Chapter 12
FRANCHISING IN AFRICA

Babette Märzheuser-Wood

INTRODUCTION

Six of the world’s 10 fastest growing economies are in Africa. Oil-rich Nigeria, politically and economically stable Botswana and Ethiopia, Mozambique, Rwanda, Tanzania and Uganda all meet the IMS criteria of 5 per cent year-on-year GDP growth and 3 per cent growth in GDP per capita. Despite these growth rates, it should not be overlooked that the average income per head in most of these countries remains below $1,500 per year. These African economies are growing through stable policymaking and the absence of civil war. Botswana is a good example. Through sound management it has transformed itself from one of the poorest countries in the world to a middle-income country with a per capita GDP of $13,100 in 2010. Ethiopia relies on coffee exports. The country is in the middle of implementing a five-year ‘growth and transformation plan’ launched in 2010. In Nigeria the GDP has doubled between 2000 and 2010 and GDP per capita is now a little above $1,500. Ethiopia remains poor with a GDP per capita of $470 while Kenya’s per capita GDP has risen to $862.

African countries have an interesting mix of indigenous micro-franchises particularly in the areas of agricultural health, mobile phones, petrol and fast food and a spattering of investments by the more prominent international franchisors such as KFC, Subway and Papa Johns. South Africa is an excellent example of how franchising can be used in Africa to create jobs quickly and efficiently by helping local people set up SMEs under a franchise system. Franchising contributes a phenomenal 12 per cent to the country’s GDP, a figure that exceeds the success of franchising in Australia and the United States. There are good reasons to believe that the same success can be achieved

1 Babette Märzheuser-Wood is head of the EMEA franchise group at Dentons.
2 ‘No need to dig’, The Economist, 2 November 2013.
3 Franchising in Africa Legal and Business Consideration 2012, p. 108.
in due course in some other African countries. Many South African franchise systems are indigenous systems tailored to the needs of this large and diverse country. This is primarily due to the potential of franchising to assist with the success of small and medium-sized companies. Failure rates of franchisees are five times lower than those of independent businesses. Another good example of an African success story is African Atlantic Franchise Farming, which sells an agricultural franchise to local farmers in Ghana. This enables the farmers to benefit from cheaper supplies of seed and fertiliser. Additional training is also provided. Despite these success stories Africa remains a challenging environment for brands. It is not always possible to own a lease in a property and restrictions exist for direct investments. Repatriation of royalties can be subject to restraints and withholding taxes erode the profitability of the venture. The standards of protection for intellectual property are substantially lower than in Europe, Australia and the United States. Corruption and bureaucracy are another inhibiting factor. Yet there is an appetite for famous brands and a growing middle class urban population. Some African countries such as Morocco (with 315 brands on the market) and South Africa (where 12 per cent of the economy is attributed to franchising) are experiencing a franchise boom. As a result, franchising has become an increasingly attractive route for foreign businesses to take in Africa. In the hotel sector Africa is the new frontier with all the big brands actively chasing deals on the continent. Marriott recently bought the South African Protea hospitality portfolio thereby acquiring 116 properties on the Continent. Fast food, particularly chicken-based, concepts are popular, with KFC and Nandos present in several African countries. Overall 200 foreign franchises are reported to be active in Africa.

Countries such as Nigeria, Kenya and Zimbabwe have established franchise associations. These can assist with improving the understanding of franchising as a business method. A Pan-African Franchise Federation was founded in spring 2013. Its formation follows ongoing efforts by the World Franchise Council to establish a formal organisation for the franchise sector in Africa.\(^4\)

## II MARKET ENTRY

### i Restrictions

There are no specific restrictions for franchisors entering the African market. While land ownership and the ability to own shares in local companies can be restricted to certain percentages particularly in industries sectors of national importance, these laws do not affect franchising. On the contrary, they support it. Typically the franchisor would prefer not to have a local lease and partner instead with a local franchisee who enters into the lease. The classic franchise sectors of retail, hotels and restaurants do not fall within the scope of regulated industries. Some African countries such as Nigeria and Uganda have foreign investment laws regulating the transfer of foreign technology. This can capture franchise agreements. In Tunisia franchise agreements may require the authorisation of

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the trade ministry if they are in certain regulated sectors. However, franchising in the fashion, tourism and leisure sectors is actively encouraged and pre-authorised.

Regulated industries that are not open to foreign companies typically cover the telecommunications, insurance, banking, oil and gas and agricultural sectors. For classic retail, restaurant and leisure franchisors these restrictions should not be an obstacle.\(^5\)

ii Foreign exchange and tax

As with all emerging markets, the question of availability of hard currency should be at the forefront of franchisors' minds. Many African countries require central bank permission for foreign currency transactions. In Kenya, Uganda, Botswana, Egypt, Ghana and Zambia there are currently no restrictions in place on payment in foreign currency. Payments must, however, be made through an authorised bank.\(^6\) Foreign exchange controls exist in the Cape Verde Islands, Ethiopia, Mozambique, Nigeria, South Africa and Tunisia to name some of the most important African countries. In Nigeria the NOTAP Guidelines stipulate that royalty fees may not exceed 5 per cent of the net sales value. In South Africa the limit in retail franchising is 4 per cent. In countries such as Cape Verde, Ethiopia and Mozambique, where hard currency is scarce, various procedures ranging from applications to permissions have to be followed by franchises in order to obtain hard currency. The Bank of Mozambique controls both currency inflows and outflows and any foreign currency transaction is subject to prior authorisation. As part of the authorisation process the franchise agreement can also be scrutinised and a translation may be requested. It is well known that South African central bank approval is needed for remitting royalties abroad in foreign currency.

iii Withholding taxes

Withholding tax regimes apply in all African countries surveyed. In Kenya a withholding tax of 20 per cent is levied on the payment of technical service fees. Under the double taxation agreement between Kenya and the UK this is reduced to 15 per cent. In Uganda the withholding tax is 15 per cent on all income paid to non-residents. There is no further reduction under the double taxation treaty with the UK. In Botswana equally the withholding tax on royalties is 15 per cent. In the Cape Verde Islands it is 20 per cent on service fees and 15 per cent on royalties. In Ethiopia the withholding tax is 5 per cent for royalties and 15 per cent VAT is payable on service fee payments. In Ghana again withholding taxes range from 10 to 20 per cent. Some African countries have very few double taxation agreements such as Mozambique, which only has agreements with South Africa, Portugal, Italy, the UAE, Mauritius and Macau. In Nigeria the applicable rate of withholding tax for royalty payments is 10 per cent. There is a double taxation agreement with the United Kingdom, France, Canada, South Africa and Italy as well as with the Netherlands. South Africa has a wide range of double taxation agreements often

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\(^5\) For example, in Kenya mandatory local equity participation is required in respect of mining, maritime, aviation, insurance and telecommunications industries.

\(^6\) See Kenya chapter by Babette Märzheuser-Wood and Philip Coulson.
reducing the rate of the withholding tax to nil. Under the double taxation agreement between South Africa and the UK the withholding tax rate is reduced to zero.

Grossing-up clauses are generally enforceable in African countries. The impact of a grossing-up clause on the affordability of the franchise for the local partner should, however, be carefully considered.

III INTELLECTUAL PROPERTY

Protection of intellectual property in some African countries can be poor. Countries such as Nigeria have been described as having ‘an intellectual property free environment’. Counterfeiting and piracy is widespread, although a large number of African countries meet certain TRIPS standards for enforcement of intellectual property rights. African states that are members of the African Regional Intellectual Property Organisation (AREIPO) recognise the protection of trademarks, patents and industrial designs. While the AREIPO membership is no guarantee that IP protection reaches Western standards, it shows a commitment to the protection of intellectual property that goes beyond that of some other African states. AREIPO members are Botswana, Gambia, Ghana, Kenya, Lesotho, Liberia, Malawi, Mozambique, Namibia, Rwanda, Sierra Leone, Somalia, Sudan, Swaziland, Tanzania, Uganda, Zambia and Zimbabwe.

In competition with AREIPO the African Intellectual Property Organisation (OAPI) was formed by certain French-speaking African nations, again to enable the filing of one regional application for the protection of trademarks in all member countries. OAPI was formed in 1997 and has 16 member countries. Applications can be filed in the Central Office in Yaoundé, Cameroon. OAPI countries include Burkina Faso, Cameroon, Chad, Congo, Ivory Coast, Guinea, Mali, Niger, Senegal, Togo and the Comoros.

A growing number of African countries have specific intellectual property or trademark legislation. For example, in Botswana the Industrial Property Act allows for the registration and protection of trademarks. The Cape Verde Industrial Property Code of 20 August 2007 protects the rights of registered trademark owners as does the Egyptian Intellectual Property Rights Law, which also requires all trademark licences to be notarised and registered. Ethiopian law requires a trademark licence to be submitted to the Ethiopian Intellectual Property Office for registration as does the Mozambique Industrial Property Code of 12 April 2006. Under the Nigerian Trade Mark Act 2004 trademark licence agreements must be registered with the Nigerian Trade Mark Registry. While technically trademark registration is only necessary to convey on the licensee the right to enforce the trademark against third parties, it is often recommended to register a trademark licence between the franchisee and the franchisor to enhance the level of protection for the trademark in the country. Typically registration of a trademark licence will prove use by the franchisor and can therefore be used to proceed against pirates. In emerging markets a formal registration certificate can help with enforcing IP rights.

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and the registration of the trademark licence should be viewed strategically and not discounted as unnecessary.

i Brand protection and enforcement
Given that AREPO covers the most important African states the procedure for an AREPO application for the registration of trademarks is given below. The application for a trademark must be filed either directly at the AREPO office in Harare, Zimbabwe or via the industrial property office of a contracting state. It is possible to file an AREPO application for trademark registration claiming priority based on the Paris Convention. Applications can be filed directly by foreign applicants. However, where the applicant’s principal place of business is outside an AREPO contracting state it is mandatory to use a recognised local trademark agent. The AREPO office will examine the application for compliance with formal requirements and issue a filing date. If the application complies with the formal requirements, AREPO will notify each designated state and request that each designated state examines the application in accordance with its own national laws. Each designated state must notify the AREPO office of its findings within a prescribed period. On expiration of that period AREPO will publish the trademark for registration in all designated countries. The period for oppositions is three months from the publication date. The trademark once registered is valid for 10 years from the filing date and can be reviewed for rolling 10-year periods. The Nice Classification system is followed by AREPO and multi-class applications are possible.8

ii Data protection
The protection of personal data is in its infancy in Africa. The best protection against data theft is to keep data secure. Uganda has a Computer Misuse Act 2011 that provides sanctions against the abuse of IT Systems. Kenya is planning a Data Protection Bill but this legislative proposal has yet to be enacted into law.

IV FRANCHISE LAW

i Legislation
There are at least eight countries in Africa with a franchise law. Two countries, namely South Africa and Tunisia have expressly regulated franchising. Other countries such as Kenya, Nigeria, Uganda, Egypt and the Cape Verde Islands and Angola regulate franchising through technology transfer legislation, application of agency laws or application of consumer protection legislation.

ii Pre-contractual disclosure
Most African legal systems do not impose pre-contractual disclosure requirements on franchisors. South Africa and Tunisia are two noteworthy exemptions.

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8 See www.lysaght.co.uk and the AREPO website, www.arepo.org, for more details.
South Africa
South Africa’s Consumer Protection Act 2008 (CPA) classes the franchisee as a consumer and extends to the franchisee many of the protections provided to consumers. Providing franchisees with the right of disclosure was one of the prime objectives of the CPA in the franchise sector.\textsuperscript{9} The franchisor must disclose to the franchisee the following information:

\begin{enumerate}
\item the number of franchise outlets;
\item the franchisor’s turnover and net profit;
\item a statement confirming whether there have been any significant changes in the financial position of the franchisor;
\item a list of current franchisees; and
\item contact details of the franchisor and an organogram depicting the support system and place for the franchisee.\textsuperscript{10}
\end{enumerate}

The disclosure document must be provided 14 days before execution of the franchise agreement. In addition the franchisee is entitled to a statutory cooling off notice.

Tunisia
In Tunisia, Law No. 2009-68 dated 12 August 2009 regulates franchising. Article 15 of Law No. 69 requires the franchisor to provide to the franchisee a disclosure document. Disclosure must be made 20 days before the execution of the franchise agreement. Law No. 69 stipulates the following disclosure items:

\begin{enumerate}
\item details of the franchisor;
\item business history of the franchisor;
\item proof of trademark registration;
\item information about the franchise network including a list of franchisees in Tunisia;
\item the amount of expenses and investments specific to the use of the trademark; and
\item the financial statements of the franchisor.
\end{enumerate}

Other African countries
The new Kenyan Consumer Protection Act expressly provides that it is applicable to ‘franchisees’ but it does not create a technical disclosure requirement. Care must be taken, however, to structure the franchise so that it does not give rise to cooling off rights.

In African countries that derive their legal systems from Portuguese law (Cape Verde Islands, Angola, Mozambique) or French law (Tunisia, Algeria, Morocco) a general duty to good faith may exist that can require voluntary disclosure of key facts. However, due to the absence of any relevant case law no specific guidance is available. In former British colonies (Uganda, Ghana, Nigeria, Zambia, Botswana) the focus is on misrepresentation. This means not that active disclosure is required but that misleading information overstating profitability or success rate must be avoided.\textsuperscript{11}

\begin{footnotesize}
\begin{enumerate}
\item Taswell Papier, ‘Franchising in South Africa’ in Franchising in Africa 2012, LexNoir.
\item South Africa Regulation 3 under the Consumer Protection Act 68/2008.
\item See, for example, Section 10.1 of the Contract Act in Uganda.
\end{enumerate}
\end{footnotesize}
iii Registration

There are no classic franchise registration laws in Africa. A number of registration issues in the wider sense arise. These relate to registration of certain franchise agreements as technology transfer agreements in countries such as Uganda, Nigeria and Ethiopia and in respect of mandatory registration of trademark licences for example in Egypt. Registration may also be needed to obtain permission to purchase hard currency. For example in Mozambique the franchise agreement, under which payment is owed, must be submitted to the Bank of Mozambique for approval.13 The South African Reserve Bank equally screens franchise and licence agreements as part of the foreign payment approval process.

Nigeria

In Nigeria the National Office for Technology Acquisition and Promotion (NOTAP) deals with the registration and review of licence agreements that deal with, inter alia, use of the trademark, supply of technical expertise, supply of managerial assistance and training of personnel.14 As franchise agreements include both a trademark licence and the transfer of technical know-how or training, they must be registered with NOTAP. NOTAP will examine the agreement to ensure it does not impose certain ‘excessive’ restrictions on the franchisee;14 this includes a review of fair pricing and a review of the powers of intervention granted to the franchisor. There are 17 ‘blacklisted’ items in total including the requirement that the franchisee must submit to the jurisdiction of foreign courts.

Uganda

On the face of it, Uganda’s Investment Code Act requires all franchise agreements that involve the transfer of foreign technology to be registered. Absent registration, the agreement is void.15 However, in practice, compliance with the Investment Code Act is rare and the authorities do not strictly enforce the Act.

Ethiopia

The Investment Proclamations 2002 and 2003 of the Ethiopian Parliament regulate technology transfer agreements. A pure product retail franchise is not caught.16 Business process franchising, particularly in the service sector, may well require registration with the agency. As in Nigeria and Uganda there are restrictions imposed on the powers of the franchisor including as regards pricing and purchase ties.17

12 Diogo Xavir Da Cunha, Franchising in Mozambique 2012, LexNoir.
17 Yohannes Asseta and Biset Beyene Molla, Franchising in Ethiopia 2012, LexNoir, p. 149.
iv Mandatory clauses
Where franchise agreements are subject to registration under technology transfer laws, they may not contain certain prohibited provisions. These include certain restrictions on the use of the technology after termination (Uganda), supply of spare parts (Ethiopia) and export restrictions (Nigeria). Because some of the prohibited clauses run contrary to key principles of franchising, franchisors generally try to structure the agreements so that they fall outside the relevant legislation.

v Guarantees and protection
Given the difficulties with local enforcement that can be encountered in many African countries, it is important that franchisors seek adequate security in the form of cash deposits, letters of credit or bank guarantees.

V TAX
i Franchisor tax liabilities
The main tax liability for franchisors is withholding tax. This has been discussed in Section II.iii, supra.

ii Franchisee tax liabilities
Franchisees would be expected to pay local income and corporation taxes. VAT may also be payable on service fees.

iii Tax-efficient structures
The most important tax structuring technique for most franchisors is to remain non-resident for tax purposes. This limits the exposure to local taxes to withholding tax. Obviously, this means that a local permanent establishment in the form of a local office or training centre must be avoided.

VI IMPACT OF GENERAL LAW
Technology transfer requirements aside, franchise agreements are not very heavily regulated in Africa. Mostly, African legal systems recognise the autonomy of the contracting parties and allow them to provide, in their contractual arrangements, for such provisions as they see fit.

i Good faith
The duty of good faith can be implied, particularly in those African countries that were influenced by French, Portuguese and German legal cultures. Given the most recent decisions of even the English courts regarding the existence of an implied duty of good faith in long-term contracts such as franchise and distribution agreements, franchisors would be well advised to act reasonably and in good faith when dealing with their African franchisees.
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ii Agency model
In African countries with a common law-based legal system, agency law is not applied to franchise agreements. Some countries with a Portuguese heritage do apply commercial agency law to franchise relationships. In Angola, the Angolan contract law specifically stipulates that the provisions governing termination of agency agreements also apply to franchise agreements. In Egypt, there is a debate ongoing regarding the application of the commercial agency law to franchising. The situation is comparable to that in most of the Middle East.

iii Employment law
The franchise agreement should contain a clear provision to the effect that the relationship of franchisor and franchisee is an arm's-length commercial relationship between two businesses and not one of employer and employee.

iv Consumer protection
Generally speaking, franchisees are not treated as consumers in Africa. Consumer protection legislation that affects franchisees only exists in South Africa and in Kenya.

In Kenya the Consumer Protection Act 2012 which came into force on 14 March 2013 (CPA) defines 'consumer' to include franchisees. The CPA protects consumers including franchisees from certain unfair practices. The CPA protects franchisees against excessively one-sided contractual agreements. Terms that are 'so adverse to the consumer as to be unacceptable' can be challenged under the CPA. The CPA is a very recent law, and as such, there is no case law to provide guidance on the type of provision that may be regarded as unacceptable. It is possible that the CPA may be viewed as mandatory law in which case it will apply despite the choice of foreign law as the governing law of the franchise agreement.18 The sanctions for violation of the CPA include rescission of the agreement and damages, including punitive damages. If the agreement is rescinded, the rescission operates to terminate at the same time all related agreements such as guarantees, product supply agreements and the like.

The Kenya CPA is based on the South African Consumers Protection Act, which came into force in 2008 (the South Africa CPA). The South Africa CPA requires franchise agreements to be in writing and drafted in plain, understandable language. The term 'franchise agreement' is defined widely. It covers the traditional concept of franchising as well as certain licensing and distribution agreements. Under the South Africa CPA franchise agreements must include certain mandatory minimum content listed in the law. Franchisees can launch complaints against non-compliant franchisors with the National Consumer Commission or take action in the High Court. Fines of up to 10 per cent of the annual turnover of the franchisor can be imposed. The South Africa CPA also seeks to protect franchisees against unfair contract terms in franchise agreements. Unusually, the South African CPA introduces a right of the franchisee to select suppliers which limits the ability of the franchisor to impose a purchase tie. An exemption is available for branded goods of the franchisor. In all cases benefits received

18 See Appendix I on Kenya.
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by the franchisor from suppliers such as kickback payments or marketing contributions must be fully disclosed. Further, all goods supplied by the franchisor to the franchisee must be reasonably fit for purpose and of good quality. Other important provisions affecting franchising include a restriction on unreasonable fees and the restriction of provisions which are not reasonably necessary for the protection of the business interest of the franchisor. The South Africa CPA regulates in some detail the advertising fund and imposes a number of restrictions on how monies contributed by franchisees may be spent.

Elsewhere in Africa the African Consumer Protection Dialogue works to assist African countries with the creation of consumer protection initiatives. This includes a legal framework toolkit. Participating countries include Egypt, Morocco, Uganda, Tanzania, Ghana, Nigeria and South Africa, to name a few. Initiatives by the United Nations are also on the way to improve competition and consumer protection law in Africa.

v Restrictive covenants

In most African countries, with a few exceptions, restrictive covenants can be enforced against the franchisee. As is the case in Europe, the restrictions need to be reasonable in order to be enforceable.

In South Africa, enforcement is judged on a case-by-case basis. The franchisor needs to demonstrate that the restraint is necessary to protect a legitimate interest and the interest protected by franchisor needs to outweigh the franchisee's interest to continue working in its learned profession. Facts considered by the court include the duration and geographical scope of the restriction and whether adequate consideration has been given for the restraint. Examples of interests capable of protection by restraint of trade include typical franchisor IP rights such as trade secrets and know-how but not general business training and business systems. Overall, given these high standards, enforcement is likely to be difficult and liquidated damages provision may be a better route to creating some protection.

In Nigeria, the NOTAP Registration Rules prevent registration of a franchise agreement that prevents the franchisee from 'using complementary technology'. This would suggest that the franchisee must be free, both during and after the term, to engage in a similar business. There are no cases of enforcement of restrictive covenants in Uganda. In Kenya restrictive covenants can be declared void by the court, if the court is of the view that the restriction goes beyond what is reasonably necessary. Angola limits enforcement to a period of no more than two years and to the contractual territory and client base covered by the agreement. In Cape Verde, Mozambique and Tunisia the

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maximum permitted restriction is 12 months. In Ethiopia a restriction of up to five years is permitted. In Egypt restrictive covenants are unlikely to be enforceable.

vi Termination

In some African countries franchise, agency and technology transfer laws restrict termination.

In Angola the application of agency law requires the payment of good will compensation for loss of the client base upon termination. The Angolan courts follow the Portuguese courts and their strict application of commercial agency law to franchising.22 Interestingly, despite their Portuguese heritage the Cape Verde Islands have not followed this approach.23 In Egypt, some sources suggest that Commercial Agency Law24 applies to franchising. The Agency Law imposes a mandatory notice to cure on the franchisor and termination of franchise agreement under the Agency Law would be limited to termination for material breach.25 Termination would typically be permitted for breach of a material contractual obligation by either party.26 Elsewhere in Africa, the view prevails that termination is governed by the contractual arrangement between the parties. This suggests that specific termination events should be included in the franchise agreement in the usual way and if these termination events occur the franchisor should be free to terminate. In South Africa termination upon the occurrence of an insolvency event may be complicated by the business rescue provisions contained in the Companies Act 71 of 2008. Under these provisions the business rescue practitioner can elect whether to suspend or cancel certain contractual provisions for a period of time.

vii Competition law

The main focus of competition law in Africa is on the control of monopolies, mergers and cartels and not on the control of vertical restraints. The main functioning authority competition law in Africa is COMESA. COMESA is a trade union comprising, inter alia, Libya, Egypt, Sudan, Eritrea, Ethiopia, Uganda, Kenya, Zambia, Zimbabwe and Madagascar. It offers to Member States a wider harmonised and more competitive market.27 The focus is on the removal of trade and investment barriers between Member States with the vision of creating a fully integrated competitive and unified region in which goods, services, capital and persons can move freely.

COMESA has a competition commission that deals principally with the approval of mergers and acquisitions. The COMESA Competition Commission is responsible for 'promoting fair competition and penalising uncompetitive practices in the region'.28 The COMESA Competition Regulations that were issued in 2013 prevent various restrictive

23 João Afonso Fialho, Franchising in the Cape Verde Islands 2012, LexNoir, p. 127.
24 Law 120 of 1982.
25 Mazzeo and Maisonneuve, ABA Paper for the 32nd ABA Forum on Franchising 2009.
27 www.comesa.int.
practices. Restrictive practices are defined as 'any conduct which appreciably restrains trade between member states'. The general principles established by the COMESA regulation follow the concepts of European competition law. The current focus as regards vertical restraints is on exclusive arrangement. It is expected that COMESA will follow European case law and practice for guidance in this area.\(^{29}\) Hopefully, this will mean that franchise agreements will be considered exempt. The general guidance available suggests that restrictions which are indispensable for attaining certain legitimate business objectives will be permitted. It is thought that exclusive vertical agreements are unlikely to be prohibited in the absence of market dominance if it can be shown that there will be some technological or efficiency gain.\(^{30}\) Given its pro-competitive effect, it is hoped that franchising will not be discouraged by the new COMESA rules.

Countries such as Botswana, Kenya and Namibia also have their own local active competition agencies. Mozambique has recently enacted a competition law that prohibits, \textit{inter alia}, certain horizontal and vertical agreements and the abuse of dominance. The Botswana competition regulations came into force in October 2011 and active enforcement is now reported to be gaining momentum.

viii Anti-corruption and anti-terrorism

Corruption is a major problem in Africa. In 1999 a number of African states adopted the African Union Convention on preventing and combating corruption. The African Union has 55 members\(^{31}\) including Algeria, Angola, Botswana, Cameroon, Chad, Congo, Egypt, Eritrea, Ethiopia, Gambia, Kenya, Libya, Madagascar, Mauritania, Namibia, Nigeria, South Africa, Senegal, Somalia and Sudan. Approximately half of the Member States of the African Union have ratified the Convention. The United Nations Convention against corruption has been ratified by 140 countries. Most African countries have ratified the Convention with the exception of Chad, Sudan, South Sudan, Eritrea, Somalia and Equatorial Guinea. The UN Convention is dedicated principally to prevention with measures directed at both the public and private sectors. It further requires that countries establish criminal offences to cover a wide range of acts of corruption. Additionally, in a major breakthrough, Member States agreed on asset recovery, which is stated explicitly as a fundamental principle of the UN Convention. As a result of the above conventions, corruption and bribery is a criminal offence in most African countries but enforcement and prevention have a long way to go before making a significant impact. Several African nations were among the worst performers in the Transparency International Annual Report on Perceived Corruption. Somalia was one of three nations receiving the lowest score in the report released on 3 December 2013 by the Corruption Watchdog Group. The report rates each nation with a score of between zero and 100 with zero being the lowest score. African countries that scored 20 or below include Sudan, South Sudan,
Guinea Bissau, Equatorial Guinea, Chad and Eritrea. Only three African nations received scores of around 50, namely Botswana, Cape Verde and Ruanda.

Another significant issue for US franchisors that enter the African market is compliance with the USA Patriot Act and the necessary anti-terrorism screening that they need to undertake in respect of their franchisees. Equally UK-listed companies and other companies listed on a recognised stock exchange need to satisfy themselves that their franchisees are not in any way associated with any form of terrorism or sources funded by terrorists. The African Union has adopted a resolution in which the Union pledges to fight terrorism but the continent clearly has a long way to go. The US has tried to combat terrorism in Africa by providing counter-terrorism aid to certain targeted African countries, mainly in north-west Africa (i.e., Morocco, Algeria, Mauritania, Niger, Chad, Nigeria and Mali) but with limited success. At this point it is recommended that the focus of franchisors should be on careful due diligence regarding their local franchisee to satisfy themselves that the local franchisee has no terrorist connection and is not funded with money that represents proceeds from terroristic activities or money laundering.

ix Dispute resolution

Franchisors have two choices when it comes to the modality of dispute resolution with their African franchisees. They can opt for international arbitration before a recognised arbitration institution such as the International Chamber of Commerce (ICC), the London Court of International Arbitration (LCIA) or the American Arbitration Association (AAA) or the United Nations Conference on International Trade Law (UNCITRAL). The ICC has a number of regional branches including in Dubai and Tunisia. The other option for franchisors is to ask the franchisee to submit to the jurisdiction of a foreign court, usually the competent court in the home jurisdiction of the franchisor. Theoretically the franchisor could accept the jurisdiction of the local courts of the country where the franchisee operates, but this is rarely done given the uncertainty and lack of development of the judiciary in most African countries. The difficulty with a foreign jurisdiction clause will be local enforcement of a foreign judgment in the relevant African country. Most African countries will have a procedure for recognition and enforcement of foreign judgments but the procedure may involve a fresh examination of some of the merits of the case. Absent specific bilateral treaties, it is therefore not recommended that franchisors impose the jurisdiction of their home courts due to the difficulties with enforcement.

As a result arbitration is often the preferred method of dispute resolution for international franchisors. Many African countries are parties to the New York Convention on the Recognition and Enforcement of Arbitration Awards. In total 149 countries have ratified this Convention but some important African states are still missing namely Libya, Chad, Sudan and South Sudan, Ethiopia, Somalia, Congo, Angola, Namibia, Zimbabwe, Malawi, Sierra Leone, Guinea Bissau and Western Sahara.

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Specific advice should be sought by franchisors regarding the best approach to choice of law and jurisdiction.

As regards choice of law, the freedom of the parties to elect the law of a foreign country to govern their contract is largely recognised with some limitations. In Angola, Mozambique and Cape Verde, the parties must demonstrate that the law chosen has a meaningful connection with the contract. This suggests that a neutral law such as Swiss law or English law can only be chosen if one of the parties is based in the UK or Switzerland. In Ethiopia, the parties must opt for one of a number of permitted choices including the law of nationality of a party or the place of performance.\textsuperscript{33} In Egypt, there is a risk that the choice of a foreign law will not be valid if the franchise agreement is classed as a technology transfer agreement or agency agreement.

Public policy limitations exist nearly everywhere and can at times be interpreted widely to include any violation of any local law, for example in Nigeria.\textsuperscript{34} Any local mandatory franchise, agency or technology transfer laws are likely to take precedence.\textsuperscript{35}

\textsuperscript{33} Draft Proclamation to Provide for Federal Rules of Private International Law, Article 21-1.
\textsuperscript{34} Theo Emuwa and Bimbola Fowler-Ekar, 'Franchising in Nigeria' in Franchising in Africa 2012, LexNoir, p. 195.
\textsuperscript{35} For example, the Tunisian Franchise Law.
Appendix 1

ABOUT THE AUTHORS

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Babette heads up the EMEA franchise group at Dentons. She has more than 20 years’ experience in international franchising with a particular focus on emerging markets. Her work includes the creation and critique of franchise contracts and their customisation to local law. Babette has transactional experience in all 28 EU Member States. Babette is recognised as one of Europe’s leading experts in hotel and leisure franchising with a particular emphasis on German-speaking Europe. Babette is ranked by Chambers Global as one of the top 10 franchise specialists in the world. She is also recommended by The International Who’s Who of Franchise Lawyers, Chambers UK and Legal 500 for her franchise expertise. Babette’s research on the role of franchising in the European hospitality industry has attracted widespread media attention. Babette is the author of numerous publications on franchising. She also lectures widely on international franchise laws and her expertise is often sought by franchisors from common law countries that enter civil law jurisdictions. She is an associated editor of The Franchise Law Review. Babette is a member of the ABA Forum on Franchising, the IBA Franchise Committee and the IFA. She is dual-qualified in both Germany and the UK. She speaks English, German, French, Spanish and Russian.
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Chapter 16

CANADA

Stéphane Teasdale

I  INTRODUCTION

For over 50 years, American and other foreign franchise systems have designated Canada as a country of choice for their international expansion. Canada presents a host of advantages including language and culture as well as geographic proximity, in particular for American systems, similarity of law, a business environment that is 'franchise-friendly' as well as a legal environment often less complex than in other jurisdictions. Canada presents many other advantages such as a well-educated and skilled workforce, average disposable income on par with American consumers and the availability of affordable commercial real estate. In addition, Canada is renowned for its abundant natural resources, effective transportation infrastructure and state-of-the-art telecommunications. Finally, Canada is a vast and arguably a highly developed country where opportunities for investment are plentiful and where success stories abound.

International franchisors occupy a significant position in the Canadian franchise landscape including well-known American systems such as McDonald's, KFC and Burger King, just to name a few in the fast food restaurant industry. However, domestic franchisors, both large and small, such as Tim Hortons or Sports Experts, constitute the majority. Moreover, franchise systems in other industry sectors such as real estate brokerage services and retail have also thrived, despite the sometimes challenging economic swings. Franchising is thus a robust and growing business model in Canada.

In Canada, the franchise community is represented by the Canadian Franchise Association (CFA), which acts as the national voice of franchising in Canada. The CFA has over 600 corporate members committed to the growth, enhancement and development of franchising, and aims to work with industry members including

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governments to develop industry-made solutions, promote excellence in franchising and educate Canadians about franchising.²

II MARKET ENTRY

i Restrictions
For foreign franchisors, Canada presents no particular restrictions or barriers to carrying on business other than having to comply with Canadian legislation and, in particular, the franchise legislation enacted in five Canadian Provinces (Alberta, Ontario, New Brunswick, Prince Edward Island and Manitoba). In addition, other than the requirement to comply with applicable legislation, there are no particular restrictions regarding the granting of master franchise or development rights to local Canadian-based entities.

Non-Canadian investors commencing a new business in Canada or acquiring control over an existing Canadian business must notify Industry Canada within 30 days of the transaction. For acquisitions, certain thresholds have been established to determine whether a transaction has to be reviewed. Acquisitions below these thresholds are generally not subject to review. As for the ownership of real estate by foreign nationals, Canada has an open-door policy and thus, there are no restrictions regarding the investment in real estate save for certain circumstances, such as agricultural land.

III INTELLECTUAL PROPERTY
In Canada, trademarks and unfair competition are governed by both federal and provincial legislation, as well as common law (or civil law in the province of Quebec) to protect acquired or registered rights.

i Brand search
Prior to filing an application for the registration of a trademark, franchisors should (although they are not required to) conduct searches to determine the availability of the trademark and its possible registration. These searches involve the consultation of the records of the Canadian Intellectual Property Office (CIPO) and can easily be performed online.³ Other searches may include those in trade directories, telephone directories, corporate name directories and generally, on the internet. All of these searches, including the records of the CIPO, should not be considered definitively conclusive but they can provide a fair indication as to the registration potential of a proposed trademark.

ii Brand protection
Once searches have been conducted and a proposed trademark has been identified for registration purposes, an application must be filed with the CIPO and a trademark examiner will review the application to determine whether the proposed trademark meets

² CFA website: www.cfa.ca/About_us/.
the requirements of the Trademarks Act\(^4\) and whether it can be registered (the process may take several months), in which case the proposed trademark may be approved for publications in the Trademarks Journal. If the proposed trademark is not approved, the applicant will be advised and may amend its application or submit arguments for consideration by the examiner. Where an application is refused, the applicant may apply to the courts to contest the decision of the examiner. It should be mentioned that failure to respond to the examiner may be deemed an automatic abandonment of the application.

Once the proposed mark is published in the Trademarks Journal, within two months of such publication, any interested party may file a statement of opposition with the Registrar of Trademarks stating the grounds for opposition. If the opposition is considered to raise substantial issues for consideration, the applicant is then offered an opportunity to respond and the Registrar may then refuse the application or reject the opposition. Either party may subsequently apply to the courts to contest the decision of the Registrar.

\section*{iii Enforcement}

Pursuant to the Trademarks Act, a person not entitled to use a registered trademark who sells, distributes or advertises wares or services in association with a confusing trademark or trade name shall be deemed to be infringing upon the right of the owner of a registered trademark. The Federal Court of Canada has jurisdiction over the enforcement of the provisions of the Trademarks Act. The enforcement by the owner of a registered trademark may be made under the Trademarks Act but also under common law. The tort of ‘passing-off’ aims to prevent a party from copying not a name but the look of a particular business, which is often referred to as ‘trade dress’ or ‘get-up’. In the province of Quebec, an action in passing-off would be based on the provisions of the Civil Code of Quebec.\(^5\)

\section*{iv Data protection}

The Personal Information Protection and Electronic Documents Act (PIPEDA)\(^6\) came into force on 1 January 2001 and aims to set ground rules for the management of personal information in the private sector. It further aims to balance an individual’s right

\footnotesize
\begin{itemize}
  \item Article 1457 C.C.Q. stipulates that:
    \begin{quote}
      Every person has a duty to abide by the rules of conduct which lie upon him, according to the circumstances, usage or laws, so as not to cause injury to another. Where he is endowed with reason and fails in his duty, he is responsible for any injury he causes to another person by such fault and is liable to reparation for the injury, whether it be bodily, moral or material in nature. He is also liable, in certain cases, to reparation for injury caused to another by the act or fault of another person or by the act of things in his custody.
    \end{quote}
  \item S.C. 2000, c. 5.
\end{itemize}

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to the privacy of personal information with the need of organisations to collect, use or disclose personal information for legitimate business purposes.\textsuperscript{7}

Organisations covered by PIPEDA must obtain an individual's consent when they collect, use or disclose the individual's personal information. The individual has a right to access personal information held by an organisation and to challenge its accuracy. Personal information can only be used for the purposes for which it was collected. If an organisation wishes to use the information for another purpose, consent must be obtained again. Individuals should also be assured that their information will be protected by specific safeguards, including measures such as locked cabinets, computer passwords or encryption.

An individual may complain to the organisation in question or to the Office of the Privacy Commissioner of Canada about any alleged breaches of the law. The Commissioner may also initiate a complaint, if there are reasonable grounds. It is an offence to destroy personal information that an individual has requested, to retaliate against an employee who has complained to the Commissioner or refuses to comply with Sections 5 to 10 of PIPEDA, or to obstruct a complaint investigation or an audit by the Commissioner or her delegate.

PIPEDA does not cover the collection, use or disclosure of personal information by federal governmental organisations listed under the Privacy Act, provincial or territorial governments and their agents, an employee's name, title, business address or telephone number, an individual's collection, use or disclosure of personal information strictly for personal purposes (e.g., personal greeting card list), an organisation's collection, use or disclosure of personal information solely for journalistic, artistic or literary purposes, and finally, employee information, except in federally regulated sectors. Finally, some provinces, such as Quebec, have enacted their own legislation relating to privacy, which should also be examined.

IV FRANCHISE LAW

i Overview of legislation

In Canada, the Constitution Act 1867\textsuperscript{8} imparts exclusive jurisdiction over certain areas to the federal government or the provinces. Consequently, where trade and commerce, banking and bills of exchange, bankruptcy and insolvency, intellectual property including trademarks, patents and copyrights, and competition (antitrust), for example, are the exclusive jurisdiction of the federal government,\textsuperscript{9} property and civil rights, contracts and the administration of justice\textsuperscript{10} are the exclusive jurisdiction of the provinces. As a result, franchising falls within the jurisdiction of the provinces, although some aspects (notably trademarks and competition) will be subject to federal scrutiny.

\textsuperscript{7} Office of the Privacy Commission of Canada, \url{www.priv.gc.ca/information}.
\textsuperscript{9} Ibid., S-91.
\textsuperscript{10} Ibid., S-92.
To date, five Canadian provinces have enacted franchise legislation. They are, in chronological order: Alberta,\(^{11}\) Ontario,\(^{12}\) Prince Edward Island,\(^{13}\) New Brunswick\(^ {14}\) and Manitoba.\(^ {15}\) The main features of each of these five franchise laws are pre-sell disclosure, the duty of fair dealing, the right to associate and relationship provisions. A sixth province, British Columbia, is currently contemplating franchise legislation and the British Columbia Law Reform Commission has recommended that franchise legislation be implemented in that province. It is expected that some of the remaining Canadian common law provinces (Saskatchewan, Nova Scotia and Newfoundland and Labrador) may eventually follow suit and enact their own similar provincial legislation. As for the only civil law province, Quebec, it is unlikely that it will adopt any form of franchise legislation in the near future.

The absence of franchise legislation in the remaining five provinces that do not have legislation essentially means that franchisors are not obligated to disclose information or bear the delays of a ‘cooling-off’ period prior to executing franchise agreements. However, if a franchisor is a member of the CFA, it is subject to its Code of Ethics, where a mandatory disclosure policy requires ‘full and accurate written disclosure of all material facts’ related to its franchise at least 14 days before a ‘binding agreement relating to the award of the franchise’ is executed. In the province of Quebec, members of the Quebec Franchise Council are encouraged to disclose, in advance, to potential franchisees all material facts and important information before executing any document related to a franchise.

**ii Specific legislation**

**Ontario**

The province of Ontario enacted the Arthur Wishart Act\(^ {16}\) (the Wishart Act) in 2000 with an effective date of 31 January 2001. The Wishart Act was designed to protect the purchase of franchises in an attempt to level the playing field between franchisors and franchisees. The Wishart Act applies to all prospective franchisees wholly or partly operated in Ontario and therefore applies, for example, to a prospective franchisee located in Alberta who plans to operate in Ontario. Franchisors are required to provide a disclosure document to prospective franchisees containing all ‘material facts’ prescribed in the regulations, as well as the financial statements of the franchisor, copies of all agreements that the franchisee will be required to sign, certain mandatory statements and other information stipulated in the regulations.

In order to be subject to the Wishart Act, franchisors must fall within the definition of a ‘franchise’, which is very broad and may cover many arrangements. The key elements of the definition of a franchise are: the right to engage in a business, the
association with a franchisor’s trademarks, the exercise, by the franchisor, of significant control over or assistance in the franchisee’s business and initial or continuing payments to the franchisor. In addition, the Wishart Act imposes on each party to the franchise agreement a duty of fair dealing in its performance and enforcement.\(^\text{17}\) The duty of fair dealing includes the duty to act in good faith and in accordance with reasonable commercial standards.\(^\text{18}\) The duty may also affect the exercise of a franchisor’s discretion in the application of the provisions of a franchise agreement. Finally, the Wishart Act gives franchisees the right to sue for breach.

Another feature of the Wishart Act relates to the right to associate. A franchisee may associate with other franchisees and may form or join an organisation of franchisees.\(^\text{19}\) The Wishart Act also stipulates that a franchisor and a franchisor’s associate may not interfere with, prohibit or restrict, by contract or otherwise, a franchisee from forming or joining an organisation of franchisees or from associating with other franchisees.\(^\text{20}\) Finally, the Wishart Act stipulates that a franchisor and a franchisor associate may not, directly or indirectly, penalise, attempt to penalise or threaten to penalise a franchisee for exercising any right under this section.\(^\text{21}\)

Of particular importance to foreign franchisors wishing to expand into Canada is the fact that the provisions of the Wishart Act cannot be excluded in a franchise agreement where there is a claim under the Act. It signifies that parties to the franchise agreement cannot contract out of, or waive rights or obligations that stem from, the Wishart Act.

Under the Wishart Act, all material facts must be disclosed. Material facts include any information about the business, operations, capital or control of the franchisor or franchisor associate, or about the franchise system, that would be reasonably expected to have a significant effect on the value or the price of the franchise to be granted or the decision to acquire the franchise. Of note is the definition of the franchisor’s associate, which means a person who, directly or indirectly, controls or is controlled by the franchisor, or, is controlled by another person who also controls, directly or indirectly, the franchisor and who is directly involved in the grant of the franchise. The granting of a franchise includes being involved in reviewing or approving the grant of the franchise or by making representations to the prospective franchisee on behalf of the franchisor for the purpose of granting the franchise or offering to grant the franchisor or exercising operational control over the franchise and to whom the franchisee has a continuing financial obligation. Franchisor’s associates include parent companies, principal shareholders, employees and franchise salespersons.

All information must be set out accurately, clearly and precisely. For further information regarding all material facts to be disclosed, we refer to the Wishart Act.

\(^\text{17}\) Ibid., Section 3(1).
\(^\text{18}\) Ibid., Section 3(3).
\(^\text{19}\) Ibid., Section 4(1).
\(^\text{20}\) Ibid., Section 4(2).
\(^\text{21}\) Ibid., Section 4(3).
Regulations. Some of these facts include the business background of the franchisor, including the name, jurisdiction, history of involvement in a franchise and franchise sales, the business background of the franchisor’s principals, litigation and bankruptcy matters, leasing relationships, purchasing requirements, statutory disclosure and warning statements, the cost disclosure, including fees, deposits, construction and ongoing expenses, the financial performance and representations (although this is voluntary), financing programmes, training programmes and other assistance summaries, historic use of collective advertising fund monies, restrictions and requirements imposed by the franchise agreement, volume rebate policies, the franchisor’s rights to trademarks, licences and permits required to operate, territory descriptions and proximity policies, franchise locations and operator lists, term and renewal summary, financial statements or opening balance sheets, certificates, etc. Other material facts may include facts that are unique to the situation and are on a case-by-case basis.

In Ontario, the complete franchise disclosure document must be delivered at one time by personal delivery or by registered mail. E-mail is not yet accepted. Also, the franchise disclosure document must be delivered to the prospective franchisee not less than 14 days before the earlier of the signing of any agreement or the taking of any money. No deposits, confidentiality or other agreements can be signed in advance of such disclosure.

The Wishart Act provides for certain exemptions from having to provide a disclosure document, including the transfer by a franchisee for its own account in the absence of any franchisor involvement, the grant of a franchise to an officer or director having at least six months’ employment with the franchisor, the grant of additional franchises to the same franchisee if no material change has occurred, the sale by a trustee or a receiver and the sale of a fractional franchise (less than 20 per cent). In addition, parties are exempt from disclosing upon the renewal or extension of a franchise if no material change and no new agreement is signed.

The complete failure to disclose may give rise to a right of rescission by the franchisee within two years of signing the franchise agreement. Improper or incomplete disclosure will give rise to the franchisor’s right to rescind within 60 days following the receipt of the disclosure document if not provided in time or if a material change statement is not provided or is deficient. In any case, a claim can include a refund of monies paid, equipment and inventory purchased, as well as compensation for losses incurred. Case law pertaining to the absence of the required disclosure reveals that the absence of financial statements in a franchise disclosure documents is tantamount to the absence of disclosure and gives rise to a two-year right of rescission. Franchise disclosure documents with significant omissions have also given rise to two-year rights of rescission. Finally, if a franchisee suffers losses due to misrepresentation, it is entitled to sue for damages.

Franchise disclosure documents must be revised and updated on a constant basis in order to incorporate any material changes such as those that would reasonably be expected to have a significant adverse effect on the value or the price of the franchise

22 O Reg 581/00.
to be granted or on the decision to acquire the franchise. In the event of a material
c change, notice must be given to the prospective franchisee by way of a statement of
material change as soon as such change happens and before signing or accepting any
consideration. Obligation to give notice will extend up to the signing of a franchise
agreement.

Alberta
Alberta was actually the first Canadian province to enact franchise legislation in 1972. In
1995, a new Alberta Franchises Act was enacted. The statute requires pre-sale disclosure
by way of a mandatory disclosure document, which must be received by a prospective
franchisee at least 14 days before the prospective franchisee signs a franchise agreement.
The disclosure document must comply with regulations requiring that it contain all
material facts. The material facts to be disclosed are very similar to those contained in
the Wishart Act. The disclosure document must also contain copies of the proposed
franchise agreement, financial statements and reports and other documents required by
the regulations.

The most distinguishing feature of the Alberta Franchises Act, unlike in the other
Canadian provinces, is the residency requirement for franchisees. As a result, in order for
the Alberta Franchises Act to apply to a particular franchise, not only must the franchise
be operated in Alberta, but the franchisee must also be an Alberta resident.

Prince Edward Island
Prince Edward Island’s Franchise Act is almost identical to the Wishart Act.

New Brunswick
The province of New Brunswick enacted its Franchisees Act (the New Brunswick Act) in
2007, and it came into force in 2011. The provisions of the New Brunswick Act are
quite similar to those of the Wishart Act in Ontario. Unlike the Wishart Act, the New
Brunswick Act specifically states that a confidentiality agreement does not qualify as a
‘franchise agreement’ for the purposes of the 14-day ‘cooling-off’ period. As a result,
franchisors have the ability to execute confidentiality agreements with prospective
franchisees within this period.

Another unique and distinguishing feature of the New Brunswick Act is the
dispute resolution process. The New Brunswick Act stipulates that, in the event of a
dispute, one party may notify the other of the nature of the dispute and the desired
outcome. If such a notice is delivered, the parties must attempt to resolve the dispute
within 15 days of receiving the notice. If the parties are unable to resolve the dispute, a
notice to mediate may be delivered, and upon delivery of such notice, the parties must
follow the rules relating to mediation. The mediation regulation allows a party receiving
a notice to decline mediation by providing a notice to that effect.

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23 Ibid., note 11.
24 Ibid., note 12.
25 Ibid., note 13.
Manitoba

On 1 October 2012, Manitoba became the fifth Canadian province to enact franchise legislation under the Franchises Act as well as its accompanying regulations (the Manitoba Act). Key features of the Manitoba Act include the duty of fair dealing on all parties, the franchisee's right to associate, the franchisor's obligation to disclose and the franchisee's right to rescind the franchise agreement. These provisions are largely similar to the franchise legislation enacted in the other provinces.

However, the one distinguishing feature between the Manitoba Act and other franchise laws in other provinces involves the possibility of disclosing in parts. In this regard, careful consideration should be given to the regulations regarding disclosure in parts in order to ensure that the requirements are met. In any event, franchisees must provide a certificate containing a statement contained in Form 1 of the Disclosure Document: Regulation when delivering the portion of the disclosure document.

Another key distinguishing feature is the possibility of delivering the disclosure document in electronic form. As well, Section 5(10) of the Manitoba Act stipulates that franchisees comply with their disclosure obligations if they 'substantially comply' with them. Franchise law practitioners have suggested that a franchisor could comply with the Manitoba franchise legislation even if a disclosure document contains a technical irregularity or mistake not affecting the substance of the document. As a result, technical irregularities that franchisees in some of the other provinces have been relying upon to claim rights of rescission may not be available in Manitoba.

In addition, the Manitoba Act also provides for the electronic delivery of documents. In addition, under Section 5(14) of the Manitoba Act, a franchisor may collect the fully refundable deposit, which will not be construed as 'consideration relating to a franchise', such maximum deposit being the lesser of $100,000 or 20 per cent of the initial franchise fee charged by the franchisor. The Manitoba Act allows franchisors to continue using a franchise disclosure document across the country. Finally, the Manitoba Act, as in other jurisdictions, allows the franchisees to rescind the franchise agreement no later than 60 days after having received the disclosure document if the franchisor failed to provide same or a statement of material change within the required time. The 14-day cooling-off period also applies in Manitoba.

26 Ibid., Section 3.
27 Ibid., Section 4.
28 Ibid., Section 5.
29 Ibid., Section 6.
30 C.C.S.M. c. F156.
TAX

Withholding taxes

A foreign franchisor may decide to expand its operations in Canada by franchising from its foreign home office or by establishing a branch office in Canada to provide a local base from which to administer a Canadian system and provide services. Setting up a branch operation generally allows the franchisor to maintain direct control over selection, training and administration of its franchise system. Amounts paid by a Canadian to a non-resident as interest, dividends, rents, royalties or most any other form of income from property are subject to Canadian withholding tax. The rate is 25 per cent but may be reduced under an applicable tax treaty. However, in the case of rents and respective Canadian real property, the rate may remain at 25 per cent. Canada has eliminated withholding tax on interest payments to non-residents who deal at arm’s length with the payer, to the extent that the interest does not constitute ‘participating debt interest’, as defined in the Income Tax Act (Canada).\(^\text{32}\)

Withholding taxes will be payable in respect of income earned by a non-resident on its investments in Canadian property, whether the Canadian payer is a subsidiary or is unrelated to the non-resident receiving the payment. The taxes are levied on non-residents, but are required to be collected by the Canadian payer and remitted to the Canadian authorities. Property or investment income that would normally be subject to withholding tax, but when it is attributable to a Canadian business carried on by a non-resident directly, is generally included in the branch’s business income and is not subject to withholding tax, although the Canadian payer is required to obtain the consent of the Canada Revenue Agency not to withhold. In addition, the province of Ontario indirectly levies a 5 per cent withholding tax on management or administration fees and on rents, royalties and similar payments when paid to related non-residents, such as a parent company. Dividends and interest are not subject to this rule. Payment of withholding tax usually will allow the non-resident to claim a foreign tax credit for its own income tax purposes, although this should be confirmed by a foreign entity’s domestic tax adviser.

The tax advantages of a branch structure include the fact that there is no Canadian income tax liability if the foreign franchisor has no permanent establishment in Canada provided the income is active; if the franchisor has no permanent establishment in Canada, Canadian income tax paid should qualify as a credit in its own jurisdiction and if the franchisor is a US corporation, the first C$500,000 is not subject to Canadian income tax; if the investment is made through a subsidiary, all dividends paid to the US franchisor subject to a 5 per cent dividend tax, losses from the Canadian branch will typically reduce taxable income in the home jurisdiction and in the case of passive income, it will be subject to Canadian withholding tax; and foreign franchisors should obtain a tax credit in their home jurisdiction if Canadian tax is paid in Canada. The tax disadvantages of a branch structure include the fact that the tax is payable at the time income is earned on an accrual basis rather than when income is paid to the foreign

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\(^{32}\) R.S.C., 1985, c. 1.
jurisdiction and the risk that tax authorities will ensure that payments to the foreign franchisors are passive income subject to a flat withholding tax on gross income paid.

Foreign franchisors establishing a branch in Canada will need to register with a number of authorities, including the official corporation registry in each of the ten provinces and in the three territories in Canada where the foreign franchisor carries on business, the Canada Revenue Agency, authorities in the municipality and the province or territory where a branch carries on business, and employees of the franchisor will need to obtain Canadian work permits or visas.

Alternatively, the foreign franchisor may decide to establish a Canadian subsidiary. This structure may provide an effective shield for franchisors seeking to insulate themselves from the liability of potential losses or liabilities in Canada. Assets of the foreign franchisor may be transferred on a tax-free basis, which may be granted by way of a licence. A subsidiary may be incorporated federally or provincially. A federal corporation must maintain at least one director who is a Canadian citizen ordinarily resident in Canada and present at directors' meetings for a quorum to be formed. Some provinces and territories also have residency requirements; others do not. A special category of incorporation known as an unlimited liability corporation (ULC) is available in Nova Scotia. A shareholder of a ULC does not have limited liability and therefore will be liable for the ULC's debts and liabilities. Furthermore, a U.S.-resident shareholder will be subject to U.S. income tax on the income or losses of the ULC entitled to benefit from foreign tax credits in respect of Canadian income tax payable.

The notion of passive or active income is irrelevant in the case of a subsidiary. Income tax on net income is calculated on those rates that would be applicable if the non-resident parent carried on business in Canada (33 to 39 per cent). No branch tax is payable on the subsidiary's income. The dividends paid by the subsidiary will be subject to a withholding tax of 25 per cent (or less in case of a treaty). The Canadian tax liability of the subsidiary does not usually qualify for tax credit in a foreign jurisdiction.

Advantages of a subsidiary structure include the avoidance of the risk of withholding tax on passive income and that dividends are not taxed until paid, where any branch tax will be payable when earned. Disadvantages of the subsidiary structure include the fact that losses in the Canadian subsidiary cannot be used to reduce the parent income and home tax liability. Canadian income tax cannot usually qualify as a foreign tax credit in calculating the parent's income tax liability in its home jurisdiction and there is no withholding tax option if the income is passive.

A commonly used and effective structure is that of a Canadian subsidiary because of the advantages discussed above, the most significant of which will be to insulate the foreign franchisor from losses or liabilities in its own jurisdiction.

Franchisee tax liabilities
Canadian franchisees will be subject to Canadian taxes of all levels (i.e., federal, provincial and municipal), where applicable. In addition, payments to a branch of the foreign
franchisor or a subsidiary may be subject to the withholding taxes discussed above, as the case may be.

VI IMPACT OF GENERAL LAW

i Agency, distributor, licence and other models
Save for the franchise laws enacted in the five noted Canadian provinces, and subject to the provisions of the Trademarks Act, there are no specific agency or distributor-type laws in Canada. Consequently, the definitions of what constitutes a franchise under the different laws enacted in those provinces that have franchise legislation will determine the necessity to comply with those laws. In the event that the business model does not fit into the description of a franchise, the pre-sale disclosure and other features of the franchise laws should not apply.

ii Employment law
Inasmuch as franchisees are not considered by way of contract and in fact as employees of the franchisor but rather independent contractors operating their own businesses, Canadian employment laws, both federal and provincial, should not apply to franchisors save for their own true employees.

iii Consumer protection
Consumer protection is provincially regulated under the Constitution Act.\textsuperscript{33} Consumer protection of the various provincial laws may affect certain industries involving the sale of goods, credit, performance of service agreements with consumers, warranties, motor vehicles and a host of other areas. Though franchisees are generally subject to consumer protection legislation because they deal with the consumer directly, franchisors may also be subject to such legislation notably for vicarious liability, management of personal information or because they are involved in a relationship with the consumer. Foreign franchisors would be well advised to consult with Canadian counsel in those Provinces where they plan to carry on business to determine the impact of consumer protection laws.

iv Competition law
The federal Competition Act\textsuperscript{34} governs competition and antitrust in Canada and applies to franchisors, franchisees and suppliers. The Competition Act stipulates substantive antitrust or competition rules and frames its administration. There are no provincial competition laws in Canada, although some provinces have active consumer protection as noted above. In addition, the common law doctrine on restraint of trade may apply to private agreements that limit competition.

\textsuperscript{33} Ibid., note 8.
\textsuperscript{34} R.S.C., 1985, c. C-34.
The Competition Act is divided into various parts. Some involve criminal offences which include conspiracies that unduly lessen competition, bid rigging, price fixing, predatory pricing, price discrimination and knowingly or recklessly falsifying material or making misleading representations to the public. Imprisonment, fines and prohibition orders are some of the sanctions that may be imposed. The provisions of the Competition Act are considered to be 'reviewable practices'. They include mergers, abuse of a dominant position, refusal to deal, tied selling, market restrictions and exclusive dealing. The Competition Act also addresses deceptive marketing practices which includes misrepresentations to the public, sales above advertised prices and promotional contests. They are considered 'reviewable contracts'.

Administratively, the competition tribunal has jurisdiction over the application of the Competition Act. The Competition Bureau is responsible for the administration of the Competition Act and directs investigations of alleged breaches. The following practices addressed by the Competition Act can apply in franchising:

**Abuse of dominance**

In contrast to the United States' Sherman Antitrust Act\(^\text{35}\) where the unilateral acquisition of dominance itself may be subject to sanction, abusive dominance in Canada is a reviewable matter under the Competition Act.

**Exclusive dealing**

Exclusive dealing may arise where franchisors require their franchisees to purchase certain supplies from the franchisor or another company designated by the franchisor. The Competition Bureau may investigate the practice where it impedes entry or expansion of a supplier or product in a market or has another exclusionary effect to significantly lessen completion.

**Tied selling**

Tied selling occurs when a franchisor or another supplier requires that the purchaser acquire another product from the supplier or its nominee or refrain from purchasing certain types of products. The Competition Bureau may intervene in cases where tied selling once again impedes entry or expansion thereby significantly lessening competition.

**Market restrictions**

Market restrictions involve a franchisor or another supplier requiring that the sale of products be restricted to a defined territory or imposing a penalty if the franchisee or customer conducts business outside the territory.

**Refusal to deal**

In this case, the purchaser must be substantially affected in its business or precluded from carrying on business because it is unable to find an adequate supply of the product on usual trade terms.

Conspiracies/restraints of trade
Subsection 45.1 of the Competition Act creates a criminal offence for conspiracies, cartels and other agreements that would likely prevent or lessen competition unduly or would otherwise restrain or harm competition.

Price maintenance (and suggestive retail pricing)
It is a reviewable practice under the Competition Act for a producer or supplier, a person who extends credit or a person who has exclusive intellectual property rights, through an agreement, threat, promise or like means to attempt, directly or indirectly, to influence or discourage the reduction of the price of a product sold in Canada. Price maintenance may occur when a supplier prevents a customer from selling a product below a minimum price by means of a threat, promise or agreement. It may also occur when a supplier refuses to supply a customer or otherwise discriminates against it because of its low pricing policy.

For the Competition Act to apply, the following requirements must be met:

a. a supplier, by means of a threat, promise or agreement, influences upward, or discourages the reduction of, the prices charged or advertised by another business that is either a customer of that supplier, or a competitor;

b. a supplier refuses to supply a product to, or discriminates against, another person because of that other person's low pricing policy; and/or

c. any person, as a condition of doing business with a supplier, induces that supplier to refuse to supply a product to another person because of that other person's low pricing policy; and

d. the conduct described above has had, is having or is likely to have an adverse effect on competition in a market.

False or misleading advertising and labelling
The misleading advertising and labelling provisions enforced by the Competition Bureau prohibit making any deceptive representations for the purpose of promoting a product or business interest, and encourage the providing of sufficient information to allow consumers to make informed choices. False or misleading representations are considered to be deceptive marketing practices under the provisions of the Competition Act and contain a general prohibition against materially false or misleading representations. They also prohibit making performance representations that are not based on adequate and proper tests, misleading warranties and guarantees, false or misleading ordinary selling price representations, untrue, misleading or unauthorised use of tests and testimonials, bait and switch selling, double ticketing, and sale of a product above its advertised price. Further, the promotional contest provisions prohibit contests that do not disclose the required information.

The Competition Act provides criminal and civil regimes to address false and misleading representations. Under both regimes, the Competition Act prohibits the making, or permitting of the making, of a representation to the public, in any form whatsoever, that is false or misleading in a material respect.
v Restrictive covenants

In Canada, restrictive covenants will generally be enforced if they contain reasonable restrictions on trade and if their geographic scope and duration are reasonable. Franchisors would be well advised to be more conservative in setting out the terms of the covenants contained in their agreements or they risk court challenges. In general, in-term non-competition covenants will tend to be farther reaching and may potentially find application beyond Canadian borders except in the province of Quebec, where the geographic scope of such provisions is more often scrutinised. Post-term non-competition provisions (upon expiration or termination of the agreement) must be reasonable and the courts will take a very strict approach in enforcing them. Finally, Canadian courts will generally not rewrite a non-competition covenant to make it reasonable and therefore enforceable. This rule has become known in Canadian law as the 'blue pencil test'. The in-term and post-term non-competition covenants contained in franchise agreements created for jurisdiction outside of Canada should therefore be carefully reviewed by a knowledgeable franchise lawyer before they are used.

vi Termination

Aside from the rights of rescission set out in the various legislation found in the five provinces noted above, there are no set termination provisions or restrictions imposed on franchisors. The franchise agreement generally sets out the grounds upon which the franchisor may terminate the franchise agreement. Some of these grounds may result in immediate termination while others require giving a franchise notice and time to cure the default prior to the termination coming into effect. Unlike some jurisdictions in the United States, there are no statutory definitions in Canada of ‘good cause’ to warrant what constitutes a default or acceptable grounds for denying a renewal or transfer. In Canada, this situation would be guided by the duty of good faith and fair dealing under the various franchise laws in some of the Canadian provinces and under the Civil Code of Quebec.

vii Anti-corruption and anti-terrorism regulation

The anti-bribery provisions of the Criminal Code

Part IV of Canada’s Criminal Code (‘Cr.C.’) concerning offences against the administration of law and justice includes provisions dealing with corruption of an official. Section 121 Cr.C. makes it a crime to, directly or indirectly, give or offer to give, a loan, reward, advantage or benefit of any kind to an official in order for the latter to exercise his or her influence, act or omit to act in connection with government business. Everyone who commits an offence under Section 121 Cr.C. is guilty of an indictable offence and liable to imprisonment for a term not exceeding five years. The provisions concerning corruption, notably Section 121 Cr.C. are applicable to persons doing business with the

36 Criminal Code, R.S., 1985, c. C-46, Section 118, defines official as a person who (1) holds an office; or (2) is appointed or elected to discharge a public duty.

37 Criminal Code, R.S., 1985, c. C-46, Section 121(3).

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government of Canada and with the provincial governments and do not address the issue of foreign corrupt practices.

The implementation of the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions and the Act Respecting the Corruption of Foreign Public Officials

In contrast to the United States, which enacted the Foreign Corrupt Practices Act (FCPA) in 1977, Canada did not adopt specific anti-corruption legislation until 1999 when it enacted the Corruption of Foreign Public Officials Act (CFPOA). The CFPOA was enacted following the signing by Canada, on 17 December 1997, of the new Anti-bribery Convention negotiated under the auspices of the Organisation for Economic Co-operation and Development (OECD). Pursuant to this Convention, it is a crime for companies and individuals that do business abroad to bribe public officials in foreign countries.

The OECD Convention requires member countries to adopt within their domestic jurisdictions legislation that criminalises bribery in the international context. The OECD Convention does not impose a set of rules but rather allows member countries to adopt their own rules that must meet the stipulated standards. In particular, Article 1 of the OECD Convention provides as follows:

Each party shall take such measures as may be necessary to establish that it is a criminal offence under its law for any person intentionally to offer, promise or give any undue pecuniary or other advantage, whether directly or through intermediaries, to a foreign public official, for that official or for a third party, in order that the official act or refrain from acting in relation to the performance of official duties, in order to obtain or retain business or other improper advantage in the conduct of international business.

As a result, on 1 December 1998, the CFPOA received royal assent and came into force on 14 February 1999. The effectiveness of a national anti-corruption law requires both rigidity in its result and flexibility in its application. This was precisely what was

39 Criminal Code, R.S., 1985, c. C-46, Section 121(3).
intended by Parliament when it defined in the CFPOA the concepts of 'business',\textsuperscript{42} 'foreign public official'\textsuperscript{43} and 'foreign state'.\textsuperscript{44}

Bribing a foreign public official under the CFPOA consists in offering or agreeing to give or offer a loan, reward, advantage or benefit of any kind to a foreign public official, or to a person for the benefit of a foreign public official, in order to obtain or retain an advantage in the course of business. Pursuant to the CFPOA, a person who bribes a foreign public official is guilty of an indictable offence and liable to imprisonment for a term not exceeding five years. A 'person' in accordance with the CFPOA includes an organisation.\textsuperscript{45}

Canadian franchisors need to bear this legislation in mind when negotiating international business transactions or operating in a foreign state. It is evident that if any franchisor contravenes the provisions of the CFPOA, it could be held responsible and eventually be indicted. For example, if a Canadian franchisor decides to expand its international operations and develop a system in a foreign country and, in doing so, it provides an advantage to a foreign public official to obtain certain authorisations, said franchisor could be in violation of the CFPOA. However, it remains to be determined whether a Canadian franchisor could be held responsible for the acts of a third party who violates the provisions of the CFPOA. In this regard, it is recommended to specifically inform any party that has some kind of power of attorney or mandate from the franchisor that they are prohibited from offering or giving an advantage to any foreign public official in the course of their business. It is further recommended that companies require approval from internal counsel for all proposed payments to foreign public officials.

\textit{Anti-terrorism laws}

In 2001, after the 9/11 attacks, the Canadian Parliament enacted the \textit{Anti-Terrorism Act}\textsuperscript{46} (ATA), which brought significant amendments to the Criminal Code, the Official

\textsuperscript{42} Section 1 of the CFPOA defines business as any business, profession, trade, calling, manufacture or undertaking of any kind carried on in Canada or elsewhere for profit.

\textsuperscript{43} Section 1 of the CFPOA defines foreign public official as:
\begin{itemize}
  \item \textit{(a)} a person who holds a legislative, administrative or judicial position of a foreign state;
  \item \textit{(b)} a person who performs public duties or functions for a foreign state, including a person employed by a board, commission, corporation or other body or authority that is established to perform a duty or function on behalf of the foreign state, or is performing such a duty or function, and
  \item \textit{(c)} an official or agent of a public international organization that is formed by two or more states or governments, or by two or more such public international organizations.
\end{itemize}

\textsuperscript{44} Section 1 of the CFPOA defines 'foreign state' as a country other than Canada, and includes:
\begin{itemize}
  \item \textit{(a)} any political subdivision of that country;
  \item \textit{(b)} the government, and any department or branch, of that country or of a political subdivision of that country; and
  \item \textit{(c)} any agency of that country or of a political subdivision of that country.
\end{itemize}

\textsuperscript{45} Section 1 of the CFPOA provides that 'person' means a person as defined in Section 2 of the Criminal Code.

\textsuperscript{46} Act to amend the Criminal Code, the Official Secrets Act, the Canada Evidence Act, the Proceeds of Crime (Money Laundering) Act and other Acts, and to enact measures respecting the registration of charities in order to combat terrorism, Bill C-36 (2001).
Secrets Act, the Canada Evidence Act, the Proceeds of Crime (Money Laundering) and Terrorist Financing Act and other legislation. Section 145 of the ATA provides that, within three years following royal assent of the ATA, a comprehensive review of the provisions and operations of the ATA must be undertaken by such committee of the Senate, the House of Commons or both. Such reviews did take place by both the House of Commons and the Senate and caused amendments to be made with respect to the procedure relating to immigration security certificates.  

Of particular interest to franchise systems are the amendments to the Proceeds of Crime (Money Laundering) and Terrorist Financing Act (PCA), which was amended to expand the mandate of the Financial Transactions and Reports Analysis Center (FINTRAC). FINTRAC is an independent federal agency which receives information from a wide range of financial institutions and intermediaries such as banks, credit unions, trust and loan companies, securities dealers, brokers and agents, accountants or accounting firms, money services businesses and other institutions. It is estimated that approximately 300,000 entities are subject to the reporting requirements of the PCA. The PCA imposes obligations with respect to record keeping, identity checks, reporting of suspicious transactions and registration requirements for entities enumerated in Section 5 of the PCA. In particular, these obligations are imposed on 'money services businesses', which are persons and entities engaged in the business of foreign exchange.

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47. Bill C-3, An Act to Amend the Immigration and Refugee Protection Act (Certificate and Special Advocate) and to Make a Consequential Amendment to Another Act, was introduced in the House of Commons on 22 October 2007. Bill C-3 received Royal Assent on February 14, 2008 and was proclaimed into force on 22 February 2008.


50. Section 5 of the PCA reads as follows:

5. This Part applies to the following persons and entities:

(a) authorized foreign banks within the meaning of section 2 of the Bank Act in respect of their business in Canada, or banks to which that Act applies;

(b) cooperative credit societies, savings and credit unions and caisses populaires regulated by a provincial Act and associations regulated by the Cooperative Credit Associations Act;

(c) life companies or foreign life companies to which the Insurance Companies Act applies or life insurance companies regulated by a provincial Act;

(d) companies to which the Trust and Loan Companies Act applies;

(e) trust companies regulated by a provincial Act;

(f) loan companies regulated by a provincial Act;

(g) persons and entities authorized under provincial legislation to engage in the business of dealing in securities or any other financial instruments, or to provide portfolio management or investment advising services;

(h) persons and entities engaged in the business of foreign exchange dealing, of remitting funds or transmitting funds by any means or through any person, entity or electronic funds transfer
dealings, remitting funds or transmitting funds or issuing or redeeming money orders, travellers cheques or other similar negotiable instruments, with the exception of cheques payable to a named person or entity. The definition of a 'money services business' is broad and of particular concern to certain franchise systems. For example, businesses engaged in issuing or redeeming money orders and travellers cheques, such as hotels or convenience stores, should consider that they could be subject to the record-keeping requirements of the PCA.

In addition to the record-keeping requirements, it is provided that every person subject to the PCA must report to FINTRAC every financial transaction that occurs or that is attempted in the course of its activities and in respect of which there are reasonable grounds to suspect that (1) the transaction is related to the commission or the attempted commission of a money laundering offence; or (2) the transaction is related to the commission or the attempted commission of a terrorist activity financing offence. These penalties are applicable to officers, directors or agents of a corporation who participated in committing an offence.  

In order to avoid penalties provided under the PCA, franchisors, prior to completing transactions, must conduct proper due diligence as to the nature and control of the entities involved in these transactions. This would evidently include a verification of Canada's terrorist list (the Canadian Terrorist List). The Canadian Terrorist List identifies entities involved in terrorist activities or that are acting on behalf of such entities. It may also be useful to require certain representations and certifications from the entities involved in transactions with respect to any relation to an entity listed on the Canadian Terrorist List.

network, or of issuing or redeeming money orders, traveler's cheques or other similar negotiable instruments except for cheques payable to a named person or entity;

(i) persons and entities engaged in a business, profession or activity described in regulations made under paragraph 73(1)(a);

(j) persons and entities engaged in a business or profession described in regulations made under paragraph 73(1)(b), while carrying out the activities described in the regulations;

(k) casinos, as defined in the regulations, including those owned or controlled by Her Majesty;

(l) departments and agents of Her Majesty in right of Canada or of a Province that are engaged in the business of accepting deposit liabilities, that sell money orders to the public or that sell prescribed precious metals, while carrying out the activities described in regulations made under paragraph 73(1)(c); and

(m) for the purposes of section 7, employees of a person or entity referred to in any of paragraphs (a) to (l).


52 Proceeds of Crime (Money Laundering) and Terrorist Financing Act, (2000, c. 17), Section 78.

53 Regulations Establishing a List of Entities pursuant to Section 83.05(1) of the Criminal Code.
viii Dispute resolution

As previously mentioned, the administration of justice in Canada is a provincial jurisdiction under the legal jurisdiction of the provinces under their powers to regulate property and civil rights issues in the province. The legal systems in all Canadian provinces other than the province of Quebec are based on English common law. The Quebec legal system is based on civil law. The courts of Canada are divided into federal courts, which have limited jurisdiction to deal only with matters regulated under federal laws, and courts of each province, which are of general jurisdiction. Each province has a series of lower courts and a Superior or Supreme Court as well as a Court of Appeal. Appeals from provincial courts are heard, if appeal is granted (only in significant cases generally of national importance), by the Supreme Court of Canada, the highest court in the country, from which there is no appeal.

Most disputes tend to be addressed before the courts rather than by arbitration. Arbitration is generally perceived as costly and not necessarily more expeditious. However, it is nonetheless recognised as an effective method of dispute resolution. Mediation is also commonly used and, in certain provinces, mandatory under the various franchise acts and other legislation enacted in certain provinces. Canadian courts will generally enforce a choice of law provision contained in franchise or other agreements with the exception that provisions purporting to exclude the application of provincial franchise laws are deemed to be null.

There are no specific procedures or industry practices for franchising disputes other than those mentioned above. It should be noted that the use of jury trials in civil matters in Canada (excluding Quebec where there are no jury trials in civil matters) is very limited. Juries are possible but extremely rare. Cases involving franchise matters will generally be heard by a judge alone. A dispute is normally brought by filing a claim and, depending on the nature of the remedy sought, can take anywhere from six months to two years or more to be brought to trial. In addition, some courts have established special divisions where commercial matters can proceed on a faster track. Injunctive or other equitable remedy can generally be obtained to enforce certain provisions of franchise agreements such as a restrictive covenants or the violation of intellectual property rights, and proceed more quickly. Awards for damages in Canadian civil trials generally fall on the following categories: general direct damages, special damages, aggravated damages and punitive damages. Costs are generally awarded to the winning party and payable by the losing party, absent special circumstances. The exception to this rule lies in the province of Quebec, where costs on a solicitor-client basis can generally only be awarded in cases of abuse of the legal process or where provided in the franchise agreement.

The enforcement of foreign judgments or awards (whether from courts or as a result of arbitration decisions) are generally enforceable and special rules will apply in such cases in the various provinces. Canada is a signatory of the United Nations Convention on the Recognition and Enforcement of Foreign Arbitration awards (the New York Convention) and local courts will generally recognise foreign arbitral awards from another convention country.
VII CURRENT DEVELOPMENTS

Canada has seen two very significant franchise cases litigated before the courts in the past few years. The first involves TDL Group Corporation, which operates the Tim Hortons franchise system, one of the largest in Canada, also present in the United States and abroad. The case involved a class action claiming C$1.8 billion in damages resulting notably from system changes brought about by the franchisor. The case was ultimately dismissed on summary judgment and confirmed in appeal. Leave to the Supreme Court was denied.

In contrast, the other case involves Dunkin' Donuts, one of the largest franchisors in the world. A small group of franchisees sued the franchisor for over C$16 million based on a number of grievances including the decline of the brand in the province of Quebec. The franchisees prevailed in the Superior Court of Quebec and the case is currently under appeal before the Quebec Court of Appeal.

Finally, as previously noted, the province of British Columbia is currently examining the possibility of enacting franchise legislation in that province.
Appendix 1

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Stéphane Teasdale, chair of the international franchise and distribution law group and co-head of the commercial group in the Montréal office of Dentons, is a leading practitioner in the area of commercial law, and is renowned in Canada and abroad for his unique expertise in the area of franchising. For almost 25 years he has provided legal and strategic counsel in transactional and litigation matters dealing with corporate, commercial and business law, franchising, competition and intellectual property.

Stéphane advises prominent Canadian franchise systems expanding internationally, as well as Canadian, American and foreign franchise and distribution systems wishing to establish themselves or expand in Canada, particularly in Quebec. Stéphane also advises several Canadian networks that have opened and expanded internationally into markets in Europe, North Africa and Australia.

Actively involved in Canadian, American and international franchise associations, Stéphane is currently the vice-president and an executive committee member of the Quebec Franchise Council. He is recognised in Canada, the United States and abroad as one of the few experts in franchise law in Quebec and Canada, an honour that has been repeatedly acknowledged by The Canadian Legal Lexpert Directory, The Best Lawyers in Canada 2013, Who’s Who Legal Canada 2013 and, for many years, the Franchise Times magazine.

In both domestic and international forums, Stéphane is a frequent lecturer on franchise and distribution matters related to markets locally, nationally and internationally. He is also an author of numerous published articles.

A graduate of the University of Ottawa Faculty of Law, the Université du Québec School of Business and Queen’s School of Business, Stéphane was called to the Quebec Bar in 1988, and is a member of the Canadian, American and International Bar Associations.
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Chapter 21

GEORGIA

Mikheil Gogeshvili and Babette Märzheuser-Wood

I INTRODUCTION

The development of franchising in Georgia started in the mid-nineties, marked by the establishment of the first McDonald's restaurant in the capital, Tbilisi, which preceded the introduction of the franchise-specific regulation now found in the Georgian Civil Code, adopted in 1997.

Franchising had a new beginning a decade ago, when the local economy started to experience sustainable growth and the overall business environment began to improve. Since then, a number of international franchises have been gradually growing in all possible sectors including, food and beverage retail, hospitality etc. The influx of tourists and visitors in recent years created the necessity for an appropriate infrastructure, notably in the Black Sea resorts. As a result, international hotel brands which are currently present include Radisson, Sheraton, Holiday Inn and Marriott, with planned opening of Hilton and Kempinski.

Nearly all entrants are established United States or European brands. Unfortunately, local franchisors are virtually non-existent. At the same time, certain local brands, notably in the retail and food and beverage sectors, have grown to a point where possible expansion via franchising cannot be overruled in the foreseeable future.

Despite its small market (both in terms of the size and purchasing power of the population), Georgia offers international brands a sound business environment in general as well as the flexible, franchisor friendly laws to structure their deals. Unlike

1 Mikheil Gogeshvili is a lawyer at MKD and Babette Märzheuser-Wood is head of the EMEA franchise group at Dentons.
2 Some of these hotel brands may be operating under hotel management agreements.
mature western markets, international brands have good opportunities to expand their business in a less competitive but growing economy.

Unfortunately there are no official statistics or governmental reports keeping record of franchise-related data in the country. Likewise, the establishment of franchising associations or similar organisations are still on the agenda.

II MARKET ENTRY

i Restrictions

Foreign franchisors do not face any legal restrictions when entering the Georgian market. That includes granting master franchise or development rights to a local entity. In fact, for area development arrangements which often cover the entire south Caucasus region (Georgia, Armenia, Azerbaijan), it is advantageous to ask the franchisee to incorporate a Georgian entity as master franchisee or area developer, since Georgia provides a sound legal system with no obstacles to enforcement and may generally be regarded as a stable and neutral place from which to operate in all three countries simultaneously.4

Foreign legal and natural persons may freely participate in the equity of a Georgian company or own real property in the country.5

ii Foreign exchange and tax

A foreign investor or entity (after payment of taxes and other charges) is entitled to convert income and funds from local to the preferred currency at the market exchange rate at banks in Georgia, and repatriate the foreign currency without any limitation. The types of income and funds include any profit, dividend or assets after the sale; proceeds from use of intellectual property rights such as royalties and franchise or service fees and payments relating to contractual obligations.

Every legal and natural person within Georgia is obliged to calculate, announce, charge and make payments for goods and services exclusively in the national currency, the Georgian lari. However, payments for import-export related transactions (including payment of franchise fees) made offshore can be denominated and paid in any currency chosen by the parties. Offshore payments relating to such activities can be made directly into offshore accounts, subject to a resident entity presenting the bank with the reasons for a foreign currency transfer (e.g., referring to the existence of the franchise agreement).

There are no other reporting requirements. Both resident and non-resident legal entities are entitled to withdraw funds from their accounts and transfer an unlimited amount abroad.

It is not necessary for a foreign franchisor to establish a local presence in Georgia. In practice, most franchisors choose not to set up a local entity. Therefore, franchise fees paid to a foreign franchisor are subject to withholding tax at 10 per cent unless the applicable domestic tariff area (DTA) provides for some exemptions or favourable

4 Due to political tensions between neighbouring Armenia and Azerbaijan.
5 A temporary restriction with respect to the ownership of agricultural land by foreigners is expected to be lifted soon.
tax treatment. Favourable DTAs exist with a number of countries including France, Germany, the United Kingdom and the Netherlands.

III INTELLECTUAL PROPERTY

i Brand search

Any interested party may apply and obtain information on the trademarks registered in Georgia from the Georgian Intellectual Property Centre. Searches are also available in the online database of the Georgian Intellectual Property Centre. It is usually best to use local lawyers or patent attorneys to handle these searches and advise on potential conflicts.

ii Brand protection

The Law of Georgia on Trademarks regulates issues related to trademarks, rights of trademark owners, registration of trademarks and their transfer and license. Under this law, a trademark is defined as a sign or combination of signs (words, letters, figures, sounds, a design including shape of goods or their packaging, etc.) that may be represented graphically and is capable of distinguishing the goods, services or both of one undertaking from those of other undertakings.

Registration of the trademarks does not represent a precondition to selling a franchise in Georgia, but since the owner may avail itself of the rights and protections granted under the Georgian Trademark Law only after the trademark registration, it is recommended that the relevant trademark is registered before or shortly after conclusion of the franchise agreement. Trademark registration generally takes up to one year from the date of application, but an accelerated procedure is available against payment of an acceleration fee of US$850. Under the accelerated procedure, registration takes only 10 days provided there are no queries or registration obstacles.

Georgia uses the unique Georgian script, so registration of a transliterated mark may be considered. There is also a new requirement to display the mark in local lettering on all advertising (explained in the last section of this chapter).

Any natural or legal person may obtain an exclusive right to a trademark by registering it with the Georgian Intellectual Property Centre. The trademark holder’s exclusive right is effective as from the date of registration, and entitles the latter to enjoy exclusive rights to the trademark and prevent third parties from using the trademark in the course of trade that is:

a identical to the protected trademark and related to the same goods;
b identical to the protected trademark and with goods so similar that there is a risk of confusion, including confusion based on association;
c similar to the protected trademark, where the goods are identical or so similar that there is a risk of confusion of the trademarks, including confusion based on association;
d identical or similar to the protected trademark, and protected on account of the good reputation of the trademark in Georgia, so that the use of the trademark affords unfair advantages to third parties or damages the good reputation of the trademark or its distinguishing power.
Without first obtaining the relevant consent of the trademark holder, any third party is prohibited (1) from affixing a sign identical or similar to the trademark on packaging materials, labels, tags, etc.; and (2) from offering, placing on the market, selling, preparing for sale, importing or exporting packaging material or packaging bearing the trademark.

Trademarks may be registered with the Georgian Intellectual Property Centre, either in accordance with ordinary or accelerated proceedings. Priority is based on the application for registration. Under both proceedings, a trademark application undergoes examination as to form as well as substantive examination and is followed by the trademark's publication, its registration and issuance of the trademark certificate.

Trademarks are registered for 10 years following their registration date. Registration is renewable for consecutive 10-year terms.

iii Enforcement

In case of infringement, the trademark holder can enforce its exclusive rights under the Trademark Law against the third party through court proceedings. Injunctions are available in trademark cases. Action can also be taken against a franchisee or licensee if the infringement relates to incorrect use of the trademarks by the franchisee. For example, this would be the case if the franchisee applied the trademark to unauthorised goods or sold the products outside the territory in which the trademark may be used. The franchisee may bring an infringement action only with the consent of the trademark owner. The franchisee is, however, entitled to participate in court proceedings for infringement of the licensed trademark rights in order to secure its right to claim damages from the infringing party. This impacts on the usual trademark defence clauses found in international franchise agreements in that it would not be possible to locally enforce the proviso by which the franchisee has no right to participate in trademark proceeding except at the request of the franchisor.

iv Data protection, cybercrime, social media and e-commerce

The Georgian Law on Personal Data Protection was adopted in 2011. The law regulates issues related to management of personal data, information disclosure, modes of data processing, rights of the data processor, administrative sanctions applicable in case of violation of the statutory requirements, etc. Normally, processing of personal data is subject to express consent by the data subjects. If franchisees process personal data, statutory procedures and requirements must be complied with including obtaining consent from data subjects.

IV FRANCHISE LAW

i Legislation

The Georgian Civil Code contains a separate chapter on franchising. Franchising is defined as 'a long-term contractual relationship under which independent businesses are bilaterally bound, as far as necessary, to promote the production and marketing of goods and rendering of services by performing specific obligations'.

The statutory provisions are relatively brief. They are mostly not mandatory in nature, and can therefore be varied in different franchise agreements. They are seen
as setting minimum standards for franchise agreements, and may be modified or supplemented in individual agreements between private contracting parties. The main points covered by the law concern:

- obligations of the parties;
- duration of the contract; and
- requirements of form and content.

These are outlined below.

**Obligations of the franchisor**

The franchisor is under an obligation to license certain intellectual property rights to the franchisee. These have to be licenced in the same form in which the franchisor uses them. This covers:

- trademarks and trade names;
- samples and packaging;
- the knowhow of the franchisor regarding items such as the methods of management, production, purchase and marketing of the goods;
- other information required for promotion of sales.

The franchisor also has an obligation to protect the franchisee's operation from intervention by third persons, to develop it consistently, and to support the franchisee by sharing business skills and furnishing information and training.

**Obligations of the franchisee**

A franchisee, in turn, is obligated to pay the franchise fee. Without agreement to the contrary, the amount of the fee is calculated by taking into account the contribution made by the franchisor to the implementation of the franchise system.

The franchisee also has an obligation to actively conduct the business with due diligence, to purchase goods through the franchiser or through persons named by the franchiser and not to disclose confidential information.

The duration of the franchise contract may be freely determined by the parties, taking into consideration the requirements for marketing the given goods and services.

The law further stipulates that after expiration of the contract the parties must act fairly when competing with each other. This is generally understood to mean that the franchisee may be prohibited from competing with the franchisor within a specified area for a period of time, not to exceed one year.

Validity of a franchise contract requires that it be in written form. Further, to be valid the contract must have a certain minimum content. The contract needs to clearly set out the rights and obligations of the parties, the term, provisions on termination or extension of the contract, description of the system of the franchise and any other terms parties deem essential and appropriate.

**ii Pre-contractual disclosure**

There is a statutory duty of pre-contractual disclosure set out in the Georgian Franchise Law.
The Law provides, in general terms, that at the time of execution of the contract parties must duly inform each other about the circumstances relating to the franchise, especially the system of the franchise, and communicate the information to each other in good faith. There are no specific disclosure items detailed in the Law and there are no additional requirements relating to the format and content of disclosure, nor is there a minimum number of days stipulated that must expire before signing or payment. However, the general pre-contractual duty of disclosure is understood to impose an obligation on the franchisor to disclose to the franchisee all material facts relating to the franchise system. Failure to make full disclosure may result in claims for misrepresentation and termination of the contract.

iii Registration
There are no franchise registration laws.

iv Mandatory clauses
The provisions of the Franchise Law are considered non-mandatory and therefore may be contracted by express agreement of the parties. In the absence of an express contractual agreement between the parties with respect to a matter covered by the Law, the relevant statutory regulations will take effect and become an implied term of the contract.

Statutory provisions feature basic descriptive regulations that are considered essential for a relevant legal relationship to be considered as franchising with the meaning of the Civil Code. Effectively this means that they operate as mandatory law when the contract is silent. Accordingly, the franchisor has to ensure that the franchise agreement covers these issues, as otherwise the statutory position will be implied.

The implied provisions are:

\(a\) obligation of the franchisor to license to the franchisee intangible property rights, trademarks and trade names, concepts of management and other information required for promotion of sale;

\(b\) obligation of the franchisor to consistently develop the system and to support the franchisee by sharing business skills and furnishing information and training;

\(c\) obligation of franchisee to pay the franchise fee;

\(d\) obligation of both parties not to disclose the information confided to them, ever if the agreement is not executed; and

\(e\) requirement of the written form.

v Guarantees and protection
In terms of guaranteeing payment or other obligations of the franchisee, both guarantees (i.e., bank guarantees) and other types of securities, particularly the suretyship, may be used. Security can be given by legal or natural persons. The guarantor may be the owner of the franchisee entity, or a third party such as a high net worth individual.
V TAX

i Franchisor tax liabilities

Unless a foreign franchisor specifically establishes a corporate presence in Georgia, the conclusion of a franchise contract and the underlying activities do not create a permanent establishment for a foreign franchisor in Georgia.

When the non-resident franchisor derives income from sources in Georgia, in the form of a franchisee fee, tax is generally required to be withheld at the source. The applicable withholding tax rate is 10 per cent. The local franchisee is also obliged to apply reverse-charge VAT (VAT will be recovered or credited by the franchisee).

The Georgian taxpayer, i.e. the local franchisee, is obliged to deduct withholding tax from its payments to the non-resident franchisor.

ii Franchisee tax liabilities

Corporate income tax is charged on the profits earned by a Georgian enterprise, including a local franchisee (and foreign enterprises carrying out their activities through a permanent establishment in Georgia), at a flat rate of 15 per cent.

Dividends distributed by Georgian companies to a natural person or a foreign enterprise are subject to 5 per cent withholding tax at the source of payment, unless in the case of a non-resident a relevant tax treaty stipulates otherwise. Dividends paid to Georgian enterprises are not taxed at the source of payment.

The VAT rate is 18 per cent.

iii Tax-efficient structures

If a person otherwise subject to withholding tax (a foreign franchisor with no permanent establishment) is resident in a jurisdiction with which Georgia has concluded a double taxation treaty, the withholding tax that would otherwise apply may be reduced or eliminated pursuant to the treaty.

Georgia has signed and ratified DTAs with more than 30 countries. In each case, it should be considered whether the country of the franchisor has a DTA with Georgia that may allow for favourable tax treatment. These countries include France, Germany, the United Kingdom and the Netherlands.

VI IMPACT OF GENERAL LAW

i Good faith and guarantees

The principle of good faith is recognised by Georgian law and applies to both franchisor and franchisee. Statutory provisions referring to the principle of good faith are found in the chapter of the Civil Code regulating franchising, as well as in the general law of obligations.

The principle of good faith extends to pre-contractual relationships as well as to the manner of performance of obligations and to the dispute resolution mechanisms and rights of termination. The principle of good faith impacts on the duty of pre-contractual disclosure in that it requires the franchisor to disclose to the franchisee all material facts regarding the franchise system prior to the execution of the franchise agreement.
Georgia

Failure to disclose material facts can give the franchisee the right to claim damages or terminate the contract.

ii Agency distributor model
There is no agency-related regulation in Georgia and, in the absence of such, no similar provisions can be applied by analogy. At the same time, it should be noted that Georgian franchising legislation provides for the possibility of compensation payments to the franchisee in certain instances (after termination).

iii Employment law
Franchising is defined as a long-term relationship between independent businesses. That implies that the franchisee is an independent entrepreneur who is being granted certain liberties in conducting its business activities.

However, Georgian case law is silent on whether a franchisee who is closely supervised and controlled by the franchisor could claim to be an employee, and therefore the risk that closely controlled franchising may be treated as employment is remote.

iv Consumer protection
Franchisees are not regarded as consumers, and there is no statutory ground or court practice that proves that there is a risk that franchisees may be treated as such.

v Competition law
Georgian competition law is underdeveloped. Currently the Law on Free Trade and Competition prohibits basic anti-competitive behaviours such as abuse of dominant market position, vertical and horizontal restraints and cartels. Theoretically, franchise agreements contain vertical constraints. However, the, enforcement of Georgian competition law is particularly weak and virtually non-existent. Therefore, the practical approach of the competition authorities to purchase ties in franchise agreements, or to resale price maintenance is unknown. No sanctions have ever been applied in respect to similar arrangements.

There have recently been calls for the reformation of competition law. Relevant developments in this respect remain to be seen.

vi Restrictive covenants
During the term of the franchise agreement, the franchisee can be prevented from competing with the franchisor and its other franchisees. Even after the expiry of the franchise agreement, the parties are under a statutory obligation to not compete with each other unfairly. This is generally understood to mean that the franchisee may be prohibited from competing with the franchisor within a specified area for a period of time, not to exceed one year.

If the prohibition of competition may endanger the professional business of the franchisee, when the franchisee agrees not to compete after termination, then the franchisee may be entitled to reasonable monetary compensation.
vii  Termination

Under Georgian Law, the franchise agreement is regarded as a long-term contractual relationship. The franchisor may, on legitimate grounds, terminate a long-term contractual relationship such as franchising before the expiry of the agreed fixed term. Grounds are legitimate when, taking into account the specific situation including force majeure and mutual interests, an early termination is justified. Grounds for termination include breach of material contractual obligations, but a reasonable opportunity to remedy the situation must first be given. A cure period should therefore be set out in the franchise agreement, but if the contract is silent on this point the law will imply a reasonable cure period. It is typically best to allow time for cure prior to proceeding with termination unless it is obvious that giving additional time will yield no results. Once the prescribed cure period has expired without the breach being cured, the franchisor may terminate the agreement by written notice. It should also be noted that the franchisee will have a defence against termination, if the breach is fully or principally attributable to the franchisor. This could be the case if the franchisee had not operated the business to the required standards but was able to show that this due to the failure of the franchisor to provide proper training and support.

As stated above, the law allows restrictive covenants regarding non-competition to be agreed by the parties. As stated, if such covenant may endanger the professional business of the franchisee, then the franchisee will be entitled to reasonable monetary compensation.

Some franchise agreements give the franchisor the option to require the franchisee to transfer the lease for the premises of the franchise business to the franchisor or its nominee on termination. The assignment of a lease agreement is possible in Georgia as Georgian law recognises contracts for the benefit of third parties. Ideally, the franchisor should also be a signatory to the initial lease agreement (along with franchisee and lessor) to expressly establish the right of assignment. Long-term leases are subject to registration with the Public Registry of the Ministry of Justice, so in that case the rights of the franchisor would have to be registered.

Other tools used by franchisors to ensure the longevity of the local business after termination, such as a buy you option, are legally possible under Georgian law but may be difficult to enforce in practice. A pledge and retention of the shares in the franchisee company may be taken to secure the franchisee's respective commitment.

viii  Anti-corruption and anti-terrorism regulation

With regard to the acceptance of 'gifts', anti-corruption legislation imposes specific requirements on public officials which are broadly defined and interpreted and cover any valuable item, property, provision of services, full or partial release from some monetary obligation, etc. if they exceed established monetary thresholds (which are minimal).

Violation of such rules would bring about legal consequences such as imposition of disciplinary sanctions or dismissal, unless the gift can be established as a bribe, which represents a criminal offence and may result in criminal sanctions for the parties involved (i.e., bribe-giver and bribe-taker).
If the franchisee gave a bribe without the knowledge of the franchisor, the
franchisor would not typically be held responsible for this, unless the franchisor and
franchisee acted in concert.

ix Dispute resolution
Since most, if not all, franchises in Georgia are granted by foreign franchisors, respective
agreements normally envisage foreign (non-Georgian) fora or international arbitration
as dispute settlement venues.

Georgian private international law allows forum shopping, but provides that
foreign court judgments will not be enforced if, inter alia:

a the case falls within the exclusive jurisdiction of the Georgian courts (such as cases
concerning immovable property located in Georgia);
b the foreign country has not recognised decisions by a court of Georgia when given
the opportunity in the past; and

c a decision contradicts certain major legal principles of Georgia, such as the right
to due summons and other procedural protections.

Franchise agreements do not normally concern immovable property, but care must
be taken if the franchise contains an option over a registered lease. Typically, lack of
reciprocity can be an obstacle to enforcement.

Georgia acceded to the New York Convention of 1958 on the Recognition and
Enforcement of Foreign Arbitral Awards in May 1994. In accordance with the New York
Convention, Georgia recognises foreign arbitral awards as binding and enforces these
awards in its courts. Recognition and enforcement of foreign court decisions (notably in
the United States and the United Kingdom) and arbitration awards have, in fact, become
quite established practices.

Mediation is recognised but not practiced widely. Injunctions are available
and may be indispensable for franchisors against trademark infringements by former
franchisees or other third parties.

Private International Law confirms that the parties to a contract may choose
the law of either one of their countries of organisation or a third country to govern
the interpretation of their contract. Contractual choice of law provisions will not be
honoured if the question relates to certain major legal principles of Georgia. The legal
concepts underlying the aforementioned major legal principles are considered imperative
norms of Georgian law.

Contractual penalties are enforceable, inter alia, for breach of restrictive covenants,
provided they are reasonable. If this is not the case, courts are entitled to decrease the
amount of penalty payable in specific cases. The underlying principle of compensation
is that a party responsible for damages must restore the state of affairs that would have
existed if the circumstances giving rise to the duty to compensate had not occurred. If
restoration of the original state of affairs is impossible, then monetary compensation may
be granted. Damages are normally compensation for actual loss, but may extend to a lost
profit. In the context of franchising, damages may include repayment of franchise fees
and wasted investment cost.
A handful of local law firms provide franchise-related advice and assistance in litigation, notably in the context of international franchising. Court fees are calculated on the basis of a fixed percentage of the value of the dispute, and the losing party is responsible for those fees. Attorney fees may be recovered from the losing party subject to application of the statutory cap – which is again a certain percentage of the value of the respective claim.

VII CURRENT DEVELOPMENTS

Recent amendments to the Advertising Law require transliteration (using Georgian script of at least same size) of trademarks appearing not only in commercials and advertisements but also on shop fronts. Local business community and trademark owners argue that this requirement is not only costly but also conflicts with the marketing policy of many international companies since the value and popularity of brands, for which companies invest, is based on their original appearance and design in Latin letters. Moreover, often brands are not made up of standard letters and sign but rather styled elements and graphic representation to create and represent logotypes. Lobbying activities by the business community are ongoing with the aim to achieve desirable amendments to the legislation.
Appendix 1

ABOUT THE AUTHORS

MIKHEIL GOGESHVILI
MKD
Mikheil Gogeshvili is a lawyer practising in MKD law firm since 2002. Mr Gogeshvili’s practice is concentrated on corporate law, M&A, contract and commercial law. Mikheil has been involved in various international and cross-border transactions and advised many international franchisors establishing their presence in Georgia in various sectors, such as retail, services, F&B. He speaks Georgian, English and Russian.

BABETTE MÄRZHEUSER-WOOD
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Babette heads up the EMEA franchise group at Dentons. She has more than 20 years’ experience in international franchising with a particular focus on emerging markets. Her work includes the creation and critique of franchise contracts and their customisation to local law. Babette has transactional experience in all 28 EU Member States. Babette is recognised as one of Europe’s leading experts in hotel and leisure franchising with a particular emphasis on German-speaking Europe. Babette is ranked by Chambers Global as one of the top 10 franchise specialists in the world. She is also recommended by The International Who’s Who of Franchise Lawyers, Chambers UK and Legal 500 for her franchise expertise. Babette’s research on the role of franchising in the European hospitality industry has attracted widespread media attention. Babette is the author of numerous publications on franchising. She also lectures widely on international franchise laws and her expertise is often sought by franchisors from common law countries that enter civil law jurisdictions. She is an associated editor of The Franchise Law Review. Babette is a member of the ABA Forum on Franchising, the IBA Franchise Committee and the IFA. She is dual-qualified in both Germany and the UK. She speaks English, German, French, Spanish and Russian.
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Chapter 22

GERMANY

Babette Märzheuser-Wood

I INTRODUCTION

After a slow start, franchising evolved in Germany in the late 1960s when domestic franchise systems such as Nordsee (take away fish sandwiches), Ihr Platz (pharmacies) and OBI (DIY stores) started to use franchising to achieve rapid growth. Between 1975 and 1985 the number of franchise systems grew from 40 to 200. German reunification resulted in a boom period, with many East German citizens looking to franchise systems as their route to self-employment. According to the German Franchise Association (DFV), there are currently more than 1,000 different franchisors active in Germany, with 50,000 franchisees. The franchise industry is dominated by the service sector, which accounts for 50 per cent of the active franchise systems, followed by retail (30 per cent) and food and beverages (15 per cent).

Germany has a mature franchise market, with a wide range of domestic and international franchise systems. McDonald’s, Domino’s Pizza, Burger King and Mailboxes etc. are amongst the more prominent foreign franchisors in Germany. In addition there is a thriving domestic market with home-grown systems such as Schülerhilfe (tuition), Vom Fass (delicatessen), Joey’s Pizza and Kamps (bakery). Every year, Impulse magazine carries out a market study and ranking and awards prizes to the top ten franchise systems in Germany. This year’s winners were Miss Sporty (fitness studio), Backwerk (bakery) and Schülerhilfe. McDonald’s ranked as fourth. Current trends show a fitness boom, while many other sectors have struggled to deliver significant growth.

There are two significant industry bodies: the German Franchise Association in Berlin and the German Franchise Association. The German Franchise Association regularly publishes statistics and recommendations.

1 Babette Märzheuser-Wood is head of the EMEA franchise group at Dentons.

2 Giesler Franchiserecht: RN 23.
II  MARKET ENTRY

i  Restrictions
Foreign franchisors do not face any legal restrictions when entering the German market. Market entry for foreign franchisors is, however, challenging because Germany is a mature western economy with a large number of successful local businesses in almost every industry sector. Many global brands have failed in Germany, not because of legal restrictions but because they have underestimated the competition from established local and regional players.

The requirement that certain service businesses must be operated by qualified members of trade guilds can restrict the growth of service franchises in sectors such as plumbing, leather and carpet cleaning and electricians. A list of regulated professions can be found in the Trade Act. Another sector restricted by similar laws is health care. A pharmacy needs to be owned by a qualified pharmacist, and a doctor's surgery or law firm can only be owned by doctors and lawyers respectively.

ii  Foreign exchange and tax
As Germany is part of the eurozone, free trade exists with all other EU Member States and payment can be made in any lawful currency, although it is market practice for domestic franchisees to make payments in euros.

Many large foreign franchisors establish a German subsidiary that acts as the local franchisor, in which case the local entity will have to pay German corporation and trade tax. For new market entrants that do not have a permanent establishment in Germany, it is important to consider the DTA between Germany and the country where the franchisor is incorporated to establish if withholding taxes apply. For the purposes of applying withholding taxes, Germany differentiates between the royalty part of the franchise fee and the service part of the franchise fee. The Germany–USA DTA contains an exemption procedure for withholding taxes.

III  INTELLECTUAL PROPERTY

i  Brand search
European trademark registrations are valid in Germany. Many franchisors rely on their Community Trade Mark registrations. Others register additional German language versions of their trademarks in Germany. Searches against both the European and the German Register are widely available through lawyers and trademark agents, and can be performed online in a matter of minutes.

ii  Brand protection
The process for registration is simple. It is possible to register any distinctive wordmark or logo with the German Patent and Trade Mark Office in Munich. In line with EU law, generic expressions cannot be protected. There is a fee of €300.

The priority of German marks is based on the date of the application for registration. Germany recognises unregistered marks which are acquired through use, provided it can also be shown that the mark or logo has achieved market recognition.

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Famous marks enjoy protection in Germany without evidence of use (see article 6 of the Paris Protocol). Further protection against passing off is available under the Act against Unfair Competition. Germany has implemented the Madrid Protocol so that foreign marks can be designated for local recognition.

iii Enforcement

As is the case in all EU countries, trademarks can be protected against infringement through court proceedings. Injunctions are widely available but must be applied for within four weeks. Germany has a sophisticated court system and specialist advice is indispensable when proceeding against infringements.

iv Data protection, cybercrime, social media and e-commerce

Germany has wholeheartedly embraced privacy. In addition to the Federal Data Privacy Act, each German state has a regional privacy law. In addition, there are a growing number of sector-specific specialist regulations in areas such as protection of children and the media.

In line with EU law, the export of personal data collected by the franchisee is restricted. Export of data to the United States is subject to compliance with the safe harbour rules or other protection to ensure that the data is safe guarded. Consent to data processing needs to be express. With very few exemptions this means that the owner of the data or data subject must opt in by ticking a box or signing a document. If the data is passed on to other organisations, this requires a separate consent. Franchisors need to carefully review their loyalty programmes and promotional campaigns to ensure that they are compliant.

IV FRANCHISE LAW

i Legislation

Despite the fact that Germany does not have a franchise law, franchising is heavily regulated. Legislation that impacts on franchising includes:

a the common law principle of *culpa in contrahendo*, which gives rise to a pre-contractual duty of disclosure;

b the law of misrepresentation;

c agency laws including compensation;

d the Civil Code, particularly the principle of good faith, the rule that immoral contracts are void and the principle that a long-term contract can be terminated for important reasons;

d competition laws; and

e cooling off rights under the Consumer Credit Act, if the franchisee commits to the ongoing purchase of products and equipment.

It is the Unfair Contract Terms Act (UCTA) that has by far the biggest impact on franchise agreements. Under the UCTA, any provision in a standard form agreement that has not been negotiated between the parties is subject to a fairness test. If the provision deviates
to the detriment of the franchisee from the fallback position, as set out in the German Civil Code, a special justification will generally be needed. Franchisees are afforded the same protection as consumers for the purposes of the law. Fortunately, the UCTA is not regarded as internationally mandatory so it is possible to contract out of the Act provided that the franchisor is based in a foreign country. It should be noted that a franchise agreement between the German subsidiary of the franchisor and a local franchisee would not benefit from this exemption.

ii Pre-contractual disclosure

German law expects the parties to treat each other fairly during contract negotiations. This includes an obligation to voluntarily disclose material facts. The franchisor will usually have in its possession certain material facts that will impact the success of the franchisee, particularly as regards the success rate of other franchisees, choice of location and financial risk. The DFV recommends that franchisors should set out this important information, together with details of the franchisor and the system, in a disclosure document. It is important that franchisors ensure that disclosures are honest and fair. It can be tempting to emphasise examples of successful franchisees while remaining silent regarding those partners that 'left the system'. Litigation and damages claims relate mostly to franchise systems that over-emphasise examples of profitable franchise units while keeping silent about problem areas. In the Aufina case, the franchisor had claimed that success was guaranteed, although 20 per cent of Aufina franchisees were in financial difficulty. Personal Total was an employment agency franchise that provided information on average fees per placement and average number of placements to franchisees. The franchisor was unable to substantiate these statements. Both the franchisor and the directors were liable, including for fraudulent misrepresentation. Finally, in the case of Pizza Hut, the concept of personal liability was extended to third-party business consultants that provided unrealistic forecasts for the German market. Current legal thinking is based on the suggestion that the franchisor should use representative figures taken from real stores. The figures should reflect average performance. The temptation to provide illustrations of what can be achieved by top performers should be resisted.

If the franchisee succeeds with its claim the contract can be set aside, in which case a full refund of all fees paid and the wasted investment are payable in damages. The franchisee has three years to bring a claim.

The following disclosures are recommended by the DFV:

- **a** description of the franchise system;
- **b** information about the franchisor and key staff;
- **c** summary of franchisor services;
- **d** investments required; and
- **e** financial outlook in the form of a prognosis.

It may not be wise to give a prognosis. If the franchisee does not achieve the projected revenue, it is likely that they will bring a claim. On the other hand, many franchisors provide financial illustrations to franchisees during the recruitment process, in which case it is generally preferable to formalise the approach. This avoids overstatements by enthusiastic sales staff. If the franchise system is new to the German market, it is
recommended to point this out. If the franchisee is to be a pioneer, they need to know this and understand the associated risks.

There has been no case law on the mandatory nature of disclosure. Mostly, the view is put forward that it is possible to contract out of the disclosure law by making the contract subject to English law. The opposing view would be that disclosure is pre-contractual, so that choice of law in a later contract cannot affect it.

iii Registration
There are no franchise registration laws.

iv Mandatory clauses
German law implies a number of provisions into the franchise agreement. These apply even where the contract is silent, so it would not be correct to speak of mandatory clauses. However, the practical effect is similar. The most important examples of prohibited clauses are listed below.

a the franchisee has an inalienable right to terminate for important reasons. This cannot be excluded from the contract;
b the franchisor must provide certain services to the franchisee. A licence type franchise that does not oblige the franchisor to provide any training or support is considered an immoral contract in German law and would not be enforceable;
c the franchisor must be the owner or licensee of a valid trademark. It is not possible to transfer the risk that the trademark is lost or challenged to the franchisee;
d it is not possible to reserve to the franchisor the unilateral right to make major changes to the system and the manual;
e it is not possible to impose a new franchisor on the franchisee without their consent. Assignment clauses that seek to anticipate this consent are not valid; and
f it is not possible for the franchisor to reserve the right to terminate for minor breach or without prior cure notice. Terminations must be reasonable, taking into account the long-term investment made by the franchisee.

v Guarantees and protection
German law recognises guarantees and other forms of security such as suretyship. Where the franchisee is a company, it is not uncommon to request a guarantee from the owner. However, German companies need to be properly capitalised as a matter of company law, so that the risk of contracting with a shell corporation is lower.

It should be noted that personal guarantees by individuals can be subject to the provisions of the Consumer Credit Act, in which case a separate cooling-off notice may have to be given.

V TAX

i Franchisor tax liabilities
Domestic franchisors in the legal form of a corporation pay corporate income tax at a flat rate of 15.8 per cent (including solidarity surcharge) and trade tax at a tax rate of 7 to
17 per cent, depending on their place of business. Dividends are subject to withholding tax at the time of the distribution, at a tax rate of 26.4 per cent (including solidarity surcharge).

Franchise fees are subject to VAT. If payment is for the use of intellectual property, the reduced rate of 7 per cent applies, while other fees are subject to VAT at a rate of 19 per cent.

For income tax purposes, the initial or joining 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. Problems can arise with marketing fees when the franchisor underspends. It is advisable to expressly state in the franchise agreement how monies underspent are returned or carried forward to avoid these being viewed as a profit; in this case the unspent funds can be netted with an accordant liability.

Foreign franchisors that have a local representative are assessed for tax on the income attributable to services delivered locally. For these reasons, a permanent establishment or representative should be avoided. Franchise fees and royalties are subject to withholding tax at a rate of 15 per cent. If the franchise agreement does not expressly stipulate which portion of the franchise fee is a payment for the use of intellectual property (royalty) and which part is paid for service (service fee), the tax authorities will assess the portions according to their experience. Germany has DTAs with a large number of countries, and these treaties often allow for exemptions to be applied for.

ii Franchisee tax liabilities

The franchisee is liable to corporate income tax if he is a corporation. If the franchisee is a natural person or a partnership, he is liable to income tax. In addition, trade tax will be levied as a franchise business is always presumed to involve a trading business. The tax rates are:

a. income tax: bands from 14 to 45 per cent;
b. corporate income tax: flat rate of 15.8 per cent;
c. trade tax: flat rate of 7 to 17 per cent, depending on the municipality; and
d. the standard VAT rate is 19 per cent and the reduced VAT rate is 7 per cent.

Franchisees often pay themselves a generous salary as directors of the franchisee company in order to pay income tax rather than corporate income tax and trade tax on revenues. Such salary needs to reflect the market rate. If the salary substantially strips out all profits or is otherwise unusual, this can lead to a challenge by the tax authorities.

Companies that voluntarily produce accounts, lose the benefit of small companies exemptions and cannot file simplified accounts. As most franchise agreements impose an obligation on the franchisee to produce accounts, this adds to the regulatory burden on the franchisee.

iii Tax-efficient structures

Foreign franchisors should carefully consider the location of their franchisor company. Countries such as Malta and Cyprus are popular because of favourable DTAs. Sometimes splitting the royalty income and the service income can be beneficial. Royalties can be paid to an offshore entity located in a country that has a DTA with Germany, whereby
withholding taxes are waived and service fees are paid to a local service company. The best structure also depends on the home jurisdiction of the franchisor and should reflect current developments on an international level, such as the new OECD approach on base erosion and profit shifting.

VI  IMPACT OF GENERAL LAW

i  Good faith and guarantees
Good faith and fair dealing is central to German contract law. 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 most prominent 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.

ii  Agency distributor model
Agency law is applied to franchise agreements. As a result, the franchisee enjoys similar protection to a commercial agent. This has two important consequences:
\[ a \] the franchisee may be entitled to compensation upon termination; and
\[ b \] the franchisee is entitled to payment of reasonable remuneration if they agree not to compete with the franchisor after termination of the franchise agreement.

iii  Employment law
Franchisors that control every aspect of the business of the franchisee can find themselves treated as their employers. This applies particularly where the franchisee is an individual. The best known case is the Iceman decision of the Federal Labour Court. The franchisees were van drivers who delivered frozen food to customers in their allocated catchment area. They were subject to detailed control and supervision, and their entrepreneurial freedom was severely limited. The differences between the franchisee drivers and employed drivers were negligible. To avoid the Iceman trap, franchisors need to ensure that they do not try to legislate every aspect of the franchisee’s business. Clauses to avoid include regulating opening hours and holidays.

iv  Consumer protection
While franchisees are not consumers because they operate a commercial business, the German Consumer Credit Act extends protection to both consumers and business start-ups. As a result, franchisees that receive start-up loans from the franchisor, and franchisees that commit to a regular mandatory purchasing programme, must be given technical statutory notices setting out their right to cancel the contract.

The consequences of failure to give the statutory notice are so severe that most franchisors voluntarily give a cooling-off notice.
v  Competition law

Germany is part of the EU, and as such European competition law principles apply. There are some local issues around 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. Less reliance is placed on European case law, and the standard for proving that a 100 per cent purchase tie is indispensable is set at the highest possible level. Most German authors recommend that the franchisee be permitted to purchase up to 20 per cent of complementary products from alternative suppliers. In the case of the Body Shop, it was decided that the franchisees must be permitted to purchase ancillary items such as brushes, hairbands and soap dishes from third-party suppliers.

The Vertical Restraints Block Exemption is taken more literally in Germany, and has been described as setting the standard for the purposes of good faith and fair dealing, so that restrictions that go beyond what is permitted under the Vertical Restraints Block Exemption are often considered unenforceable as a matter of contract law because they go beyond what is fair and reasonable.³

vi  Restrictive covenants

During the term, the franchisor can insist that the franchisee should not compete. Even where the contract is silent, the implied duty of loyalty can give rise to an implied restriction on competition. Equally, the franchisor can be prevented from introducing a second competing brand to the catchment area of the franchisee.

vii  Termination

A franchise agreement is a long-term contract requiring substantial investment on the part of the franchisee. Since the Burger King decision it has been clear law in Germany that the franchisor cannot terminate a long-term contract for minor breach. The breach needs to be substantial, and with very rare exceptions cure notice must first be given.

Restrictive covenants as to competition are enforceable in Germany provided the franchisor pays adequate compensation to the franchisee. Since most franchisors do not wish to pay compensation, post-term restrictive covenants are rare.

Contractual penalties, on the other hand, are enforceable and can be used to effectively enforce the obligation to de-identify.

It is possible to provide that the franchisee must sell his business to the franchisor upon termination, but the transfer of the lease would require the written consent of the landlord. This can be a major obstacle in practice.

An option over the shares would require a notarial deed, which is expensive and time consuming to obtain so is rarely used.

³ Leitfunktion – Modell function.
viii Anti-corruption and anti-terrorism regulation

Bribery and corruption are criminal offences in Germany. However, the franchisor would not normally be responsible for bribes paid by franchisees. It is rare for German franchisors to carry out background checks. German franchisees may take offence where this is suggested.

ix Dispute resolution

Germany has a well-developed court system. Judgments made in other EU countries are enforceable without a retrial, and arbitration awards are fully recognised. Mediation is recognised as a form of alternative dispute resolution.

German courts will respect the choice of foreign law if the contract has sufficient connection to a foreign country. Usually this applies where the franchisor is incorporated abroad. Conversely, foreign franchisors that set up a German subsidiary to deal with local franchisees are unable to contract out of German law because the contracting parties are both located in Germany.

Injunctions are widely available as a remedy in urgent cases. The courts take a strict view of 'urgency' and will not permit injunctions after four weeks. Typically, trademark infringements by former franchisees that continue to use the trade name of the franchisor can be prevented through interim injunctions.

Contractual penalties are enforceable and can be a powerful remedy against franchisees that breach restrictive covenants.

Damages for certain breaches can be on an indemnity basis, but the general principle is that damages are compensation for actual loss suffered as a result of the breach committed. Most commonly, franchisees claim a refund of all franchise fees paid and compensation for wasted investment. Not all breaches of contract result in termination, as termination before the expiry of the term is only permitted for major breaches. Damages can still be claimed for other breaches but the contract would continue. Enforcement is possible through a range of methods including confiscation of property and payment orders diverting salaries.

Germany has a lively franchise dispute market. Franchisees have access to quality legal advice, as most Germans carry legal expense insurance. Smaller German law firms will handle franchise disputes for a fixed fee. Specialist franchisee litigation firms exist. Only the statutory maximum fee (a percentage of the dispute value) is payable to the winning party by the party that has lost, making litigation risk manageable for franchisees.

Major landmark disputes relate to the following:

a Apollo Optik cases. These relate to the question of whether the franchisor can keep volume discounts and rebates paid by suppliers. Unless the franchisor openly discloses the discounts, it will be difficult for the franchisor to keep these payments;

b Holiday Inn cases. There are numerous cases relating to excessive fees and overcharging. Where the franchisee has no realistic prospect of earning back the fees and making a profit, the franchise agreement can be void;

c disclosure cases. Failure to disclose fully and fairly all key facts and misrepresentation (mainly by overstating positive factors) is a frequent reason for franchise disputes;

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Germany

d agency compensation claims. Franchisees often claim compensation upon termination for loss of goodwill and customer base. Not all franchisees are entitled to compensation; and
e enforcement of post-term non-competition covenants. Monetary compensation is payable to franchisees that are subject to contractual restrictions on competition. It is not always possible to avoid these payments unless a written waiver of the non-compete is given six months before the end of the term.

VII CURRENT DEVELOPMENTS

Issues around cooling-off rights and the treatment of small franchisees as quasi employees remain topical:

a A statutory cooling-off right applies where the franchisee is under an obligation to make repeat purchases. This applies not only to retail franchising with a purchase tie, but also to service franchises where certain equipment must be bought from nominated suppliers. The application of the €50,000 loan exemption to franchising is the subject of much debate. If the value of the purchasing commitment exceeds this limit, arguably the cooling-off right does not apply. The debate affects both calculation of the limit (forecasting the value of a purchase tie over a five-year term) and the question of whether the initial franchise fee can be included in the calculation. It is important to notice that even minor purchase ties (towels for a sun studio, branded gifts for a fitness studio) can trigger the cooling-off right. Failure to give cooling-off notice can have disastrous consequences for the franchisor.

b The status of small ‘man and a van’ franchisees as employees has been topical for some years. The debate impacts both employment rights and tax treatment. If the franchisee is an employee, the franchisor is responsible for payroll taxes, social insurance and income tax deductions and for employer contributions to social insurance up to an extra 40 per cent. Furthermore, the franchisee enjoys protection against unfair dismissal under employment statutes. A range of reforms of the tax laws has set and reset the bar for quasi-employees, and great care needs to be taken to ensure that small franchisees are truly operating an independent business.
Appendix 1

ABOUT THE AUTHORS

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*Dentons*

Babette heads up the EMEA franchise group at Dentons. She has more than 20 years’ experience in international franchising with a particular focus on emerging markets. Her work includes the creation and critique of franchise contracts and their customisation to local law. Babette has transactional experience in all 28 EU Member States. Babette is recognised as one of Europe’s leading experts in hotel and leisure franchising with a particular emphasis on German-speaking Europe. Babette is ranked by *Chambers Global* as one of the top 10 franchise specialists in the world. She is also recommended by *The International Who’s Who of Franchise Lawyers*, *Chambers UK* and *Legal 500* for her franchise expertise. Babette’s research on the role of franchising in the European hospitality industry has attracted widespread media attention. Babette is the author of numerous publications on franchising. She also lectures widely on international franchise laws and her expertise is often sought by franchisors from common law countries that enter civil law jurisdictions. She is an associated editor of *The Franchise Law Review*. Babette is a member of the ABA Forum on Franchising, the IBA Franchise Committee and the IFA. She is dual-qualified in both Germany and the UK. She speaks English, German, French, Spanish and Russian.
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I INTRODUCTION

The history of franchising in Kazakhstan began with two projects. First, under a sub-licence of a Turkish franchisor a plant to produce Coca-Cola was built in 1994. Secondly, Kazakhstan Hotel Rahat Palace began operating under the brand of Hyatt international hotel chain.²

A mass market of foreign franchise projects in Kazakhstan began with clothing shops, food courts (cafes, restaurants, coffee houses) and supermarket chains. Examples of such projects are Adidas, Baskin Robbins and Ramstore supermarkets. Additionally, fast food restaurants such as Hardee’s, KFC and Burger King, as well as internationally renowned coffee houses such as Gloria Jean’s Coffees and Starbucks, are now actively operating in Kazakhstan. International hotel chains, such as InterContinental, have opened in Kazakhstan under the franchise scheme. Some more well-known hotel chains are currently in the early stages of negotiations.

Recently a large number of Russian companies have built their businesses in Kazakhstan as franchisors. These include the coffee shops ‘Shokoladnitsa’,³ the ice-cream shops ‘33 Pingvina’,⁴ the children’s shops ‘Oranzhevy Slon’,⁵ the leather shops ‘Econika’,⁶ and the gift shop ‘Krasny Cube’, to mention but a few.

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1 Aigoul Kenjebayeva is managing partner, Nataliya Shapovalova and Stanislav Lechshak are associates, and Babette Märzheuser-Wood is head of the EMEA franchise group at Dentons.
3 www.shoko.ru.
4 http://33pingvina.ru.
5 www.orange-elephant.ru.
The first Kazakhstan company to utilise the franchise system was Seimar. Seimar started working in the market of agricultural products, including poultry products. Many other Kazakhstan companies have followed suit by executing franchising agreements. The largest of them are Kuralai fashion house and the cable casting company Alma-TV, as well as a number of companies in the food service sector.

Franchising in Kazakhstan is supported in a number of ways. First, the Eurasian Franchise Association (the Franchise Association) provides consulting and information services for companies looking to develop their business via franchising. Secondly, the state supports franchising through the Small Entrepreneurship Development Fund JSC (the Fund). The main objective of the Fund is to promote establishment and economic growth of small business entities in Kazakhstan and to enhance the efficiency of funds allocated by the state to support small businesses. Additionally, the following organisations also promote the development of franchises:

a. the National Intellectual Property Institute (the Intellectual Property Institute), which is an expert organisation of the authorised body in the area of intellectual property in Kazakhstan – the IP Committee for Intellectual Property Rights of the Ministry of Justice of the Republic of Kazakhstan (the IP Committee); and

b. the Independent Association of Entrepreneurs of the Republic of Kazakhstan;

The Intellectual Property Institute has a learning centre which holds various seminars, roundtable discussions and conferences on security and protection of intellectual property.

The Independent Association of Entrepreneurs is engaged in the promotion of franchising in Kazakhstan and acts as an organiser of exhibitions related to franchising.

II MARKET ENTRY

Kazakhstan has specific legislation regulating the franchise market. In addition, the relationship between the parties to the franchise agreement is governed by the law applicable to each particular sector of the economy. The extent of regulation applicable to a franchisee is much greater than that applicable to a franchisor as the franchisee is the party operating the business locally.

If a franchisor is considering entering the Kazakhstan market, it should make sure that its intellectual property that will be the subject of a franchise agreement is protected in Kazakhstan. It is worth noting that Kazakhstan is a member of the main international conventions on protection of intellectual property, and it therefore acknowledges and respects the generally accepted principle that exclusive rights exist in intellectual property. Trademarks, utility models and industrial designs are all capable of registration in Kazakhstan.

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8 www.almatv.kz/ru.
In addition to the protection of its intellectual property, the franchisor, as a person generating income in Kazakhstan, should take into consideration the tax legislation of Kazakhstan, particularly as regards withholding tax.

III INTELLECTUAL PROPERTY

i Brand search
Preliminary searches can be made to establish whether there are any similar or identical marks already on the register.

ii Brand protection
Most intellectual property rights must be registered in order to be protected in the territory of Kazakhstan. This includes trademarks and industrial property (inventions, utility models and industrial designs).

Copyright items are protected from the moment of their expression in physical form.

Confidential know-how (and trade secrets) are protected subject to the following conditions: (1) the information that constitutes a trade secret has actual or potential commercial value by virtue of it being unknown to third parties; (2) there is no free access to it on legal grounds; and (3) the holder of the information takes measures to secure its confidentiality.

Trademarks and industrial property are subject to registration with the IP Committee. The IP Committee takes a decision on the basis of the opinion of the Intellectual Property Institute as to whether the relevant intellectual property items meet the relevant criteria of protectability.

With regard to trademarks, the IP Committee will deny registration of a trademark if it appears to be identical or confusingly similar to a trademark registered or filed earlier (relative grounds for denial). Registration will also be denied if a trademark is a descriptive (absolute grounds for denial).

Applications for registration of intellectual property rights must be filed with the Intellectual Property Institute. Based on the results of its expert review, the Intellectual Property Institute prepares an expert opinion for consideration by the IP Committee. On the basis of such expert opinion, the IP Committee issues a decision on registration or denial of registration.

The IP Committee also deals with registration of licensing agreements and assignments. Registration of a trademark licence or other IP licence (such as a franchise agreement) is mandatory and is a determining factor for the valid creation of rights and obligations of the parties to the licensing agreement. The Intellectual Property Institute reviews the licensing agreement for its compliance with the laws of Kazakhstan.

The laws of Kazakhstan do not regulate which party is responsible for the registration of the licensing agreement. In practice, this duty is most often assumed by the licensor (franchisor).

It should be noted that within the structure of the IP Committee, there is a quasi-judicial body – a Board of Appeal – which considers challenges to the decisions of the Intellectual Property Institute adopted by the IP Committee. When an applicant is
not satisfied with the decision of the Board of Appeal, its decision may be appealed in court. When decisions on denial of registration of intellectual property items or licensing agreements are challenged, the objections must first be filed with the Board of Appeal.

iii Enforcement

The legislation of Kazakhstan provides for civil, administrative and criminal forms of protection of intellectual property rights.

**Civil protection**

Civil protection may be sought through court proceedings claiming damages. Both direct losses and loss of profits can be claimed, but liability can be contractually limited to direct loss. The process of proving loss of profits in court is fairly complicated. The courts of Kazakhstan often deny recovery of lost profits or significantly reduce the amount of the lost profits sought.

**Administrative protection**

As an alternative, a right holder may seek protection of its rights from governmental bodies where the actions of an infringer are qualified as an administrative offence.

Upon receipt of an application from a right holder, the government body will consider it, and if it finds elements of offence, it will draw up an administrative protocol and submit it to the administrative court for disposition of the case on its merits and imposition of an administrative sanction (with respect to offences related to violation of rights to IP rights).

Government bodies responsible for the protection of competition will consider a case independently and are authorised to impose administrative sanctions and issue binding administrative ordinances to stop the offence.

**Criminal protection**

Acts of infringement of intellectual property rights can qualify as crimes, in which case they will be considered by the financial police. Upon discovery of elements of crime, the financial police will initiate a criminal case.

The component elements of crimes and administrative offences are for the most part identical. Qualification of an act as an offence or a crime depends on whether an administrative sanction was imposed during the preceding year and on the scale of the damage.

IV FRANCHISE LAW

i Legislation

The Civil Code of the Republic of Kazakhstan (Special Part) No. 409-I dated 1 July 1999 (the Civil Code) contains provisions about business licences. In 2002, a special law regulating the franchise relationship was passed in Kazakhstan – the Law of the Republic of Kazakhstan on Business Licence Packages (Franchise) (the Franchise Law). The Franchise Law is fairly general. It gives definitions of the main concepts used in a franchise relationship, establishes principles and measures of governmental support. It
also establishes the rights and obligations of a franchisor and provides for some measures for protection of confidential information transferred under a franchise agreement.

ii  Disclosure

We note that neither the Civil Code nor the Franchise Law contain any specific disclosure requirement. However, the Civil Code contains a general obligation that a franchisor shall disclose to a franchisee information on the set of exclusive rights to be transferred upon execution of an agreement. The obligation of a franchisor with respect to disclosure business information depends on the facts of each case. The corresponding obligation of a franchisee is to not disclose the information received.

Kazakhstan legislation does not contain the concept of pre-contractual liability (culpa in contrahendo), i.e., civil liability for losses caused by failure to fulfil pre-contractual obligations. However, this does not mean that it is impossible to make a counterparty liable as remedies for fraud or wilful misrepresentation do exist.

Further, it is possible to invalidate a transaction if such transaction was made as a result of an error that was material for the transaction or as a result of fraud. According to the Civil Code, the error is material if it relates to the nature of the transaction or qualities of the subject of the transaction. The court must also determine whether such error resulted from gross negligence of a party or whether the error is one that is covered by general business risk.

As a general rule, if a transaction is invalidated, each of the parties must return to the other party all benefits received by it and, if the return in kind is not possible, pay the value of the property to be returned or the cost of use of property. In addition, the court may order damages to be paid by the party whose actions invalidated the transaction.

iii  Registration

Franchise agreements are subject to state registration with the IP Committee due to the trademark licence that usually forms an integral part of the franchise agreement. As only the trademark licence requires registration, it is acceptable to register a short form trademark licence and submit this for registration. Based on the principle of territorial protection of trademarks, the franchise agreement or trademark licence can only be registered if the relevant mark has been registered with the IP Committee in the name of the franchisor. The registration process in practice takes two to three months. Without registration the franchisee may have difficulty making royalty payments abroad and tax relief under any applicable double tax treaty may be difficult to obtain due to the fact that without registration of the licence agreement with the IP Committee it is considered invalid.

iv  Mandatory clauses

The legislation of the Republic of Kazakhstan recognises the principle of freedom of contract. This principle means that individuals and legal entities are free to enter into an agreement and the terms of an agreement are determined at the parties’ discretion, except where the law prescribes otherwise.
If one of the parties to a franchise agreement is a foreign national, the parties may elect a foreign law as the law applicable to the agreement. However, the imperative rules of the Kazakhstan law will continue to apply.

The mandatory rules applicable to franchise agreements are described below.

The franchise agreement may include only trademarks that are registered in Kazakhstan. A trade secret may be the subject of a franchise agreement, provided that a number of conditions set forth by the Kazakhstan legislation are met. The term of a franchise agreement depends on the period of protection of the licensed property rights. A sub-licence depends on the validity of the head licence.

A franchise agreement should, regardless of its applicable law, contain a number of mandatory terms. The mandatory terms of a franchise agreement relate to the licensed intellectual property rights. A franchise agreement should clearly identify the licensed IPR (e.g., trademarks by application or registration). A franchise agreement must specify how the industrial property may be used by a franchisee, the period for which the right of use is granted, and the territory covered by the franchise agreement. A franchise agreement should contain conditions on the quality of goods, services and the ability of the franchisor to inspect the quality of goods produced or services rendered by the franchisee.

Very often, agreements governed by a foreign law include representations and warranties of the parties to an agreement and an indemnity requires the franchisee to hold the franchisor harmless against liability to third parties. Kazakhstan legislation requires that non-contractual liability to third parties is to be borne by the person that committed the offence or breach. If the liability results from the fault of a counterparty of an agreement, the losses can be recovered from such party by way of recourse. For instance, if the right to use an item of intellectual property is transferred to a franchisee under a franchise agreement in breach of third-party rights, the franchisee will be liable to such third party, but may recover losses from the franchisor under the franchise agreement.

V TAX

Transactions concluded by residents and non-residents of Kazakhstan involving foreign currency are subject to the Law on Currency Regulation and Control No. 57-III dated 13 June 2005. As a general principle, the law provides that payments and transfers between residents and non-residents for performance of currency operations should be conducted by authorised banks as established by the National Bank of the Republic of Kazakhstan (NBK).

Certain currency operations may require registration with or submission of notification to the NBK. Payments to non-residents for the right to use intellectual property rights require registration with the NBK, if the amount of the transaction exceeds certain limits defined by the NBK.

The fees payable under the franchise agreement often include several payments such as royalties, fees for services performed inside or outside of Kazakhstan, cost of imported goods, and other payments. For tax purposes it is important that the franchise contract makes a clear distinction between those different types of fees. In general non-
resident’s business income (e.g., service fee) is subject to 20 per cent withholding tax, whereas passive incomes (capital gains, dividends, interest, royalties, etc.) are subject to 15 per cent withholding tax.

In general services performed by a foreign entity outside of Kazakhstan are not subject to taxation in Kazakhstan, except for several kinds of so-called ‘tinted services’ that include managerial, financial, consulting, auditing and legal services. Proceeds from services performed in Kazakhstan are subject to income tax, however active business income might be exempt from taxation in Kazakhstan under the provisions of a relevant double taxation treaty. Goods imported to Kazakhstan are subject to import customs duties and value added tax.

For the purposes of this chapter we particularly focus on taxation of royalties as a major source of income for franchisors.

Under Kazakhstan tax legislation royalty payments received from a franchisee registered in Kazakhstan are recognised as a Kazakh source income. The Tax Code of the Republic of Kazakhstan No. 99-IV dated 10 December 2008 (the Tax Code) defines royalties as a payment for the use of copyright, software, patents, designs or models, trademarks or other similar types of rights, the use of ‘know-how’, etc.

According to the provisions of the Tax Code, royalties are subject to 15 per cent income withholding tax (WHT) from non-resident’s income at the source of payment. Any kind of income paid to a resident of a tax haven jurisdiction (the List of Tax Haven Jurisdictions approved by the Decree of the Government the Republic of Kazakhstan No. 1318 dated 31 December 2008 (the List of Tax Haven Jurisdictions)) is subject to 20 per cent WHT. Therefore, the applicable tax rate depends on whether the country of the franchisor’s registration is included in the List of Tax Haven Jurisdictions.

Kazakhstan maintains and expands a network of double taxation treaties (DTTs) with various countries. Currently there are 46 DTTs ratified by Kazakhstan that provide for reduced WHT rates on royalties. Under the most effective DTTs the applicable tax rate on royalties can be reduced from 15 to 10 per cent.

To apply for a reduced tax rate under provisions of the relevant DTT a franchisor should provide the franchisee with a document confirming its tax residence (tax residence certificate) in the country that concluded the DTT with Kazakhstan.

The Tax Code requires that a tax residence certificate should be provided before 31 December of the year in which the corresponding income was paid. Moreover, there are a number of requirements in respect of content and formalisation of the tax residence certificate: (1) it should be signed by an authorised employee of the competent body; (2) it should fully and precisely state the franchisor’s name and registered address; (3) it should indicate the period in which the franchisor was a tax resident; and (4) the signature and the seal should be notarised and apostilled.

The franchisor does not bear responsibility for remittance of Kazakhstan tax. Such liability is assigned to the franchisee, acting as a tax agent in respect of royalties payable to a non-resident. In order to apply for a reduced tax rate under a DTT, the franchisor will need to confirm its tax residence status. However the parties can agree who actually bears the tax cost by inclusion (or non-inclusion) of a gross-up clause into the contract.

The development of a tax-efficient structure under the franchise agreement depends on analysis of the following criteria.
Availability of an effective DTT between Kazakhstan and the country of residence of the Franchisor. It is recommended to ensure that the country of a franchisor’s residence is not included in the List of Tax Haven Jurisdictions maintained by Kazakhstan.

Popular jurisdiction for holding companies doing business with Kazakhstan includes Austria, Netherlands, Switzerland, Sweden and Singapore. The provisions of the DTTs concluded by Kazakhstan with these states are quite similar to one another and provide for the same levels of reduced tax rates.

A franchise agreement should provide a clear distinction between the different kinds of payments that may have different tax treatments. From a practical point of view it may be more tax-efficient to conclude a separate contract for the provision of services or supply of goods.

VI IMPACT OF GENERAL LAW

i General
The franchisee may need a government licence to be able to import goods into Kazakhstan and the imported or produced goods may have to be certificated. Apart from licences, some activities may require additional permissions from governmental bodies.

In general, the legislation of Kazakhstan is fairly favourable for the development of franchising, as it does not impose any restrictions on franchisors, for example, with respect to their place of registration. Accordingly a foreign franchisor can license its system directly to a local franchisee.

A franchisor that wishes to set up locally will need a business licence. There are a number of different business licence packages that can be used to carry out business in Kazakhstan. The most popular business licence package is the licence enabling a franchisor to grant to a franchisee the right to produce and sell goods (or to provide services) using the intellectual property of the franchisor (IP licence package). There are also other popular structures, such as the creation of a joint venture with a Kazakhstan partner. Apart from a few exceptions, there is no general restriction for acquisition or lease of real estate by foreign companies in Kazakhstan.

ii Agency distributor model
Classification of franchise agreements under the laws of Kazakhstan is not a straightforward matter. In Kazakhstan agency law cannot be applied to the relations between franchisor and franchisee because the parties to a franchise agreement act at their own cost, on their own behalf, and acquire rights and obligations for themselves. This is in stark contrast to an agency agreement, where the rights and obligations are acquired by an agent for the principal, on behalf of and at the expense of the principal.

A franchise agreement is viewed as being closer to a sale and purchase agreement (or distribution agreement), particularly where the relationship between a franchisor and a franchisee is based on supply of specific goods. However, the franchise relationship is complicated by the obligations of the buyer (franchisee) to maintain a certain sales levels and quality standards. Franchising is often used for the import and sale of luxury goods (watches, exclusive mobile phones, leather goods, etc.) in cases when the importer has to follow the standards of the sale of goods that are adhered to worldwide.
iii Employment  
Typically, franchisees would not be classed as employees.

iv Consumer protection  
Consumer legislation does not apply to the relationship between a franchisor and a franchisee, as according to the legislation of Kazakhstan, consumers may only be individuals who buy goods or services for their own needs, and not for the purposes of a business.

v Competition law  
Very often, franchise agreements are executed on an exclusive basis. Under the competition law of Kazakhstan such agreements are seen as anti-competitive and are prohibited. However, Kazakhstan competition law expressly excludes franchise agreements from the operation of the provision of the competition law prohibiting restriction of access to a particular market of entrepreneurs as suppliers of goods (services).

The legislators’ decision to exclude franchising from the operation of the said provision of competition law is based on the fact that franchising is essentially pro-competitive. Further, we believe, the state wishes to access the intellectual property developed in foreign countries, access to which can be very valuable for the country’s economy.

The Civil Code lists so-called restrictive conditions that might be considered as anti-competitive, but nevertheless may be included into a franchise agreements. A franchise agreement may contain an obligation of a franchisor (licensor) not to issue similar package business licences to third parties, and/or to refrain from similar activities in the territory covered by the franchise agreement. A franchise agreement may provide for a non compete obligation of the franchisee (licensee) (an obligation not to purchase a competing franchise and a general obligation not to compete with the franchisor in the use of the package business licence.

However, hard-core restrictions such as the right of the franchisor to determine the franchisee’s selling price or to determine the upper and/or the lower limit of prices are not permitted in franchising agreements. Equally, a commitment by the franchisee to sell products or to provide services exclusively to a specific category of buyers or only to buyers having their registered office or place of residence in the territory defined in the contract are not permitted.

vi Termination  
If a franchise agreement is governed by Kazakhstan law, it is necessary to take into account the rules for termination of an agreement contemplated by Kazakhstan law. It is possible to unilaterally terminate an agreement only if the agreement provides for such termination and specifies the cases in which a termination is possible. Most franchise agreements will comply with this rule by listing termination grounds. In such cases, one month’s notice must be given.

If a franchise agreement is executed for an indefinite period, either party may terminate the agreement on six months’ notice.
Anti-corruption

Kazakhstan’s anti-corruption legislative framework is relatively strong. Kazakhstan has adopted several laws aimed at reducing corruption through better coordination between government bodies and civil society: the Law on Fighting Corruption No. 267-I dated 2 July 1998 (the Law on Fighting Corruption), the Law on Preventing Legalisation (Laundering) of Illegal Proceeds No. 191-IV dated 28 August 2009, and the Law on Law Enforcement Bodies of Kazakhstan No. 380-IV dated 6 January 2011. In addition the government has created programmes to combat corruption and special government agencies targeting corruption.

The Law on the Fighting Corruption defines what actions are corrupt and the conditions under which persons are responsible and punishable for corruption. The definition of corruption includes acceptance personally and through third parties of material benefits by state officials with the use of official powers and resulting from such opportunities of power or other use of official powers for receipt of material benefits and equally bribes of state officials by illegal provision of material benefits by natural and legal entities to state officials.

In 2008 Kazakhstan took steps to bring its national regulations into conformity with international standards by ratifying two major anti-corruption documents: the UN Convention against Corruption and the UN Convention against Transnational Organized Crime and all of its protocols. Ratification of these conventions was a major step towards more effective prevention of corruption.

The US Foreign Corrupt Practices Act (1977) and the UK Bribery Act (2011) compel not only US and UK companies, but also Kazakhstan entities, namely their joint venture partners, suppliers, agents and service providers to comply with their strict prohibitions against bribery. The UK and US companies require that their future partners or contractors themselves have anti-bribery compliance policies and programmes in place. Thorough examination of past and current practices in this area will be conducted prior to conclusion of the contracts with supplier of goods and services, advisers and business partners. Such examination is already an integral part of the complex due diligence required to screen themselves from blame for assisting in corruption. The consequences of these two laws will support and reinforce in a major way the efforts to confront corruption by the Kazakh government, regulators and legislators.

Dispute resolution

Parties to a franchise agreement may freely choose the method of resolution of any disputes arising from the franchise agreement. There is no established practice of using a particular dispute resolution institute. In Kazakhstan, disputes arising from entrepreneurial activity are considered by specialised commercial courts.

Alternative means of dispute resolution are arbitration and mediation courts. In Kazakhstan, there exists an Institute for International Commercial Arbitration (ICA). The International Commercial Arbitration will consider a dispute when at least one
party to the dispute is a foreign national and the elected place of arbitration proceedings is Kazakhstan.

Quite recently the legislators of Kazakhstan made it their policy to develop extrajudicial procedures of dispute resolution. As a result, in 2011, conciliation procedures were promulgated as part of the mediation institution. The objective of the mediation institution in Kazakhstan is to help all parties involved in the conflict to find a mutually beneficial solution. Participation in a mediation procedure is based on the free will of the parties as expressed in a mediation agreement. The mediation procedure is not obligatory before going to court.

Mediation services are rendered by mediation organisations that are established in the form of non-profit organisations. Each mediation organisation maintains its own list of professional mediators. The Franchise Association does not provide mediation services.

Currently mediation is not in demand for several reasons: lack of public awareness, mistrust by the parties to a dispute, lack of professional competence of mediators themselves and insufficient quality of their work. In due course, we believe, the above shortcomings of the mediation system will be overcome.

Now, let us briefly discuss the issue of enforceability of foreign court judgments and awards of various arbitral institutions. Kazakhstan enforces foreign court judgments as well as arbitral awards on the basis of the following international treaties:

a the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 1958 (the New York Convention);

b the European Convention on International Commercial Arbitration, 1961;

c the Washington Convention on the Settlement of Investment Disputes between States and Nationals of Other States, 1965;

d the Agreement on the Business-Related Dispute Resolution Procedure, 1992 (Kiev); and

e the Convention on Legal Assistance and Legal Relations in Civil, Family and Criminal Matters, 2002 (Kishinev).

The courts of the Republic of Kazakhstan issue writs of execution according to submitted applications for enforcement of foreign court judgments and arbitral awards. A decision of a foreign court or arbitration body may be made enforceable within a period of three years from the effective date of the decision. A deadline missed due to a reasonable excuse may be extended by a court of the Republic of Kazakhstan.

As to arbitral awards, a court may refuse to issue a writ of execution to enforce an arbitral award. The grounds for such refusal set forth in the Civil Procedure Code No. 411-I dated 13 July 1999 and the ICA Law duplicate the grounds for refusal in enforcement of arbitral awards provided for in the New York Convention.

In addition to issuing writs of execution for the enforcement of foreign court judgments and arbitral awards, the parties to arbitral or intermediate court proceedings

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11 This institution is regulated by the Law of the Republic of Kazakhstan on Mediation No. 401-IV dated 28 January 2011.
may apply to courts of the Republic of Kazakhstan seeking security. The main security measures include attachment, prohibition of certain actions by respondents, prohibition to transfer property, etc.

VII  CURRENT DEVELOPMENTS

According to a rough figures there are about 120 franchise systems and 1,000 franchisees in the country. The country is now seen as a leader in Central Asia in the area of franchising. Although franchising is still a fairly new business concept in Kazakhstan, it is drawing increased interest from entrepreneurs. Some value the annual turnover in the sector in the region of $500 million. The franchising statistics for Kazakhstan are very dynamic. The rapid growth of the economy with a per capita GDP of $12,500 and 5 per cent year-on-year growth, increasing the share of SMEs in the country’s GDP suggest that this will be a growth area going forward. Sadly a number of negative factors continue to hinder the growth of franchising in the country, including weak intellectual property protection and limited access to funding as well as a lack of understanding of franchising as a business model and massive real estate price inflation.12

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Babette heads up the EMEA franchise group at Dentons. She has more than 20 years’ experience in international franchising with a particular focus on emerging markets. Her work includes the creation and critique of franchise contracts and their customisation.
Kazakhstan

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I INTRODUCTION

The international franchise market in Kenya has grown extensively. There are currently a considerable number of international franchisors with established operations in the Kenyan market, for example KFC, Nando’s, Subway, Papa John’s and Dubai-based Baby Shop or South African Mr Price. Local franchisors are few but well established within the Kenyan market, such as the livestock services offered by Sidai Africa to local farmers and Sasini Tea and Coffee or Dormans Coffee. The Kenyan franchise industry is not formally organised into a national body but there is a Kenya Franchise Association (KEFRA) which was called into life as part of a private local initiative.

II MARKET ENTRY

i Restrictions

There are no specific restrictions or approvals for foreign franchisors entering the Kenyan market. There are, however, regulatory issues relating to establishing a business or operating a branch in Kenya. Typically, it would be best to structure the franchise so that the franchisor does not acquire a local presence. Most franchise agreements are structured in this way. Kenyan law is based on common law principles and very similar to English law so that English law agreements can be used without substantial amendments. The decisions of the English courts are often used as persuasive precedents.

Certain franchise agreements or arrangements may fall within the ambit of the Competition Act, 2010 if they are determined to involve restrictive trade practices, that is:

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1 John Syekei and Philip Coulson are partners at Coulson Harney Advocates and Babette Märzheuser-Wood is head of the EMEA franchise group at Dentons.
agreements between undertakings, decisions by associations of undertakings, decisions by undertakings or concerted practices by undertakings which have as their object or effect the prevention, distortion or lessening of competition in trade in goods or services in Kenya, or a part of Kenya.  

Examples of restricted practices under the Competition Act include fixing purchase or sale prices, limiting or controlling production or investment, distorting or restricting competition, among others. The foregoing practices are prohibited unless they have been specifically exempted in the prescribed manner under the Competition Act by the Competition Authority. The nature of the franchise business may also require the franchisor to seek approval from the regulatory body and procure a licence if it operates or proposes to operate in a regulated industry, for example, telecommunications, insurance, banking and so on. Most franchise industry sectors such as retail, restaurants and hotels are unregulated and freely accessible. For a service franchise a closer look needs to be taken at the relevant industry.

There are no specific restrictions on a foreign entity granting a master franchise or development right to a local entity since there is no specific law in Kenya governing franchise arrangements. Parties to a franchise agreement are free to incorporate transfer restrictions into the franchise agreement subject to the provisions of the Competition Act as highlighted above.

Local equity participation requirements will apply in respect of the following industries:

- mining;
- maritime;
- aviation;
- banking and insurance; and
- telecommunications.

Statutory restrictions on ownership of land by foreign nationals will also apply to foreign individuals or corporate entities with foreign shareholders under the Kenyan Constitution and the Land Registration Act.

ii Foreign exchange and tax

There are currently no exchange controls applicable in Kenya that restrict the repatriation or remittance of foreign currency.

The Central Bank Act, Cap 491 of the Laws of Kenya states that the following transactions must be effected through an authorised bank:

- payments in Kenya, to or for the credit of a person outside Kenya;
- payments outside Kenya, to or for the credit of a person in Kenya; and
- payments in Kenya (other than a payment for a current transaction) between a resident and non-resident.

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2 Section 21(1), Competition Act, Cap 504 Laws of Kenya.
3 Section 33H(1) Central Bank Act, Cap 491 Laws of Kenya.
A person who contravenes the above provisions commits an offence and shall be liable on conviction to a fine not exceeding 500,000 shillings or to imprisonment for a term not exceeding three years, or to both. However, it is a formality to handle payments through an authorised bank and not an obstacle in practice to payment of franchise fees.

In Kenya, withholding tax is chargeable with respect to dividends, interest, royalties and technical services fees. Royalty payments payable by the franchisee to the franchisor are subject to a 5 per cent withholding tax where paid to a resident whereas the rate of 20 per cent applies if royalties are paid to a non-resident. As most foreign franchisors will be non-residents, they face a 20 per cent withholding tax. This can have a significant impact on royalty revenue unless a grossing up clause is agreed.

A withholding tax of 10 per cent is levied on the payment of technical service fees (as well as professional/management fees) where the services are provided by a resident. The rate is 20 per cent where the service provider is non-resident.

Under the current VAT Act, VAT is chargeable at 16 per cent regardless of whether or not the franchisor has a place of business in Kenya. Where the franchisor has no place of business in Kenya and the franchisee is a registered person (invariably a Kenya-based business), the franchise will be treated as an imported taxable service and VAT will be due from the franchisee.

### III INTELLECTUAL PROPERTY

#### i Brand search

Trademark searches are conducted at the Kenya Intellectual Property Institute (KIPI).

The trademarks registries database (trademark register) is computerised and searches are undertaken to confirm availability of trademarks and whether prior third party rights exist on the register. Searches will also reveal whether the conflicting marks are registered in similar classes which are identical or similar in representation (visually and phonetically). When considering phonetic similarity local language needs to be considered.

The search can be conducted by any person or by a trademark agent authorised by such person (personal search), or by a trademark examiner at KIPI (official search) who will issue a search report on the trademark and whether there is any conflict.

There is no specific protection regime for image rights or business processes in Kenya. Common law principles on privacy, copyright image rights, passing off and trade secrets/confidentiality would be applicable in this regard.

Kenya also recognises and protects unregistered marks.

#### ii Brand protection

Trademarks are filed at KIPI. The process for trademark filing is as follows:

- **a** filing and lodging the prescribed application form together with seven representations of the proposed trademark;
- **b** payment of prescribed fees;
- **c** examination of the application (for formal accuracy [and merit]) by the Registrar of Trademarks;
The process of registration normally takes six months.

Copyright subsists and is protected at the time when a copyright work is created by the author in a material form. Copyright-protectable works can be registered in Kenya with the Kenya Copyright Board. This can be used by franchisors to protect the manual or training materials, etc. The registration process entails the following:

1. **Filing and Lodging**
   - **a** filing and lodging the prescribed application form together with a representation of the copyrightable works and an affidavit sworn by the author of the works;
   - **b** payment of prescribed fees of US$125; and
   - **c** a certificate of registration is normally issued within two weeks of filing the application.

### iii Enforcement

The registered owner of a trademark obtains the right to exclusive use of the trademark for a period of 10 years. The Trademarks Act makes it a criminal offence for any person to forge and use a forged trademark or falsely apply for a registered trademark, and upon conviction, a person is liable to the prescribed fines, imprisonment and forfeiture of goods.

The Trademarks Act also provides for proceedings before the High Court for passing-off in the case of unregistered marks, and infringement in the case of registered marks. A claim for unfair competition may also be made as a subsidiary claim to either passing-off or trademark infringement. The owner of the trademarks is entitled to the following remedies, among others: damages, injunctive relief and interestingly an account for profit.

Infringement of copyright is also actionable in the High Court. The remedies available for infringement of copyright include: damages; injunctive relief; and again an account for profits; delivery up of any infringing copies, or any article used or intended to be used for making infringing copies; or an award of an amount calculated on the basis of reasonable royalty that would have been payable by a licensee in respect of the work or type of work concerned.

These provisions are very useful to franchisors in that they can claim ongoing payment of franchise fees and an account of profits if a franchisee continues to use their trademarks and copyright materials after termination or expiry of the franchise agreement.

The Anti-Counterfeit Act Cap 130A prohibits trade in counterfeit goods and establishes the Anti-Counterfeit Agency which combats dealing in and authorises seizure of counterfeit goods in Kenya. Offences in counterfeiting are liable to imprisonment or to a fine, in respect of each article or item involved in the particular act of dealing in
counterfeit goods to which the offence relates, not less than three times the value of the prevailing retail price of the goods, or both.

Confidentiality clauses and non-disclosure clauses in franchise agreements are enforceable in accordance with their provisions and according to contract law and English common law principles which are persuasive in Kenyan courts.

iv Data protection, cybercrime, social media and e-commerce
Kenya does not have specific statutory law regulating data protection and follows principles of English common law relating to data protection as a guide. The Data Protection Bill and Freedom of Information Bill, which are yet to be enacted into law, will regulate data protection and privacy. The Kenya Information Communications Act 2010 contains certain data protection provisions such as protection of confidential information, consumer protection against unauthorised use of personal information as well as safekeeping of data security by a certification service provider.

The Central Bank of Kenya regulates money remittance and payment systems, including electrical retail transfers and e-money under the National Payment System Act and Money Remittance Regulations under the Central Bank of Kenya Act.

IV FRANCHISE LAW

i Legislation
There are no specific laws in Kenya governing franchise agreements. Franchise agreements are generally regulated by the Law of Contract Act and English common law principles relating to contract law.

Kenyan courts generally observe choice of law and forum clauses in contract. The governing law is chosen by the parties. Kenyan courts will only disregard the application of a rule of foreign law where it application would be contrary to public policy.

Aspects of the franchise agreements are also regulated by the Trademark Act, with regard to the protection of trademarks and patents of the franchisor, the Competition Act, the Consumer Protection Act, and the Income Tax Act, among others.

ii Pre-contractual disclosure
Kenyan law does not prescribe any pre-contractual disclosure requirements in franchising since there is no specific legislation governing franchise agreements in Kenya and the general common law approach of caveat emptor (the buyer beware – or the buyer must do its own research and due diligence) applies. A cooling off notice may, however, have to be given in relation to certain franchise agreements that are made remotely under the new Kenyan Consumer Protection Act (CPA).

iii Registration
There are no specific approval, registration or filing requirements for franchise agreements. Franchise agreements in Kenya are governed by the law of contracts.

However, any trademarks that are the subject of a franchise agreement should first be registered. While Kenya recognises unregistered trademarks as a concept it will
be much easier to take proceedings against a franchisee that continues to use the system and the marks after termination if such action can be based on trademark infringement.

The nature of the franchise business may also require the franchisee to seek regulatory approval if they operate or propose to operate in a regulated industry, for example, telecommunications, insurance, banking and so on.

Certain franchise transactions may also need approval of the Competition Authority under the Competition Act to ensure that the franchise does not impede competition, and assess its effects on consumer welfare in Kenya. This is due to the fact that agreements between undertakings, decisions by associations of undertakings, decisions by undertakings or concerted practices by undertakings that have as their object or effect the prevention, distortion or lessening of competition in trade in goods or services in Kenya or a part of Kenya are prohibited unless they have been specifically exempted under the Competition Act.

iv Mandatory clauses
A franchise agreement is a contract between the franchisor and the franchisee governed under the law of contracts in Kenya and the provisions of English common law. Since there is no specific legislation governing franchise agreements in Kenya, there are no mandatory clauses for franchise agreements.

Contracts are not prescribed in Kenya and hence the franchise agreement will contain provisions agreed upon between the franchisor and the franchise. There are, however, typical boilerplate clauses contained in contractual agreements such as: duration/term, assignment, payment terms, disclosure, confidentiality, dispute resolution, obligations of parties as well as termination.

v Guarantees and protection
It is common practice for the franchisor to require a guarantee from the franchisee’s owner as guarantor acting as security to ensure the franchisee meets its obligations.

A guarantee must meet the essential conditions required to form a valid and enforceable contract. The Law of Contract Act provides that a guarantee must be in writing or there must be a memorandum of it in writing signed by the guarantor. For it to be enforceable, it must be perceived that the guarantor was aware of the full implications of signing a guarantee. It must also be perceived that the franchisor reasonably believed that the guarantor was not acting under ‘undue influence’, and that the franchisor acted in good faith in this regard. The guarantee should therefore be in a stand-alone written agreement containing express language covering the above requirements.

 Guarantees from individuals as well as companies are enforceable in Kenya.

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4 Section 21(1) Competition Act, Cap 504 Laws of Kenya.
V TAX

i Franchisor tax liabilities
Local franchisors, resident in Kenya will be liable to corporate tax at the rate of 30 per cent. A rate of 37.5 per cent is applicable to the taxable profits of non-resident foreign companies.

International franchisors have no tax obligation where they are not operating any business in Kenya. The obligation to pay withholding tax will fall with the franchisee operating the business in Kenya before remittance of the royalties to an international franchisor. As stated above the rate of withholding tax is 20 per cent.

ii Franchisee tax liabilities
Part of the franchisee’s obligations is the payment of royalties to the franchisor. In Kenya, royalty payments to a resident are subject to a 5 per cent withholding tax whereas the rate of 20 per cent applies if royalties are paid to a non-resident.

The franchisee is also obligated to pay VAT in Kenya as per the Value Added Tax Act, No. 35 of 2013. Where the franchisor does not have a place of business in Kenya and the franchisee is a registered person (invariably a Kenya-based business), the franchise will be treated as an imported taxable service and VAT on it will be due from the franchisee.

iii Tax-efficient structures
The Kenya Revenue Authority has introduced remarkable efficiency and professionalism in tax administration and operations. There is a deduction allowed against profits on expenditure of a capital nature spent on buildings and machinery used for the purposes of manufacture and certain hotels of 100 per cent. Manufacturing investment in buildings and machinery attract an investment allowance of 150 per cent on the plant, machinery, buildings and equipment. Enterprises in export processing zones also enjoy a 10-year tax holiday.

Inclusion of gross-up provisions in franchise agreements may also provide some tax efficiency for franchisors who receive payments such as royalties from franchisees.

VI IMPACT OF GENERAL LAW

i Good faith and guarantees
There is no implied duty of good faith under Kenyan contract law, in respect of franchise agreements. Where parties wish to include a duty of good faith, this must be expressly provided in the terms of the contract. The newly enacted CPA which came into force on 14 March 2013 defines ‘consumer’ to include franchisees. The CPA protects franchisees from certain unfair practices and extremely one-sided franchise agreements may come under threat.

ii  Agency distributor model

Franchisors can be treated as principals while the franchisees can be treated as agents. English common law principles on agency and contract apply in Kenya in construing provisions in a contract; hence, under common law a claimant can sue a franchisor for the acts of the franchisee where it can be shown that the franchisee acted under ostensible authority.

Claims brought against a franchisor are decided on the common law principles of agency or apparent agency. However, it is for the claimant to show that indeed there was an agency relationship created by the franchise agreement. To protect against this it is important that the franchise agreement clearly states that there is no agency. Further, the franchisee should be required to display in its business premises and on all official correspondence a clear statement that they are an independent business operated under licence from the franchisor.

iii  Employment law

A corporate franchisee cannot be an employee of the franchisor as an employee must be a natural person.

There are no specific restrictions on an individual franchisee being an employee of the franchisor. However, if a court was required to determine this question, it would look at the circumstances of the working relationship between the franchisee and the franchisor as well as the terms set out in the franchise agreement. Agency liability and tax consequences would also be considered.

iv  Consumer protection

The CPA defines a consumer to include a franchisee in terms of a franchise agreement to the extent applicable in terms of the CPA. Therefore, franchise agreements should be made in accordance with the provisions of the CPA and its regulations.

There is an exception to this provision where the court may order that a consumer be bound by all or parts of the franchise agreement where it determines that it would be inequitable in the circumstances for the consumer/franchisee not to be bound. This could be of some help where the franchisee is very clearly a large company that is not in need of consumer type protection.

As a consumer, the franchisee has a number of rights including: the right to quality goods and services; the right to disclosure; and protection from unfair practices, which includes protection from unconscionable conduct.

The Consumer Protection Act also provides for protection of the franchisee (consumer) from unfair practices. The Consumer Protection Act provides that unfair practices include false, misleading or deceptive representations and unconscionable representations, and gives instances of what would constitute these.

Where a franchise agreement is not signed by the franchisor and the franchisee at the same time and in the same room, a franchise agreement could also be a ‘remote agreement’ under the CPA giving the franchisee a cooling off right. To avoid this situation

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6 Section 2(1) Consumer Protection Act, No. 46 of 2012.
it is recommended that all franchise agreements be signed in person and not by e-mail or otherwise remotely.

v Competition law

Certain franchise agreements or arrangements may fall within the ambit of the Competition Act, 2010 if they are determined to be restrictive trade practices, that is:

agreements between undertakings, decisions by associations of undertakings, decisions by undertakings or concerted practices by undertakings which have as their object or effect the prevention, distortion or lessening of competition in trade in goods or services in Kenya, or a part of Kenya.

Such agreements are prohibited unless they have been specifically exempted under the Competition Act by the Competition Authority. Examples of prohibited restrictive practices include:

a directly or indirectly fixing purchase or selling prices or any other trading conditions;
b dividing markets by allocating customers, suppliers, areas or specific types of goods or services;
c any practice involving a practice of minimum resale price maintenance;
d limiting or controlling production, market outlets or access, technical development or investment; or
e otherwise preventing, distorting or restricting competition.

Clearly most franchise agreements involve the allocation of exclusive territories and hence the division of markets. Franchise agreements also contain purchase ties by requiring the franchisee to purchase products from the franchisor or its nominated suppliers. This suggests that franchise agreements could be prohibited agreements unless they are exempted. The Competition Act, however, provides that an undertaking or association of undertakings may apply to be exempted in the prescribed manner from the above provisions of the Act. Without obtaining an express exemption it is difficult to say whether the restrictions in the franchise agreement will be enforceable. Mostly, competition authorities in emerging markets focus on more obvious and significant anti-competitive practices such as cartels and abuse of market power, but it cannot be ruled out that a certain practice in a franchise agreement that restricts competition could not be challenged under the Act, absent an exemption. If the franchisor is looking for certainty, they should therefore apply for an exemption.

The Authority in determining the application for exemption may:

a grant or refuse to grant the exemption; or
b issue a certificate of clearance stating that in its opinion, on the basis of the facts in its possession, the agreement, decision or concerted practice or the category of agreements, decisions or concerted practices does not constitute a restricted trade practice.
vi  Restrictive covenants

The Contracts in Restraint of Trade Act provides that an agreement containing a restriction of trade is not void but can be declared void by the court if it is of the view that the covenant is not reasonable either in the interests of the parties, inasmuch as it affords more than adequate protection to the party in whose favour it is imposed against,7 or the provision is contrary to public interest. This could typically be used to challenge post-term restrictions of competition by the franchisee such as the requirement not to engage in a competing business for a period of time after termination. If it can be shown that the restriction does not go beyond what is reasonably necessary, it will normally be enforceable. As a rule, restrictions should be limited geographically and in time, and similar drafting principles to those recommended for English law agreements do apply. A restriction for a period of time not exceeding one year whereby the franchisee could not compete with the franchisor from the location of its former store (or a reasonable area nearby) would normally be enforceable. If the franchisee breaches the non-compete and other restrictive covenants outlined in the franchise agreement, the franchisor may seek redress through the courts, possibly by applying for an injunction to prevent further breach or the parties can use alternative dispute resolution mechanisms provided for in the agreement such as arbitration or mediation.

vii  Termination

The termination of franchise agreements will typically be governed by the contract between the parties and English common law principles on agency and contract.

Post-term restrictive covenants will be enforced as laid out in the contractual agreement between the franchisor and franchisee and by the Contracts in Restraint of Trade Act. See subsection vi, supra.

The franchisor may be able to take over the franchisee’s business but only upon prior satisfaction of the legal requirements for certain specific businesses as well as the provisions of the Competition Act above. Accordingly, if the franchisee is active in a restricted sector, a foreign franchisor may not be able to take over the business but it may be able to nominate a local successor franchisee that meets the relevant licensing requirements.

The franchisor may face restrictions on the percentage of equity that it may legally be authorised to acquire in a local entity or franchisee for some specific business industries which require that a certain percentage of local shareholding shall be maintained.

viii  Anti-corruption and anti-terrorism regulation

Kenya does not have specific anti-terrorism legislation although there is an Anti-Terrorism Bill that contained controversial provisions and still awaits debate and approval in Parliament. The Penal Code and the Proceeds of Crime and Anti-Money Laundering Act, 2009 makes it an offence for any person (franchisor or franchisee) to open, operate, finance, recruit or assist any person or organisation engaged in terrorist activities.

7  Section 2(1) Contracts in Restraint of Trade, Cap 24 Laws of Kenya.
Under the Proceeds of Crime and Anti-Money Laundering Act, a person (both franchisee and franchisor) should not enter into any agreement or engage in any arrangement or transaction with anyone in connection with property that it knows or ought reasonably to know or perform any other act in connection with the property obtained through commission of an offence.

There is an Anti-Corruption and Economic Crimes Act (Cap 65 of the Laws of Kenya) with the objective of providing for the prevention, investigation and punishment of corruption, economic crime and related offences.

### ix Dispute resolution

Parties to franchise deals generally tend to follow the method of dispute resolution stipulated in the franchise agreement between them. Typical franchise agreements provide for arbitration as a dispute resolution mechanism. However, the franchisor and franchisee in a franchise agreement may opt for litigation on matters that call for the attention of the courts.

The Constitution of Kenya provides that alternative forms of dispute resolution including reconciliation, mediation, arbitration and traditional dispute resolution mechanisms shall be promoted, provided that they do not contravene the Bill of Rights, are repugnant to justice and morality or inconsistent with the Constitution or any written law.\(^8\)

Mediation is recognised as form of alternative dispute resolution in Kenya. Mediation is, however, not mandatory, although parties are at liberty to convert arbitration to mediation or to suspend court proceedings to seek alternative dispute resolution methods, mediation included.

Kenyan courts do recognise and uphold foreign choice of law or jurisdiction. In the case of *Skoda Export Limited v. Tamoil East Africa Limited*,\(^9\) the court held they are empowered to respect the rights of parties to choose the place where they intended to resolve their dispute. Despite this principle, there have been instances where the Kenyan courts have accepted jurisdiction despite an exclusive foreign jurisdiction clause.

There is no specific specialist mediation facility for franchise disputes. Arbitration is probably best suited to tailor the dispute resolution mechanism to the preferences of the parties as arbitrators with experience in international licensing can be chosen. Failing that, disputes arising from franchise agreements may be resolved before the Kenyan courts. The procedure and timelines for instituting the suits in the Kenyan courts is set out under the Civil Procedure Act and Civil Procedure Rules, 2010. Where the parties have provided for arbitration and other methods of dispute resolution in the franchise agreement, Kenyan law allows for parties to agree to seek conservatory or similar interim relief in any court of competent jurisdiction, including Kenyan courts.

It is possible to obtain an interim or permanent injunction to prevent a former franchisee from continuing to trade in breach of non-compete provisions.

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8 Article 159(2) and (3), Constitution of Kenya, 2010.
9 Civil Case No. 645 of 2007.
Damages for breach of contract are calculated based on the English principle that the plaintiff is only due damages that were contemplated in the agreement. Any claim for damages must be specifically pleaded and proved for it to be awarded.

In making an award for damages for breach of contract, the courts are guided by the following principles:

\[ a \] the amount of damages is to compensate the claimant for his or her loss not to punish the defendant;

\[ b \] damages are compensatory – not restitutionary;

\[ c \] contractual damages are limited to those damages that the parties intended to be recoverable; and

\[ d \] damages must be specifically pleaded and proved.

The courts have discretion and power to determine by whom and out of what property and to what extent such costs and damages are to be paid, and to give all necessary directions for that purpose. It may also award interest on costs at any rate not exceeding 14 per cent per annum, and such interest shall be added to the costs and shall be recoverable as part of the costs.\(^\text{10}\)

Costs are capped if they are taxed.

Enforcement of a judgment is made by a separate application to court in which the party seeking to enforce judgment sets out what mode of enforcement it desires in the form of a decree. The party seeking to enforce its judgment requests assistance from the court to execute its decree whether by attachment or property, imprisonment of the judgment debtor, delivery of property or whatever relief it requires. The civil procedure rules provide that the decree is signed and sealed by the Registrar of the High Court upon satisfaction that it is drawn up in accordance with the judgment and is approved by all parties to the suit.

Enforcement of arbitral awards is done by the successful party making an application to the court accompanied by the original award and the arbitration agreement. Once the award is recognised by the court, it is enforceable in the same manner as a judgment.

Kenyan courts readily recognise foreign arbitral awards. Kenya is a signatory to New York Convention, which it assented to on 10 January 1989.

A foreign arbitral award is enforceable in Kenya in the manner prescribed in the New York Convention, which states that a party seeking to enforce an arbitral award shall apply to the High Court of Kenya for its enforcement with the following documents accompanying the application:

\[ a \] the original arbitral award or a certified copy; and

\[ b \] the original arbitration agreement.

The Kenyan Arbitration Act also provides that an international arbitration award shall be recognised as binding and enforced in accordance with the provisions of the New York

\(^{10}\) Section 27, Civil Procedure Act, Cap 21 Laws of Kenya.
Convention or any other convention to which Kenya is signatory and relating to arbitral awards. On balance it is easier to enforce foreign arbitral awards than foreign judgments.

The case of *CMC Holdings Limited & CMC Motors Group Limited v. Jaguar Land Rover Exports Limited*[^11] is noteworthy, where CMC Holdings had entered into a franchise agreement with Land Rover Exports Limited on 12 December 1985 in relation to the Landrover franchise. The applicant was seeking an interim injunction restraining the respondent from interfering with the distributorship agreement. The judge held that the application for an injunction was not merited and was dismissed with costs to the respondent and that the matter be determined through arbitration as provided in the franchise agreement between the parties. The arbitration is still ongoing.

### VII CURRENT DEVELOPMENTS

In spite of lack of a comprehensive legal framework that deals with franchising, the developments in this field are impressive. It is growing rapidly even though in the recent past it had been slow and limited to foreign firms partly due to lack of intellectual property enforcement in most African countries, which hampers the process of branding that is required for successful franchising.[^12] The franchising market in Kenya is evolving from single-unit owners to multi-unit operators employing professional staff of field and unit managers.

The Kenyan market has seen a considerable number of new franchise entrants such as Clarks, Subway, KFC, as well as Estée Lauder, which launched its products in Kenya through a franchise agreement with Lyntons Beauty World.

Franchising in Kenya is on the rise and will call for more specialised franchise laws in Kenya. The recent introduction of the CPA follows the South African example and like South Africa includes franchisees among the definition of consumer.


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Philip Coulson is an experienced lawyer having qualified in the UK (1991) and worked as an English solicitor. From 1994 to 2008 he worked with Kaplan & Stratton, one of Kenya’s leading law practices. In September 2008, Philip left Kaplan & Stratton to establish a new law firm, Coulson Harney.

Mr Coulson’s experience covers company and commercial law, capital markets, property development, finance, acquisitions, takeovers, joint ventures, investments, corporate reorganisations, general commercial contracts and advice on land law matters tourism and conservation. He has received several citations as one of the leading lawyers in corporate and commercial law in Kenya from several international legal directories. His most recent citations were by IFLR and Chambers and Partners who recognised him as a Leading Lawyer and Band 1 commercial and corporate lawyer respectively. Philip is also a member of the Law Society of Kenya, the Law Society of England & Wales, the International Bar Association and the Commonwealth Lawyers’ Association.

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John trained at Daly & Figgis Advocates and Deloitte and headed the intellectual property department at a leading firm as a partner until joining Coulson Harney in March 2010. John’s practice areas and experience cover commercial intellectual property advice, IP litigation, advertising law and litigation, advice on drafting and negotiation of information technology agreements the seller or buyer side, and advice on the protection and enforcement of trademarks, patents, copyright and industrial designs. He practises across Africa directly for local clients. He also acts for clients in intellectual property infringement actions, anti-counterfeiting raids, due diligence investigations and reports, drafting of licensing and franchise agreements, trademark oppositions, trademark cancellations and domain name dispute resolutions before WIPO. He advises a number of leading technology companies in the world including Google, Facebook, Microsoft and IBM. He also acts as the Kenyan counsel on regulation, compliance and corporate matters for Philip Morris International. He is a member of the Internatioanl Trademarks
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Babette heads up the EMEA franchise group at Dentons. She has more than 20 years’ experience in international franchising with a particular focus on emerging markets. Her work includes the creation and critique of franchise contracts and their customisation to local law. Babette has transactional experience in all 28 EU Member States. Babette is recognised as one of Europe’s leading experts in hotel and leisure franchising with a particular emphasis on German-speaking Europe. Babette is ranked by *Chambers Global* as one of the top 10 franchise specialists in the world. She is also recommended by *The International Who’s Who of Franchise Lawyers*, *Chambers UK* and *Legal 500* for her franchise expertise. Babette’s research on the role of franchising in the European hospitality industry has attracted widespread media attention. Babette is the author of numerous publications on franchising. She also lectures widely on international franchise laws and her expertise is often sought by franchisors from common law countries that enter civil law jurisdictions. She is an associated editor of *The Franchise Law Review*. Babette is a member of the ABA Forum on Franchising, the IBA Franchise Committee and the IFA. She is dual-qualified in both Germany and the UK. She speaks English, German, French, Spanish and Russian.
Chapter 34

POLAND

Magdalena Karpińska

I  INTRODUCTION

Franchising systems have become increasingly popular in Poland over the past 20 years. After an initial period of slow growth, the last decade has seen a definite uptake in momentum. Importantly, the growth trend continues despite the worldwide economic crisis following 2008.

At year-end 2012, there were 864 franchise systems active in Poland having between them over 51,200 franchise outlets, up by 3,200 outlets from year-end 2011. According to preliminary forecasts, by the end of 2013 the total number of franchise outlets may reach almost 55,000 (with approximately 930 franchising systems on the market). This is an impressive number and the growth rate is encouraging. Franchising systems have been thriving in the food business with the likes of McDonald’s as leaders while franchised retail outlets such as clothes and shoe shops are in decline. That said, the fashion retail sector is still Poland’s number one in terms of the number of available franchising systems. Franchising systems in the service sector seem to be going through a phase of intensive growth, helping Poland catch up with more mature West European markets such as Germany or France where franchises in the service sector prevail. Another sign of maturity is that there are more home-grown than foreign franchising networks in Poland.

Poland’s franchisors include well-known international firms such as McDonald’s, Telepizza, Subway, ITM (Intermarché and Bricomarché stores), Carrefour, Makro Cash

1 Magdalena Karpińska is counsel at Dentons.
2 All data and forecasts are quoted from franchising.pl and the brochure attached to the 18 October 2013 issue of Gazeta Prawna, No. 203 (3593) entitled ‘Franchising, sposób na biznes’ and are based on the ‘Report on Franchising in Poland in 2013’ produced by PROFIT system Sp. z o.o.
Poland

& Carry, BP and Shell, Accor (Mercure and Ibis hotels), and Polish players, such as Da Grasso (pizzerias), Eurocash Group and Żabka (food stores), Getin Bank and BPH Bank (banking sector), Abra (furniture stores), Fornetti (mini-bakeries).

In 2010 the Franchise Organisation (PFO) affiliated with the European Franchise Federation and in 2011 with the World Franchise Council. Members of the PFO sign up to the European Code of Ethics for Franchising (ECEF).

II MARKET ENTRY

i Restrictions
The Polish market is open to foreign franchisors. As Poland is a Member State of the European Union, EU companies may directly operate outlets in Poland so that the franchise business model is a matter of choice. Non-EU companies, in order to operate a business in Poland, must register a branch or subsidiary company, which in turns opens the door to the whole EU market.

The main vehicles used by foreign franchisors that opt for a local presence are limited liability companies (LLC) and joint-stock companies (JCS). Other vehicles (e.g., partnerships or branches), although utilised (e.g., for tax reasons) are less common and may not be available for companies from outside the EU/European Economic Area (EEA). LLC is the most popular, due to its relatively low costs of operation and simplified corporate governance rules.

There are restrictions on land ownership for foreign companies from outside the EEA. The acquisition by a non-EEA foreign national of an ownership title or perpetual usufruct right\(^3\) to land in Poland requires, as a rule, a prior permit from the interior ministry. Similarly, a permit is needed to acquire shares in a Polish company holding such titles to land. Special rules apply to agricultural and forest land. Non-EU franchisors are, however, able to take an ordinary short-term lease for offices, shop or restaurant premises.

Regulatory law in Poland is relatively liberal; generally, no administrative permit is needed to set up a company or start running a business (exceptions apply to some sectors e.g., banking, insurance). Franchisors in the service sector need to take into account that some professions and services remain regulated and must be owned and/or operated by a qualified professional (especially the health care, veterinary and legal sectors).

ii Foreign exchange and tax
Poland is seeking to join the eurozone within a few years (before 2020). The national currency is the Polish zloty, which is traded freely. Monetary obligations can be determined in a foreign currency; however, unless the parties agree otherwise, they can be repaid in zlotys as well. In practice, euros and US dollars are commonly used in international franchise agreements.

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3 Perpetual usufruct is a type of public ground lease-like relationship lasting usually 99 years (with an option to extend), under which the State Treasury or local authority retains ownership, while the perpetual usufructuary may use the land and freely sell the perpetual usufruct right.
Poland, as an EU Member State, forms part of the EU Single Market and benefits from free trade within the EU. When Poland joined the EU, foreign exchange law restrictions were reduced to a minimum and now should provide no barrier in day-to-day operations of franchisors.

Franchisors established in Poland will be subject to Polish taxation and must register for tax purposes. In practice, many foreign franchisors operate through Polish subsidiaries or master-franchisors.

The franchise fees or dividends payable to foreign franchisors will generally be subject to withholding tax (WHT). The rate of WHT is dependent on the double tax treaty (DTT) between Poland and the country of the franchisor’s registered office.4

In the absence of a DTT the rate of withholding tax is 20 per cent. If the franchisor employs a workforce in Poland, it will be obliged to calculate, withhold and remit, on a monthly basis, personal income tax (PIT) and social security contributions due on the employees’ remuneration. The employer partially finances the social security contributions of its employees, which increases the costs of employment.

III INTELLECTUAL PROPERTY

i Brand search

Poland, as an EU Member State, gives protection to Community trademarks (CTMs) registered with the Office for Harmonization in the Internal Market (OHIM). Alternatively, if protection throughout the whole of the EU is not needed, the trademark may be registered with the Polish Patent Office (PPO), for protection in Poland only. Finally, Poland is a signatory to the Madrid Treaty; thus trademarks under international registration with WIPO in Geneva benefit from protection in Poland.

Searches for registered CTMs and international trademarks can be easily handled online, in databases available at respectively http://oami.europa.eu and www.wipo.int. Trademarks registered in Poland can be searched for on the PPO’s website.

ii Brand protection

Registration of a trademark with the PPO is not complicated. If the registration is for a foreign company, the proceedings need to be conducted through a patent agent. The application is subject to a one-time fee of 550 zlotys, which covers up to three product classes.

To benefit from legal protection, a trademark (brand name, logo or graphic) must meet a number of tests. Among others, it needs to be sufficiently distinctive, not mislead recipients (especially in terms of product characteristics and nature) and not cause confusion with any trademark of another entity that was previously registered or submitted for registration for the same or similar product classes (priority rule). Further, one cannot register a trademark that is commonly known and utilised by a third party

4 For instance, under the new Poland–US DTT, the withholding tax on dividends, interest and royalties is 5 per cent.
even if it remains unregistered. As is typical for other trademark protection systems, in principle, generic or descriptive expressions (e.g., ‘book’ or ‘the best’) are not protected.

Although the registration proceedings are quite time-consuming, once the protection is granted, it binds from the initial date of the application. The protection is granted for 10 years (and can be prolonged for further 10-year periods) and covers Poland.

Depending on the circumstances, the brand can also be protected under the unfair competition regime or copyright law. Nonetheless, in practical terms, a trademark registration offers much better protection.

iii Enforcement
The protection of trademarks and other intellectual property rights is enforced in court proceedings. Injunctive relief is commonly applied for – often with success – by those whose intellectual property rights were infringed. To obtain an injunction the applicant needs to show that he or she has a probable claim and a legal interest in obtaining relief (i.e., that a failure to obtain relief would make impossible or significantly hinder the enforcement of any future judgment in this case).

iv Data protection, cybercrime, social media and e-commerce
Poland has transposed EU law on personal data protection, sometimes providing for even stricter requirements. Generally, the regime is based on an opt-in system (i.e., explicit consent of the data subject is required to process his or her data). The law also provides for other grounds legitimising data processing that may apply in franchise relations, including performance of the contract with the data subject and fulfilment of legally justified purposes of the data controller/third party. Collection of customer data by the franchisee may require express consent, particularly if the data were subsequently shared with the franchisor for marketing purposes.

Potentially of interest to foreign franchisors: additional restrictions apply on the transfer of personal data to countries that do not provide an adequate level of personal data protection (for instance, the US is recognised as such a country unless the franchisor as data recipient has signed up to the Safe Harbour System). In practice, to facilitate the transfer of data from Polish franchisees to a non-EU franchisor, the parties enter into a contract containing EU standard clauses5 whereby the recipient/franchisor agrees, among others, to implement data protection measures at a level at least corresponding to those required under Polish law. No such additional precautions apply to data transfers within the EEA and other countries that are recognised as protecting data at a sufficient level (e.g., Switzerland).

As in other EU countries, business-to-consumer relations are subject to special regulations purposed primarily at consumer protection. In principle, consumers must not be misled and shall receive all necessary information required so that the consumer can make an informed decision on purchase. Additional requirements apply to e-commerce

5 E.g., pursuant to 2001/497/EC: Commission Decision of 15 June 2001 on standard contractual clauses for the transfer of personal data to third countries, under Directive 95/46/EC.
where, among others, consumers are entitled to return purchased products without giving any reason within 10 days of purchase. To ensure full compliance with Polish law all consumer-related restrictions should be taken into account when structuring the franchising model or planning marketing activity addressed to consumers. It should be noted, however, that franchisees will not enjoy consumer protection. Consumer protection is only available to the customers of the franchisee.

IV FRANCHISE LAW

i Legislation

In Poland, there is no franchising law. Franchising agreements are recognised as innominate civil law contracts (i.e., not specially regulated by law), benefiting from the freedom of contract principle. Consequently, the parties are free to tailor their legal relationship at their discretion, so long as the content and purpose of the franchise agreement do not violate the law, the nature of franchising or public policy (bona mores).

The flexibility of franchisors is limited by some statutory provisions. The main provisions are certain general principles set out in the Civil Code, the concept of a pre-contractual duty of good faith (culpa in contrahendo concept) and competition law. Nonetheless, compared to legislation in numerous other EU Member States, Polish law applies a relatively light touch to its regulation of franchising. Although account is taken of the franchisee’s tendency to be the weaker party, franchising contracts qualify as business-to-business relations and, in principle, are not subject to the regulations that are designed to protect consumers and certain other categories of market players (e.g., employees, agents).

In the absence of detailed legal regulations, soft law attracts more attention, especially the Code of Conduct of the European Franchise Federation, which is observed by members of the PFO.

ii Pre-contractual disclosure

In stark contrast to the US system, the Polish market has no express statutory disclosure regulations.

However, this does not mean that the franchisor is free to proceed without regard to the situation of the franchisee. Polish law recognises a pre-contractual principle of good faith (the culpa in contrahendo concept) and some other general rules of the Civil Code, including the right to rescind the agreement in case of misrepresentation (this right is designed first and foremost to protect those who were misled by the contracting party as to the content of the agreement). These principles require franchisors to be fair

6 Culpa in contrahendo offers protection against damage incurred as a result of negotiations conducted unfairly (contrary to law or public policy) if the contract, finally, is not concluded. If fault can be assigned, the party that acted unfairly will be obliged to redress the damage incurred by the other party albeit in a limited scope (i.e., the damage the contracting party would not have incurred had it not started the negotiations (liability does not extend to redressing what the party could have achieved if the agreement had been concluded)).
and open in their discussions with franchisees. Misleading or incomplete statements should be avoided and if information is given it must be accurate and give the correct overall impression. However, one would be hard-pressed to argue with the conviction that based on the above general principles, franchisors have a positive obligation to disclose specifically defined information to potential franchisees. On the contrary, the franchisor’s fairness in the pre-contractual phase is instead assessed on a case-by-case basis, taking into account all circumstances accompanying the negotiation process, including the degree of professionalism and experience of the franchisee. Given that most franchisors provide information on their system to franchisees before the contract is signed, franchisors need to ensure that they monitor the information that is provided to ensure it is accurate and not misleading in any way.

In this context, the ECEF might play a helpful role. It obliges franchisors to provide potential franchisees, in writing and in good time, with full and accurate information material for franchising relations so that the franchisee might analyse the situation and reach an informed decision. Further, all such information (including, specifically, any forecast of future revenues) must be objective, clear and not misleading – a rule that extends to all franchising related materials supplied by the franchisor. The franchisor must be able to substantiate data provided to the franchisee. Thus, any figures relating to possible revenues should represent the real and usual achievements of franchisees operating in a given franchising model. Finally, franchisors are expected to handle the recruitment process in such a way as to ensure that only those candidates who have at least basic skills, education and personal qualities as well as sufficient funds are selected as franchisees. The ECEF requires that Polish franchising agreements be drawn up and signed in Polish, which is not a legal requirement in business-to-business contracts.

While the ECEF is gaining traction among franchisors, the practices they recommend (on a self-regulatory basis only) are still far from common at present on the Polish market.

iii Registration

There are no franchise registration duties.

iv Mandatory clauses

A number of clauses can be implied into franchise agreements under Polish civil law. Some of these terms are mandatory, while others can be waived in the contract. The following rules might be of material relevance for franchising contracts:

a Any provision of a franchise agreement that is contrary to law, public policy or the nature of a franchise might be deemed invalid; for example this would apply

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7 It is assumed that such information should encompass description of the franchising model, rights and obligations of the parties, required investments/payments by the franchisee and overall financial information.

8 If exceptionally good results achieved by one or a few franchisees are to be disclosed, they should be presented very carefully and a reservation made that they are extraordinary in nature, so as to avoid any chance of misleading.
to the exclusion of the franchisor’s liability for defects in sold products under the statutory warranty if the defect was intentionally concealed by the franchisor;

b The franchisor is responsible – under the statutory warranty – for defects of products sold to the franchisee unless the statutory warranty is limited or excluded (which is permitted in business-to-business relations subject to a few exemptions).

c If the late payment interest agreed by the parties exceeds the maximum specified under Polish law, the latter rate will prevail.

d Any provision excluding liability for damage caused intentionally will be unenforceable.

e The right to terminate a fixed-term franchising contract for important reasons cannot be effectively waived;\(^9\) this means that both the franchisee and the franchisor can terminate the franchise agreement for important reasons.

f Either party may terminate an indefinite-term franchising contract.

The franchisor’s right to unilaterally make material changes to the franchising model could be subject to legal challenge under Polish law, especially if it can be shown that the changes could be detrimental to the franchisee’s business. In principle, such amendments should be agreed by both parties. Some flexibility can be provided by authorising specified changes in the contract or providing the franchisee with a reasonable exit option in the event that the changes are detrimental to the interests of the franchisee.

v Guarantees and protection

Polish law recognises a wide variety of security that can be given by the franchisee to the franchisor in respect of payment obligations and contractual performance. Generally, there are two main types of security: (1) a charge over assets and enforceable vis-à-vis any owner of the asset, for example, mortgages (over real estate), pledges (over moveables, shares, receivables); and (2) personal securities, enforceable against the guarantor (debtor) personally such as suretyship, guarantee, cash deposit, promissory note. The security is usually granted by way of an agreement; in certain cases, registration is required (e.g., mortgage or registered pledge). A personal guarantee of the owner of the franchisee company granted to the franchisor is often accepted in dealings with franchisees operating as a legal entity.

V TAX

i Franchisor tax liabilities

Franchisors established in Poland as legal persons are liable to 19 per cent corporate income tax (CIT) applicable to all kinds of income, including dividends.\(^10\)

From the franchisor’s perspective, franchise fees will constitute income calculated on an accrual basis. Generally, that income arises on the day a service is provided (but

\(^9\) Based on regulations related to mandate contract applied accordingly to the franchise agreement.

\(^10\) Other franchisors will pay PIT – for rates, please see Section V.ii, infra.
Poland

no later than on the invoice issue date or day of payment). However, if the parties agree on settlement periods for services rendered periodically, the income generally arises on the last day of the settlement period determined in the franchising agreement (this may apply, for example, to current franchising fees).

Franchisors that are not Polish tax residents and have no permanent establishment in Poland will pay tax only on income generated in Poland. Any withholding tax on franchising fees will be withheld and paid by the franchisee. Generally speaking, licence fees (and, notably, franchise fees may potentially be treated as licence fees) are subject to 20 per cent withholding tax, although this rate may be reduced or waived altogether, depending on whether Poland has signed a DTT with the foreign franchisor’s country of residence. To be eligible for a DTT-based reduction, the franchisor must present a tax residency certificate issued by its local tax office.

Franchising is generally perceived as a service subject to valued added taxe (VAT) of 23 per cent. Any franchisors doing business in Poland must register for VAT if they have taxable annual turnover above 150,000 zlotys. Generally, the duty to assess and remit VAT liabilities lies on the franchisor. However, if a Polish franchisee purchases services from a foreign franchisor that has no permanent place of business in Poland, the franchisee will have to reverse charge VAT on the transaction (import of services).

ii Franchisee tax liabilities

Franchisees established in Poland as legal persons are liable to 19 per cent corporate income tax. Others will pay personal income tax (PIT), which is either 19 per cent (flat rate), or 18 to 32 per cent (progressive rates), depending on the taxpayer’s choice.

As franchising fees will be paid by the franchisee with a view to generating business income, they will generally be tax deductible. That said, it will not always be possible to deduct franchising fees in one go. In some cases, they will be subject to depreciation write-offs.

Franchising fees include: (1) an initial fee (usually paid on receipt of the franchising package, including know-how and licence); (2) recurrent franchising fees (usually paid for cooperation and consulting during the period of validity); and (3) marketing fees.

Generally, initial fees take the form of a fee for the licence granted to the franchisee. The acquired licence represents an intangible asset for the franchisee, on which it may post depreciation write-offs. By the same token, the initial fee does not constitute a one-off tax cost but is settled over time, in the form of depreciation write-offs on the licence value. That value will generally not include the portion of the initial fee contingent on future income from the licensed right. This part of the fee will constitute the franchisee’s one-off tax cost. Similarly, recurrent franchising and marketing fees will be tax costs on a general basis.

Notably, to correctly qualify each individual franchising fee, it will be necessary to analyse the franchising contract. This is because Polish legal regulations do not give clear guidelines on the tax treatment of franchising fees and their qualification for tax

11 WHT assessments on franchise fees require individual analyses of franchise contracts.
purposes. Franchise fees often cover a range of aspects such as a payment for services and a royalty.

The franchisee will generally be entitled to deduct VAT from the franchisor’s invoice, provided that the franchising fees are attributable to the franchisee’s business activities subject to VAT. The franchisee will generally also have the right to deduct VAT if it reverse charges VAT on a transaction (i.e., in the case of acquiring services from a foreign franchisor). In practice, the VAT reverse charge mechanism means that a franchisee accounts for output VAT on the franchising fees and deducts this VAT (as input VAT) in the same VAT return. Typically, no actual payment to the tax office will be made by the franchisee in such a case.

iii Tax-efficient structures
Before choosing a franchising model, its prospective tax efficiency should be scrutinised. If a structure involves an overseas franchisor, it is essential that it should be located in a country that has signed a DTT with Poland, which will enable it to minimise withholding tax exposure and deduct this tax in the country of tax residency. Good countries from a Polish DTT perspective are, for example, Luxembourg and Holland. The contractual language used with respect to fees should be precisely worded, and the service charges be expressly differentiated from licence or quasi-licence fees. If an agreement is between affiliates, care must be taken to ensure the franchising terms are compliant with transfer pricing regulations.

VI IMPACT OF GENERAL LAW

i Good faith and guarantees
A contractual provision that runs contrary to the nature of the legal relationship or public policy is invalid under Polish law. Further, rights must be exercised fairly so that an abusive exercise of a contractual right cannot, in principle, benefit from legal enforcement. Further, protection is offered to those acting in good faith. Thus, fair dealing and good faith should be seen as fundamental pillars of Polish law. This has a significant practical impact on franchising contracts in the sense that the positions of the franchisor and franchisee should be adequately balanced in the franchise agreement.

ii Agency distributor model
The Polish law does not explicitly extend the protective agency regime (which, following EU regulations, was implemented in Poland) to franchisees.

However, in view of judging discretion vested with Polish courts, one may not exclude that in line with tendencies observed in some other EU jurisdictions, Polish judges may start to apply agency law to franchisees by analogy. This may, in particular, affect claims for compensation after termination of the franchise.\textsuperscript{12} \textit{Prima facie}, it seems

\textsuperscript{12} Generally, the agent is entitled to an indemnity if he or she has brought the principal new customers or has significantly increased the volume of business with existing customers and the
that there might be insufficient grounds for any such claims to be brought by the franchisee. However, in some franchising systems an analogy may prove justifiable.\textsuperscript{13}

iii Employment law

In principle, franchising qualifies in Poland as business-to-business relations, and is outside the employment law regime.

In Poland, sole proprietors are quite common in simple franchise models (no partnership required), as it is tax efficient: 19 per cent PIT is available. Naturally, this concept relies on a private individual acting as an independent contractor and taking a business risk. If the above requirements were not met, but instead the franchisee-franchisor relationship met the characteristics typical for an employment contract (e.g., subordination), a risk of reclassification as employment could not be excluded.\textsuperscript{14} Thus, franchise concepts based primarily on the franchisor’s assets and full control of franchisees’ operations require very careful drafting to avoid implications as regards employment contracts (in particular, employee-style entitlements should be avoided: sick leave, holiday, 40 working hours a week, etc.).

iv Consumer protection

Individual franchisees are not recognised as consumers under Polish law to the extent they act in relation to the business they run. Consequently, consumer law does not generally apply to franchising agreements.

v Competition law

EU competition law generally prohibits vertical agreements that may affect trade by restricting or distorting competition, subject to the \textit{de minimis} rule or applicable block exemption regulations. In principle, Poland implemented the EU competition law and the Polish competition authority has the power to directly enforce Polish and EU competition laws. While there are no franchise-specific regulations, provisions on franchise can be found in the Polish and EU Block Exemption Regulations on Vertical Restraints (jointly, VBER).

Under the \textit{de minimis} rule, restrictive clauses are permitted\textsuperscript{15} if the market share of the parties to the franchise agreement is below a certain threshold. The \textit{de minimis} threshold is 10 per cent under Polish law and 15 per cent under EU law for non-competing businesses and, respectively, 5 per cent and 10 per cent, for contracts between principal continues to derive substantial benefits from the business with such customers after the agency contract ended.

\textsuperscript{13} No decision of Polish court speaking in favour of such an analogy has been published thus far.

\textsuperscript{14} This risk seems rather remote in the case of typical franchising agreement. Reclassification often relates to cases where an earlier employment agreement was replaced by a contract with a sole proprietor (individual contractor) for tax reasons, but the factual and/or legal relations remained unchanged or still significantly resemble employment.

\textsuperscript{15} Except for enumerated clauses that are particularly harmful for competition (e.g., price fixing, market sharing).
competitors. Otherwise, restrictive clauses can be permitted under the VBER. However, due to a legislative error, the Polish VBER qualifies franchise agreements that do not involve the resale of products as ordinary vertical agreements. This notwithstanding, given the importance of effects on EU trade, generally, EU law will prevail over Polish competition law.

EU and Polish VBER allow potentially restrictive clauses if the aggregate share of the franchisor and the franchisee in the relevant market does not exceed 30 per cent, except for listed ‘hard-core’ vertical restraints. Franchise agreement provisions that may fall outside the exemption offered by the VBER include:

\begin{itemize}
  \item [a] in-term non-competition provisions that are indefinite or exceed five years;\footnote{The Commission Guidelines on Vertical Restraints (2010/C 130/01) indicate that traditional non-competition covenants may be acceptable so long as they are necessary to maintain the common identity and reputation of the franchise system.}
  \item [b] restrictions on the franchisee’s right to have its own website;
  \item [c] post-termination restrictions on competition that exceed one year;
  \item [d] certain resale price restrictions; and
  \item [e] certain restrictions on the geographic area in which franchisees can market their products.
\end{itemize}

Under the Polish VBER the time limit on covenants against competition contains one exception, namely, it is permitted to establish a restraint, without limitation in time, concerning use or disclosure of know-how that is not in the public domain.

A franchisor with a dominant position in the market must obey stricter rules. Any abuse of a dominant market position is prohibited. Dominance is generally presumed if the market share exceeds 40 per cent in a relevant market. There are no exemptions from the prohibition against abuse of a dominant position.

vi Restrictive covenants

In-term non-compete clauses are quite common in franchise agreements, and, in general, are are valid under Polish law. The approach taken on post-term non-compete bans usually depends on practical risks involved for the franchisor. The non-compete obligation post-term (up to one year) is generally valid, and, in principle, does not need to be compensated unless otherwise agreed with the franchisee. Some franchisors prefer not to negotiate compensation in which case a post-term non-compete clause is not included in their agreements. Further, it is advisable to provide in the contract a right of the franchisor to terminate the non-compete agreement. By terminating the non-compete agreement the franchisor can escape the obligation to pay compensation in the event that it is no longer interested in enforcing the duty against the former franchisee.

vii Termination

Under Polish law, agreements for an indefinite term may be terminated by either party, by observing the contractual, statutory or customary termination periods. If none is provided, the agreement expires immediately after the termination notice is delivered to
the other party. Thus, to limit the flexibility in terminating a franchise, one should either
have a fixed term contract or provide for a long termination notice.

Another principle of Polish law that may be applied to franchise agreements is
the right of both parties to terminate the franchise agreement for important reasons. In
practice, fixed-term franchise contracts specify circumstances justifying their termination
for important reason by either party. If no such clause is added, the franchisee might be
able to rely on the above Polish law principle to terminate the franchise agreement for
important reasons (e.g., if the franchisor had committed a material breach).

As the franchise is a long-term relationship requiring certain investments on the
franchisee’s part, the PFO advises that the term of the franchise agreement should be
long enough to allow the franchisee to amortise its initial investment. Consequently,
as good practice, the franchisor should not reserve the right to terminate the franchise
without justified reasons prior to the lapse of an agreed period of time.17

The parties may agree that the franchise business can be acquired by the
franchisor after the franchise expires. Various legal tools can be used to secure such a
right, including a preliminary sale agreement, a call option, a right of first refusal or pre-
emption right. Acquisition of a going concern usually needs to meet a number of legal
requirements, including prior corporate authorisations (of franchisor and/or franchisee)
and third parties’ consent for assignment to the franchisor of agreements concluded by
the franchisee (e.g., lease contract). The acquiring franchisor will generally, by virtue
of law (1) assume joint and several liability with the franchisee for any civil law and
tax debts relating to the franchise business that arose before the sale (subject to some
exemptions and limitations); and (2) take over the employees of the franchisee under the
Polish equivalent of TUPE. For the above reasons, any ‘takeover’ clauses in the franchise
agreement should only create a right (and not an obligation) on the franchisor’s part so
that the franchisor could decide against going ahead if the acquisition of the franchise
business involves unacceptable costs or risks.

viii Anti-corruption and anti-terrorism regulation
Polish law treats bribery as a criminal offence. Generally, criminal liability is personal
and allocated to individuals. Consequently, franchisors will not be responsible for crimes
committed by franchisees unless they played a role in the crime (e.g., as an assistant or
accomplice).

ix Dispute resolution
The choice of law is ruled by EU regulation (Rome I).18 The parties are generally free to
choose the law governing the franchise relationship. However, a choice of law does not in

17 It is a soft law principle only. However, one may not exclude the possibility that early termination
of the franchise agreement with no justified reason could, depending on the circumstances,
result in an obligation to compensate a damage incurred by the franchisee as a result of the early
termination.

2008 on the law applicable to contractual obligations (Rome I).
principle prejudice the application of those EU provisions or the closest-related law that cannot be derogated by agreement (e.g., consumer laws). Naturally, in line with other legal systems, Polish law excludes the application of foreign law insofar it runs contrary to Polish public policy (i.e., basic principles of Polish law).

Arbitration clauses are generally enforceable under Polish law. Further, Poland is a signatory to the New York Convention on the Recognition and Enforcement of Foreign Arbitral and Awards, and foreign arbitration awards have been enforced in Poland. Usually, the more complex the franchising model is, the more likely the parties are to opt for arbitration. There are a few recognised arbitration tribunals in Poland, but no arbitration court operates at the PFO.

Mediation is recognised in Poland but as a relatively new legal instrument, it is still quite rarely chosen by the parties as an alternative dispute resolution.

EU court judgments can be enforced in Poland without formal recognition (if an enforcement clause is attached). The judgments of other foreign courts generally require formal recognition by the Polish courts. A foreign judgment will not, however, be recognised if it is contrary to Polish public policy.

Although the Polish court system is being systematically reformed (especially, to speed up proceedings, the judge may demand the parties to provide all supporting evidence by a set deadline), it remains relatively slow. It takes one to two years to obtain a judgment, especially, as some local courts might be overloaded. Franchise cases are decided in standard proceedings.

Injunctions are often applied and granted as an interim security of claims. The injunction may prohibit a certain practice (e.g., further use of intellectual property rights). Usually, the courts have one week to decide on the injunction. Injunctive relief can be granted in the course of the main proceedings or even before, but in the latter case the deadline fixed by the court for filing the claim needs to be observed, as otherwise the injunctive expires. The court can make the injunction conditional on posting a deposit (to secure possible damage occasioned to the other party).

In principle, contractual liability covers actual damage and lost profits. The breaching party is liable for the normal result of its action or omission. The liability extends to damage caused by intentional action and negligence. If the party incurring damage contributed to it, the compensation is decreased pro rata. Contractual penalties are enforceable and often used to prevent breach of material covenants. Contractual penalties can, however, be decreased by court if exorbitant.

Court fees are calculated proportionally to the claim value and are capped at 100,000 zlotys. Delivery of evidence (e.g., an expert report, sworn translation) may result in additional costs. Generally, the court fees and costs are reimbursed by the party losing the dispute on a pro rata basis. Attorneys’ fees for representing the party in court are usually pre-agreed with a represented party; in the absence of such an agreement, maximum fees prescribed by law apply.

19 Including the Arbitration Court at Polish Chamber of Commerce (KIG) and the Court of Arbitration at the Polish Confederation Lewiatan.
Surprisingly, published Polish court judgments related to franchise disputes that would be precedential for franchise relations are few and far between. Thus, it is difficult to foresee how Polish case law will develop in legal interpretations related to franchise agreements.

**VII CURRENT DEVELOPMENTS**

Despite the dynamic growth seen in recent years, there is still considerable potential for expansion for new franchising chains in Poland. Nevertheless, new concepts may take more effort to get off the ground due to fiercer market competition than several years ago. It is estimated that the Polish market will be able to absorb approximately 1,000 franchising chains, and this level of market saturation could be achieved quite soon.

As it becomes more challenging to develop new franchise systems, franchisors are seeking to boost their credibility on the market, in particular, by joining the Polish Franchise Federation and by following the best practices recommended under the European Code of Ethics for Franchising. The PFO currently has 40 members and partners, most of whom are leading franchisors in Poland (including McDonald’s, Carrefour, ITM, Telepizza, etc.). Association with the PFO makes it easier to attract new franchisees and develop their franchise network.

It is worth noting that some recognised franchisors have decided to re-enter the Polish market in recent years after earlier failed attempts. An example is Domino’s Pizza, which started operations in Poland in the 1990s but enjoyed little success, which prompted its withdrawal. Now, Domino’s Pizza is aggressively developing its network in Warsaw and its environs. Chocolate Company and Sagafredo Zanetti should also be listed among the new international entrants in Poland.
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Chapter 35

ROMANIA

Cristina Daianu, Anamaria Corbescu and Babette Märzheuser-Wood

I INTRODUCTION

Romania has a strong franchise market, the past decade showing great support and opportunities for existing and potential foreign franchisors. The first law issued with regard to franchising was Government Ordinance No. 52/1997, which set out a legal framework for franchisors looking to develop businesses in Romania. After this law was promoted, the market began to evolve more and more, and as a result large-scale franchises such as McDonald’s and Starbucks have entered the market.

One of the benefits that foreign franchisors see in the Romanian market is the fact that Romanian consumers are highly receptive to international brands. The most successful areas for franchising currently are restaurants, catering, hotels and retail.

The Romanian Franchise Association is the most significant industry body, its purpose being the observance, analysis, development and promotion of franchising as a commercial method in Romania.

II MARKET ENTRY

i Restrictions

There are no specific restrictions or approvals necessary for foreign franchisors when entering the Romanian market. However, there are specific restrictions and requirements, (e.g., licences, permits, and requirements to be part of a regulated profession, Trade Registry requirements in order to set up a business, etc.) depending on the type of business.

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ii Foreign exchange and tax

According to the Romanian Currency Legislation (National Bank of Romania Regulation No. 4/2005 regarding currency regulations, as amended), payment between Romanian residents and non-residents may be performed in any currency chosen by the parties without restriction. In this respect, a Romanian resident franchisee would be allowed to make payments to a non-resident franchisor in any currency agreed between the parties. Payment between residents needs to be made, however, in the Romanian national currency (the leu).

Some international franchisors may choose to establish a Romanian subsidiary, to act as their master franchisor for Romania. These entities will be subject to 16 per cent flat corporate tax as any other Romanian entity. Other taxes, such as tax on dividends, may also apply, depending on the specific circumstances.

Amounts paid in cash or kind for the right to use a franchise are deemed as royalties under the Romanian Fiscal Code. Amounts payable to those companies without a local presence are subject to a 16 per cent withholding tax, unless a more favourable taxation regime is provided under the Interests and Royalties Directive or by double taxation treaties (DTTIs) between the country of the franchisor and Romania. As a general rule, the Interests and Royalty Directive or the DTT provisions may be applied only if the franchisor provides a valid certificate of tax residence issued by the competent tax authority at the moment of payment of the royalty.

III INTELLECTUAL PROPERTY

i Brand search

Romania maintains public national databases of those intellectual property rights that require registration for validity purposes (such as trademarks, designs, utility models, patents) or for opposability purposes (copyrights).

Such databases can be searched against payment of nominal fees by any interested third party. It is usually best to use a registered IP agent (there are specialised IP agents providing 'watching' or 'monitoring' services) who will file a request for information with the relevant public register. Such a search can be performed without any particular reason, for example just to prospect the market. At times, depending on the type of intellectual property rights in question, such a search is performed by the State Office for Inventions and Trademarks, during the registration process for a new trademark. If a potential conflict is revealed during the search, the franchisor needs to assess its impact on the proposed franchise project.

Subsequent to an amendment to the trademark legislation, in 2010, the State Office for Trademarks and Inventions (OSIM) can no longer examine and refuse trademark registrations ex officio for cases of perceived conflicts with identical or similar prior trademarks. Monitoring new trademark applications and objecting to a possibly competing registration will now be the exclusive responsibility of current trademark owners, who will have to watch the publication of new trademark applications carefully and react through the opposition proceedings.
ii Brand protection

In case of trademarks, to obtain exclusive protection in Romania franchisors should register their marks either (1) as Community trademarks, through the Office of Harmonization for the Internal Market (OHIM), for protection in all EU Member States (which, after 2007, includes Romania); (2) as a domestic (Romanian) trademark directly with OSIM; or (3) through the World Intellectual Property Organization (WIPO), with Romania as one of the designated countries. This would help preclude the use of confusingly similar trademarks in Romania by any third parties and entitle the holder to actively fight any infringement or counterfeiting that may occur in Romania (including claiming damages or injunctive relief such as prohibiting unauthorised use, etc.).

The legal protection of national trademarks in Romania is ensured through registration with OSIM, as set out in Law 84/1998 regarding trademarks and geographical indications. The validity period for a trademark is 10 years from the date of the application, being subject to fee-based renewal every 10 years. The procedure usually takes at least three to five months but can take up to two years, the timing thereof depending upon the potential contestations or other obstacles encountered.

A franchisor interested in the Romanian market would need to make sure that all the relevant intellectual property is adequately protected. Typically in a franchise system this would be the trademark, the domain name and the copyright in the written materials. These represent different types of intellectual property and are subject to different legal regimes under Romanian law.

iii Enforcement

In Romania, intellectual property rights may be enforced through court proceedings in case of infringements or through opposition proceedings based on underlying specific legislation (i.e., court action for cancellation of trademarks registered in bad faith, specific customs actions such as confiscation of counterfeit goods, etc.). Additional rights of action arise under general law based on tort or criminal liability. Violation of intellectual property rights may result in civil, administrative and criminal liability. Title holders may request courts to acknowledge their rights and to ascertain and stop the infringement of such rights, claiming damages on such grounds. The Romanian legislation is generally in line with the EU requirements and Romania has acceded to most international treaties and conventions related to intellectual property rights.

iv Data protection, cybercrime, social media and e-commerce

Romanian data protection law is based on Romanian Law No. 677/2001 regarding the protection of individuals in connection with the processing and free circulation of personal data, as amended and harmonised with applicable EU directives. There is a Data Protection Authority (DPA). Under the law, the processing and transfer abroad of personal data must be reported to the DPA prior to carrying out any such operations. No operations involving processing and transfer of data should be initiated in the absence of DPA's prior approval. Approval can be implied, in the case of simple processing, if the DPA does not object within five working days from the filing. For EU franchisors this should be a formality but for franchisors from outside the EU additional steps may have to be taken to ensure the data are secure and processed correctly.
Processing of personal data means any operation performed upon the personal data of an individual such as collection of customer data or the storage of customer feedback forms as well as any form use or, disclosure of such data to a third party such as the franchisor.

In addition, Romania has specific legislation in place regulating e-commerce, e-signature, distance contracts and fighting cybercrime any other types of internet or electronic crimes, in line with the EU requirements.

IV FRANCHISE LAW

i Legislation

The primary legislation is the Franchise Law, which defines franchise in Article 1 and further describes in broad terms the general framework and the main rights and obligations of the parties when entering into franchise agreements.

According to the Franchise Law, a franchise is defined as 'a trading system based on a continuous cooperation between individuals or legal persons, who are financially independent, whereby a franchisor grants the franchisee the right to exploit or develop a business, a product, a technology or a service'. Thus, the franchisee is an independent contractor selected by the franchisor, which adheres to the uniformity principle of the franchise network, as this is defined by the franchisor.

More specifically, the Franchise Law regulates the following three aspects of a franchise relationship:

a first, it regulates the pre-contractual phase by imposing an obligation of pre-contractual disclosure;

b second, it regulates the contractual phase by requiring the franchise agreement to have a certain minimum content; and

c finally, it addresses the post-contractual phase by dealing with certain effects of termination.

The Franchise Law sets out certain general principles regulating the relations between the contracting parties, which are complemented, inter alia, by the provisions of the New Civil Code, general civil law principles, and relevant competition norms.

ii Pre-contractual disclosure

The Franchise Law imposes a pre-contractual disclosure obligation on the franchisor. The purpose of the pre-contractual phase is seen as allowing each of the parties to take an informed decision based on disclosure of material facts. The Franchise Law sets forth the general information that the franchisor must disclose to the franchisee prior to the conclusion of the franchise agreement. Although not expressly requested by the Franchise Law, disclosure should be made a reasonable time before the franchise agreement is signed. We would typically recommend allowing a waiting period of at least a couple of weeks.
The information that must be disclosed by the franchisor to the franchisee comprises the following:

\( a \) A description of the franchisor's experience that will be made available to the franchisee. According to experts, this obligation does not oblige the franchisor to disclose actual know-how that would be confidential until the franchise agreement is signed. Rather a summary of the history and identity of the franchisor and general information about the franchise system is required.

\( b \) A summary of the financial conditions of the franchise agreement must be given. This covers not only fees (the initial fee, the periodical royalties, advertising fees, etc.) but also information on the price payable for products services and the costs of technologies that must be purchased from the franchisor.

\( c \) The disclosure document must outline the duration of the franchise agreement, any rights of renewal and the termination provisions of the agreement.

\( d \) If exclusivity is granted, this matter should be also disclosed in the disclosure document. It is a requirement to state the purpose and area of the exclusivity granted.

\( e \) Finally and importantly the franchisor must provide to the franchisee sufficient information to enable the franchisee to compile a financial plan and to calculate a financial result.

Although not expressly provided for the pre-contractual phase by the Franchise Law, disclosure obligations are also imposed on the franchisee, which should sufficiently disclose its financial credentials and ability to successfully run the franchised business.

The Franchise Law does not mention any particular form for such disclosure. However, it is in the franchisor's (and sometimes, in both parties') interest to have written evidence that proper disclosure was made.

Although not expressly provided by the Franchise Law, it can be implied that the information has to be correct and not misleading. Improper disclosure may lead to a damages claim or to the cancellation of the contract because of an improper consent.

iii Registration

Romania does not have a franchise registration law. The franchise agreement is valid if it is duly executed by the contractual parties; no notarisation or other formalities are required. However, registrations required by other laws such as Trade Registry registrations (for companies or for individuals — under the form of a so-called registered individual (\textit{persoana fizica autorizata})) may apply.

Further, under the Romanian trademark law, trademark licences can be registered with the Romanian Office for Patents and Trade Marks to enable the franchisee to enforce trademark rights against third parties. As a general comment, lack of registration does not affect the validity of the licence itself. If the franchisor does not want the franchisee to have an independent right of action against third parties, it may prefer not to register the licence.
Mandatory clauses

Franchise agreements in Romania tend to comply with international standards (covering rights and obligations of the parties, non-compete, IP-protection clauses, etc.). The particularity in Romania, as opposed to other jurisdictions, is that most of these principles are included in the Franchise Law offering a general framework for the clauses and principles that have to be included in a franchise contract. It is debatable whether these provisions are mandatory or not, as no clear sanctions are provided in the law. It can be said that while certain norms offer general guidelines (a sort of best practice guide), leaving room for variation, others are likely to be interpreted as being mandatory and their non-observance could result in the invalidity of the specific provision or in the case of a very important omission, even of the entire contract.

The Franchise Law requires the franchise agreement to cover the following clauses:

- the object of the agreement;
- the parties’ rights and obligations (which have to be provided without ambiguity);
- the financial conditions;
- the duration of the agreement; and
- the possibilities to amend, prolong and terminate the agreement.

The franchise contract has to comply, by law, with the following principles:

- the term of the contract has to be long enough to enable the franchisee to depreciate its initial investment;
- the franchisor has to give sufficient advance notice to the franchisee of its intention not to extend the contract;
- as regards rights of termination, the contract should be specific listing all acts and incidents that can result in an early termination;
- the contract should be specific about the conditions of assignment of the contract and more specifically, the selection criteria for a potential successor in rights to the franchisor or franchisee;
- a pre-emption right may be provided in favour of the franchisor but this is optional;
- non-compete and confidentiality clauses may be included, in order to protect the know-how of the franchisor; again this is optional;
- the financial conditions have to be clearly provided;
- mandatory notice to cure. The law requires that in case of any breach by the franchisee of its obligations, notice to cure must be given in writing by the franchisor in order to allow the franchisee to remedy the breaches;
- trademark protection clauses may be included; and
- exclusivity may be granted.

According to the Franchise Law, the franchisor has to comply with the following requirements and obligations:

- the franchisor must have owned and exploited a business a couple of years before launching a franchise network;
- the franchisor must be the right-holder of the relevant IP rights; and
the franchisor has to provide to the franchisees an initial training programme as well as ongoing technical and commercial support. The franchisee has to fulfil the following requirements and comply with the following obligations:

- \( a \) the franchisee has to develop the franchise network and to maintain its identity and reputation;
- \( b \) the franchisee has to provide the franchisor with any information enabling the franchisor to assess the performance and the financial status of the franchised business; and
- \( c \) the franchisee has to keep the confidentiality of the know-how received from the franchisor, both during the term of the contract and following its termination.

Guarantees and protection

Romanian law recognises different forms of security such as mortgage, surety, pledge over accounts, bank guarantee, etc. The preferred form of guarantee in franchise relationships is the surety (for local franchises). Typically the owner of the franchised business stands surety for its debts. International franchisors tend to prefer bank guarantees. While bank guarantees are easier to enforce, they are more difficult to obtain in practice as it is necessary to have a local franchisee with high financial standing and a good credit record. A surety is easier to obtain in practice (although the personal liability is disliked and entrepreneurs try to avoid it), but they are more difficult to enforce as court enforcement is required and certain defences are available that would not exist in a first-demand bank guarantee.

TAX

Franchisor tax liabilities

If the franchisor is a Romanian company, it is subject to the flat 16 per cent profit tax, like any other Romanian company. Dividends are equally subject to taxation at 16 per cent, unless either the Parent-Subsidiary Directive or a more favourable DTT applies.

Payments made to foreign franchisors qualify as royalty and are taxed with 16 per cent withholding tax, unless the Interest and Royalties Directive or a more favourable taxation regime applies under a DTT.

Franchisee tax liabilities

If the franchisee is a company it will pay corporation tax at a flat tax of 16 per cent. Individuals are subject to 16 per cent flat income tax.

Tax-efficient structures

Foreign franchisors should consider carefully the location of their franchisor company. Countries such as Cyprus, the Netherlands and Luxembourg are popular because of favourable DT Ts, but Romania has also implemented the Interest and Royalties Directive, which allows zero withholding for payment of royalties.
VI IMPACT OF GENERAL LAW

i Good faith and guarantees

As a general principle under the Romanian law, the contracting parties may freely agree upon the terms of a commercial agreement, provided that they do not breach the rules of public policy, good faith and the mandatory provisions of the law.

It is widely accepted among scholars that good faith is a general principle under the New Civil Code of Romania that applies to all civil and commercial relationships. Thus the principle of good faith does apply to franchise agreements.

With respect to contracts, the New Civil Code provides that contracts shall also be executed in good faith. To this end, the contracting parties have to act in good faith during the negotiation, execution and performance of a contract. The New Civil Code expressly provides that the parties cannot exclude or limit the obligation of good faith. Launching or continuing negotiations without the intention of closing a deal is considered by law an act of bad faith. The party breaking off negotiations in bad faith is liable to the other party for any damage caused. Damages are calculated taking into account the expenses of the negotiation process, the offers rejected by the other party and other, similar, circumstances. Good faith equally affects the performance of the franchise agreement in that the parties must act in good faith when exercising their contractual rights and performing their contractual obligations.

ii Agency distributor model

The agency contract is regulated by the New Civil Code and is defined as a contract by way of which the principal appoints the agent to negotiate or to negotiate and sign contracts in the principal’s name and on the principal’s behalf in a certain territory, against a compensation to be paid by the principal. The franchisee does not act on behalf of the franchisor and its compensation is not paid by the latter; there are also two separate norms governing the two contracts, so there are arguments to consider the franchise and the agency as two separate agreements, the norms governing one not applying to the other (and vice versa).

iii Employment law

Under Romanian law, it is possible that a franchisee that is subject to a large degree of dependence on the franchisor could be characterised as an employee. This would apply where the franchisee’s activity, as carried out for the benefit of a Romanian organisation, may be considered a dependent activity and thus, the underlying contractual relationship may be re-characterised as a labour relationship, which would entitle the relevant individuals to the statutory protection afforded under Romanian law to employees. In that case their income would be reclassified as salary income, which would need to be taxed accordingly (i.e., taking into account also all related social security charges).

That said, if the elements that are specific to a labour relationship are avoided (such as complete subordination, fixed and monthly remuneration, vacation periods, etc.), the risk for such a requalification would be remote.
iv Consumer protection
Under the current relevant Romanian legislation on consumer protection, there are arguments that franchisees cannot be assimilated to consumers because they are not, in many cases, individuals, and because, generally, they operate a commercial business.

v Competition law
Romania is a part of the EU and as a result European competition law principles apply. Consequently, the Vertical Restraints Block Exemption (VBER) and the Guidelines to the Vertical Restraints Block Exemption are applicable.

Certain Competition Council investigations have taken place in Romania in respect of some franchise networks operating in Romania investigating allegations of price fixing.

In the \textit{Fornetti} case, the franchisor – a bakery producer – provided pre-printed pricing labels to its franchisees. The main issues pointed out during these investigations were to the effect that the pre-printed labels were imposing fixed prices on goods.

vi Restrictive covenants
Non-compete, confidentiality and exclusivity are under the most common restrictive covenants during the term of the franchise agreement. Non-compete and confidentiality can be provided also post-termination.

Romania follows the VBER and, as such, certain IP-related obligations, considered necessary to protect the franchisor, are also covered:

\begin{itemize}
  \item \textit{a} an obligation on the franchisee not to engage, directly or indirectly, in any similar business;
  \item \textit{b} an obligation on the franchisee not to acquire financial interests in the capital of a competing undertaking such as would give the franchisee the power to influence the economic conduct of such undertaking;
  \item \textit{c} an obligation on the franchisee not to disclose to third parties the know-how provided by the franchisor as long as this know-how is not in the public domain;
  \item \textit{d} an obligation on the franchisee to communicate to the franchisor any experience gained in exploiting the franchise and to grant the franchisor, and other franchisees, a non-exclusive licence for the know-how resulting from that experience;
  \item \textit{e} an obligation on the franchisee to inform the franchisor of infringements of licensed intellectual property rights, to take legal action against infringers or to assist the franchisor in any legal actions against infringers;
  \item \textit{f} an obligation on the franchisee not to use know-how licensed by the franchisor for purposes other than the exploitation of the franchise; and
  \item \textit{g} an obligation on the franchisee not to assign the rights and obligations under the franchise agreement without the franchisor's consent.
\end{itemize}
In line with the VBER, restrictions on the purchase, sale and resale of goods and services within a franchising arrangement, such as selective distribution, non-compete obligations or exclusive distribution, need to be assessed based on the 30 per cent market share threshold, but taking into account the fact that:

(a) The more important the transfer of know-how, the more likely it is that the restraints create efficiencies and/or are indispensable to protect the know-how and that the vertical restraints fulfil the conditions of Article 101(3);

(b) A non-compete obligation on the goods or services purchased by the franchisee falls outside the scope of Article 101(1) where the obligation is necessary to maintain the common identity and reputation of the franchised network. In such cases, the duration of the non-compete obligation is also irrelevant under Article 101(1), as long as it does not exceed the duration of the franchise agreement itself.

vii Termination

The franchise agreement is generally concluded for a specific period of time and expires automatically at the end of the term. There are no mandatory renewal rights. However, the franchisor is obliged under mandatory law to notify the franchisee with sufficient time in advance of its intention not to renew the franchise contract.

The franchise agreement may further be terminated for default or breach by the other party and, according to the Franchise Law, notice to cure must first be given. The Franchise Law provides that the franchisor will notify the franchisee in writing about any breach of its contractual obligations, at the same time allowing the latter a reasonable time to remedy the breach. As an exception to this rule, the Franchise Law stipulates that the parties may include in the franchise agreement a clause that permits termination without prior notice to cure. Such a clause must set out in clear detail the conditions when termination without prior notification is acceptable.

In Romania, it generally used to be difficult to unilaterally terminate a contract – in the specific case of franchise agreements this could only be achieved upon allowing the defaulting party a remedial period and, at times, in the absence of very clear contractual rules regarding situations of default or breach, the involvement and oversight of the judiciary was needed (a court action was needed in most cases). The New Civil Code adopted in 2011 shifted more clearly towards termination by notice as the general rule and the court intervention as a default situation only. As a general recommendation for a swift and efficient termination mechanism in case of default or breach by one of the parties, in light of the new civil law framework, it is important for the parties to carefully regulate in the contract the cases of default or breach that may trigger the termination (as opposed to penalties or other contractual sanctions), by listing the contractual obligations that are deemed material and by stipulating the applicable remedial periods. Nonetheless, the courts’ intervention cannot be excluded as a problematic or disputed termination would likely need to be finally settled by a judge.

Legal scholars consider that, unless otherwise agreed by the parties, the death of the franchisee (where it is an individual), should also trigger termination, given the fact that the franchise agreement is a contract personal to the franchisee (intuitu personae).
The most important post-termination clauses in local practice are:

a) the negotiation of taking over the stocks by the franchisor (there is no statutory obligation in this respect);
b) the possibility or obligation of the franchisor to acquire the franchisee’s business;
c) the franchisee stopping using the know-how, the brand and the trademark of the franchisor; and
d) non-compete and confidentiality clauses for the franchisee.

viii Anti-corruption and anti-terrorism regulation

In Romania, fraud, corruption and money laundering are criminal offences and as such, are punishable by law. There are no provisions that apply specifically to franchise agreements, but the general legislation prohibiting such practices would apply, along with the criminal law concepts of instigation, accomplice or attempt.

ix Dispute resolution

The franchising system (although very popular) does not have a long-standing history in Romania. As such, relevant case law concerning the matter is scarce and legal doctrine tends to rely extensively on the opinions expressed in foreign scholarly literature.

Romania is a civil-law jurisdiction, and the court system is inspired by the French judiciary. In practice, due to the large workload of Romanian courts, it is not uncommon for the parties to wait between one and three years (in some extreme cases even more) before an enforceable judgement is issued.

Due to these circumstances, certain international franchisors tend to prefer international arbitration (and to the extent possible, foreign courts) over national litigation. Romania is a party to the New York Convention on the Recognition and Enforcement of Arbitration Awards. Thus, foreign awards can be enforced in Romania, but, nonetheless, one should consider that the enforcement process may prove quite lengthy as one may try to use any means of opposition allowed by Romania’s civil procedure rules applicable to court cases. Enforcing a foreign award in Romania may sometimes take as long as two years, but conservatory measures are available if not already in place at the time the enforcement commenced. The decisions of the European courts can be enforced locally under the applicable EU Regulations but, as indicated above and for similar reasons, even this process can be time-consuming as an order of the local courts is needed and the Romanian courts tend to be slow.

In an effort to modernise dispute resolution proceedings and to curtail the length of litigation a new Code of Civil Procedure was passed and has entered into force during early 2013. Assessing the overall effectiveness of the new Code of Civil Procedure is however premature considering the recent date of the Code’s enactment and the fact that many ongoing disputes are still governed by the former Code of Civil Procedure.

Parties to a franchise contract have the freedom to choose a foreign law as governing law if the contract has sufficient connection to a foreign country, such as may be the case where the franchisor is incorporated abroad. In light of certain rulings of the Supreme Court it is debatable whether two Romanian entities, notwithstanding their foreign shareholding, can subject their contract to a foreign law in absence of a material ‘foreign’ element of the agreement.
Injunctions are available as a temporary remedy in urgent cases. Trademark infringements by former franchisees that continue to use the trade name of the franchisor can be temporarily prevented through interim injunctions, until a court rules on the merits of the case.

VII CURRENT DEVELOPMENTS

Romania is a popular market for franchises and the legal framework is very much aligned with other EU Member States. Every year, new international brands are entering the market and most of them develop rapidly, given also the recent construction of shopping malls in all major cities.
Appendix 1

ABOUT THE AUTHORS

CRISTINA DAIANU
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Cristina Daianu, local partner in Dentons Bucharest office, has extensive experience in corporate and M&A work. She has also dealt with numerous franchising matters for multinational companies entering Romania. Cristina has assisted clients from a wide range of industries such as retail, logistics, advertising, printing, banking, pharmaceuticals and medical services, FMCG or the steel industry. Over the years, she has worked for and developed strong abilities in dealing with international investors. Cristina worked for several years in Frankfurt am Main and completed her studies at the University of Paris I Pantheon-Sorbonne; she is a lawyer qualified in both Romania and France and speaks Romanian, German, French and English.

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Anamaria Corbescu, managing counsel, is a core member of the corporate group, and is experienced in compliance and regulatory matters. In addition, Anamaria has solid experience in intellectual property and data protection issues. In terms of specific franchising experience, she has worked for Hilton, Marriott and Accor with respect to franchising and hotel management agreements, as well as brand management, IP and other commercial issues. As a Fulbright scholar, Anamaria completed her LLM studies at Columbia University in New York.

BABETTE MÄRZHEUSER-WOOD
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Babette heads up the EMEA franchise group at Dentons. She has more than 20 years’ experience in international franchising with a particular focus on emerging markets. Her work includes the creation and critique of franchise contracts and their customisation to local law. Babette has transactional experience in all 28 EU Member States. Babette
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a particular emphasis on German-speaking Europe. Babette is ranked by *Chambers
Global* as one of the top 10 franchise specialists in the world. She is also recommended
by *The International Who's Who of Franchise Lawyers, Chambers UK* and *Legal 500* for
her franchise expertise. Babette's research on the role of franchising in the European
hospitality industry has attracted widespread media attention. Babette is the author of
numerous publications on franchising. She also lectures widely on international franchise
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Chapter 36

SAUDI ARABIA

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I INTRODUCTION

The significance of franchising is apparent from visiting any of the commercial districts throughout Saudi Arabia, which are lined with popular Western restaurants, clothing stores and other retail outlets.

Since the days of the oil boom, Saudi Arabia has been a destination for international franchisors and now hosts more than 300 foreign companies operating franchises. Franchising has grown exponentially in the past decade and continues to grow in the largest country in the Gulf, where 47 per cent of the population is younger than 25 years old and there is a strong affinity to products from the United States and Europe. According to local statistics, there is an expected average of 10–12 per cent annual growth in the franchise sector and paid fees and royalties have exceeded $323 million.

The most prevalent franchises in Saudi Arabia revolve around the food and beverage sector, with Starbucks, McDonald’s, Burger King, KFC, and Subway leading the way, while Gap, Victoria’s Secret, and H&M are some of the well-known retail names. Franchising opportunities in Saudi Arabia are not limited to global brands. The growth of entrepreneurial activity has sparked opportunities for franchising of local and regional concepts, which are gaining popularity.

While Saudi Arabia does not have any formal franchise association, the local Saudi Arabian Chambers of Commerce have been instrumental in endorsing and promoting

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the franchise sector. In 2008, under the guidance of the Riyadh Chamber of Commerce, Saudi Arabia held its first international franchising conference and expo as well as two additional franchise expos annually thereafter.

II MARKET ENTRY

1 Restrictions

The Saudi market is open to foreign franchisors and franchisees with very few legal restrictions. There is no distinction between a Saudi franchisor and a foreign franchisee, franchisor or developer. Both are treated as foreign investors and subject to foreign investment regulations. It should be noted that nationals of the Gulf Cooperation Council (GCC) countries\(^3\) are treated as Saudi nationals and are not considered foreign investors. As a result, some foreign brands enter the Saudi market with a UAE partner.

Legal restrictions on foreign investment depend on whether the activity being conducted is classified as a 'service' or 'trading'. A foreign investor (non-GCC) engaging in service activities, such as restaurants, maintenance, IT support and other services can, for example, establish a branch office or a 100 per cent wholly-owned limited liability company (LLC) in Saudi Arabia. In the case of a foreign franchisor, these entities can operate company-owned outlets or service its franchisees. The Saudi Arabian General Investment Authority (SAGIA) does not require any minimum paid-up capital for a services entity, but it is common for companies to have a minimum capital of 500,000 Saudi riyals. Despite the absence of restrictions, foreign restaurant brands tend to prefer the franchise model because it gives them access to local know-how, connections and the expertise of the franchisee. Securing a lease for an AAA location can be very difficult, and a good local partner can be invaluable.

On the other hand, foreign investors engaging in retail or wholesale trading are restricted to establishing an LLC where there must be at least 25 per cent ownership by a Saudi national or company. The minimum capital required for a retail or wholesale trading company is 20 million Saudi riyals, excluding the capital that will be paid by the Saudi shareholders. Due to the large capital requirement, this option is unsuitable for all but the very largest multinational franchisors.

Another foreign investment option is the establishment of a manufacturing facility that produces products in Saudi Arabia that may be distributed to local franchisees or exported to other jurisdictions. There is a minimum capital requirement of 1 million Saudi riyals for setting up a manufacturing facility, albeit a nominal amount for the manufacturing industry. The advantage of manufacturing locally would be that locally-made products would not face import restrictions.

\(^3\) GCC countries include Saudi Arabia, Kuwait, Bahrain, Qatar, United Arab Emirates and Oman.
SAGIA also publishes a list of activities that are off-limits to foreign investors, such as but not limited to oil exploration, manufacturing of military equipment, services to military sectors, and security and detective services.\(^4\)

ii **Foreign exchange and tax**

Saudi Arabia does not enforce any exchange control, but it is most common for payments and transactions to occur in Saudi riyals.

There is no personal income tax in Saudi Arabia, which makes it an ideal place for individuals and employees. Tax mainly consists of corporate tax, withholding tax or zakat (Islamic wealth tax). Corporate tax and zakat depends on the companies’ shareholding structures. Withholding tax is mandatory on all persons or entities making payments to non-residents, such as for rents, royalties, and management fees. Withholding tax for royalties and service fees are assessed at the rate of 15 per cent.

### III INTELLECTUAL PROPERTY

i **Brand search**

The Trademark Office at the Ministry of Commerce and Industry (MOCI) is responsible for the registration of trademarks in Saudi Arabia. Trademarks or service marks including company name registration may be searched by filing a request with the MOCI to determine whether there are any previous filings by other parties.

ii **Brand protection**

Trademark protection is afforded on the basis of the first to register the mark with the MOCI in Riyadh. The first to register the trademark has priority over all other users of the mark and is deemed the owner of the mark. Trademarks must be distinctive, and registration of a globally recognised brand is only permitted by its rightful owner. Also, a trademark cannot be contrary to religious practices or morality and cannot be a geographical name.

To register a foreign trademark, the owner or someone authorised to register the mark on the owner’s behalf must complete the standard application form and include a copy of the registration certificate from the owner’s home jurisdiction. The application must include a list of goods and their class, and a separate application is required for each class of goods or services.

Trademark applications are generally decided within 60 days after filing, and an applicant has 90 days to correct any deficiencies in its applications to the satisfaction of the MOCI. If a trademark registration is approved, it is valid for a period of 10 years and may be renewed during the last year of the registration and through a grace period of six months after expiration of the registration.

If the MOCI issues a final rejection of a trademark application, the applicant may appeal the decision to the Board of Grievances (or Saudi Arabian commercial court) within 30 days of the rejection.

iii Enforcement

As part of its 2005 accession to the World Trade Organization, Saudi Arabia committed to the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS), and has taken measures to step up enforcement of intellectual property rights.

Trademark infringement and counterfeiting issues are punishable by both civil and criminal proceedings, and are subject to fines and imprisonment. The Board of Grievances may issue an injunction if the trademark owner can demonstrate the imminent need to prevent certain circumstances, such as the continued sales of counterfeit goods, or the need to seize counterfeit goods and related equipment. The MOCI also has the authority to take action against counterfeiters. Upon receiving a request by a trademark owner showing compelling evidence of alleged infringement, the MOCI may conduct raids on alleged counterfeiters and refer its findings to the Board of Grievances for further prosecution.

iv Data protection, cybercrime, social media and e-commerce

Saudi Arabia has outlined a framework on privacy rights based on its interpretation of shariah and Islamic values. The Basic Law of Governance, which serves as a Constitution for Saudi Arabia, lays out the privacy rights of Saudi Arabian citizens. The Basic Law guarantees the privacy of telegraphic and postal communications and telephone and other means of communication (including e-mail) by prohibiting confiscation, delay, surveillance or eavesdropping, except in cases provided by law.

Shariah serves as the basic legal framework within Saudi Arabia. Under shariah, as construed and applied in Saudi Arabia, a person may receive compensation for damages caused by a second party that wrongfully disclosed the first person’s personal information. In addition to tort damages, the authorities may impose sanctions as punishment for such violations.

Although there is no separate code dedicated to data protection as there are in many Western jurisdictions, privacy as it relates to data protection is treated in various other codes and industry specific regulations, such as the Anti-Cyber Crime Law and the Telecommunications Act.

Franchises must safeguard customer data obtained in Saudi Arabia, and should ensure it complies with any applicable regulations prior to transmitting data outside of the Kingdom. Personal data may not be sent abroad without the obtaining the pre-authorisation of the data subject, and in some cases regulatory approval is required.

IV FRANCHISE LAW

i Legislation

Although Saudi Arabia does not have a specific franchise law, Ministerial Order No. 1012 of 17/09/1412 (corresponding to 22 March 1992), issued by the Minister of Commerce
and Industry, brought franchising under the umbrella of the Saudi Arabian Commercial Agency Regulations and its Implementing Regulations.

The Commercial Agency Regulations set out the rules governing the relationship between a principal (franchisor) and agent (franchisee), including the procedures for registration of a franchise, their rights and obligations and a model franchise agreement that the parties may adopt at their own discretion.

ii Pre-contractual disclosure

In general, shariah law requires parties to be truthful, provide full disclosure of material facts and information and act fairly towards one another in their dealings.

Franchisors are generally in a superior bargaining position when negotiating with franchisees, who may be eager to obtain franchise rights. For example, a franchisor may be aware of certain issues such as the importation of products or necessary supplies that will impact a franchisee's ability to meet consumer demands and meet sales targets. Franchisees may file a complaint against the franchisor for failure to disclose material facts and hold them liable for any damages, such as start-up and investment costs. Franchisors should therefore hand a disclosure document to Saudi franchisees setting out all material facts.

These concepts apply equally to both franchisors and franchisees. Franchisees may be held responsible for misrepresenting their track records and experience, or knowingly concealing facts that demonstrate their incapability of performing their obligations under a franchise arrangement.

Although there is no specific code or regulation laying out these disclosure and fairness requirements, shariah law will be applied as a matter of right by the courts.

iii Registration

The Commercial Agency Law requires a franchise agreement to be registered in the Commercial Agencies Register at the MOCI within six months of the agreement taking effect. The franchisee is responsible for the registration of the franchise agreement, and only a Saudi individual or entity is permitted to register a franchise. Non-Saudis, including GCC nationals, are not permitted to register franchises or agencies in Saudi Arabia.

To register a franchise agreement, the franchisee must provide the following:

\[\begin{array}{ll}
\text{a} & \text{an application to the MOCI;} \\
\text{b} & \text{an Arabic translation of the franchise agreement and supporting documents, certified by a translation office;} \\
\text{c} & \text{a copy of its commercial registration, demonstrating its authority to carry out the relevant activities; and} \\
\text{d} & \text{a written declaration that the company's capital is Saudi-owned and the authorised representative is a Saudi national.}
\end{array}\]

Traditionally, franchise contracts were registered to provide legitimacy to the franchisee and afford it certain protection, particularly where the franchisee had exclusivity in Saudi Arabia. However, there is currently a nominal value in registering a franchise
agreement, except to the extent of being able to secure government contracts, which
require transactions to be with registered agents or franchisees.

Another benefit of registration is a franchisee’s ability to prevent the appointment
of another franchisee in the event of termination of the franchise agreement. A new
franchisee may not be able to register the franchise until the dispute is resolved with the
former franchisee.

The failure to register a franchise will not prevent enforcement of the franchise
agreement. Notwithstanding the inability to register a franchise, non-Saudi nationals
such as GCC master franchisees are still able to enter into a franchise agreement in Saudi
Arabia and operate as a franchisee, but they will not have the protection of the agency
law.

iv  Mandatory clauses
As mentioned above, shariah law will apply to any franchise agreement as a matter of
right and law and provides the parties a significant amount of autonomy to structure
their contract. A franchisor and franchisee are free to contract with one another without
using any specific form, but the franchise agreement must comply with the following:

a. execution must be directly with the franchisor in the country of origin of the
   franchise;

b. the rights, responsibilities and obligations of each party must be explicitly stated;

c. the obligations of both parties regarding the consumer, in relation to maintenance
   and availability of spare parts, must be stated;

d. the capacity and the nationality of each party must be stated;

e. the subject of the franchise must be stated;

f. the geographical area covered must be specified;

g. the services, works and goods covered by the franchise must be stipulated;

h. the duration of the franchise agreement and the terms of renewal must be
   specified; and

i. the method of termination or expiration must be specified.

v  Guarantees and protection
Guarantees are common in Saudi Arabia, and are used as security for a variety of
transactions. A guarantee can be requested by a franchisor and may be included in the
franchise agreement or as a separate agreement.

Personal guarantees are enforceable against individuals, and guarantees can be
enforced against a company assuming it has the assets or capital to back the guarantee.
The enforceability of a guarantee will depend on whether the guarantee contravenes any
aspect of shariah law or public policy.

V  TAX

i  Franchisor tax liabilities
Tax liability is based on a corporation’s shareholding structure.
Saudi Arabia

Saudi and GCC nationals are exempt from corporate tax, and instead assessed with zakat at the rate of 2.5 per cent. Thus, a franchisor who is a Saudi or GCC national will only pay zakat.

A foreign franchisor operating in Saudi Arabia is subject to a 20 per cent flat rate corporate tax. In the event that a company consists of Saudi or GCC national shareholders and non-Saudi national shareholders, the tax authorities will apply a 20 per cent corporate tax to the interest of the non-Saudi nationals and a 2.5 per cent zakat to the interest attributable to Saudi or GCC shareholders.

Payments to non-residents from income earned from a source in Saudi Arabia are subject to withholding tax that varies from 5–20 per cent, depending on its classification. Franchisors will be subject to a 5 per cent withholding tax for remittance of payments outside of Saudi Arabia. A Saudi resident individual or company making the overseas payment is responsible for declaring and paying the withholding tax to the tax authorities. Withholding tax does not apply to payments in relation to the sale of goods and other property.

Furthermore, Saudi Arabia does not have VAT, transfer tax, stamp duty, sales tax, property tax or regional and municipal taxes.

ii Franchisee tax liabilities
Individual franchisees will not have any tax liability, as there is no personal income tax. Similar to the franchisor tax liabilities mentioned above, a franchisee entity will be subject to either corporate tax or zakat depending on their shareholding structure. If the franchisee is a Saudi or GCC national, they are only subject to a 2.5 per cent zakat; but if the franchisee is a non-Saudi national they will be subject to a 20 per cent flat rate corporate tax. Also, if the franchisee’s entity contains both Saudi or GCC national shareholders and non-Saudi shareholders, the tax authorities will apply the 2.5 per cent zakat or the 20 per cent corporate tax to their interest respectively.

Franchisees are also required to withhold tax at the rate of 5–20 per cent for payments made to non-residents. Royalties and payments for services made to a head office or affiliated company are subject to 15 per cent withholding tax. Royalties paid to a foreign franchisor are subject to 15 per cent withholding tax. The franchisee will be responsible for declaring and paying the withholding tax and consequently incur any penalties for failure to do so.

iii Tax-efficient structures
Saudi Arabia has tax treaties with several countries such as the United Kingdom, Russia, China, The Netherlands, Japan and Spain, which may offer tax breaks for foreign franchisors and franchisees. Saudi Arabia also provides tax incentives for companies establishing entities in designated economic zones.

VI IMPACT OF GENERAL LAW
i Good faith and guarantees
The principle of good faith is a continuation of the tenets of shariah law, requiring parties to have fair and honest dealings, avoid misrepresentations and provide full disclosure to
one another. Courts may take into consideration a party’s lack of good faith if a dispute arises between the franchisor and franchisee.

Shariah law provides a great deal of freedom for the parties to agree to their own contractual terms, and Saudi courts will look to the intention of the parties with the objective of enforcing an arrangement as it was intended. It is essential for the parties to clearly state their rights and obligations in a franchise agreement for the purposes of demonstrating their agreed terms and preventing possible allegations of bad faith. A typical United States or United Kingdom franchise agreement will have the required level of detail.

ii Agency distributor model
Franchising is under the umbrella of the Commercial Agency Regulations and is treated in the same way as a commercial agency. A franchise is viewed more as a principal–agent relationship, except the franchisor is not liable for the negligent actions or tortious conduct of the franchisee.

Franchisors have a strong interest in protecting their trademark, brand name and reputation, and may exert a considerable amount of supervision over the franchisee. However, franchisors should refrain from being involved in franchisees’ day-to-day operations and limit their involvement to a reasonable amount of support that ensures the success of the franchise. Exercising direct control increases a franchisor’s risk of vicarious liability for acts of negligence and tortious conduct committed by the franchisee.

iii Employment law
Notwithstanding a franchisor’s supervisory authority over a franchisee, a court will not construe the franchise as that of an employer–employee relationship.

iv Consumer protection
A franchisee will not be considered a consumer in Saudi Arabia, but is considered to be similar to an agent of a franchisor. Remedies available to a franchisee are limited to those by Sharia law and contractual arrangements.

For the protection of public consumers, the Commercial Agency Regulations require a franchisee to ensure maintenance of any products at reasonable cost, and the availability of spare parts at reasonable prices throughout the term of the franchise and for up to one year after termination of the franchise agreement or the appointment of a new franchisee. Necessary spare parts should remain in stock, and other spare parts should be made available within 30 days after receiving a request from a consumer. The franchisee is also required to abide by any warranty periods provided by the franchisor. These provisions will require a franchisor to make available and supply a franchisee with spare parts and support for up to one year after termination of the franchise. Obviously the spare parts requirement has in mind motor vehicle franchises, but it can also be applied to retail shops in that the franchisee would have to have sufficient replacement items to exchange faulty goods.
v  Competition law

Saudi Arabia has enacted a Competition Law for the purpose of protecting and encouraging fair competition and combating monopolies that affect lawful competition and anti-competitive business practices.

Prices of commodities and services are subject to supply and demand principles. The Competition Law prohibits price manipulation that either lowers prices to eliminate the competition from the market or creates artificial shortages that increase prices.

Similarly, it is illegal to impose special conditions on the purchase or sale of goods or offering services in a way that negatively impacts a merchant in comparison with others. A recent case was filed by franchisees alleging that their sales have been hindered by the actions of the franchisor who was supplying goods to merchants in the market at much lower prices than prices charged to the franchisees for the same goods. The franchisees are alleging that the franchisor's actions have put them in an unequal position in comparison to other merchants. The outcome of the case has yet to be determined.

vi  Restrictive covenants

Restrictive covenants such as non-compete clauses are lawful and enforceable in Saudi Arabia. It is common for franchisors to restrict a franchisee from competing with the franchise. The franchisor and franchisee can also agree to restrict the geographical area of the franchise or to provide exclusivity to the franchisee in the territory.

As a general rule, courts will enforce restrictive covenants that comply with shariah law and are not overly burdensome on the parties and limited in application, such as for up to two years and limited to specific industries or related industries.

vii  Termination

A franchise agreement, like any other commercial contract, should be terminated in accordance to its terms. Although Saudi law does not require a minimum term for the franchise agreement, the parties must stipulate the duration of the contract as well as specify the manner for terminating the agreement. Saudi courts will enforce clauses contained in the franchise agreement that allow for the automatic expiration or non-renewal of a franchise. Similarly, the courts will give credence to provisions in the franchise agreement that limit or even deny the franchisee any compensation upon termination.

In the event of a dispute related to termination, the MOCI will not permit the registration of a new franchisee until the previous franchisee has obtained its full rights and entitlements, if any. This will not prevent the franchisor from appointing a new franchisee, but rather only prevents the registration of the new franchise agreement. This will have little impact on the franchisor or the new franchisee, as the courts will recognise the new franchise agreement regardless of registration.

A finding by the court that a franchisor unlawfully terminated a franchise agreement may result in the award of direct damages to a franchisee. Saudi courts rarely provide for any consequential damages or lost profits in contractual disputes, but may in some instances calculate damages on the basis of the profits of a new franchisee, if one is appointed. If the claims of a franchisee lack merit, the courts will issue an order to deregister the former franchisee from the Commercial Agency Register.
The ability to take over a franchisee's business is impossible without their agreement. In many cases, the franchisee may even own the property where the franchise is located, and cannot be compelled to give up the location. Franchisors can require franchisees to remove and cease to use any items that identify the franchise, such as trademarks, brand names, signage and marketing materials. The lease of property and any other items that were not provided or leased out by a franchisor cannot be claimed. As mitigation, a franchisor may include a provision in the franchise agreement stipulating that either it or a subsequent franchisee have the right to take over the business, including the property lease upon termination. However, enforcement of such a provision is time consuming and also dependent upon the lessor's willingness for the franchisor to assume the lease, and in the case of a retail franchise on compliance with the minimum local investment threshold.

viii Anti-corruption and anti-terrorism regulation

Saudi Arabia has a number of regulations addressing corruption, bribery and money laundering, which are all serious criminal violations. The Anti-Bribery Law penalises persons or companies offering bribes to public officials, as well as public officials who demand bribes for themselves or for the benefit of others. The National Anti-Corruption Commission has initiated an aggressive campaign for transparency and for combatting bribery and corruption, including advertisements and an anonymous hotline for whistleblowers.

Franchisors will rarely be liable for violations of these laws committed by a franchisee, unless the franchisor actively participated or encouraged the illicit activities. Nevertheless, franchisors will suffer reputational harm in the local and overseas markets for violations committed by its franchisee and may endure further scrutiny when conducting future business in Saudi Arabia.

ix Dispute resolution

As in the case of a franchise agreement, the parties to a contract are free to stipulate the dispute resolution mechanism, including the governing law and jurisdiction. Unless the parties have opted for arbitration in the franchise agreement, a dispute will be resolved by litigation in a court that has jurisdiction.

In Saudi Arabia, the Board of Grievances has jurisdiction to handle franchise disputes. Although arbitration is an option, it is not recommended as awards are not final and binding and may be re-adjudicated by the Board. A final decision by the Board may take in excess of one year, excluding the appeals process. Nevertheless, enforcement of a judgment is less difficult than enforcing a foreign judgment or arbitration award.

Saudi Arabia will enforce foreign judgments, and as a signatory to the New York Convention it will enforce foreign arbitral awards. The enforcement courts have the jurisdiction to enforce foreign arbitral awards or judgments issued by a foreign court if the following conditions are met:

1. 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.
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.

Reciprocity: There is reciprocity between the foreign jurisdiction which 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.

Consistency: The judgment being enforced does not contravene a judgment issued by a Saudi court or other governing body on a similar matter.

Finality: The foreign court’s decision is final and binding and not subject to further appeal.

Public policy: The judgment does not violate Saudi law or public policy (i.e. charging or payments of interest or concerning unlawful activities such as alcohol and gambling).

If a foreign arbitration award or judgment contravenes Saudi law or public policy, the courts may enforce only those portions that are lawful or it may deny the enforcement and re-adjudicate the matter locally. Since foreign courts tend to award judgments that include the payment of interest and consequential damages or lost profits, which typically contravene Saudi law, it is mostly in the parties' interest to have the matter heard by the Board of Grievances from the onset.

Generally, courts will only award direct damages to the aggrieved party. Injunctions may be obtained if a party can demonstrate to the court the imminent need to prevent any irreparable harm that it may incur and will be required to post a bond. There are no administrative or court fees associated with litigation and most fees are incurred as a result of retaining competent legal counsel to handle the matter before the court or an arbitration panel.

VII CURRENT DEVELOPMENTS

There have been ongoing discussions on the enactment of a specific franchise law independent from the Commercial Agency Regulations, but there has not been any progress.

Other developments have been in the area of importation of goods by non-registered franchisees. In the past, only registered agents could import goods into Saudi Arabia, and this caused concern for franchisors where there is an ongoing dispute with the franchisee and a new franchisee is prevented from registering. In recent years, non-registered agents and franchisees have been able to import goods to Saudi Arabia with little difficulty and without having registered their franchise agreement.

The franchise industry in Saudi Arabia will continue to grow as Saudis travel to new destinations that were previously not on their radar. In recent times, Saudi Arabia has experienced an influx of new franchises from South Africa and Turkey and brands and products from those countries have become familiar. This trend is expected to continue due to the increase of foreign visitors making pilgrimage to Saudi Arabia, as well as the large number of Saudi students studying abroad.
Appendix 1

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Amgad Husein is the managing partner of the Dentons operations in Saudi Arabia and has advised on a number of high-profile transactions in the Kingdom. Amgad has published many articles on doing business in Saudi Arabia and is also a co-author of the Legal Guide to Doing Business in Saudi Arabia (forthcoming, Thomson Reuters).

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Babette heads up the EMEA franchise group at Dentons. She has more than 20 years' experience in international franchising with a particular focus on emerging markets. Her work includes the creation and critique of franchise contracts and their customisation to local law. Babette has transactional experience in all 28 EU Member States. Babette is recognised as one of Europe's leading experts in hotel and leisure franchising with a particular emphasis on German-speaking Europe. Babette is ranked by Chambers Global as one of the top 10 franchise specialists in the world. She is also recommended by The International Who's Who of Franchise Lawyers, Chambers UK and Legal 500 for her franchise expertise. Babette's research on the role of franchising in the European hospitality industry has attracted widespread media attention. Babette is the author of numerous publications on franchising. She also lectures widely on international franchise
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laws and her expertise is often sought by franchisors from common law countries that enter civil law jurisdictions. She is an associated editor of The Franchise Law Review. Babette is a member of the ABA Forum on Franchising, the IBA Franchise Committee and the IFA. She is dual-qualified in both Germany and the UK. She speaks English, German, French, Spanish and Russian.

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Chapter 41

UGANDA

Paul Asimwe and Babette Märzheuser-Wood

I INTRODUCTION

The franchise market in Uganda is dominated by domestic micro-franchises although some well-established foreign brands have also operated in this jurisdiction for a long time. The most significant foreign franchises are in the petrochemical industry and these include Shell, Total and Caltex (Chevron, Texaco). In more recent times, privatisation in the telecoms sector has created a new wave of franchisees. MTN Uganda entered the market in 1997 and rolled out its products through thousands of franchisees known as super dealers. These in turn sell the products on through micro-franchisees, leading to MTN’s current dominance of the telecoms market. The post-1990s telecoms boom in Uganda has seen the steady growth of franchises in the fusion of the telecoms and financial services sector through establishment of mobile money outlets. Another area employing the franchise model to good effect is the renewable energy sector, where leading players such as Barefoot Power have used the micro-franchise model to increase its market share for solar products.²

All these developments continue at an exponential pace in the absence of a formal regulatory environment for franchising. What is key to note is that almost all of the franchising regulations are based on contract law, with little consideration for other aspects such as intellectual property. For the industry to flourish, there may need to be formal structures, such as an association. The key function of such an entity would not be to regulate as such, but rather to support and give direction to franchisors and franchisees alike, in the basic areas of establishment and running successful franchises.

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1 Paul Asimwe is a partner at Sipi Law Associates and Babette Märzheuser-Wood is head of the EMEA franchise group at Dentons.

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II MARKET ENTRY

i Restrictions
Uganda offers a liberal environment for foreign franchisors to enter and set up businesses. This is largely in part due to restructuring of the economy in 1987, through measures such as liberalisation of FOREX trade. Foreigners do not have to have local shareholders, nor are they limited in exporting their profits from their local businesses. However, the legal environment retains some provisions that foreign franchisors may need to be aware of as they embark on doing business in Uganda. The Investment Code Act contains provisions requiring the franchisees to register any agreement that includes the transfer of foreign technology. In a previous study, it was noted that Section 29 of the Investment Code Act, which requires registration of technology licences, has been unpopular with investors. As a result, the Uganda Investment Authority hardly registers any licences and this requirement is likely to be dropped in the proposed amendment to this Act.

Uganda's legislation on ownership of land limits non-Ugandans to owning leasehold property. The only option around this is to seek a long lease, which has now been reduced from a maximum of 99 years to 49 years under a proposed new Land Policy.

ii Foreign exchange and tax
Foreign exchange regulation in Uganda is relatively liberal compared with other countries in Africa. Businesses will be permitted to bring in and take out foreign exchange as long as it is declared. Only in exceptional circumstances under Section 10 of the Foreign Exchange Act can the Central Bank limit foreign exchange transactions, particularly where the country's foreign exchange reserves have fallen below critical levels.

Another key point for a foreign franchisor to note is the tax treatment under Ugandan law. Since almost all foreign franchisors do not incorporate in Uganda and do not attain resident status, they are taxed as non-residents. They therefore pay a withholding tax of 15 per cent on their income, which is normally to be withheld by the franchisee and paid to the Uganda Revenue Authority.

III INTELLECTUAL PROPERTY

i Brand search
As in most other jurisdictions, conducting a search whether in the registry of companies or the trademark registry is possible. A number of cases have occurred where locals have registered famous brands once it has become known that the brand owner intends to start business in Uganda. An intending franchisor would be well advised to first conduct a search in the trademarks registry for the relevant trademark. Absent registration protection is limited to passing off and the famous brands doctrine. The position regarding famous brands in Uganda will most likely will be in line with the Kenyan

3 Sections 29 and 30 of the Investment Code Act require beneficiaries of agreements such as franchise agreements to register these agreements with the Investment Authority.
Uganda

Intellectual Property Institute's Trademark Office position in the matter of Bulzai Energy Drink & Bull Device KE/T/2010/0067288. In this case, the Registrar held that a famous mark must be proven to be famous in Kenya, rather than in the market of origin per se.4

ii Brand protection

The trademark filing process in Uganda is relatively straightforward, following the practice in most common law jurisdictions as follows:

a The agent or advocate is issued with a power of attorney by the franchisor, under a form cited as TM1.

b The applicant conducts a trademark search. Fees for foreign applicants are US$65 per class and results will typically be given within two to three days.

c Once the preliminary search indicates availability of the mark, the applicant can file an application using form TM2, normally through a local trademark agent.

d Once the application is filed, it is given a filing date and number and proceeds to examination. In the absence of a formal report, a gazette notice will be issued, permitting the franchisor or applicant to proceed and publish the trademark in the official gazette. A fee of 300,000 Ugandan shillings is paid for a notice covering a few goods. However, longer schedules of goods will attract significant charges. The mark is published for 60 days within which period anyone interested in lodging an opposition may do so.

e If the publication period expires without an opposition being lodged, the franchisor will through their agent apply for a grant of a certificate, upon paying the official fee of US$250.

iii Enforcement

Enforcement of franchise-related intellectual property rights is in the commercial division of the High Court. The High Court has unlimited jurisdiction over all matters including intellectual property laws. Actions for the enforcement of intellectual property rights are normally instituted by civil suit and claims can be made for injunctions, damages, declarations and other reliefs. Enforcement proceedings can also be initiated by bringing criminal complaints against any party, in which case the police will investigate, the Director of Prosecutions will prosecute and the courts will sentence or fine the accused. The High Court also entertains criminal cases, particularly those related to abuse of trademark rights.5

iv Data protection, cybercrime, social media and e-commerce

Uganda does not have a domain name dispute settlement system. It is prudent for any franchisor to protect their desired domain by immediately registering it with the Uganda top domain name registrar.6 This will enable the franchisor to license this domain,

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4 This can be through registration of a licence as a permitted user under Section 49 of the Trademarks Act, 2010.
6 See https://www.registry.co.ug.
Uganda

along with any other intellectual property for use by the franchisee. While Uganda does not have any explicit laws on data protection, it has some important laws that franchisors need to be aware of in relation to e-commerce and cybercrime, including the Uganda Communications Commission Act 2013 for most communication services such as telecoms and broadcasting, excluding information technology, and the Electronic Transactions Act, regulating the safe use of electronic signatures in a commercial environment, as well as the use of electronic signatures in e-government. The Computer Misuse Act is intended to regulate the safe use of electronic transactions in Uganda. While it cannot prevent misuse of IT systems, it provides a sanctions mechanism for the abuse of IT infrastructure, particularly where the offence is of a criminal nature.

IV FRANCHISE LAW

i Legislation

The main laws governing a franchise arrangement in Uganda are the Contract Act, the Investment Code and common law.

ii Pre-contractual disclosure

Under Section 10(1) of the Contract Act, free consent to any agreement is a vital requirement for a binding contract. This implies that before a contract is entered into, there should be no misrepresentation whatsoever of any facts material to the transaction at hand. In the event that there was a misrepresentation, the contract becomes voidable. The person whose consent to the contract was obtained under a misrepresentation may either insist that the contract is performed and that he or she is put in the position in which he or she would have been if the representations made had been true or rescind the contract. However, one needs to prove that they actually acted on the misrepresentation in order to consider it voidable.

It is also important to note that an agreement is void that restricts a party absolutely from enforcing his or her rights under or in respect of a contract, by legal proceedings or that limits the time within which the party may enforce his or her rights unless the parties agree on arbitration as the form of dispute resolution for any matters arising (Section 22).

iii Registration

Under the Investment Code Act, all agreements involved in the transfer of foreign technology or expertise, including commercial franchise agreements are required to be registered with the Investment Authority by the beneficiary of the transfer (franchisee). The agreement can only be effective after registration as provided for under Section 29(1). This provision has not been actively policed in practice. Unless it is manifestly necessary for the agreement to explicitly be defined as a technology transfer agreement, it

7 Computer Misuse Act, 2011.
8 See Section 16 of the Contract Act.
would be sufficient to make it clear in the wording of the agreement that no technology is being transferred to comply with the Contract Act in order for it to be enforceable.

iv  Mandatory clauses
Uganda has no explicit statutory regime governing franchise agreements. As such, there are no mandatory provisions unless the Investment Code Act applies. Certain provisions are considered essential to make a binding bargain. These include:

a  date of commencement and expiry of agreement;
b  names and addresses of the parties;
c  assignability of rights, especially of the franchisee;
d  confidentiality;
e  royalty rate and when it is due for payment;
f  taxes and which party is to pay them;
g  intellectual property rights;
h  dispute settlement;
i  choice of law and forum; and
j  termination.

Any well-drafted franchise agreement will contain these provisions.

v  Guarantees and protection
Guarantees made by parties to a franchise agreement are enforceable as is any provision of a contractual nature. This is subject to any other relevant factors surrounding the conclusion of the agreement in which the guarantee is made, such as exertion of undue pressure, misrepresentation or fraud. All of these elements could vitiate a guarantee made in the context of a franchise agreement.

Under the Contracts Act a guarantor shall be liable to the extent to which the principal debtor is liable, unless otherwise provided by a contract. Under Section 71, liability takes effect upon default by the principal debtor. Any variance made in the terms of a contract between a principal debtor and a creditor without the consent of a guarantor discharges the guarantor.9

V  TAX

i  Franchisor tax liabilities
The main tax liability for franchisors is withholding tax at 15 per cent, which is retained by the franchisee and passed on to the tax authorities. Withholding tax is payable on royalties, management fees and professional fees.

9  See Section 74.
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ii Franchisee tax liabilities
Franchisees would normally expect to bear the following taxes:

a. Income tax. Corporation tax of 30 per cent would apply.
b. Pay as you earn (PAYE) deducted from employees wages and remitted to the tax authorities at the end of the month. Rates depend on the income bracket.
c. VAT if the franchisee is registered at a rate of 18 per cent.
d. Workmen compensation insurance is another mandatory levy taken out by employers in favour of any employees who may be injured on the premises during working hours.

iii Tax-efficient structures
The most appropriate structure for a franchisor to adopt is to remain non-resident for tax purposes. This is largely because most of the tax incentives of resident taxpayers have been phased out. This implies that once a franchisor can ascertain the withholding tax applicable, it is clear what tax liability they will suffer. Secondly, if they were to incorporate locally, corporation tax at 30 per cent is higher than withholding tax applicable to franchisor’s income.

VI IMPACT OF GENERAL LAW

i Good faith and guarantees
The duty of good faith is not expressly provided in the Contract Act but can be implied. Under Section 80 of the Contract Act for instance, a guarantor is discharged where the eventual remedy of the guarantor against a principal debtor is impaired, because a creditor acts in a manner inconsistent with the rights of the guarantor.

ii Agency distributor model
Commercial agency laws do not apply to franchising in Uganda. The separate question of whether the franchisee could be acting as agent of the franchisor under ostensible authority has some practical application. In a franchise arrangement in Uganda, it would be preferable to clearly exclude agency. This is because agency law in Uganda is not well developed. Where the franchisor and franchisee come from different business cultures, the likelihood of the franchisee seeking to enter into contractual relationships on behalf of the franchisor cannot be ruled out. Requiring the franchisee to display a sign in the premises that clearly states that the franchisee is an independent business operating under licence is recommended.

iii Employment law
It is important that the franchise agreement clearly spells out that there is no employer-employee relationship to avoid future conflicts as well as tax complications. Under the Employment Act, employment can be construed from conduct. This therefore means that the franchisor needs to clarify that the franchisee is not an employee nor an agent and has separate legal capacity under the law. If this is not clear, franchisors could be held
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legally liable for unpaid wages or face liability for other matters, such as injury at work if the franchisee does not take out the statutory workmens compensation insurance.10

iv Consumer protection
While Uganda has had a draft Consumer Protection Bill for a long time, the government has shown little interest in passing it. This draft law provides extensively for consumer rights including cooling off rights. It remains to be seen whether Uganda will follow the examples of Kenya and South Africa in including franchisees among those protected by the Consumer Protection Act as ‘consumers’.11

v Competition law
Uganda does not have a substantive legal regime regulating anti-competitive practices, although a draft bill on Competition has been pending since 2005. The only explicit competition provisions fall under the Uganda Communication Commission Act 2013. While the Act appears to prohibit anti-competitive practices under Section 53, there are no clear sanctions for players in the sector against this negative behaviour. The Act12 provides for the creation of a Competition Tribunal and this is a positive step. However, past practice shows that there is a need for the tribunal to practise more regulatory ‘activism’ especially where the complaints mechanism is weak or ineffective in eliminating anti-competitive practices in the market.

vi Restrictive covenants
There are no significant cases of enforcement of restrictive covenants in Uganda. It would be preferable to liquidate the potential costs of breach in order to discourage breach. This is particularly important since Ugandan courts widely appear to respect freedom of contract, unless it is clear that the agreement was tainted with undue influence or fraud. The only other case in which the courts may not enforce such a liquidated damages provision is where the amount to be forfeited upon breach is manifestly excessive.

vii Termination
The Contract Act gives freedom to parties to an agreement to determine how and when their contract can be terminated. To this extent, post-term covenants will be enforced as long as they are not oppressive. It is possible for the franchisor to take over the franchisor’s business, if this is clearly spelt out in the franchise agreement and subject to the restrictions on regulated industries and land ownership. It would, however, be advisable for the franchisor to ensure that any liabilities, tax or otherwise are settled or borne by the franchisee. Uganda’s commercial laws have no restrictions on foreign shareholding in local businesses. This creates a more favourable environment compared

10 See Section 3(1) of the Workmens Compensation Act, 2000, Principal Laws of Uganda.
11 See Section 33 of the Judicature Act.
12 See Part X providing for creation of a Communication Tribunal, Sections 60–65.
to some other countries in Africa, where an equity stake by a local shareholder would be required. The land laws, however, restrict foreigners to ownership of leases only.

viii Anti-corruption and anti-terrorism regulation
Uganda prides itself on its numerous anti-corruption institutions, although the vice is yet to be eradicated. Key among the institutions is the Anti Corruption Court, a division of the High Court. The country recently passed the Anti-Money Laundering Bill 2009 but it will only come into force once the President assents to it. In the meantime, other laws such as the Financial Institutions (Anti-Money Laundering) Regulations 2010 have been enacted. Under these Regulations, banks are entitled to enquire into suspicious transactions in order to check for money laundering. The full impact of these measures may remain limited considering the fact that a large part of Uganda's economy remains in the informal and cash sector.

ix Dispute resolution
Free choice of law and jurisdiction is available in Uganda and the country is a signatory to the New York Convention on the Recognition and Enforcement of Arbitration Awards.

VII CURRENT DEVELOPMENTS
The pending introduction of the CPA and the proposed abolishment of the Investment Code Act requirement for registration should be looked out for.

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13 See Section 3 of the Regulations.
Appendix 1

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Chapter 42

UKRAINE

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I

INTRODUCTION

Ukraine is a relatively new country, hence the imprint of international business generally is relatively new in Ukraine. In short, Ukraine is an emerging market for franchising.

Franchising started in Ukraine in the mid to late 90s, but did not start to develop significantly until the Ukrainian market generally picked up in 2003–2004.

An important legislative boost to the industry was the adoption of the Ukrainian Civil and Commercial Codes in January 2003, which, for the first time, actually statutorily defined and to some degree regulated the basics of 'commercial concession' (as franchising is legally understood in Ukraine). To date there is no other franchise-specific legislation in Ukraine, although regulations have been promised for around a decade.

McDonald's opened its first restaurant in Kiev and in Ukraine in May 1997. This was a fairly late start bearing in mind that McDonald's opened its first restaurant in Moscow still under the Soviet Union in January 1990. Nevertheless, McDonald's currently has 76 outlets in Ukraine.

The market consists of many international brands (McDonald's, Domino's Pizza, Marks & Spencer, Basking & Robbins, Crocs, Mango, Mexx, and, as of 2013, KFC), Russian brands (McFoxy (fast food), Tez Tour) and a growing number of local brands (Novus supermarkets, Coffee Haus, Pan Pizza, Videnski Bulochky, Puzata Khata, etc.).

The Ukrainian Franchise Association was established in December 2001 when, according to the Association, there were fewer than 100 franchises in the country. Currently the Association claims its membership includes over 164 franchisers and over 2,300 companies as franchisees. The Association has a website, publishes, holds seminars and acts as a lobbyist for the industry.

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1 Babette Märzheuser-Wood is head of the EMEA franchise group at Dentons and Myron B Rabij is a partner at the firm.
II MARKET ENTRY

i Restrictions
Foreign franchisors do not face any legal restrictions when entering the Ukrainian market. Market entry for foreign franchisors is, however, challenging because Ukraine is a not a mature economy and is, quite frankly, a very difficult market in which to do business. The market is heavily regulated and quite bureaucratic. Market entry requires adequate preparation as well as adequate due diligence on potential franchisees.

ii Foreign exchange and tax
Ukraine is not a member of the EU and, as recent political developments have shown, will not sign its anticipated association agreement with the EU anytime soon.

Bearing this in mind, foreign franchisors should appreciate that the currency of payment in Ukrainian domestic transactions is the Ukrainian hryvna, which is not a fully freely convertible currency. Although settlements between a Ukrainian franchisee and a foreign franchisor may be made in foreign currency, the foreign franchisor should appreciate that the franchisee's income is in hryvnas, which is set to slowly depreciate over the next year.

Many large foreign franchisors establish a Ukrainian subsidiary that acts as the local franchisor, in which case the local entity will have to pay Ukrainian corporate tax. For new market entrants that do not have a permanent establishment in Ukraine, it is important to consider the double taxation agreement (DTA) between Ukraine and the country where the franchisor is incorporated to establish whether withholding taxes apply (they typically do). For the purposes of applying withholding taxes, Ukraine would generally differentiate (if possible to so ascertain from the agreement) between the royalty part of the franchise fee (subject to withholding) and the service part of the franchise fee (subject to VAT).

III INTELLECTUAL PROPERTY

i Brand search
International trademark registrations are valid in Ukraine if the registration covers Ukraine. Many franchisors typically register additional Ukrainian language versions of their main trademarks in Ukraine. Searches against both the European and the Ukrainian Register are widely available through lawyers and trademark agents and can be performed online in a matter of minutes.

ii Brand protection
The process for copyright registration is simple and follows international norms. It is possible to register any distinctive word mark or logo with the Ukrainian Patent Office. In line with international practice, generic expressions cannot be protected. The problem is simply that the Patent Office is backlogged. A registration process may take two to three years.

Priority of Ukrainian marks is based on the date of the application for registration. Ukraine recognises unregistered marks that are acquired through use provided it can
also be shown that the mark or logo has achieved market recognition. Famous marks enjoy protection in Ukraine without evidence of use (see Article 6 of the Paris Protocol). Ukraine has implemented the Madrid Protocol so that foreign marks can be designated for local recognition.

iii Enforcement
Trademarks can be protected against infringement through court proceedings. Injunctions are available but specific performance is difficult to implement and enforce. Ukraine has a byzantine court system and specialist advice is indispensable when proceeding against infringements.

iv Data protection, cybercrime, social media and e-commerce
Similar to EU law, Ukraine also has laws and regulations governing the collection of personal data. Consent to personal data processing needs to be express. With very few exemptions this means that the owner of the personal data or data subject must 'opt in' by ticking a box or signing a document. If the personal data are passed on to other organisations this requires a separate consent. Franchisors need to carefully review their loyalty programmes and promotional campaigns to ensure that they comply with these requirements.

IV FRANCHISE LAW

i Legislation
Ukraine does not have a franchising law per se. However, Ukraine does have franchise-specific legislation, specifically, relevant provisions of its Civil Code and Commercial Code. Certain provisions of Ukrainian competition legislation also are relevant.

ii Pre-contractual disclosure
Ukrainian law expects the parties to treat each other fairly during contract negotiations. This being said, an obligation to voluntarily disclose material facts is relevant primarily for real property transactions only.

iii Registration
Article 1118.2 of the Civil Code of Ukraine and Article 367 of the Commercial Code of Ukraine require the registration of franchise agreements with the same registration authority that registered the franchisor or franchisee (provided that the franchisor is a foreign company and hence not registered in Ukraine). In other words, registration is contemplated at the national corporate registry. The language in both Codes is virtually identical and states that the parties to a franchise agreement cannot rely on their contract vis-à-vis third parties absent such registration.

Unfortunately, however, there is no regulation in place that allows for implementation of the contemplated national franchise registry. Hence, agreements that have not been properly registered (and in fact this means all such agreements) are generally deemed not valid as against third parties.
This being said, the relevant provisions of the two Codes as well as limited court practice indicates that the absence of registration should not affect the validity of the contract vis-à-vis the contracting parties themselves.

iv  Mandatory clauses

Ukrainian law implies into the franchise agreement a number of provisions. These apply even where the contract is silent, so it would not be correct to speak of mandatory clauses. However, the practical effect is similar. The most important examples of prohibited clauses are listed below:

a  The franchisor must provide certain services to the franchisee. A licence type franchise that does not oblige the franchisor to provide any training or support would not be enforceable.

b  Price fixing or regulation of prices is prohibited.

c  Upon expiry of the fixed term of a franchise agreement, the franchisee is entitled to renew on the same terms (mandatory renewal).

d  Interestingly, the renewal right does not apply if the franchise agreement is for an open-ended term. In those cases, either party has the right to terminate the agreement on six months’ notice.

e  Under Article 1123 of the Civil Code and Article 373 of the Commercial Code, the franchisor is jointly liable to the consumer for defective goods, works or services supplied by the franchisee. If it is a quality (warranty) claim the franchisee has primary liability, but the franchisor is jointly liable for manufacturer defect claims made against the franchisor as manufacturer. We are not aware of any court practice as to whether a franchisor can avoid liability if the franchisee was not following the guidelines established by the franchisor.

v  Guarantees and protection

Ukrainian law recognises both bank guarantees and other forms of security such as suretyship. However, Ukrainian law insists that a Ukrainian entity can act only as a surety (not as a primary obligor – i.e., guarantor). Further Ukrainian currency regulations would require the Ukrainian surety to obtain a one-off licence to actually perform its payment obligation in foreign currency before a foreign party (the foreign franchisor would be unable to obtain the licence on behalf of a defaulting franchisee).

V  TAX

i  Franchisor tax liabilities

Domestic franchisors pay corporate profit tax at a flat rate of 19 per cent (16 per cent starting from 1 January 2014) unless such a franchisor opts to simplified taxation regime. Dividends are subject to income tax in the hands of the shareholders or withholding tax if payable to non-resident shareholders. Upon distribution of dividends the Ukrainian company should pay 19 per cent advance corporate profit tax (16 per cent starting from 1 January 2014), based on the amount of dividends payable to its shareholders. The payer of dividends is entitled to further reduce (credit) its corporate profits tax liability in
the period following the period when dividends were paid out, by the amount of advance
tax remitted to the state.

Franchise fees are subject to VAT at 20 per cent (17 per cent starting from
1 January 2014). Domestic franchisors may have difficulties with tax deductibility of
the initial or joining fee for corporate profit tax purposes. If part of the fee represents
payment for initial services that part can be recognised in the first year of the term of
the franchise. Problems can arise with marketing fees where the franchisor underspends.
It is advisable to expressly state in the franchise agreement how monies underspent are
returned or carried forward to avoid these being viewed as profit or gifts (non-repayable
financial aid).

Foreign franchisors that have a local representative in Ukraine are likely to be
treated as having a permanent establishment in Ukraine. Permanent establishment of
a foreign franchisor is assessed for Ukrainian tax purposes on the income attributable
to services delivered locally. For these reasons a local office or activities that lead to
the creation of a permanent establishment are best avoided. Royalties are subject to
withholding taxes.

Ukrainian tax legislation provides for different taxation regimes with respect to
royalties and franchise fees. In short, payments of royalties will not be subject to Ukrainian
VAT, whereas payments for services, goods and works will be subject to Ukrainian VAT
at the current rate of 20 per cent (17 per cent starting from 1 January 2014) under a
reverse charge procedure. Additionally, royalty payments will be subject to withholding
tax at the rate of 15 per cent if not provided otherwise under the relevant DTA. Many
DTAs exist and these often allow for exemptions from withholding tax to be applied for.

ii Franchisee tax liabilities
If the franchisee is a company it will pay corporate profit tax unless such a franchisee opts
in to the simplified taxation regime. Otherwise, personal income tax will be payable. In
addition, VAT is likely to apply 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 which can substitute for corporate profit
tax and VAT.

The standard tax rates are:

- a Personal tax rates: bands from 15 per cent and 17 per cent.
- b Corporate profit: flat rate of 19 per cent (16 per cent starting from 1 January
  2014).
- c The VAT rate is 20 per cent (17 per cent starting from 1 January 2014).
- d Unified tax: 3 per cent, 5 per cent or 7 per cent depending on turnover of a
  franchisee, number of employees and on whether such unified tax covers VAT or
  not.

Ukrainian transfer-pricing rules need to be considered in case a foreign franchisor
comes from a jurisdiction in which the rate of the corporate profit tax is lower by 5
per cent or more than the Ukrainian corporate profit tax rate on the condition that the
price of transactions between a foreign franchisor and a Ukrainian franchisee is at least
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50 million hryvnas, net of VAT, which applies cumulatively for all transactions with one counterparty per calendar year.

Ukrainian tax legislation is very dynamic, there are number of changes being implemented starting from 1 January 2011, when the Tax Code of Ukraine entered into force. Although there are attempts to assess transactions on their substance, the ‘form’ of the transaction still dominates over its substance. Thus, careful attention shall be given to documentary support of each transaction.

iii Tax-efficient structures

Foreign franchisors should consider carefully the location of their franchisor company. Countries such as the UK and Cyprus are popular because of favourable DTAs. However, taking into account that the new DTA between Ukraine and Cyprus is entering into force from 1 January 2014, which provides for a less favourable tax regime than that enjoyed to date as well as due to the recent financial and banking crisis in Cyprus, alternative jurisdictions such as the Netherlands, Switzerland, etc. may be considered. Sometimes splitting the royalty income and the service income can be beneficial. Royalties can be paid to an offshore entity located in a country that has a DTA with Ukraine whereby withholding taxes are waived and service fees to a local service company. The best structure also depends on the home jurisdiction of the franchisor.

V IMPACT OF GENERAL LAW

i Competition law

As mentioned above, the Civil Code of Ukraine and the Commercial Code of Ukraine set forth principal requirements for ‘commercial concession’ arrangements which, by their essence, can be regarded as ‘franchising’ under applicable Ukrainian law.

Article 1122 of the Civil Code provides that the commercial concession agreements may establish specific provisions such as territorial exclusivity and non-compete clauses. In particular the franchisor may undertake not to grant similar rights to third parties on the territory in question or not to compete with the franchisee on this territory. The franchisee may undertake not to compete with the franchisor on the territory considered, as well as not to acquire similar rights from franchisor’s competitors. It seems that the provisions limiting the operation of the franchisee to a certain area or to a specific category of customers are also permitted by Article 1122 (although its wording is quite vague). Article 1122 of the Civil Code expressly prohibits price fixing (including establishment of a minimum or maximum price by the franchisor).

The Ukrainian Competition Law (Law of Ukraine on Protection of Economic Competition No. 2210-III dated 11 January 2001) does not specifically regulate franchising or similar agreements. Franchising agreements, however, can be considered as ‘concerted actions’, which fall within jurisdiction of the Competition Law. Article 5 of the Competition Law describes ‘concerted actions’ as conclusion of agreements by business entities in any form as well as any other agreed behaviour of business entities. The Competition Law prohibits anti-competitive concerted actions, which are defined in Article 6 of the Law as ‘concerted actions which have resulted or may result in prevention, elimination or restriction of competition’.

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Article 6 of the Competition Law provides for an indicative list of actions to serve as a guide as to what may be treated as anti-competitive concerted actions. This list includes, among others, setting prices or other conditions for purchase or sale of goods, distribution of markets or sources of supply based on territorial principles, assortment of goods, range of customers, etc.

However, Article 8 of the Competition Law provides conditional exemption specifically with respect to vertical concerted actions. It states that the prohibitions of Article 6 are not applicable with respect to 'concerted actions' involving 'supply or use' of goods if a party (i.e., franchisor) to such a concerted action imposes restrictions on the other party (i.e., franchisee) relating to:

- use of the goods supplied by the party or by other suppliers;
- purchase from or sale to other business entities or customers of other goods;
- purchase of goods, which due to their nature or based on prevailing business practices in the relevant market segment do not relate to the subject of the agreement; and
- setting of prices or other conditions of the agreement for sale of the supplied goods to other business entities or customers.

The above exemptions are applicable if a particular form of concerted action does not: (1) result in substantial restriction of competition on the whole market or its significant part, including in monopolisation of the relevant markets; (2) restrict access to the market for other business entities; or (3) result in an economically unjustified increase in prices or in the goods' deficiency.

Further, we would add that under Article 1121 of the Civil Code, a franchisor may place restrictions on the behaviour and actions of a franchisee. The franchisee is in fact obliged to adhere to instructions of the franchisor 'directed at securing the appropriate character, methods and terms of use of the complex of the rights granted'. This provision as you can see is fairly broad. We are not aware of court practice on this point.

Although the vertical exemptions under Article 8 are formulated quite broadly and sometimes vaguely (e.g., it is unclear what the word 'use' means in the context of the Article 8 exemption), it appears that Article 8 is intended to protect quite a wide range of vertical restraints, including maintaining the retail price and exclusive dealing arrangements. Unfortunately, however, as of today there are neither official guidelines/interpretations of the AMC, nor reliable court practice of the application of those exemptions. It is also unclear whether such exemptions cover restrictions in franchising and similar contracts.

ii Restrictive covenants

Under Article 1122 of the Civil Code the franchisor may undertake not to compete with the franchisee on the territory covered by franchising agreement. The franchisee may undertake not to compete with the franchisor on the territory considered, as well as not to acquire similar rights from the franchisor's competitors.
iii Termination

A franchise agreement is a long-term contract requiring substantial investment on the part of the franchisee. This being said, Ukrainian law does not specify what constitutes a major or a minor breach of contract. However, a cure notice generally must be given.

Most legal practitioners will argue that restrictive covenants as to competition are enforceable in Ukraine provided the franchisor pays adequate compensation to the franchisee. This being said, this view is somewhat academic as we are not aware of any court practice on this issue. Further, since most franchisors do not wish to pay compensation, post-term restrictive covenants are rare.

Contractual penalties, on the other hand, are enforceable and can be used to effectively enforce the obligation to de-identify.

It is possible to provide that the franchisee must sell its business to the franchisor upon termination but the transfer of the lease would require the written consent of the landlord. This can be a major obstacle in practice. Further, as the parties must agree the price at the time of termination, the obligation to sell may be deemed simply as an agreement to agree.

Options over the shares of the Ukrainian franchisor are not enforceable and are not used in the market.

iv Anti-corruption and anti-terrorism regulation

Bribery and corruption are criminal offences in Ukraine. However, the franchisor would not normally be responsible for bribes paid by franchisees under Ukrainian law, although this may not be the case under the US Foreign Corrupt Practices Act or the UK Bribery Act (as examples).

v Dispute resolution

Ukraine's court system is widely condemned as corrupt and inefficient. This being said, international arbitration awards are generally fully recognised subject to the standard treaty exemptions. The Ukrainian International Commercial Arbitration Court of the Ukrainian Chamber of Commerce and Industry is an alternative to foreign arbitration.

As to the judgments of foreign national courts, Ukraine has recently subscribed to the reciprocity principle. To date, however, we are aware of only one court case where the judgment of a foreign court was enforced in Ukraine. The general practice is that these are not enforced.

Ukrainian courts will respect the choice of foreign law if the contract has sufficient connection to a foreign country. Usually this applies where the franchisor is incorporated abroad. Conversely, foreign franchisors that set up a Ukrainian subsidiary to deal with local franchisees are unable to contract out of Ukrainian law because the contracting parties are both located in Ukraine. Nevertheless, a foreign-owned Ukrainian company may contractually agree to foreign arbitration although under Ukrainian law as against a purely Ukrainian company.

As to Ukrainian court practice, injunctions are rare and require commencement of proceedings in order to implement.

Contractual penalties are enforceable and can be a remedy against franchisees that breach restrictive covenants.
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Damages for certain breaches can be on an indemnity basis but the general principle is that damages are compensation for actual loss suffered as a result of the breach committed.

Moral damages are possible but are very much subject to the discretion of the judge.

VII CURRENT DEVELOPMENTS

Currently, we are not aware of any franchise-specific legislative developments in Ukraine, but market players generally will need to closely adhere to new Ukrainian tax guidelines as to transfer pricing between related entities. The market has recently (autumn 2013) welcomed the entry of KFC into Ukraine, with three outlets currently operating in Kiev.
Appendix 1

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Babette heads up the EMEA franchise group at Dentons. She has more than 20 years’ experience in international franchising with a particular focus on emerging markets. Her work includes the creation and critique of franchise contracts and their customisation to local law. Babette has transactional experience in all 28 EU Member States. Babette is recognised as one of Europe’s leading experts in hotel and leisure franchising with a particular emphasis on German-speaking Europe. Babette is ranked by Chambers Global as one of the top 10 franchise specialists in the world. She is also recommended by The International Who’s Who of Franchise Lawyers, Chambers UK and Legal 500 for her franchise expertise. Babette’s research on the role of franchising in the European hospitality industry has attracted widespread media attention. Babette is the author of numerous publications on franchising. She also lectures widely on international franchise laws and her expertise is often sought by franchisors from common law countries that enter civil law jurisdictions. She is an associated editor of The Franchise Law Review. Babette is a member of the ABA Forum on Franchising, the IBA Franchise Committee and the IFA. She is dual-qualified in both Germany and the UK. She speaks English, German, French, Spanish and Russian.

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