged during online transactions. Franchisors engaging in e-commerce must take special care to develop policies and procedures for their franchisees to adequately secure all customer information and to protect against hackers, viruses and malware. Failure to do so may leave a franchisor and its franchisees vulnerable to lawsuits from customers whose private information has been hacked or stolen. In addition, the FTC, the federal agency responsible for protecting consumers and promoting competition, enforces a wide variety of laws and regulations that require businesses to secure and protect the personal information that is collected, stored, analysed, shared, accessed, used, disclosed and discarded. Further, all 50 states have enacted laws to protect the privacy, security and confidentiality of personal data, some of which are more stringent than federal law. For example, the California Consumer Privacy Act of 2018 (CCPA), which became effective on 1 January 2020, is the most comprehensive data protection law in the United States, and the California Online Privacy Protection Act is the most restrictive online privacy protection law in the United States. In addition to government enforcement actions, private plaintiffs can bring lawsuits, including class actions, under these statutes. Several other states, including New York and Massachusetts, are considering passing data privacy laws similar to the CCPA. Meanwhile, two bills proposing a national federal law are currently pending in the US Congress.

There are also a variety of federal statutes that provide consumer protections in specific industries or with respect to specific kinds of transactions or interactions businesses have with consumers. For example, the Telephone Consumer Protection Act of 1991 (TCPA) governs a range of telecommunications activities. Among other things, the TCPA regulates the use of automated telephone dialling systems and pre-recorded and artificial voice phone messages that are delivered to consumers. The TCPA regulates telemarketing calls, robocalls and text messages delivered to both residential and wireless telephone numbers. The statute also operates in conjunction with the FTC's Telemarketing Sales Rule and the Do Not Call Implementation Act, which forbid telemarketers from calling phone numbers that have been registered on the national Do Not Call Registry.

The Fair Credit Reporting Act (FCRA) is another important consumer protection statute. It regulates businesses that compile 'consumer reports' as well as persons who use such reports and businesses that provide information to credit reporting agencies. It requires companies that use credit reports to give consumers notice when their credit report is investigated or used as part of an adverse decision, such as to deny an application for credit.

In addition to actual damages, a violation can result in statutory damages of up to US\$2,500 per violation. Franchisors must comply with the FCRA when obtaining credit checks on prospective franchisees.

In addition to the federal laws listed above, there are federal statutes that (1) regulate, with specific opt-out requirements, the delivery of emails in which the primary purpose is the commercial advertisement of a product or service; (2) require operators of websites or mobile applications directed at children under the age of 13 to provide a detailed privacy notice and obtain prior verifiable parental consent before collecting information from children under the age of 13; and (3) require financial institutions to give customers notice of the institutions' privacy practices and to safeguard customers' non-public personal information.

Because of the evolving nature of technology and the ever expanding laws protecting data privacy and security, franchisors should draft franchise agreement provisions relating to technology and data privacy and security as broadly as possible to allow for these future changes in the law, as well as changes in technology.

IV FRANCHISE LAW

i Legislation

Franchising in the United States is regulated at both the federal and state levels. Therefore, it is imperative for a business considering expansion into the United States to determine whether its business arrangement constitutes a 'franchise' or 'business opportunity' and, if it does, to comply with all applicable federal and state laws.

Federal franchise legislation

As noted above, the FTC regulates franchising at the federal level under the FTC Franchise Rule.² The FTC Franchise Rule (the FTC Rule) governs franchise offerings in each of the 50 states, the District of Columbia and all US territories. Under the FTC Rule, a business or licensing arrangement will be regulated as a franchise if it has three elements: (1) the franchisor grants the franchisee a right to use the franchisor's trademark; (2) the franchisor exerts or has the authority to exert a significant degree of control or assistance over the franchisee's method of operation; and (3) the franchisee pays the franchisor a fee of at least US\$570. Even if the parties to a contract call it a licensing agreement, a distribution agreement, or explicitly state that it is not a franchise arrangement, if the three elements are present, then US franchise law will apply.

The FTC Rule requires that franchisors provide certain pre-contractual disclosures to potential franchisees.³ In addition, the FTC Rule prohibits certain unfair and deceptive trade practices, such as contradicting the information provided in an FDD. The FTC Rule is a disclosure-only rule. It does not impose a federal registration obligation, nor does it

2 16 CFR Part 436 et seq.

3 The FTC Rule exempts certain franchise offerings from the FTC Rule disclosure requirements. For example, a franchise offered to a large franchisee (a business in operation for at least five years with a net worth of at least US\$5,715,500) is exempt from the FTC Rule's disclosure obligations. Franchisors that qualify for an exemption under the FTC Rule must, however, ensure that a similar or separate exemption is available at state level.

regulate the franchise relationship after the sale. Importantly, the FTC Rule does not include a private right of action and, therefore, only the federal government has standing to enforce the FTC Rule.⁴

State franchise legislation

Certain states have passed franchise laws that build upon the federal franchise rules. These state franchise laws may regulate the offer and sale of franchises, impose additional FDD requirements, prohibit certain franchise agreement provisions, impose state registration obligations, or otherwise regulate the ongoing franchise relationship. Approximately 15 states have laws that regulate the offer and sale of franchises. Nine additional states have franchise laws that regulate various aspects of the ongoing franchise relationship. Because the federal and state definitions of a franchise differ, franchisors contemplating sales activity in multiple states must evaluate each state's franchise act to determine the applicability and requirements of state law. To complicate matters further, franchise acts of multiple states may apply to a single franchise offering depending on where the franchise is to be located, the residence or domicile of the prospective franchise and where the offer was made and accepted.

Federal and state business opportunity laws

Finally, businesses considering US expansion must also comply with applicable business opportunity laws at the federal and state levels. The FTC, under the FTC Business Opportunity Rule, and approximately 26 states regulate the sale of business opportunities. The FTC Business Opportunity Rule defines a business opportunity as a commercial arrangement in which:

- a* a seller solicits a prospective purchaser to enter into a new business;
- b* the prospective purchaser makes a required payment; and
- c* the seller represents to the prospective purchaser that the seller will:
 - provide locations for the use or operation of equipment, displays, vending machines, or similar devices, owned, leased, controlled or paid for by the purchaser;
 - provide outlets, accounts or customers, including, but not limited to, internet outlets, accounts or customers for the purchaser's goods or services; or
 - buy back any or all the goods or services that the purchaser makes, produces, fabricates, grows, breeds, modifies or provides.

While the state definitions of business opportunities differ, most business arrangements that qualify as franchises will also meet the definition of at least some business opportunity laws. Like franchise sales laws, business opportunity laws typically require disclosure or registration, or both. However, most provide an exemption for franchises if the franchise offerings comply with the franchise registration and disclosure requirements under state and federal franchise laws.

⁴ While no private right of action exists under the FTC Rule, most states have 'Little FTC Acts' that provide franchisees with standing to sue for unfair and deceptive conduct, which could include a violation of the FTC Rule.

ii Pre-contractual disclosure

Federal and state franchise laws impose pre-sale disclosure obligations and restrictions. First, the FTC Rule and most states require franchisors to provide prospective franchisees with the FDD upon reasonable request by the prospective franchisee, and no later than 14 calendar days before any agreement is signed or any money is paid. New York requires delivery of the FDD at the earlier of (1) the franchisor and prospective franchisee's first personal meeting or (2) 10 business days prior to the execution of any agreement or payment of any consideration.

The FTC Rule also requires advance disclosure of the specific franchise agreement to be executed by the parties. If no modifications have been made to the form franchise agreement included as an exhibit to the FDD (including filling in material terms), no additional disclosure requirements apply. If, however, the franchisor unilaterally and materially alters the form franchise agreement, the FTC Rule requires a secondary disclosure process and a seven-calendar-day waiting period before the agreement is signed or consideration paid. There are two exceptions to this requirement. First, the seven-day period does not apply to non-substantive 'fill-in-the-blanks' provisions. Second, if the franchisee initiates negotiations regarding changes to the franchise agreement, the seven-day period is unnecessary.

Finally, the FTC Rule and many state franchise acts identify certain pre-signing actions and conduct as 'unfair and deceptive'. One of the most commonly litigated pre-signing disclosure violations is an illegal financial performance representation. A financial performance representation includes any oral, written or visual representation that states or implies a specific range of actual or potential sales, income, gross profits or net profits that a franchisee can expect to achieve. Except in limited circumstances, financial performance information may only be provided to prospects in Item 19 of the FDD. Sharing financial performance information with prospective franchisees outside Item 19 constitutes an unfair and deceptive practice under the FTC Rule and violates most state franchise acts.

iii Registration

Although the FTC Rule does not impose a federal registration requirement, 15 states require registration of the franchise offering prior to the offer or sale of a franchise – California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Oregon, Rhode Island, South Dakota, Virginia, Washington and Wisconsin. The registration process varies by state but generally requires franchisors to pay fees, submit a copy of their FDDs or file certain state-specific registration forms and documents, or a combination of these requirements. The registration states can be divided into 'notice' states and review states. Indiana, Michigan, South Dakota and Wisconsin are considered notice states, with the franchise offering considered 'effective' the day the complete application is received by the state. The remaining registration states undertake some level of review of the franchisor's FDD. As part of the registration process, each state reviewing the FDD application may require changes to the FDD to ensure that the FDD complies with state law. Franchisors that intend to offer franchises in multiple states typically prepare multi-state FDDs that include state-specific addenda to comply with any state-specific requirements that may be imposed during the registration process. Depending on the state, franchise registrations are granted either for a period of one year, or until a certain number of days following the franchisor's fiscal year end. To maintain a franchise registration and continue offering and selling franchises, franchisors must renew their registrations before the prior registration expires, by updating and filing their new FDD. In addition to the renewal requirements, a franchisor must also

amend its franchise registration in the event of a material change to information contained in its FDD. Generally, a change to the franchise system that a prospective franchisee would reasonably want to know about before purchasing a franchise is considered material.

Besides ensuring compliance with state franchise registration requirements, franchisors must also comply with or be exempt from business opportunity registration requirements. As mentioned in Section IV.i, most franchisors will qualify for exemption from state business opportunity laws if the franchise offering complies with the FTC Rule and the franchisor has a registered trademark. Certain states, however, require a notice filing to claim exemption. Specifically, Kentucky, Nebraska and Texas require a one-time exemption filing, while Florida and Utah require annual exemption filings. If the franchise programme does not have a federally registered trademark, additional filing requirements will need to be satisfied to claim exemptions in states such as Connecticut, Georgia, Louisiana, Maine, North Carolina and South Carolina.

Because of these complex pre-sale disclosure and registration requirements, foreign-based franchisors that intend to enter the US market through the sale of unit or area development franchises should engage experienced US franchise counsel and establish an internal franchise sales compliance programme. The programme should serve to help establish internal procedures to track prospective franchisee leads and otherwise satisfy disclosure and registration requirements, identify appropriate record-keeping requirements and organise periodic training for all franchise sales personnel and management.

iv Mandatory clauses

At the federal level, the FTC Rule requires franchisors to prepare an FDD that contains several mandatory disclosure items. The FTC Rule also prohibits certain statements and types of contractual provisions. For example, the FTC Rule considers it an unfair and deceptive practice for franchisors to disclaim or require prospective franchisees to waive reliance on any representations made in FDDs. Franchisors must be mindful of this prohibition when crafting an integration clause to ensure that the disclosures contained in the FDD are not disclaimed or waived.

At the state level, there are a variety of state-specific requirements and restrictions for FDDs and restrictions for franchise contracts. Certain state franchise acts prohibit franchisors from, *inter alia*, waiving application of the state's franchise law, waiving franchisees' right to jury trials, limiting damages claims and requiring franchisees to consent to litigation in a forum outside the franchisees' state. Franchisors engaged in multi-state offerings may use state-specific addenda to accommodate the varying state-specific requirements.

Other than the restrictions noted above, there are no mandatory contractual provisions required by either the FTC Rule or state statute. However, foreign franchisors should be aware that US franchise contracts are often more detailed regarding the rights of the parties than other jurisdictions because, under US law, any ambiguities will generally be resolved in favour of the non-drafting party. Franchisors operating in the United States generally address the following items in their franchise agreements: territorial rights and restrictions, product and service sourcing restrictions, default and termination rights, post-termination obligations and dispute resolution. For example, if a franchisor offers territorial protection, any limitations, exclusions or rights reserved to the franchisor should be expressly stated. US franchisors often reserve for themselves, and exclude from the franchisee's territorial rights, the development of franchises at certain 'non-traditional venues' and sales through alternative channels of distribution, including the internet, catalogue sales and direct retail distribution.

Likewise, it is often critical from a system-standard perspective for franchisors to restrict or limit the source from which franchisees may obtain products or services. Franchisors operating in the United States commonly reserve the right to designate single-source suppliers or approved suppliers (which may include themselves or an affiliate) or specify product standards and requirements in the franchise agreement to ensure a consistent consumer experience.

The inclusion of default and termination provisions, and specifying a franchisee's post-termination obligations in the franchise agreement, are crucial. When drafting default and termination provisions, as well as provisions governing non-renewal, franchisors should note that many states have enacted franchise relationship laws that can affect the enforceability of the contractual language. Drafting a default and termination provision and a renewal provision that accounts for common provisions of relationship laws, including incorporating 'good-cause' and 'opportunity-to-cure' language, can increase the franchisor's ability to enforce terminations and non-renewals.

v Guarantees and protection

If the franchisee is a legal entity rather than an individual, the franchisor will typically require each of the entity's owners to provide a personal guarantee for the franchisee's obligations under the franchise agreement. In some cases, should the franchisee entity have a corporate parent or affiliate, it may be possible to obtain a corporate guarantee from the legal entity. The purpose of the guarantee is to ensure that if the franchisee entity fails to pay or perform under the franchise agreement, the guarantors must do so. A guarantee is normally broad in scope and covers not only the franchise agreement obligations, but also the obligations of the franchisee under any related agreements with the franchisor or its affiliates. No special guarantee form is required by law, and a guarantee's execution does not require witnessing or notarisation. Letters of credit, which are widely used in many countries, are rarely used in the United States. On occasion, a franchisor will accept a letter of credit in lieu of multiple guarantees from an owner of multiple franchise units in the event that the owner seeks to cap its potential liability at a specific amount.

V TAX

i Franchisor tax liabilities

Franchisors will generally be responsible for US federal income tax on income earned in the United States and for withholding and payroll taxes for their US employees. Franchisors also will be responsible for state income taxes to the extent that they conduct business in 40 or more US states that impose such taxes. The 2017 Tax Cuts and Jobs Act (the Tax Act) significantly reduced corporate tax rates, which went from graduated rates, ranging from 15 per cent to 35 per cent, to what is now a flat rate of 21 per cent. State corporate income marginal taxes generally range from 3 to 12 per cent.

A significant tax issue franchisors face in the United States is the extent to which a state may conclude that a franchisor is 'doing business' in that state and hold a franchisor responsible for state income taxes if the franchisor's only operations in a state are through its franchisees. Although the presence of franchisees in a particular state is not usually conclusive evidence that a franchisor is doing business in a state, some states are asserting that franchisors

are subject to state tax, even with relatively minor business contacts with a particular state. While this state activity merely results in re-allocation of tax revenue among different states, franchisors can face stiff penalties if they do not properly report and pay state tax liabilities.

Other tax issues involve the timing of tax recognition and tax liabilities involving advertising funds. Upfront franchise fees received by franchisors are generally fully taxable at the time received by the franchisor at ordinary income tax rates. In addition, royalties (contingent payments) received by a franchisor during the franchise term are taxable when received. As for advertising fees that a franchisor collects for placement in an advertising fund, courts generally have concluded that those fees are not income to the franchisor to the extent the fee revenue can be used only for advertising purposes.

ii Franchisee tax liabilities

Franchisees are subject to the same overlay of federal and state taxation, at the same rates as franchisors. Upfront franchise fees paid by franchisees are not fully deductible at the time of payment. Rather, and regardless of the duration of the franchise term, franchise fees are amortised over a 15-year period. Franchise royalties are generally deductible by franchisees in the year paid or accrued.

iii Tax-efficient structures

Franchisor and franchisee entities generally are formed either as taxable corporations or as 'pass-through' entities, such as limited liability companies or partnerships. Corporations pay tax at the entity level. Shareholders of a corporation generally have no liability for taxes owed by the corporations. Pass-through entities do not pay tax at the entity level as the income flows through to the owners, who are taxed directly on their share of the pass-through entity's taxable income. Foreign-based franchisors should determine whether certain pass-through entities receive similar tax treatment in their home countries. There is no single preferred tax structure for a franchisor or franchisee, whether US-based or foreign-based. The optimum structure is best determined after considering the tax status and jurisdiction of the foreign-based franchisor.

One noteworthy change brought by the Tax Act is that, in addition to corporate tax rate reduction, the new law has deductions for pass-through businesses, which could apply to many franchises. Under the previous law, net taxable income from pass-through businesses entities (such as partnerships, S corporations and limited liability companies) was passed through to owners and then taxed at the owners' applicable tax rates. There was no special treatment applied to pass-through income recognised by business owners. The Tax Act now allows pass-throughs to deduct up to 20 per cent of income, subject to certain other limitations and restrictions. One notable exception to this business income reduction is for service-based businesses, such as realtors, doctors and lawyers, in which the 20 per cent deduction is only available for married couples filing jointly with incomes up to US\$315,000 or to US\$157,500 for single taxpayers. The pass-through deduction was included as an individual income tax provision, which expires at the end of 2025. The new 20 per cent deduction for pass-through businesses will mean an estimated annual tax savings of US\$2.5 billion for the franchise community, according to the International Franchise Association.

VI IMPACT OF GENERAL LAW

i Contract law

US courts have developed equitable principles to promote fairness in contractual relationships, to prevent parties from taking unfair advantage of each other and to prevent a party from abusing the discretion granted to it under the contract. One of the most important of these principles is the implied covenant of good faith and fair dealing in the performance of commercial contracts. Under this covenant, US courts expect that contracting parties will deal with each other honestly and fairly, and that neither party will do anything having the effect of destroying or injuring the right of the other party to receive the benefits of the contract. Conduct is generally considered to be in bad faith when it 'violates community standards of decency, fairness, or reasonableness'.⁵ The covenant of good faith and fair dealing also helps to interpret the intent of the parties when the contract is silent on a particular subject.

The implied covenant of good faith and fair dealing has been adopted by nearly every US state and is applicable to many types of contracts, including franchise agreements. There are, however, significant limitations on the scope of the covenant. Most importantly, the US courts have generally held that the covenant of good faith cannot contradict the express terms of the contract. Moreover, the covenant cannot create rights and duties that are not otherwise provided for in the contract; it arises only out of a party's conduct related to its existing contractual obligations. In addition, in many US states, the covenant only applies where the contract gives the party whose conduct is at issue some kind of discretion. In those circumstances, US courts recognise that the dependent party must rely on the good faith of the other party.

Implied-covenant-of-good-faith claims are frequently raised by franchisees against franchisors, often in the context of challenges to franchise terminations, decisions by franchisors to deny transfers of franchise ownership and challenges to conditions placed on franchise agreement renewals. Such a claim may also be raised either as an affirmative cause of action or counterclaim when the franchisor's decision at issue has adversely affected a franchisee. Because of the significant limitations US courts have imposed on the implied covenant of good faith and fair dealing, however, franchisee claims based on this covenant have largely failed.

To deter potential franchisee claims for breach of the implied covenant of good faith and fair dealing in US contracts, franchisors should exercise care in drafting franchise agreements. Unlike franchise agreements governed by civil law jurisdictions, agreements subject to US law are often comprehensive and contain detailed provisions. Although the implied covenant of good faith and fair dealing cannot directly contradict the express terms of the franchise agreement, to limit the potential application of the implied covenant, when drafting franchisors should avoid the use of language that gives either party unfettered discretion. By using such drafting techniques, franchisors may minimise the risk of claims based on the implied covenant of good faith and fair dealing.

ii Agency distributor model

In the United States, there is law based on federal trade regulation rules and there are certain state laws that regulate franchising. There are no similar laws of general applicability directly regulating agents or distributors, but various laws often affect the distribution of goods or

⁵ Restatement (Second) of Contracts, Section 205, comment a (1981).

services by agents or distributors, or both. These include franchise disclosure, registration notice laws and regulations, business opportunity laws, termination and non-renewal or relationship laws, a number of special industry laws (e.g., automobile dealerships or alcohol distributorship laws) as well as laws regulating the sales representative relationship. A company that sells products or services for resale cannot ignore these laws and regulations; in fact, a company that fails to comply with these laws or regulations exposes itself – and its officers, directors and other persons engaged in the sales process – to damages, injunctions, rescission orders and civil or criminal penalties.

iii Employment law

The franchise community in the United States has become increasingly concerned with two sets of employment law issues in recent years. One issue relates to the potential for franchisors to be held jointly liable (along with their franchisees) for employment claims brought by a franchisees' employees. Such potential joint employment liability arises from a variety of developments. For example, in 2014 and 2016, federal and state authorities alleged joint employment liability against two high-profile US franchisors. Moreover, in 2015, the National Labor Relations Board (NLRB), the federal agency charged with protecting individuals' right to organise unions, issued a decision in *Browning-Ferris Indus. of California, Inc.*,⁶ which held that joint employment liability may be found where the right to control the terms of employment was reserved or exercised indirectly through an intermediary. In 2017, the NLRB issued another decision in *Hy-Brand Industrial Contractors Ltd.*,⁷ which would have overturned the 'indirect control' test under the *Browning-Ferris* decision, but the *Hy-Brand* decision was subsequently vacated. Separately, at the same time, 19 states have independently enacted legislation to codify the more traditional 'direct and immediate control' standard that had, until recently, prevailed in the United States for many years. Most recently, in September 2018, the NLRB published a Notice of Proposed Rulemaking to change the joint employment standard through an NLRB rule-making procedure. Under the proposed rule an employer may be found to be a joint employer of another employer's employees only if the employer possesses and exercises substantial, direct and immediate control over the essential terms and conditions of employment and does so in a manner that is not limited and routine.

A number of significant legal consequences can result from a franchisor being found to be its franchisees' employer or joint employer, including:

- a* liability for tax withholding from franchisees' employees and timely payment of those withheld amounts to government taxing authorities;
- b* payment of franchisees' employees' benefits;
- c* payment of franchisees' employees' wages and overtime pay;
- d* payment of franchisees' employees' unemployment and social security taxes;
- e* liability for franchisees' employment discrimination;
- f* liability for franchisees' workers' compensation insurance;
- g* vicarious liability to third parties for franchisees' actions; and
- h* liability for income taxes to each state in which a franchisee is located based on having a 'presence' in that state.

6 *Browning-Ferris Indus. of California, Inc.*, 362 NLRB No. 186 (Aug. 27, 2015).

7 *Hy-Brand Industrial Contractors Ltd.*, 366 NLRB No. 26 (Feb. 26, 2018).

The second employment issue relates to worker misclassification claims, which have also become increasingly common. Misclassification claims in the franchise context first gained significant notoriety in 2006 when a Massachusetts franchisee successfully sought unemployment insurance after her franchise was negatively affected by a customer decision. That case became the basis for several follow-on cases in the franchised janitorial service market seeking to reclassify franchisees as employees. These cases have generally had limited success when evaluated using the common law ‘right-of-control’ test. However, a number of states have begun applying tests that are more stringent and generally more onerous for franchisors. For example, more recently, in April 2018 a California court, in a non-franchise case, *Dynamex Operations West Inc. v. The Superior Court of Los Angeles County*,⁸ embraced an expansive misclassification test (this test is known as the ‘ABC’ test and is the same test applied by the court in the Massachusetts case), which effectively starts with a presumption that a worker is an employee and not an independent contractor). The *Dynamex* decision was codified in California on 18 September 2019, when the governor of California signed California Assembly Bill 5 (AB5)⁹ into law. AB5 was heavily backed by labour groups and intended to provide more protection to ‘gig-economy’ workers, which are typically classified as independent contractors. Unfortunately for franchisors, the language of AB5 is broad enough that it may apply to franchise relationships. Notably, the IFA unsuccessfully lobbied the California legislature for an exemption for franchising from AB5. Because AB5 applies across the entire California Labor Code, franchisors could be subject to misclassification-based claims by franchisees and employees of franchisees for unpaid overtime, missed meal and rest breaks, and operational costs and expenses. AB5 stipulates that its provisions may be retroactive to the maximum extent permitted by law.

In light of the changing landscape, determining the extent of control a franchisor may exercise over its franchisees’ operations without exposing itself to additional liability presents a difficult problem for many franchising systems. It is necessary to establish and maintain brand standards; indeed, to maintain ownership over trademarks, US law requires mark owners to exercise control over the quality of the goods or services offered under such marks. Franchisors usually balance these competing requirements by limiting control over franchisees’ employees and employment-related decisions while exercising control over only brand-specific matters, but this may no longer be enough. It is important to closely examine the proper balance for each franchise system.

iv Consumer protection

Consumer protection and unfair and deceptive trade practices acts have been adopted at the federal level and in every state. For the most part, these statutes are aimed at ‘immoral, unethical, oppressive or unscrupulous’ business practices that have resulted in ‘substantial injury’ to consumers. Although these statutes typically were enacted to protect ordinary consumers, franchisees have sometimes qualified as a consumer who is deserving of protection against violations of these statutes by franchisors. Those decisions significantly expand the rights afforded to franchisees under their franchise agreements and usually allow consumers who have been harmed to obtain double or triple damages awards along with their attorneys’ fees.

8 *Dynamex Operations West Inc. v. The Superior Court of Los Angeles County*, 4 Cal.5th 903 (Cal. 2018).

9 A.B. 5, 2019 Assemb. Sess. (Cal. 2019).

v Competition law

Franchising has always been a focus of antitrust, or competition, law because franchisors want to have uniformity throughout their franchise systems and have to enforce standards and maintain quality. Accordingly, there is a real business need to control pricing, to control the supply chain, to control locations and to position the franchise system for inter-brand competition (rather than intra-brand competition). These are the types of restrictions often encompassed by antitrust laws.

The primary antitrust risk that franchisors face is vertical price-fixing (also known as resale price maintenance or RPM), when they exert too much control over the prices charged by franchisees. Franchisors have a legitimate interest in the prices at which franchisees sell their products and services, and in the margins earned by franchisees. Many franchisors believe that franchisee pricing is the key to the success or failure of their franchisees and, ultimately, to the success or failure of the franchisor. Consistent pricing throughout a franchise system is critical to the uniformity and brand-building that many franchisors desire. In addition, franchisors do not like to see price wars among their own franchisees – they want their franchisees to focus on inter-brand competition.

Prior to 2007, it was automatically – or *per se* – illegal for a franchisor to require or coerce its franchisees into reselling goods either at a specified price or above a certain minimum price, meaning that it was *per se* illegal to prevent franchisees from discounting. However, these vertical price-fixing agreements are now governed by a rule of reason in which legality or illegality is dependent upon whether the RPM programme unreasonably restricts trade in a defined market. Despite this new, relaxed standard, many franchisors have been reluctant to implement RPM in their franchise systems, for a variety of reasons.

First, RPM may be found unlawful under the rule-of-reason standard if a franchisor is deemed to have market power or if a pricing agreement was entered into by the franchisees themselves (horizontally) and in effect was foisted upon the franchisor by a franchisee cartel. Second, although RPM is analysed under a rule of reason under federal antitrust law, RPM is still *per se* illegal under a number of state antitrust laws, including California, Maryland and New York. Third, franchisors may be able to take advantage of other pricing techniques that have greater legal certainty. These include the use of suggested resale prices, unilateral pricing policies (known as Colgate policies), minimum advertised price policies (known as MAP policies) and an agency model. Even though these techniques are not as rigid as an RPM policy, many franchisors are willing to sacrifice some degree of pricing control for the reduced legal risk provided by the avoidance of the RPM policy.

Mandatory purchasing programmes and other restrictive supply policies may give rise to illegal tying arrangements. In recent years, however, franchisors have been able to avoid antitrust liability for their restrictive supply policies by providing detailed pre-sale disclosure about the policies in the FDD provided to prospective franchisees.

vi Restrictive covenants

Franchise agreements typically contain in-term and post-term covenants prohibiting franchisees from engaging in any business activities of the same type as the franchised business. For example, franchise agreements for restaurants often impose a non-competition restriction on the franchisee during the franchise term and after the expiration, termination or transfer of the franchise agreement, which prevents franchisees from directly or indirectly owning or having any involvement in food establishments offering, as the primary menu item, the same or similar menu items as offered at the franchised restaurants. In-term non-compete

obligations are widely enforced in the United States because the courts recognise the franchisors' interests in protecting their trade secrets and goodwill. Post-term non-compete obligations are also enforceable in most states so long as the prohibition is (1) reasonable in duration, geographic scope and the prohibited conduct, and (2) only as broad as is necessary to protect the franchisor's legitimate business interest.

If a franchisee violates a non-competition prohibition, franchisors generally reserve the right to pursue various remedies, including immediately terminating the franchise agreement, seeking injunctive relief to quickly halt any violating conduct or payment of liquidated damages by the franchisee.

vii Termination

A franchisor's right to terminate a franchise agreement is governed, for the most part, by the terms of the franchise agreement, which typically identify the breaches that can lead to termination. Most franchise agreements place breaches into two categories: those that can be cured by the franchisee following written notice, and those that cannot be cured and can lead to immediate termination. Incurable breaches typically involve those that go to the heart of the franchisor–franchisee relationship, including the intentional under-reporting of sales, violation of in-term covenants not to compete or a franchisee's conviction of a crime. Franchise agreements commonly set out detailed procedures for termination, the obligations of the parties related to shutting down the business, and the franchisee's post-termination obligations once the termination goes into effect. Although the FTC Franchise Rule does not regulate the ongoing franchise relationship, approximately half of all states have franchise relationship statutes that outline rules governing the termination of the franchise relationship and take precedence over the terms of the franchise agreement. Most of these statutes, for example, require a franchisor to have 'good cause' to terminate the agreement, although there is no consensus on this standard from state to state. In addition, some states require a franchisor to provide the franchisee with a minimum notice period and opportunity to cure before the termination goes into effect.

Post-termination non-compete covenants are commonly included in franchise agreements. Courts often take the position that, to enforce these restrictions, they must be reasonable in terms of the scope of activities the former franchisee is prohibited from engaging in, the geographical area to which the restriction applies and the length of time the covenant is in effect. This determination is highly fact-specific and depends on the circumstances surrounding each case as well as the state law applicable to the covenant. As a result, restrictions that are effective for a longer period, cover a wider scope of prohibited activities and are broader in geographical reach are less likely to be enforceable. Franchisors should also be mindful that a handful of states, by statute or judicial precedent, do not acknowledge or severely limit the enforceability of post-termination covenants not to compete.

viii Anti-corruption and anti-terrorism regulations

Franchisors and other businesses operating in the United States must be cognisant of US laws governing corruption and bribery. Corruption and bribery encompass a range of conduct. They include the offering, giving or soliciting of something of value for the purpose of influencing the action of an official in the discharge of his or her public or legal duties. Guarding against and eliminating corruption in the United States is a high enforcement priority, second only to eradicating terrorism in the homeland. A foreign franchisor's inability

to negotiate the US anti-corruption landscape can lead to significant financial penalties, potential prison time for individuals and collateral damage such as brand devaluation and threat to reputation.

The most significant law promulgated to deter corporate corruption is the US Foreign Corrupt Practices Act (FCPA). The FCPA is intended 'to halt corrupt practices, create a level playing field for honest businesses and restore public confidence in the integrity of the marketplace'. It is the 'single most significant compliance challenge for companies operating internationally' including foreign-based franchisors looking to establish franchise relationships in the United States. Jurisdictionally, the FCPA extends to foreign nationals and companies, including foreign-based franchisors, operating or doing business in the United States.

There are two primary provisions under the FCPA: the anti-bribery provision and the accounting provision. The accounting provisions require corporations to make and keep accurate books and records and devise and maintain a system of internal accounting controls. Liability under the anti-bribery provision of the FCPA is premised on the conduct of company employees and third parties acting on behalf of the company, such as consultants. As a general matter, this provision prohibits direct or indirect payments to foreign officials for the purpose of obtaining or retaining business. The FCPA applies to any individual, firm, company, officer, director, employee, agent of a company, or stockholder acting on behalf of a firm. Individuals and firms can also be penalised if they order, authorise, influence, induce or assist someone else to violate the anti-bribery provisions or if they conspire to violate those provisions. An exception to this bribery proscription includes instances where facilitating or expediting payments are made to a foreign official, political party or party official to accelerate or to secure the performance of a routine governmental action by a foreign official, political party or party official. To the extent companies and individuals are found to be in violation of the FCPA, they may be subject to criminal and civil penalties, which may include fines and imprisonment.

Franchisors should also have an awareness of other US anti-bribery laws as they look to do business in the United States. The federal official bribery and gratuity statute prohibits, among other things, the giving of gifts, gratuities or anything of value either directly or indirectly to public officials 'with intent . . . to influence any official act; or to influence such public official or person who has been selected to be a public official to commit or aid in committing, or collude in, or allow, any fraud, or make opportunity for the commission of any fraud, on the United States; or to induce such public official or such person who has been selected to be a public official to do or omit to do any act in violation of the lawful duty of such official or person'. A violation of this anti-bribery statute could result in fines as much as three times the monetary equivalent of the thing of value being offered, or imprisonment of up to 15 years.

Franchisors must also comply with certain laws designed to exclude from commerce those individuals and entities seeking to engage in terroristic threats against the United States. This includes 'criminal acts intended or calculated to provoke a state of terror in the general public, a group of persons or particular persons for political purposes'. Awareness of anti-terrorism laws such as the USA PATRIOT Act requires franchisors to closely examine their business relationships. In the absence of vigilance, franchisors can find themselves unknowingly supporting terrorist operations, both at home and abroad in violation of this law. An essential component of the Act, of which foreign-based franchisors should be

cognisant, is the International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001. This component of the Act is intended to facilitate the prevention, detection and prosecution of international money laundering and the financing of terrorism.

Franchisors should also be aware of US Department of the Treasury's Office of Foreign Assets Control (OFAC) policies against terrorists. OFAC administers and enforces economic and trade sanctions based on US foreign policy and national security goals against targeted foreign countries and regimes, terrorists and international narcotics traffickers. OFAC also focuses on those engaged in activities related to the proliferation of weapons of mass destruction and other threats to the national security, foreign policy or economy of the United States. To ensure that business is conducted with reputable persons, franchisors should pay attention to OFAC's 'specifically designated nationals' or 'SDNs' list of individuals and companies. Included on this list are known or suspected terrorists and narcotics traffickers, owned or controlled by, or acting for or on behalf of, targeted countries. Failure to comply with OFAC by engaging in business with those who are sanctioned as a result of having been specifically designated can result in significant civil and criminal penalties.

As foreign-based franchisors enter the US marketplace, their liability may be based on the conduct of their employees, franchisees, agents and other third parties acting on the franchisor's behalf. To manage this risk, foreign-based franchisors are advised to become actively involved in their US operations.

ix Dispute resolution

Forum

Parties to franchise relationships usually provide for dispute resolution in their franchise and related agreements. Sometimes their written agreements provide for arbitration or mediation as a condition precedent to litigation, and sometimes they chose neither and specify a venue for any litigation between franchisor and franchisee. Mediation is a recognised form of alternate dispute resolution that is especially well-suited for franchise disputes because of the relationship between franchisor and franchisee. The contractual obligations to mediate and arbitrate are generally enforceable under the Federal Arbitration Act. Should a party contest its obligation to arbitrate, a court will usually require that issue to be presented to an arbitrator for disposition. In the past several years, the Supreme Court has clarified that class action waivers will generally be enforced in arbitration proceedings. See *AT&T Mobility LLC v. Concepcion*,¹⁰ and *American Express Co. v. Italian Colors Restaurant*.¹¹ Unless the parties have agreed to arbitration, the courts will not require them to arbitrate. The same can be said for mediation except that many jurisdictions as a matter of course require litigation parties to mediate at some point before a case is called to trial. While mediation is voluntary, parties who are ordered by a court to mediate must participate in good faith.

Venue selection clauses in franchise agreements, and commercial contracts generally, are upheld as a matter of course. Since the Supreme Court's decision in *Atlantic Marine Construction Co., Inc. v. US District Court for the Western District of Texas*,¹² in most cases, parties are held to their contractual venue choice irrespective of later claims of inconvenience. As to choice-of-law or governing-law clauses, in the absence of conflict-of-laws issues, the

10 *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333 (2011).

11 *American Express Co. v. Italian Colors Restaurant*, 570 U.S. 228 (2013).

12 *Atlantic Marine Construction Co., Inc. v. U.S. District Court for the Western District of Texas*, 571 U.S. 49 (2013).

parties' choice of law will be applied so long as the chosen law has a relationship to the parties and their dispute. In franchise cases, it should be noted that state relationship laws governing the franchise relationship in several jurisdictions may prohibit or limit the application of a foreign state law to a franchise dispute as a matter of public policy.

Procedure

There is no industry practice or trade association rule that specifically governs the procedures for resolution of franchise relationship disputes. If the parties have not chosen in their written franchise agreement to arbitrate their disputes privately, they will be bound by the rules of procedure of the court (state or federal) in which they present their claim for adjudication. Those rules generally require a written summons or complaint to institute an action (and toll the applicable statute of limitations), and then provide the defending party, after service of summons or complaint, a period to respond by motion or answer. Once the issues presented by the dispute are joined by the filing of an answer, the parties typically engage in discovery of documents and depositions of witnesses before presenting the case to the court for ruling, either by motion for judgment without trial (summary judgment) or by trial either with or without jury. A jury trial is generally available to litigants in federal and state courts as a matter of constitution, except when the parties have by written agreement waived their right to jury trial. Rules of procedure differ from courthouse to courthouse, and a prudent practitioner will familiarise herself or himself with local rules before taking on an engagement. If the parties have instead chosen to arbitrate their dispute, they will be bound by the rules of the administering arbitral body they have chosen; if there is no administering arbitral body provided for in the franchise agreement, the disputing parties must agree upon a set of procedural rules to apply to their dispute.

If the parties have chosen to mediate their dispute, they are largely in charge of mediation procedures, except for some key elements that apply universally to mediation – the mediator is neutral and has no authority to decide the parties' dispute; all contents of the mediation are confidential and cannot be used by any party in any other proceeding; and the mediator will not share with any party communications from another party without the express consent of the communicating party.

Remedies

The same remedies are available in franchise disputes as in any other commercial dispute – monetary damages for legal claims (such as breach of contract or violations of applicable statutes) or injunctive relief to prevent conduct for which an award of monetary damages would be inadequate. Contract damages require specificity and cannot be based on conjecture or speculation. In a written contract, parties may, and often do, waive certain types of monetary damages – often punitive, multiple or exemplary damages and consequential damages. Monetary damages sought by franchisors generally involve claims for unpaid royalties and other fees due under the franchise agreement and may include lost future royalty fees when a location closes prior to the end of its term. Monetary damages sought by franchisees generally involve claims for lost profits in the event of failure, under-performance or wrongful termination by the franchisor of the franchise business.

Injunctive relief is available where a party will suffer 'irreparable harm' that cannot be redressed through monetary damages. In franchise litigation, this usually involves claims for unauthorised use of a trademark, misappropriation of trade secrets and confidential information, and enforcement of a restrictive covenant prohibiting operation of a business

similar to the franchise for a time and place certain. In the event that a former franchisee continues to use a franchisor's trademark after termination of a franchise agreement, injunctive relief to prohibit such use is generally available in both state and federal courts under the federal law governing trademarks, the Lanham Act¹³ or state laws governing trademarks. Trade secret misappropriation – the unauthorised use or disclosure of a franchisor's proprietary systems or confidential information – is traditionally a creature of state law. Recent federal law has, however, expanded jurisdiction of such claims to federal courts and enhanced available remedies.¹⁴ Enforcement of restrictive covenants against post-term competition is more difficult to obtain. The laws governing such covenants vary from state to state, and proof of irreparable harm is often difficult to provide, especially since the Supreme Court's decision in *eBay Inc. v. MercExchange, LLC*.¹⁵ Generally, in states that permit enforcement of post-term covenants, a franchisor must show that the scope of the prohibited business activity is reasonable, that the length of time and geographical scope are reasonable and that there is some 'protectable interest' worthy of protection, such as trade secrets or customer goodwill.

Enforcement

The Federal Arbitration Act, Chapter 2, of the United States Code provides for the recognition of foreign arbitral awards and incorporates the New York Convention.

VII CURRENT DEVELOPMENTS

In 2019, key legal developments affecting the US franchise industry included continuing changes to the law of joint employment and worker misclassification, increased scrutiny of anti-poaching provisions and restrictive covenants in franchise agreements, new disclosure rules issued by the North American Securities Administrators Association (NASAA) and privacy developments.

i Continued joint-employer and misclassification developments

In 2019, the risks for franchisors related to joint-employer liability and misclassification claims remained unclear. As discussed in more detail in Section VI.iii, some recent decisions appear to expose franchisors to more potential liability from their franchisee's employee's employment-related claims. At the same time, other decisions and legislative efforts seek to contain such risks to those cases in which the franchisor is exercising direct and immediate control over its franchisee's employees.

ii Restrictions on anti-poaching provisions and non-competition covenants

Historically, many standard US franchise contracts contained provisions that prohibited franchisees from soliciting or hiring employees from one another ('anti-poaching' provisions). Although rarely enforced, these provisions promoted harmony within a franchise system. Similarly, many standard US franchise agreements impose in-term and post-term non-competition covenants on franchisees. These provisions prevent franchisees from using

13 Lanham Act, 15 U.S.C. § 1051 et seq.

14 Defend Trade Secrets Act of 2016, 18 U.S.C. § 1836 et seq.

15 *eBay Inc. v. MercExchange, LLC*, 547 U.S. 388 (2006).

the franchisor's proprietary information and know-how to compete with the franchise brand. In recent years, there has been an increasing trend towards limiting the enforceability of both anti-poaching provisions and non-competition clauses.

Many US officials have begun to regard anti-poaching provisions as anticompetitive and argue that such provisions depress wage growth for low-wage workers by preventing departing workers from getting the very jobs for which they are most qualified. As a result, many large franchisors have received demands from officials or agencies seeking information regarding their anti-poaching contractual provisions and practices. In particular, the Washington Attorney General launched investigations into several high-profile franchise systems during 2018 and 2019, generally resulting in settlements in which the franchisors agreed to remove the provisions from future franchise agreements and to amend existing agreements to remove such provisions. By late 2019, more than 150 franchise systems had entered into agreements with the state of Washington. In addition to governmental actions, some states have enacted or are considering legislation that prohibits the use of anti-poaching provisions. For example, House Bill 1450 (HB 1450) was signed into law in the state of Washington on 8 May 2019. The new law, which took effect on 1 January 2020, provides that '[n]o franchisor may restrict, restrain, or prohibit in any way a franchisee from soliciting or hiring any employee of [another] franchisee of the same franchisor . . . [or] may restrict, restrain, or prohibit in any way a franchisee from soliciting or hiring any employee of the franchisor.'¹⁶

In addition to restricting anti-poaching provisions, HB 1450 also represents a trend of increasing limitations on non-competition agreements. There are a growing number of states, such as California, Illinois, Maine, Maryland and New Hampshire, that either prohibit non-competition agreements entirely, or significantly limit non-competition requirements that can be enforced against low-wage workers.

iii New franchise disclosure document state cover page

On 19 May 2019, NASAA adopted new Franchise State Cover Sheets Instructions that update the state cover page section of its Commentary on 2008 Franchise Registration and Disclosure Guidelines. The new instructions clarify the proper use of the 'State Effective Dates' page used in multi-state FDDs and relocate the State Effective Dates page to the end of the FDD. The new instructions also replace the old State Cover Page with three preliminary pages: a first page, entitled 'How to Use This Franchise Disclosure Document', with standard information about where to find key information within the disclosure document; a second page entitled 'What You Need to Know About Franchising, *Generally*', with general information about franchising; and a third page entitled 'Special Risk(s) to Consider about *This* Franchise', which contains risk factor information in a more standardised and streamlined format. These rules will apply to all disclosure documents issued on or after 1 January 2020.

16 H.B. 1450, 66th Leg., 2019 Reg. Sess. (Wash. 2019).

iv Privacy developments

Following the lead of the European Union and the General Data Protection Regulation, various US jurisdictions are considering or have adopted new laws intended to safeguard consumer data and protect privacy. As described in Section III.iv, the CCPA of 2018 is the most comprehensive privacy law in the United States and became effective on 1 January 2020. Other states are considering similar legislation, and national legislation has been introduced in the US congress.

DISPUTE RESOLUTION APPENDIX

GENERAL TERMS AND CONDITIONS IN A FRANCHISE CONTRACT: AN EXAMPLE IN SPANISH CASE LAW

*Pablo Berenguer*¹

If an oversight in a contract is potentially damaging, this can prove even worse in a franchise situation. Because the same template is generally used for the entire network of franchisees, the oversight might potentially be reproduced a number of times equivalent to the number of franchisees – and it is perfectly plausible for a franchisor to have more than 500 franchisees spread across the relevant territory.

The fact that the same template is generally used for the entire network of franchises is sometimes used as an argument to obtain the annulment of a clause that has turned out to be contrary to the interests of the franchisee. However, the Spanish courts have established that this cannot be invoked as a reason per se to render an agreement a nullity, and does not release the adherent party (the franchisee) from duly complying with its onus of the proof when a conflict arises and the corresponding action is filed before the courts. The judgment of 20 March 2015 issued by the Commercial Court of Castellón is a good example of this. This judgment referred to the dispute between Servicio de Restauración de Costa, SL and McDonald's Sistemas de España Inc, Sucursal en España.

The aforementioned Servicio de Restauración de Costa, SL signed three franchise agreements with McDonald's, which were not later renewed. Servicio de Restauración de Costa, SL filed a claim before the Commercial Court in Castellón asking for the declaration of the nullity of certain clauses in the corresponding agreements on the basis of those clauses being mere general terms and conditions that had been unilaterally established by the franchisor and were contrary to the unfair competition regulations. The plaintiff also asked the Court to declare its right to renew the franchise agreements or, on a subsidiary basis, to be indemnified for the damage suffered because of the lack of renewal of those agreements. The plaintiff also asked the Court to declare its right to establish new franchised business within the territory. One of the arguments used to ask for the renewal of the franchise agreements was that the pre-contractual documentation that was handed to the franchisee before entering into the three franchise agreements included a 'White Book', in which the options to establish new franchised business and to agree a new term to the agreements were foreseen.

When addressing the alleged nullity of the clauses mentioned by the plaintiff, the Court established that their general character and their lack of individual negotiation was not a reason to declare their nullity per se. In this regard, the Court referred to the case law of the Spanish Supreme Court and, in particular, to its judgment of 9 May 2013, wherein it

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was said that such 'mass agreements' represent a common tool in the current legal situation, with this type of agreement justified by the need to speed up negotiations and provide legal certainty to the parties during their transactional agreements.

Notwithstanding that, the Court mentioned the need to establish certain controls that every general condition needs to pass to be considered valid. These are the 'transparency control' (which would include a control on the 'incorporation and transparency' of every single clause in the agreement, and the 'real comprehensibility' of the clauses in the agreement when entered into with a consumer) and the 'content control' (which would affect those clauses that are null and void according to the applicable regulations, and those others that are abusive when the adherent party is a consumer).

In the case submitted to the Commercial Court in Castellón, the adherent party was not a consumer. As a result, only the incorporation and transparency control and the content control could be applied when assessing the nullity of the clauses invoked by the plaintiff. The plaintiff, however, relying only on the *iura novit curia* principle, failed to comply with his onus of the proof and did not devote any effort to explaining why the alleged clauses were contrary to the unfair competition regulations. Only the clause in the contract determining the court's jurisdiction was found to be null since it contravened an imperative principle (the courts mentioned in the agreements were not the courts of the franchisee's domicile).

With regard to the requested declaration of the franchisee's right to renew the franchise agreements, the Court indicated that the provisions in the White Book could not be interpreted as being part of the franchise agreements. The White Book reflected only the protocol with which the franchised business had to comply, and was a document that had been unilaterally drafted by McDonald's. Moreover, the White Book expressly established that its content was simply a complement to the franchise policies and had an informative purpose only. Nothing in the White Book could be understood to modify any of the clauses agreed upon by the parties in the corresponding franchise agreements.

It turned out that the franchise agreements established no right of renewal. On the contrary, the agreements included a clause stating that the franchisor made no promises regarding possible renewals. The reference to the new term was only mentioned in the White Book. Moreover, the intention of the franchisor not to renew the franchise agreements had been clear well before termination. As a result of that and despite the assertions made by the plaintiff, the Court rejected the plaintiff's claim and found that the inclusion of the clause regarding possible renewals was not abusive at all. Bearing in mind the *intuit personae* character of franchise agreements, the franchisor could quite legitimately establish such a general clause in the agreements.

The Court applied the same reasoning when deciding about the right to establish additional franchised business: this possibility was not foreseen in the agreements. On the contrary, the franchise agreements mentioned the possibility of other parties settling franchised business in the territory. In this regard, the Court said that, even if exclusivity was common when entering into a franchise agreement, it was not a requirement of these types of agreement. As a result, the plaintiff was not entitled to claim any damages.

As can be seen, therefore, the validity of general terms and conditions in a franchise agreement need to be assessed from the outset. Their general nature is no reason to invoke the agreement's nullity and does not release the franchisee from the burden of proof in the event that a conflict arises.

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WEN-YUEH CHUNG

Formosa Transnational Attorneys at Law

Wen-Yueh Chung is a senior partner at Formosa Transnational Attorneys at Law. His practice includes intellectual property, international business, corporate matters, franchising, labour laws, debt collection, litigation and alternative methods of dispute resolution, and construction.

Drawing on his solid basis in graduate studies and training at the Kyoto University School of Law in Japan, Mr Chung assists Japanese clients in entering and doing business in Taiwan. He works closely with Japanese companies to manage and protect their business interests and intellectual property rights. He represents one of the most popular Japanese entertainment brands and advises on strategies for, and takes actions to build, solid trademark portfolios, to eliminate counterfeits and to negotiate and complete licensing agreements in the Taiwan market. Mr Chung also provides comprehensive legal services in assisting Japanese companies in corporation registrations, employment policies and strategies, legal compliance checks and business contract reviews.

Mr Chung has been counsel to the Japan Chamber of Commerce and Industry Taipei (JCCI) and the Japan–Taiwan Exchange Association (JTEA) for many years. His wide and varied professional experiences enable him foresee emerging business and legal trends and to formulate suitable and effective strategies for brand development.

DANIEL DEANE

Nixon Peabody LLP

Dan Deane is a leader of the Telephone Consumer Protection Act (TCPA) team and the class actions and aggregate litigation group at Nixon Peabody. His practice focuses on defending businesses and individuals in high-exposure, complex civil and criminal litigation and government investigations before state and federal courts, arbitral tribunals and regulatory agencies. His clients include national and international businesses and franchises across a variety of industries with a focus on consumer-facing business, such as retail products and services, healthcare and pharmaceuticals, financial services and education. Dan has experience defending lenders and franchisors and other consumer-facing businesses against claims of unfair and deceptive business practices, unfair debt collection practices and invasion of privacy under statutes such as the TCPA, Fair Debt Collection Practices Act (FDCPA), Fair Credit Reporting Act (FCRA) and state consumer protection laws. He has been listed in *The Best Lawyers in America* since 2016.

ALEXANDER DUISBERG

Bird & Bird LLP

Alexander Duisberg is a partner at Bird & Bird LLP (Munich office). His main focus is online distribution, technology and privacy laws. He advises clients on the implementation and restructuring of distribution models, including the contentious resolution of existing models. Alexander Duisberg is admitted to the Bar in Germany.

STEVEN FEIRMAN

Nixon Peabody LLP

Steven Feirman practises franchise and distribution law, where he focuses on helping franchisors expand their franchise systems in the United States and in foreign jurisdictions. He has gained renown for his work at the intersection of franchising and antitrust, including pricing strategy and supply-chain matters. Steven is a frequent speaker and contributor to legal publications on franchising topics and he has served as an editor of some of the leading publications in the field, including *Franchise Law Journal* and *Franchise Legal Digest*. Steven was selected by his peers for inclusion in *The Best Lawyers in America 2020* in the field of franchise law, is recognised for exceptional standing in the field of franchising in the current edition of *Chambers USA*, and is recognised as one of the top franchise lawyers in the United States and internationally in the current edition of *Who's Who Legal: Franchise*. He also has been recognised for the past 13 years as a 'Legal Eagle' by *Franchise Times*. Steven is a former enforcement attorney with the Federal Trade Commission, where he received the FTC's Meritorious Service Award.

ZOE FELLER

Bird & Bird LLP

Zoe Feller is a solicitor and tax partner in the London office of Bird & Bird LLP. She specialises in corporate and business taxation, both domestic and international. She acts for a wide variety of clients across a broad spectrum of the firm's sectors, including advising a number of franchising clients on their international structures from both a direct and indirect tax perspective. Zoe joined Bird & Bird in January 2016 from another large international law firm, and has spent time on secondment with two international banks.

ECKHARD FLOHR

LADM Lawyers

Eckhard Flohr is of counsel and was one of the heads of the franchise department of LADM Lawyers, supervising the offices in Düsseldorf (Germany) and Kitzbühel (Austria) until December 2017. His practice focuses on the national and international aspects of franchising, licensing and distribution, and trade agency contracts.

Prof Dr Flohr was admitted to the German Bar in 1976 and as a certified specialist in tax law in 1978. He was one of the founder members of the legal committee of the German Franchise Association and an Association member for more than 22 years. He was also a member of the Austrian and Swiss Franchise Associations and the European Franchise Lawyers' Association, as well as the Canadian-German, Swiss-German and Austrian-German Lawyers' Associations. He has been retained by the German federal Ministry of Labour and Economy as an expert on franchising. Prof Dr Flohr is currently an 'honour member' of the Bulgarian and German Franchise Associations.

Prof Dr Flohr has spoken and written extensively in German and English on franchising, including in books such as *Der Franchise-Vertrag*, *Franchise-Recht*, *Masterfranchisevertrag*, *Handbuch des Vertriebsrechts*, *Formularbuch Vertragsrecht*, *Handbuch*

der EU-Gruppenfreistellungsverordnungen und Kommentar Vertriebsrecht. He is also counsel to a number of German, Austrian and international franchisors, start-up businesses and manufacturers.

Prof Dr Flohr has been a lecturer in company, distribution and private law at universities since 1992 and is a lecturer in international economic law at the Munich University of Applied Sciences. He was appointed to an honorary professorship at the Dortmund University of Applied Sciences in 2006. He is also a lecturer in national and international franchising law at Chemnitz University and in franchise and EU cartel law at the University of St Gallen in Switzerland. He speaks English and German.

WESLEY GANGI

Nixon Peabody LLP

Wes Gangi is a member of the corporate practice group and franchise team at Nixon Peabody. His practice focuses on counselling public and private companies in connection with mergers, divestitures, strategic and financial acquisitions and other corporate transactions, as well as representing franchisors in drafting franchise agreements, franchise disclosure documents to be filed with US and international regulatory agencies, and other documents at the heart of the franchise relationship. Wes has experience representing franchisors of varying sizes in complying with the wide array of disclosure requirements imposed upon franchisors at the federal, state and international levels.

MICHAEL GASSNER

Bird & Bird LLP

Michael Gaßner works as a counsel for Bird & Bird LLP (Munich Office). He is focused on advising clients on all questions of distribution-related commercial law, especially agency and franchise law, as well as corporate law. His work includes drafting and negotiating agreements as well as representing clients before the German courts. Michael Gaßner is admitted to the Bar in Germany.

STEWART GERMANN

Stewart Germann Law Office

Stewart Germann founded Stewart Germann Law Office (SGL) in 1993 as a boutique law firm at Auckland, New Zealand, specialising in franchising, licensing and business law.

Stewart Germann has over 35 years' experience in franchising law and acts for franchisors in New Zealand, Australia, the United States and the United Kingdom. SGL also acts for franchisees and provides legal advice. Stewart has spoken at franchising conferences in New Zealand, Australia, Italy and the United States, and he was on the board of the Supplier Forum of the International Franchise Association (IFA) for six years until March 2007.

Stewart has extensive franchising contacts worldwide and locally. He is actively involved in international franchising and has written many articles that have been published overseas, including in the *International Journal of Franchising Law*. Stewart is included in *Who's Who Legal: Franchise 2018*.

Stewart is a past chairman of the Franchise Association of New Zealand (FANZ) and wrote the original Franchising Code of Practice for the FANZ. He has also written many

published articles on franchising. In October 2018, Stewart received an award from the Franchise Council of Australia in recognition of his outstanding contribution to franchising for over 30 years. Stewart graduated as a Certified Franchise Executive and was presented with his CFE certificate and pin at the FCA conference at Gold Coast in October 2019, and he is the first person in New Zealand to gain CFE accreditation.

JONATHAN GOLDSWORTHY

Bird & Bird LLP

Jonathan Goldsworthy is a senior associate in Bird & Bird's international HR services group based in London, specialising in employment law and business immigration law, and advising clients on the full spectrum of HR and global mobility issues.

Mr Goldsworthy has a diverse practice, supporting a broad range of clients, many of which are household names in a variety of sectors, including retail and consumer, media and entertainment, sports, technology and communications, and financial services.

Mr Goldsworthy's employment experience includes international restructurings, prevention of misuse of confidential information, protection of trade secrets, restrictive covenant disputes, TUPE and outsourcings and Employment Tribunal litigation for a wide variety of claims. Mr Goldsworthy is also recognised as a leading business immigration lawyer and advises on the full range of issues under the UK points-based system, immigration warranties, audits and compliance and tribunal litigation. He regularly combines his employment and immigration expertise to support on end-to-end global mobility mandates.

Mr Goldsworthy has participated in panel discussions and lectured extensively on employment law, business immigration and Brexit. He has also written for and been quoted in the UK national press and industry publications. He is a member of the Employment Lawyers Association and the Immigration Law Practitioners' Association.

NICK GREEN

Bird & Bird LLP

Nick Green is an associate in the commercial group, based in London.

He advises on a range of commercial contracts focusing on the food and beverage, retail and technology sectors. Nick has worked with UK and international clients on a wide range of commercial areas, with a particular focus on franchising, distribution and agency agreements and other hybrid growth strategies. He regularly works with lawyers in other jurisdictions to ensure agreements and structures comply with local regulations.

Nick's recent project experience includes working as part of a team providing drafting and strategic legal support to a major US restaurant brand on the sale of its UK franchise business, and advising a multinational workspace provider on its international strategy and in-country arrangements.

Nick has published articles in the *International Journal of Franchising Law* and authored chapters in *The Franchise Law Review* on Africa and Kazakhstan.

NIPUN GUPTA

Bird & Bird LLP

Currently, as co-head of Bird & Bird's India strategy group, Nipun Gupta advises the firm on its international strategy. She is a regular speaker in India and in the United Kingdom on M&A matters facing companies investing in emerging markets.

Ms Gupta qualified as a solicitor in England and advised international clients on both inbound and outbound mergers and acquisitions and disposals, with a particular focus on emerging markets. She was previously a partner at White & Case (where she was recognised as being 'a driving force behind the India practice', *Chambers Global*, 2005/6) and was also the global head of legal at Ispat International (now rebranded ArcelorMittal), the world's largest steel manufacturing group.

Ms Gupta was named in *The Lawyer's* Hot 100 in the United Kingdom 2001, she was profiled in *The Lawyer* as general counsel of Ispat, LNM Group (November 2000) and she received the prestigious National Law Day award from the Indian prime minister in recognition of her outstanding contributions in the field of law and to acknowledge her as a 'role model for women lawyers in India and abroad' in 2006.

VICTORIA HOBBS

Bird & Bird LLP

Victoria Hobbs is a partner in the international dispute resolution group at Bird & Bird LLP, based in London. She advises companies who have expanded (whether domestically or globally) via multichannel strategies, including franchising, licensing, distribution and agency relationships on all stages of the dispute avoidance and resolution process. She works with clients on pre-contractual disclosure documents and audits of recruitment materials (to minimise the exposure to misrepresentation and breach of contract claims), termination rights, managing franchisee or licensee performance issues, and strategies to avoid escalation of network-wide franchisee or licensee unrest, as well as general dispute-avoidance strategy advice. She also has extensive experience of mediation and enforcing post-termination obligations and restrictions through injunctive relief, litigation and arbitration.

In addition to her significant expertise in UK disputes, Ms Hobbs also regularly advises clients on disputes arising out of global multichannel expansion programmes and has managed such disputes throughout the EU, Middle East, India, China and South America.

She also has experience of both bringing and defending franchisee class actions and has successfully represented large groups of franchisees to renegotiate their franchise agreements, obtain damages and free themselves from contractual restrictions.

Ms Hobbs is rated as a leading franchise lawyer in the *Chambers and Partners*, *Who's Who Legal: Franchise* and *Best Lawyers* directories.

She is a regular contributor to industry publications such as *Franchise World*, *Franchising Business & Law Alert*, *International Journal of Franchise Law* and *Business Franchise Magazine*, and regularly speaks at trade events and seminars.

BEN HUGHES

Bird & Bird LLP

Ben Hughes is a senior associate in Bird & Bird LLP's commercial group, based in London, who draws on his experience of working as a non-lawyer in managing the production of websites and online software development projects. He writes about and advises clients on the legal issues relating to e-commerce as well as high-profile multi-sourcing ICT projects, including in the retail, banking, financial services and public sectors.

JIN WOO HWANG

Yoon & Yang LLC

Jin Woo Hwang is a partner in the antitrust practice group at Yoon & Yang LLC. His antitrust expertise covers all areas of the field, including cartels, abuse of dominance, unfair trade practices, business combinations, franchise law and subcontracting law. In addition, he has expanded his practice into antitrust issues in the media, communications, medical and pharmaceutical sectors. Further, Hwang provides major Korean and international companies with legal service for legal risk management. He obtained his BA in economics from Yonsei University and an LLM from Northwestern University Pritzker School of Law. He was a visiting jurist at UCLA School of Law and worked at Steptoe & Johnson LLP in Century City, Los Angeles.

JIRI JAEGER

Bird & Bird LLP

Dr Jiri Jaeger is a partner in Bird & Bird's Düsseldorf office. He is the head of the German dispute resolution group and member of the international commercial and dispute resolution practice groups.

Jiri advises on a wide range of commercial contracts focusing on the life sciences, retail and fashion sectors.

He has particular expertise in all aspects of franchising and general commercial contracts, including drafting and negotiating franchising, licensing and distribution agreements and other hybrid growth strategies.

Jiri's practice also focuses on contentious commercial litigation. He conducts complex litigation and arbitration proceedings in a national and international context. This includes post-M&A litigation, joint ventures and sales structures, as well as licensing agreements.

JASON SANGO JEON

Yoon & Yang LLC

Jason Sangoh Jeon is a partner at Yoon & Yang LLC and his practice focuses on antitrust and fair trade laws (including subcontracting law and franchise business law, etc.), international contracts, corporate consulting services and international litigation. He specialises in advising on Korea Fair Trade Commission investigations regarding various cartel cases, unfair trade practice cases, subcontracting law and franchise business law. His experience covers claims for damages for violation of antitrust law and administrative litigation against dispositions of the Korea Fair Trade Commission. He also has represented foreign companies in their

international lawsuits, domestic and overseas companies in international contracts and general corporate matters, and various franchise headquarters regarding litigation and legal matters. He has provided compliance training for major domestic and foreign companies.

PAUL JONES

Jones & Co

Paul Jones's practice is broadly focused on the national and international distribution of goods and services. Paul helps clients develop franchise systems and licensing and distribution programmes, including preparation of disclosure documents and agreements, and he negotiates disputes. He assists many foreign businesses expanding into Canada and internationally. He regularly advises on national and multi-jurisdictional trademark applications and disputes, including counterfeiting matters, and on copyright protection issues. Paul has developed significant expertise in marketing and pricing practices and advises clients on the interaction between intellectual property and competition law.

Paul is familiar with both common law and civil law systems. In addition to his Canadian law expertise, Paul is internationally known for his expertise in Chinese franchising, intellectual property and competition law.

FARID KANI

Atieh Associates Law Firm

Farid Kani is a partner at Atieh Associates Law firm. He is a licensed attorney admitted to the Iranian Central Bar Association. Farid has an LLB from Allameh Tabataba'i University and an LLM in international trade law from Queen Mary University of London. He holds a separate LLM in international commercial law from Shahid Beheshti University and an LLM in public international law from the University of Tehran. His main areas of practice include corporate transactions, the automotive sector, logistics, transportation, labour, pharmaceuticals and franchising. Farid has also been recognised as a leading lawyer by international publications such as *IFLR1000*, and he is fluent in Farsi and English.

EDUARDO KLEINBERG

Basham, Ringe y Correa, SC

Eduardo Kleinberg has been a partner at Basham, Ringe y Correa, SC since 2003. His practice focuses on matters related to intellectual property and franchising. Eduardo has been practising law in the field of intellectual property since 1993 and he has been a managing partner at Basham, Ringe y Correa, SC since 2014. He is head of the firm's trademark and licensing practices and has extensive experience in domestic and international matters, including in advising clients in IP matters in general; negotiating and drafting licence, franchise, copyright and confidentiality contracts; filing and prosecuting trademarks and patents before the Mexican Institute of Industrial Property (IMPI); filing copyrights with the National Copyright Institute (INDAUTOR); due diligence in IP matters; classifying and registering product and service trademarks for Mexican and leading foreign companies; registering trademarks in South and Central America, Europe, Asia and the United States,

working with local counsel in each of those regions; counselling Mexican and international clients in intellectual property-related e-commerce issues; and registering and cancellation of domain names.

Eduardo is president of the Intellectual Property Commission of the Confederation of Industrial Chambers of Mexico (CONCAMIN), and is designated by CONCAMIN as the representative of the Mexican private sector with respect to the intellectual property chapter of the Trans-Pacific Partnership Agreement (TPP). Among other positions he has held, he is a past president of the Mexican Association for the Protection of Intellectual Property (AMPPI); of the Mexican chapter of the International Association for the Protection of Intellectual Property (AIPPI); and of the Copyright Committee of the International Chamber of Commerce Mexico. He is a member of the Association of European Trade Mark Owners (MARQUES), the Mexican Franchise Association and the International Franchise Association (IFA).

Eduardo is ranked in the principal legal directories, including *The Legal 500*, *Chambers* and *Who's Who Legal*, and by the International Legal Alliance Summit. He is the contributor in charge of the Mexican chapter in *International Licensing* published for the Center for International Legal Studies in Salzburg, Austria by BNA International Inc.

Eduardo graduated from the Ibero-American University and has a master's degree from the University of Chicago. He speaks Spanish and English.

MARKUS KÖRNER

Bird & Bird LLP

Markus Körner is a partner at Bird & Bird LLP (Munich office). His main focus is intellectual property, copyright and unfair competition law, in particular in contentious matters. He advises clients on IP and advertising strategies and coordinates international projects and proceedings. Markus Körner is admitted to the Bar in Germany.

BETTINA KÖVECSES

Siegler Bird & Bird Ügyvédi Iroda

Bettina Kövecses is a senior associate working in the IP and corporate teams in Bird & Bird's Budapest office.

She uses her in-depth experience to give advice in various fields of IP law, but predominantly in trademark and design prosecution and enforcement matters, at national, European and international level. She advises a wide spectrum of clients, predominantly in the pharma and FMCG sectors, from multinationals to smaller labels and design or architectural companies. She specialises in IP law and copyright and additional legal areas with relevance for IP-heavy businesses in their day-to-day operations, such as branding, licensing, know-how and trade secrets protection, and including strategic or investment transfers of IP rights. She is actively involved in the effects of the EU's Digital Single Market strategy and regularly holds seminars and events on 'geo-blocking' and social media marketing topics.

Dr Kövecses graduated from the Eötvös Loránd University faculty of law in Budapest in 2010. Before commencing university, she studied English in Auckland, New Zealand for two years. In 2008/2009, she also participated in a scholarship programme at the Saarland University in Saarbrücken, Germany; at the Europa-Institut, the university's postgraduate and master's studies institution, she studied, among other topics, EU and German civil law.

She also holds a postgraduate certificate in intellectual property law from the Hungarian Intellectual Property Office. A member of the Hungarian Trademark Association, the Hungarian Association for the Protection of Industrial Property and Copyright, the Licensing Executives Society International (LESI), the Licensing Executives Society Hungary group (LES Hungary) and the Budapest Bar, Dr Kövecses speaks Hungarian, English and German.

LEE LIN LI

Tay & Partners

Lee Lin Li is a partner at Tay & Partners, where she is the head of the intellectual property and technology department. She handles contentious matters involving patent, trademark, copyright and industrial design infringement, and passing off, including seizure and anti-counterfeiting actions, and notably provides strategic advice on settlement negotiations. She also advises on domain name registration issues and disputes. Ms Lee regularly advises clients on cross-border transactions involving licensing, technology transfer, assignment and franchising as a model for business expansion. She also advises on applications to register foreign and local franchises. A major part of her practice consists of advising and working closely with local and international clients on the management, protection and commercialisation of their IP portfolio in various sectors. She regularly speaks at seminars and workshops on intellectual property, franchising and personal data protection. Ms Lee read law at the University of Leeds and was admitted as an advocate and solicitor of the High Court of Malaya in 2001.

HANK LEUNG

Bird & Bird

Hank Leung is a partner in the intellectual property practice based in Hong Kong. He has more than 13 years of experience in working on intellectual property matters, covering brand management, copyright and franchise matters in the Asian region.

KATYA LOGUNOV (STEPANISHCHEVA)

Jones & Co

Katya Logunov (Stepanishcheva) is an international business lawyer experienced in both civil law and common law systems. Katya's practice is focused on franchising law, intellectual property licensing and corporate commercial law. Katya holds a master's degree in international business law from Osgoode Hall Law School (Toronto, Canada) and a law degree from the Moscow State University (Russia). Prior to joining Jones & Co, Katya practised corporate law and mergers and acquisitions with Moscow offices of major international law firms.

FRANCESCA LONGSWORTH

Bird & Bird LLP

Francesca Longworth is an associate in Bird & Bird LLP's commercial group, based in London. She advises clients on a range of technology-focused contracts, with a particular interest in the retail and travel spaces, drawing on her in-house secondment experience with a global jewellery brand.

KERI MCWILLIAMS

Nixon Peabody LLP

Keri McWilliams is a co-leader of Nixon Peabody's franchise team. She represents franchisors across numerous industries, including restaurants, retailers, education providers and health and fitness concepts. She provides strategic counselling on expansion and growth, and domestic and international sales and compliance. Keri was selected by her peers for inclusion in *The Best Lawyers in America 2020* in the field of franchise law and has been named in *Who's Who Legal* as being among the world's leading franchise lawyers. Keri is a leader in the franchise industry, serving as an associate editor of *The Franchise Lawyer* since 2015. She is also a regular writer and presenter on franchise law topics; she was a co-presenter of the judicial update at the 2019 International Franchise Association Legal Symposium, and co-authored chapters in the ABA's 2019 publication *Franchise Desk Book* (3rd edn) and the ABA's 2017 publication *Exemptions and Exclusions under Federal and State Franchise Registration and Disclosure Laws*.

SERGEY MEDVEDEV

Gorodissky & Partners

Sergey Medvedev, PhD, LL.M. is a partner working in the Moscow office of the law firm Gorodissky & Partners (Russia). He specialises in various legal issues related to legal protection, ownership, acquisition, exploitation, licensing, franchising, litigation and enforcement of IP and IT rights in Russia and CIS.

Sergey deals with various types of IP and IT matters, including copyrights and related rights, software and databases, patents and designs, trademarks, brands and domain names. He also deals with know-how and confidential information, as well as privacy and data protection.

Sergey provides legal support to clients in connection with various transactions related to disposal and conveyance of IP and IT assets. He is regularly in charge of developing, reviewing, negotiating, registering and perfecting assignment deeds, licence agreements, franchise contracts, security agreements and other contractual arrangements. Sergey is also involved in heavyweight M&A, joint venture and investment projects, master development and franchise transactions, IP and IT legal due diligence and IP and IT transfer processes.

Sergey litigates IP and IT rights and combats unlawful or unauthorised use of IP and IT as well as illegal content on the internet, unfair competition and false advertising. He also tackles parallel imports and grey market goods, and fights against counterfeit goods and piracy. He represents the interests of clients in the courts and before law enforcement

agencies on a variety of IP and IT infringement matters. Sergey participates in extra-judicial and judicial dispute resolution actions, civil and litigation procedures, and administrative and criminal proceedings.

Sergey frequently delivers speeches at national and international seminars and conferences. He is the author of a number of articles and works, including on franchising, published by the leading Russian and international publishing houses.

Sergey is a registered member of EuroFranchise Lawyers (EFL), the Licensing Executives Society International (LESI) and the International Distribution Institute (IDI), and an official attendee of the International Franchise Association (IFA). He is also a member of the board of the Russian Franchise Association. Sergey is a registered trademark, design and software attorney in Russia.

RAPHAËL MELLERIO

Aramis

Raphaël Mellerio is one of the founding partners of Aramis, which was established in 2006. He formerly worked for the firm Clifford Chance in London and Paris, where he spent 10 years and became counsel in 2003.

Mr Mellerio is the partner in charge of the corporate and mergers and acquisitions practice at Aramis. His main activities relate to mergers and acquisitions, restructurings and joint ventures. He also represents companies on a regular basis in the setting up of complex agreements in the field of franchising and industrial transactions. He also deals with certain issues of economic law and international commercial law.

In the field of franchising, Mr Mellerio regularly assists French and foreign franchisors in the areas of retail distribution, restaurants and services, and he is a regular contributor to various legal publications on the subject. He is also a member of the IBA International Franchising Committee.

STEFAN MÜNCH

Bird & Bird LLP

Stefan Münch is a partner at Bird & Bird LLP (Munich office). His main focus is corporate and M&A law. He also advises clients on related commercial aspects, including distribution, franchise and agency agreements. Stefan Münch is admitted to the Bar in Germany.

MELISSA MURRAY

Bird & Bird (MEA) LLP

Melissa Murray is the head of the intellectual property group for Bird & Bird's Middle East offices and a partner in the firm's international commercial group. She has practised in the UAE for over 14 years and is ranked in *Chambers and Partners*, *The Legal 500* and *Who's Who Legal* for her commercial and intellectual property experience.

She advises the firm's clients on intellectual property, commercial, corporate and general litigation matters relating to their operations in the UAE and the wider Middle East region. This covers matters such as IT, IP, trademark protection, franchising and commercial licensing of intellectual property, media, healthcare, consumer protection and regulatory

issues. She particularly specialises in franchising, distribution and supply agreements, having acted for some of the world largest brands when licensing their intellectual property in the Middle East.

Melissa's professional memberships include INTA and the American Bar Association, as well as a number of UAE, UK, US and Australian business associations. She is also a member of the International Franchising Committee of the International Bar Association. She also regularly writes chapters for legal text books such as *The Franchise Law Review*, *The Life Sciences Law Review*, the *Franchise Law Journal*, the IBA's newsletters, and Middle East journals, and she is regularly invited to speak at events throughout the GCC.

SHELLEY NADLER

Bird & Bird LLP

Shelley Nadler is a member of Bird & Bird's franchising, licensing and multichannel strategies team based in London.

She is a specialist franchise lawyer with over 20 years' experience in advising on all aspects of franchising.

Shelley is retained as counsel for a number of household names in the retail and food and beverage sectors.

She also advises a wide variety of businesses in the leisure and services sectors including start-ups and established brands looking at multi-country expansion strategies. Shelley's particular expertise is in the structuring and development of franchise networks in the United Kingdom and new markets including India, the Middle East, the Far East, South East Asia, Russia and South America.

In addition, Shelley advises on multichannel expansion strategies, intellectual property ownership, protection and exploitation structures and general commercial contracts including agency, distribution, wholesale, supply, confidentiality and know-how agreements, together with domestic and international terms and conditions of sale.

The author of many articles for the franchise trade press, Shelley also writes a monthly 'ask the experts' column in *Making Money* magazine. She has spoken at a number of national and international franchise and licensing seminars and British Franchise Association conferences and workshops. Recently Shelley spoke on franchising in the United Kingdom for a webinar for the Franchise Association of India. Shelley is recognised as an expert in franchising in the *Legal Business Guide to Legal Experts*.

Shelley co-wrote the UK section of *The International Encyclopaedia of Franchising* published by Kluwer.

JACOB ØRSKOV RASMUSSEN

Plesner Law Firm

Jacob Ørskov Rasmussen is head of Plesner's corporate, commercial and international trade practice group, including the commercial contracts, franchise and automotive teams, and he has years of experience in advising Danish and international clients on contractual relationships, both nationally and internationally.

Jacob has acquired in-depth knowledge of and experience in a broad spectrum of commercial contract types, including sales and distribution agreements, agency agreements, franchise agreements, logistics and warehousing agreements, facility management agreements and supply agreements, as well as purchasing agreements.

Jacob has extensive experience in franchising, including comprehensive experience in the drafting and negotiation of franchise agreements, Danish and EU competition law related to franchising, and setting up franchise systems in Denmark. Jacob has, among other things, been involved in franchise matters concerning the following brands: Starbucks Coffee, Carl's Jr. Restaurants, KellyDeli (Sushi Daily), Joe & The Juice, Gucci, Pret A Manger, Flying Tiger Copenhagen and Berlitz.

Jacob has been designated by the International Distribution Institute (idiproject.com) as country expert regarding franchising in Denmark. He is also an expert in relation to distribution and agency law and he has years of experience in advising national, international and multinational clients within this legal field.

Jacob furthermore provides legal advice on export control and trade sanctions, contract management, compliance and legal risk management.

The automotive industry is also one of Jacob's special areas of expertise and he has in-depth knowledge of this industry. Jacob's clients include car factories and factory-owned and private car importers, as well as banks and financing companies.

Jacob is listed by *The Legal 500: EMEA* 2016 and 2017 as a 'recommended lawyer' in the commercial, corporate and M&A practice area.

In addition, Jacob is listed by *Who's Who Legal: Franchise* 2017 and the 2018 and 2019 editions as a 'leading franchise lawyer': 'Jacob Ørskov Rasmussen receives wide-ranging endorsements for his outstanding contractual practice and specialist experience in the retail sector;' 'Jacob Ørskov Rasmussen stands out as "a commercially orientated and responsive lawyer" and earns plaudits for his "impressive knowledge of franchise law and his commitment to the assignments";' and 'Jacob Ørskov Rasmussen is a go-to name in the international franchise market. His "very professional" manner is praised by peers who "highly recommend" him.'

GRAEME PAYNE

Bird & Bird LLP

Graeme Payne is a partner in Bird & Bird's global franchising, licensing and multichannel strategies team. He works closely with businesses to determine and develop the most commercially appropriate expansion models and routes to market.

Mr Payne's practice focuses on the retail, leisure, food and beverage, services and healthcare sectors. He is retained as counsel by a number of leading and up-and-coming brands in these sectors. He has particular expertise in advising businesses on the use of franchising as a tool for strategic growth and expansion.

In addition to advising on appropriate multichannel expansion strategies, he advises on intellectual property ownership, protection and exploitation structures, technology transfer licensing and general commercial contracts including agency, distribution, wholesale, supply, confidentiality and know-how agreements together with domestic and international terms and conditions of sale.

Mr Payne's clients range from individual entrepreneurs, early-stage ventures and SMEs to multinationals. He has particular experience in assisting businesses expand into new markets including India, the Middle East, the Far East, South East Asia, Russia and South America.

He has written numerous articles for *Franchise World*, and has spoken at a number of national and international franchise and retail seminars, and British Franchise Association conferences and workshops.

Mr Payne has contributed to a number of publications including 'Alternative Corporate Re-engineering: Building Businesses through Third-Party Relationships and Expansion into New Markets' (*European Lawyer*, 2011) and *International Business Transactions: Standard Forms and Documents (Franchising)* (Wolters Kluwer).

CRISTÓBAL PORZIO

Porzio, Rios, Garcia

Cristóbal Porzio joined Porzio, Rios, Garcia in 1993 and has been a partner since 2002. He was admitted to practise in 1994 after gaining his JD at the Pontifical Catholic University of Chile in 1993. His practice areas include intellectual and industrial property, distribution law and franchising, and corporate law.

He advises local and foreign clients in matters related to patents, trademarks and technology transfer. Moreover, he participates in the boards of directors of companies and acts as local counsel for foreign companies in Chile.

He is a professor at the School of Law of the Pontifical Catholic University of Chile and he is the immediate past president of the Chilean Association of Intellectual Property (ACHIPI). He is the Chilean expert for the International Distribution Institute, a member of honour of the International Association of Young Lawyers (AIJA), and a member of the Chilean Bar Association, AIPPI, AIPLA and INTA. Cristóbal Porzio is also an accredited International Distribution Institute (IDI) arbitrator and an appointed member of the IDI IDArb list of arbitrators (providing dispute resolution in the field of international distribution).

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Allan Poulter is a partner based in Bird & Bird's London office.

He has particular expertise in all aspects of international brand management, protection and enforcement with a specific focus on portfolio management, legal clearance searches, contentious registry proceedings and advising on global branding strategies. He has represented the owners of many of the most recognised and valuable international brands.

Mr Poulter has experience as a barrister, trademark attorney and solicitor, and in-house, having spent three years as a director of the world's largest branding consultancy, Interbrand.

Mr Poulter is a member and former chair of the International Trademark Association's publications committee and has written and contributed to numerous leading publications on trademark law and branding issues. He is a regular speaker at international conferences.

CLAUDIA RICCIARDI

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Claudia Ricciardi joined Bird & Bird in April 2003; she primarily focuses on intellectual property and information technology, copyright, telecommunications and advertising law.

Before joining Bird & Bird, Ms Ricciardi worked for three years in the IP department of Andersen Legal and for some months at the Studio Legale Tributario associated with Ernst & Young.

Her experience includes: advising on issues relating to trademarks and patents, drafting deeds and opinion, and in particular, advising in judicial proceedings related to trademarks and patents; drafting and review of trademark licence and transfer agreements; patent licence agreements, know-how licence agreements, domain-name transfer agreements, franchising contracts, software development and licence agreements, distribution and supply agreements, advertising agency agreements, outsourcing contracts and internet-related contracts (general conditions for access and use of websites, and lease of advertising spaces); legal advice in the course of the realisation of websites, with specific reference to the examination of the various issues connected to the supply of products and services through the web; and due diligence relating to immaterial goods (trademarks, patents, etc.).

Ms Ricciardi is a native Italian speaker and is fluent in English.

PÉTER RIPPEL-SZABÓ

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Péter Rippel-Szabó is an experienced adviser on commercial agreements, such as supplier agreements, contracts for works and services, franchising, property leases and joint ventures, as well as complex international litigation providing advice to clients in various industries, including the IT, energy, food and media sectors. Péter also advises several sports industry stakeholders on broadcasting matters; organisation of events; enforcement of rights; marketing, sponsorship, endorsement, ambassador, cooperation and player contracts; regulatory issues; e-sports; disciplinary procedures; and day-to-day operations, as well as on sports federations' own internal regulation. He is often invited to speak at national and international conferences and expert workshops on sports law. As the national expert for Hungary, he contributed to the 'Study on sports organisers' rights in the EU' and the 'Study on assessment and management and prevention of conflicts of interest in the prevention and fight against betting-related match-fixing' for the European Commission. Péter is the author of numerous articles and studies analysing the many crossovers between sport and the law. He is co-author of the textbook *Sports Law – The Civil Law of Sports*. His articles on sports law are regularly published by prestigious law journals, leading business newspapers and prominent websites. He is the lecturer for the Sport: Law and Business course at the Mathias Corvinus Collegium. According to *The Legal 500* (2016): 'Péter Rippel-Szabó is a key name for broadcasting and sports law.' Péter is an editorial board member for the Europe division of LawInSport. He graduated from the University of Pécs, having completed the LL.M. programme at the University of Erlangen–Nuremberg as a DAAD scholarship holder, where he studied German law and sports law in 2008–2009.

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Kuba Ruiz is head of the business transactions practice at Bird & Bird's Warsaw office. He has been advising clients since 2004 and has extensive experience in new technology and IT-related legal practices, transactional and commercial law, and dispute resolution, including litigation and court administrative disputes, arbitration and mediation.

He has advised on, drafted and negotiated all manner of contracts and commercial arrangements, including contracts for supply of goods or services, contracts relating to telecoms equipment, networks, agency, distribution, franchising, licensing, outsourcing, content, sponsorship, media and entertainment, IP and leasing and maintenance.

He studied law at the University of Warsaw faculty of law and administration. He also obtained a second Master of Laws degree from the Amsterdam Law School at the University of Amsterdam (specialisation: international trade law and international investment arbitration).

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Ms Divya Sharma is dual-qualified to practise in England and India. After spending over six and a half years at Bird & Bird in London, where she was part of the India group at Bird & Bird, Divya is now based in Mumbai and advises Indian and international clients on corporate, commercial, franchising, joint ventures, company law and related matters in India.

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Seung Hyeon Sung is a partner in the antitrust practice group at Yoon & Yang LLC. His main practice areas include antitrust law, such as cartel and unfair competition practices. He also handles cases related to the Fair Transactions in Subcontracting Act (technology theft) and the Act on Fair Transactions in Large Franchise and Retail Business. He has experience providing consultation, and lectures on compliance matters. After graduating from the Seoul National University School of Law, he handled competition law matters while working at Deacons (Hong Kong) in 2016. He was a member of the exam board for competition law in the 2017 Sixth National Bar Examination of Korea.

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Péter Sziládi is a junior associate in the data protection team at Bird & Bird's Budapest office. Péter has been advising clients since 2019, and specialises in IP, IT law and data protection. He assists clients with patent litigation matters, copyright issues, agreements relating to IT and data protection (GDPR) questions. Prior to joining the firm in 2019, he worked as a legal intern for an international law firm, mainly advising on GDPR matters, and for an automotive company on labour law issues. Péter graduated from the Eötvös Loránd University faculty of law in Budapest in July 2019. From 2014 to 2019, he was a member of the Bibó István College for Advanced Studies, which offers interdisciplinary education for outstanding university students. In 2017, he was an Erasmus exchange student at the faculty

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LORRAINE ANNE TAY

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Lorraine Anne Tay is the joint managing partner and head of the intellectual property group at Bird & Bird in Singapore.

Lorraine focuses primarily on non-contentious intellectual property (IP) and general IP advisory work. She works closely with numerous clients across various industries to manage and protect their portfolio of intellectual property rights, which include trademarks, patents and designs, and covering multiple jurisdictions worldwide. She is also very experienced in handling complex cross-border IP issues, as well as disputes, including oppositions and negotiations.

She also manages commercial transactions involving IP issues (such as mergers and acquisitions, licensing, franchising and the sale and purchase of intellectual property rights), and has experience in managing global due diligence and clearance exercises, negotiations and the drafting and preparation of related documentation. Aside from these areas, Lorraine also regularly advises clients on regulatory and advertising-related issues.

Lorraine actively participates on various committees with the International Trademark Association (INTA) and is consistently recognised as a leading IP lawyer by clients and top legal directories, including *The Legal 500*, *Chambers Asia-Pacific*, *Managing Intellectual Property*, *World Trademark Review* and *Expert Guides*. She regularly presents on intellectual property issues at seminars and events. Lorraine is also a registered Singapore patent agent.

KENDAL TYRE

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Kendal Tyre is a co-leader of Nixon Peabody's franchise team. With over 25 years of experience, he handles domestic and cross-border transactions, including mergers and acquisitions, joint ventures and strategic alliances. Kendal counsels companies expanding through master franchising, area development franchising, international franchising, management contracts, joint venture agreements, licensing agreements and product distribution arrangements throughout the world. Kendal has earned recognition as a 'Legal Eagle' by *Franchise Times* magazine. He has been named in *Who's Who Legal* as being among the world's leading franchise lawyers and was selected by his peers for inclusion in *The Best Lawyers in America 2020* in the field of franchise law. Kendal serves on the editorial advisory board of the *International Journal of Franchising Law* and is an author and editor of *International Franchising 2016: Legal and Business Considerations*, a 600-page publication that covers 41 countries and was a collaboration of over 60 legal practitioners across the globe, published by LexNoir Foundation.

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Alfons Umschaden is a lawyer at Umschaden Law Firm. He has a Master of Laws from the University of Graz, a Master of Business from the University of Salzburg and a Master of Business Administration. He joined the Austrian Bar Association in 2007.

Alfons Umschaden was previously an associate at Baker & McKenzie in Vienna, and at Raists Ebner Lawyers in Salzburg, and a counsellor at the Austria International Chamber of Commerce. He speaks English, German and Polish.

ELIZABETH UPTON

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Liz Upton is a legal director in the commercial group based in London. She has been practising data protection law since joining Bird & Bird in 2000. Her areas of expertise include general compliance and GDPR strategies for organisations, as well as specific matters, such as drafting policies and data processor agreements, direct marketing, individual rights and international data transfers.

JANE WANG

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Jane Wang is a partner at Formosa Transnational Attorneys at Law. Her practice includes franchising, IP litigation, data protection, licensing, antitrust matters, entertainment, and emerging technologies. Ms Wang counsels a broad range of well-known companies, both international and domestic. She represents clients in protecting and enforcing their intangible assets, such as patents, trademarks, copyrights and trade secrets. She also assists leading global brands in making investments in franchises in the food and beverage, fitness, convenience-store and fashion sectors in Taiwan. Ms Wang is more than experienced in cross-jurisdictional projects, with the Formosa team having been honoured for many years with a ranking in the IAM Patent 1000, where it featured, once again, in 2019. Ms Wang is also the only environmental law expert in Taiwan listed by *Who's Who Legal*.

JUST WANG

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Just Wang is a senior associate in the intellectual property group at Bird & Bird in Singapore.

Mr Wang has been involved in a variety of both contentious and non-contentious matters, with a focus on intellectual property litigation work across all levels of intellectual property courts in Singapore. In particular, he assisted in Singapore's first shape mark infringement trial and appeal. Mr Wang is also regularly involved in intellectual property enforcement work, with experience in anti-counterfeiting activities and private prosecutions against intellectual property infringers.

Mr Wang graduated from the National University of Singapore with an LLB (Hons.) in 2013 and was admitted as an advocate and solicitor of the Supreme Court of Singapore in 2014 after completing his training contract with the firm.

NATHAN WARECKI

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Nathan Warecki is a member of the complex commercial disputes team at Nixon Peabody. His practice focuses on defending businesses and individuals in high-exposure, complex civil litigation before state and federal courts, arbitral tribunals and regulatory agencies. Nathan has experience representing businesses and franchises operating in a variety of industries, including healthcare, transportation, personal fitness, financial services, manufacturing and commercial cleaning. Nathan's practice focuses on a number of topics important to franchisors in the United States, such as trademark infringement, trade secret misappropriation, restrictive covenant litigation, franchise relationship laws and product liability.

SVEN-MICHAEL WERNER

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Dr Sven-Michael Werner has almost 20 years' experience of practising law in China. His extensive experience includes M&A and foreign direct investment transactions, with a strong focus on advising European clients in relation to their inbound investment into China.

Dr Werner joined Bird & Bird in January 2014 as a partner in the international corporate group based in Shanghai.

He has been living and working in China since 1999 and has been based in Shanghai since 2003. During his career he has also been based in both London and Munich, with a remit to develop inbound and outbound work for the Chinese market.

In addition to his extensive experience in M&A and foreign direct investment transactions, Dr Werner also regularly advises European and US clients in the automotive, technology, media, life sciences, consumer goods, high-end retail and services sectors in relation to commercial, compliance and anti-bribery matters.

Dr Werner was admitted to practise law in Germany in March 2004, and is fluent in German and English, and proficient in Mandarin Chinese.

In October 2003 Dr Werner obtained a PhD degree (*Dr iur*) in Chinese and Hong Kong law. Prior to this, he studied law and business administration in Hamburg followed by a Master of Laws programme at the University of Hong Kong in the field of Chinese business law and international financial transactions.

ROBERT WILLIAMS

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Robert Williams is a partner and co-head of the UK intellectual property group of Bird & Bird.

He has significant experience in both contentious and non-contentious IP work, advising on the full range of issues relating to patents, copyright, trademarks, designs and trade secrets and confidential information.

Mr Williams has particular experience of complex IP disputes, advising clients from a range of IP-rich industries, including life sciences, energy and utilities, speciality chemicals, mechanical engineering and electronics on strategic IP issues, including life-cycle management.

He was a member of the teams acting for Pfizer in patent cases concerning Viagra and Lipitor, and acted for Synthon in its action against GSK concerning paroxetine mesylate, which resulted in one of the leading House of Lords judgments on the law of novelty in the United Kingdom.

VOLODYMYR YAKUBOVSKYY

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Volodymyr Yakubovskyy is a partner at Nobles. He has a trusted reputation for representing major international corporations and leading national market participants in various transactional, investment and commercial matters. He regularly advises companies on business projects with a particular focus on corporate, labour, distribution, franchising and intellectual property issues. Mr Yakubovskyy's areas of expertise include such industries as retail, e-commerce, agriculture, media, pharmaceuticals, regulated industries and financial institutions.

Mr Yakubovskyy has written a number of articles on franchising, e-commerce, and corporate and commercial matters. He is the member for Central and Eastern Europe of the editorial advisory board of the *International Journal of Franchising Law*.

Mr Yakubovskyy has an LLM in corporate and commercial law from the University of Cambridge (2010), an LLM in American and international business law from Boston University (2009) and degrees in law and international law from Lviv University (2005).

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