PANORAMIC

FRANCHISE 2026

Contributing Editor

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LEXOLOGY

Franchise 2026

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

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Global overview

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When the United States sneezes, the rest of the world catches a cold. While that quip has been used since the Great Depression of 1929, and was likely a modification of a similar comment about Paris and Europe from the time of Napoleon, it is still applicable today because the world is, more than ever, interconnected, with commerce one of the fundamental aspects of this interconnectedness. Since 2020, we have seen local, regional and global changes – pandemic, wars, climate change, economic and financial disruptions and inflation, economic growth, as well as artificial intelligence (AI) increasingly becoming part of our mainstream business and personal lives, just to name a few – affecting travel, hospitality, restaurants, healthcare, education and, of course, economies and industry. Individuals, businesses and entire economies around the world have reacted to these events, and have also continued to evolve.

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

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

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

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

In addition, where applicable, the chapter provides links to the most critical and relevant laws and regulations accessible through the Lexology website.

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

- Company X is using direct franchising in its home country but wishes to explore alternative forms of franchising in other countries, such as master franchising or sub-franchising – this edition addresses each country's regulations and requirements as applied to different franchise models.

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

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

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

Business opportunities and challenges continue to evolve, from navigating economic, supply chain and technology changes, to adapting to new or modified governmental regulations or financial requirements. However, one thing has not changed: the need for lawyers and executives to intelligently analyse and evaluate business growth opportunities to provide their clients with the best advice in an efficient manner, so that both counsel and clients can make sound strategic decisions. The world keeps changing, and businesses and commercial relationships continue to evolve. Are you poised to act?

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Summary

FRANCHISE CONTRACTS AND THE FRANCHISOR/FRANCHISEE RELATIONSHIP

UPDATE AND TRENDS

MARKET OVERVIEW

Franchising in the market

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

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

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

Law stated - 30 May 2025

Associations

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

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

Law stated - 30 May 2025

BUSINESS OVERVIEW

Types of vehicle

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

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

Law stated - 30 May 2025

Regulation of business formation

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

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

Law stated - 30 May 2025

Requirements for forming a business

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

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

Law stated - 30 May 2025

Restrictions on foreign investors

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

Pursuant to the Investment Canada Act, foreign business entities seeking to acquire or establish a Canadian business are required to notify Innovation, Science and Economic Development Canada no later than 30 days following such acquisition or establishment. An onerous and thorough review process applies to non-World Trade Organization investors where the asset value of the acquired Canadian business is at least C$5 million for direct acquisitions or C$50 million for indirect acquisitions. However, the C$5 million threshold will apply to indirect acquisitions where the asset value of the acquired Canadian business represents greater than 50 per cent of the asset value of the global transaction. The review threshold for World Trade Organization investors was increased to an 'enterprise value' of C$1.386 billion as of January 2025. This amount is indexed annually. Most franchisors do not meet this threshold.

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

Law stated - 30 May 2025

Taxation

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

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

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

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

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

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

Law stated - 30 May 2025

Labour and employment

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

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

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

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

Law stated - 30 May 2025

Intellectual property

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

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

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

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

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

Law stated - 30 May 2025

Real estate

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

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

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

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

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

Law stated - 30 May 2025

Competition law

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

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

While the penal provisions of the Competition Act impose a higher burden of proof, their violation grants injured parties the right to sue for damages caused by such practices; those damages are restricted to actual loss and costs. Fines are also applicable for certain types of offences. By contrast, reviewable practices are civil in nature and are subject to the exclusive jurisdiction of the Competition Tribunal, upon the request of the commissioner of competition or at the request of a private party with leave from the Competition Tribunal to that effect. In the latter case, private litigants may only seek redress of conduct that constitutes a breach of an order under the Competition Act, as monetary awards are not provided for. The Competition Tribunal may make orders for a reviewable trade practice to cease or compel a business to accept a given customer or order on reasonable trade terms.

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

Law stated - 30 May 2025

OFFER AND SALE OF FRANCHISES

Legal definition

12 | What is the legal definition of a franchise?

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

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

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

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

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

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

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

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

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

Law stated - 30 May 2025

Laws and agencies

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

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

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

Full exemptions

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

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

Partial exemptions – the obligation to disclose

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

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

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

- sale of a franchise by a franchisee provided that:

- the franchisee is not the franchisor or an associate, director, officer or employee of the franchisor;
- the sale is for the franchisee's own account;
- the sale is not effected by or through the franchisor; and
- in the case of a master franchise, the entire franchise is sold;
- sale of a franchise to a person who has been an officer or director of the franchisor or its associate for at least six months for that person's own account (Alberta Act and BC Act only);
- sale of a franchise to a person for the person's own account or to a corporation that the person controls if the person:

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

The exemptions set out in each of the Canadian Franchise Acts, while substantively similar, are not identical. Under the BC Act, the sale of a franchise to a franchisee who invests more than a prescribed amount (currently C$5 million) in the acquisition and operation of the franchise is exempted from the application of the disclosure requirements. Under the Ontario Act, the sale of a franchise if the prospective franchisee is required to make a total initial investment, determined in the prescribed manner, of an amount that is greater than a prescribed amount, currently C$3 million, is exempted from the application of the disclosure requirements.

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

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

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

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

Law stated - 30 May 2025

Principal requirements

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

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

Law stated - 30 May 2025

Franchisor eligibility

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

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

Law stated - 30 May 2025

Franchisee and supplier selection

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

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

Law stated - 30 May 2025

Pre-contractual disclosure – procedures and formalities

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

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

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

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

Law stated - 30 May 2025

Pre-contractual disclosure – content

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

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

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

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

Law stated - 30 May 2025

Pre-sale disclosure to sub-franchisees

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

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

Law stated - 30 May 2025

Due diligence

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

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

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

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

Law stated - 30 May 2025

Failure to disclose – enforcement and remedies

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

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

Rescission

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

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

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

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

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

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

Damages

Pursuant to all Canadian Franchise Acts, other than the Alberta Act, if a franchisee suffers a loss because of a misrepresentation contained in the disclosure document or in a statement of material change or as a result of the franchisor's failure to comply with any disclosure requirements, the franchisee has a right of action for damages against the franchisor, the franchisor's broker (if any), the franchisor's associates, every person who signed the disclosure document or statement of material change and, under the Ontario Act, the franchisor's agent, all of whom are jointly and severally liable.

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

Law stated - 30 May 2025

Failure to disclose – apportionment of liability

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

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

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

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

Law stated - 30 May 2025

General legal principles and codes of conduct

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

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

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

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

Law stated - 30 May 2025

Fraudulent sale

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

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

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

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

Law stated - 30 May 2025

FRANCHISE CONTRACTS AND THE FRANCHISOR/FRANCHISEE RELATIONSHIP

Franchise relationship laws

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

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

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

Law stated - 30 May 2025

Operational compliance

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

Franchise agreements will often contain several controls and oversight mechanisms in favour of the franchisor to verify the accuracy of royalty payments made, supervise the use of its marks and ensure overall compliance of the franchised operations with the franchised concept and the brand. These may include an obligation for the franchisee to submit weekly, monthly or annual (or all three) reports of its sales, in addition to point of sale, inventory control and other software that report in real-time. The franchisor may also have a right to inspect and audit a franchisee's records in the event that a franchisee fails to submit these reports or these reports are suspected or determined to be inaccurate. Other controls include requiring that franchisees submit all proposed store locations, store designers and contractors, product suppliers and marketing materials to the franchisor for prior approval, as well as a right to inspect the franchise location during operating hours to ensure that the franchisee is properly implementing the franchise system, which includes the right to assume management of the franchised location in extreme cases.

Law stated - 30 May 2025

Amendment of operational terms

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

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

Law stated - 30 May 2025

Policy affecting franchise relations

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

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

Law stated - 30 May 2025

Termination by franchisor

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

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

Law stated - 30 May 2025

Termination by franchisee

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

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

Law stated - 30 May 2025

Renewal

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

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

Law stated - 30 May 2025

Refusal to renew

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

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

Law stated - 30 May 2025

Transfer restrictions

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

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

Law stated - 30 May 2025

Fees

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

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

Law stated - 30 May 2025

Usury

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

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

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

Law stated - 30 May 2025

Foreign exchange controls

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

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

Law stated - 30 May 2025

Confidentiality covenant enforceability

37 | Are confidentiality covenants in franchise agreements enforceable?

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

Law stated - 30 May 2025

Good-faith obligation

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

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

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

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

The duty to act in good faith does not necessarily preclude a franchisor from competing with its franchisee (assuming, of course, the absence of contractual exclusivity in favour of the franchisee). A franchisor that opts to compete with its franchisee must ensure that it continues to perform its legal obligations towards the latter and that it acts in such a way that the franchisee may continue to enjoy the benefits of its franchise. The common law principle of non-interference with the freedom of the parties to contract will often limit judicial interference in franchise agreements whose terms are found to accurately reflect the intent of the parties and are not patently inequitable. A determination as to whether a duty of good faith has been breached will be contingent upon all the surrounding circumstances.

Law stated - 30 May 2025

Franchisees as consumers

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

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

Law stated - 30 May 2025

Language of the agreement

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

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

Law stated - 30 May 2025

Restrictions on franchisees

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

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

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

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

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

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

Law stated - 30 May 2025

Courts and dispute resolution

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

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

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

Law stated - 30 May 2025

Governing law

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

Under the Canadian Franchise Acts, a choice of law provision that attempts to contractually restrict the application of local franchise laws will be void. Where the Canadian Franchise Acts do not apply, Canadian courts will generally recognise and uphold a parties' choice of foreign governing law, provided that there is a sufficient nexus to the parties' relationship. However, a choice of foreign governing law made with the aim of avoiding the consequences of the applicable provincial laws of any Canadian jurisdiction will generally be considered invalid. Furthermore, where the applicable law is that of any province in Canada, the United Nations Convention on the International Sale of Goods will automatically apply in respect of sales of goods by foreign franchisors who are nationals of any other signatory nation, unless expressly set aside by the parties in the contract. Enforcement of a contract in any province of Canada governed by the law of another province of Canada (or another country) may also prove to be cumbersome from a practical perspective as experts of the governing law in question must be retained to provide evidence of the relevant provisions of such foreign law in court.

Law stated - 30 May 2025

Arbitration – advantages for franchisors

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

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

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

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

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

Law stated - 30 May 2025

National treatment

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

There is no legal discrimination or heightened level of legal requirements for foreign franchisors. Nevertheless, depending on the vehicle they choose through which to export their franchises to Canada, foreign franchisors may find themselves subject to a different taxation regime from domestic franchisors, and subject to certain notice requirements under the Investment Canada Act. As a practical matter, franchisees may be more hesitant to enter into a franchise agreement, particularly one where the obligations of the franchisor (eg, training, advertising) are numerous, in circumstances where the franchisor has no domestic presence of note.

Law stated - 30 May 2025

UPDATE AND TRENDS

Legal and other current developments

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

The province of Saskatchewan had tabled a bill governing pre-contractual disclosure in franchise sales, the Act respecting Franchises (Bill 149), which received royal assent on 8 May 2024. However, no date has yet been set for the coming into force of Saskatchewan's franchise legislation.

Bill 149 is largely aligned with the Canadian Franchise Acts – that is, the franchise legislation of Alberta, Ontario, Prince Edward Island, New Brunswick, Manitoba and British Columbia.

However, compared to other Canadian Franchise Acts, Bill 149 provides a narrower definition of ‘franchise’, whereby the franchisor (or the franchisor’s associate) must actually exercise significant control over, or provide significant assistance in, the franchisee’s method of operation, as opposed to merely having a right or offeringto do any of the foregoing.

Draft regulations for this legislation were published on 16 April 2025, which establish further requirements with respect to franchise sales and disclosure compliance. Franchisors and franchisees should remain abreast of developments in this regard.

Law stated - 30 May 2025

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Summary

MARKET OVERVIEW

Franchising in the market

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

Franchising has become a mainstream business expansion model in China, with its prevalence increasing rapidly. According to public information, the total market size exceeded 2.8 trillion yuan in 2024, with a compound annual growth rate of more than 15 per cent, reflecting the rapid development of the industry.

In China, franchising is particularly prevalent in the food & beverage and retail industries. For instance, the beverage chain Mixue operates over 46,000 outlets, more than 99.99 per cent of which are franchised. Additionally, education and training, hospitality and agency services are also sectors where franchising is widely adopted.

At present, China's economy and monetary policy remain accommodating, making it easier for small and medium-sized business owners to secure low-interest financing through various channels. Compared to traditional investment and brand-building, the franchise model significantly reduces operational costs for franchisees (eg, marketing expenses, the cost of establishing brand systems and business models, and supply chain set-up costs), thereby requiring less capital. Against this backdrop, the relaxed economic and monetary policies have notably accelerated the rapid development of franchising.

Law stated - 20 June 2025

Associations

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

The key national association in China's franchising sector is the China Chain Store & Franchise Association (CCFA) with over 1,200 members. The CCFA's goal of promoting development of the franchise industry, the CCFA's primary roles include participating in policy formulation and coordination, safeguarding industry and member interests, providing training and industry data to members, and establishing communication and cooperation platform within the industry. The CCFA is also missioned to put forward policy opinions and legislative proposals to relevant governmental authorities from industry perspective.

Membership of CCFA is voluntary.

Law stated - 20 June 2025

BUSINESS OVERVIEW

Types of vehicle

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

The business entity structures typically used by franchisors that set up a China-based system are either a domestic company (if a domestic franchisor) or a foreign-invested company (if a foreign franchisor). Entities or individuals other than enterprises may not assume the role of franchisor to conduct franchising activities in China.

Listed below are the main types of legal entities that a franchisor can set up in China:

- domestic enterprises:

- companies – limited liability companies and limited joint-stock companies;
- partnership enterprises – special enterprises and sole proprietorship enterprises;
- state-owned enterprises; and
- collective-owned enterprises; and

- foreign-invested enterprises (FIEs):

- companies – limited liability companies and limited joint-stock companies; and
- partnership enterprises.

Furthermore, with China's progressive market liberalisation, the Ministry of Commerce of the People's Republic of China (MOFCOM) permits foreign companies to sell franchises and manage franchising activities within China without the need to set up a local entity. These foreign enterprises, however, should complete their commercial franchise filing with MOFCOM.

Law stated - 20 June 2025

Regulation of business formation

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

The laws governing the formation of business entities in China vary based on the nature and the type of business entity.

Domestic enterprises

- Companies are governed by the Company Law (promulgated by the Standing Committee of the National People's Congress with the latest amendments effective from 1 July 2024) (the Company Law).
- Partnership enterprises are governed by the Partnership Enterprise Law (promulgated by the Standing Committee of the National People's Congress with the latest amendments effective from 1 June 2007).
-

Sole proprietorship enterprises are governed by the Law on Sole Proprietorship Enterprises (promulgated by the Standing Committee of the National People's Congress and effective from 1 January 2000).

Foreign-invested enterprises

FIEs are subject to the Company Law and the Partnership Enterprise Law. In addition, FIEs are also regulated by the Foreign Investment Law (promulgated by the National People's Congress and effective from 1 January 2020) and its implementation rules. The Foreign Investment Law unifies the entities form of FIEs with domestic enterprises.

Law stated - 20 June 2025

Requirements for forming a business

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

As listed above, different types of business entities are governed by different laws and regulations with different requirements. When setting up a specific type of business entity, a franchisor must carefully follow the requirements of the applicable laws and regulations.

The Company Law was amended in 2023 (effective from 1 July 2024). One of the most noteworthy amendments is the reduced timeframe for shareholders' injection of capital contribution. For limited liability companies, shareholders are required to complete their capital contributions within five years of the establishment of the companies, while promoters of joint-stock limited companies must complete their contributions prior to company incorporation registration. Pre-existing companies are provided with a transition period of three years to comply with the new requirements.

In order to maintain the legality of a business entity, compliance with applicable laws in respect of, among other things, registration, taxation, labour, customs and consumer protection is required. More specifically with regards to companies, a franchisor needs to pay attention to the Regulation on the Administration of the Registration of Market Entities (promulgated by the State Council, effective from 1 March 2022), the Implementation Measures for the Regulation on the Administration of the Registration of Market Entities (promulgated by the State Administration for Market Regulation (SAMR, previously known as the State Administration for Industry and Commerce), effective from 1 March 2022), and the Implementation Measures for the Administration of Company Registration (promulgated by the SAMR, effective from 10 February 2025). Between 1 January and 30 June every year, a market entity must submit an annual report for the previous year to the SAMR. Most information in the annual report will be made available to the public. The contents of the annual report are subject to supervision and inspection by the SAMR.

Law stated - 20 June 2025

Restrictions on foreign investors

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

The Special Administrative Measures for Foreign Investment Access (also known as the Negative List) (2024 Edition) (promulgated by the National Development and Reform Commission (NDRC) and the SAMR and effective from 1 November 2024) specifies industries where foreign investment is either prohibited or restricted (note, however, that entities incorporated in free trade zones in China will be subject to different scopes of prohibited and restricted industries for foreign investors). In addition, both domestic and foreign investors are subject to the provisions of the Market Access Negative List (2025 Edition) (promulgated by MOFCOM, the NDRC and the SAMR and effective from 16 April 2025), which also specifies certain prohibited or restricted investment categories. Therefore, foreign investors that are considering investing in China should first clear that their intended business does not fall under the prohibited category (and, to a lesser extent, under the restricted category) of two negative lists.

If a foreign franchisor is looking to expand its business into China, two specific regulations issued by MOFCOM need to be considered. First, in order to conduct franchise activities in China, all foreign franchisors must follow the measures set out in the Administrative Measures for the Record Filing of Commercial Franchises (promulgated by MOFCOM, with the latest amendments effective from 29 December 2023). Second, the Measures for the Reporting of Foreign Investment Information (promulgated by MOFCOM and the SAMR, effective from 1 January 2020) must be taken into consideration when a foreign franchisor establishes foreign-funded commercial enterprises within the territory of China and engages in business activities. Furthermore, when an enterprise with foreign investment invests in commercial sectors within the territory of China, it must comply with the Interim Provisions on Investment of Foreign-funded Enterprises and Foreign Investment Law in China.

Law stated - 20 June 2025

Taxation

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

The major legal regime governing franchisors is the Law on Enterprise Income Tax, whose latest revision came into effect on 29 December 2018 (Enterprise Income Tax Law), as well as its implementation rules. Pursuant to the Enterprise Income Tax Law, taxpayers are classified in two categories: resident taxpayers, who pay enterprise income tax on their income earned inside and outside China; and non-resident taxpayers, who pay enterprise income tax on their income sourced from China (eg, dividends, interest and royalties, etc), income earned by agencies or offices in China, and income earned outside China yet associated in substance with such agencies or offices. 'Resident taxpayer' status refers to enterprises established in China according to Chinese law, or established according to the law of a foreign country (region) with its actual management body in China. 'Non-resident taxpayer' status refers to enterprises established according to the law of a foreign country with its actual management body located outside of China, but that have established agencies or offices in China, or have income earned in China.

If a foreign franchisor sells its franchise system to a Chinese company, it will be deemed a non-resident taxpayer and subject to income tax (withholding tax) at the rate of 20 per cent (reduced to 10 per cent under current provisions) of the income generated in China (ie, franchise fee, royalty, service fee and trademark licence fee (transaction amount)), unless otherwise provided by the tax treaty between China and the country in which the franchisor is located. If the foreign enterprise establishes a Chinese entity to sell franchises in China, then such Chinese entity would be the franchisor and the resident taxpayer. In this scenario, the profit of the franchisor will be subject to enterprise income tax set (at the time of writing) at the rate of 25 per cent.

In addition to enterprise income tax, the franchisor's business sales will be subject to VAT. Taxpayers in China are divided into categories of 'general taxpayers' and 'small-scale taxpayers' for VAT purposes, according to the scale of their business operations and the degree of sophistication of their accounting systems. The VAT payable by general taxpayers is calculated using the output tax or input tax crediting system at the rate of 13 per cent for sale of products or at the rate of 6 per cent for the transfer of intangible assets and provision of consulting or technical services. For small-scale taxpayers, a simplified VAT calculation formula applies under which no credit or deduction is allowed for input tax, but tax is calculated at a lower rate of 3 per cent. The VAT is applicable regardless of whether the franchisor is a resident taxpayer or a non-resident taxpayer. However, a non-resident franchisor should apply the tax rates applicable to general taxpayers with no input credit available.

Law stated - 20 June 2025

Labour and employment

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

A franchisor typically enters into a franchise contract with a franchisee with the franchisee put in charge of the business established according to the franchise contract. The franchisor is usually not in direct contact with the employees of a franchisee. Thus, there is little to no risk that employees of a franchisee could be deemed employees of the franchisor. Moreover, the risk of recognising the franchisee as the franchisor's employee could be effectively managed by including a well drafted relationship clause in the franchise contract addressing the relationship between the two parties and by requiring that the franchisee enter into labour contracts with its employees explicitly documenting the employment relationship.

Law stated - 20 June 2025

Intellectual property

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

China has a comprehensive set of intellectual property (IP) laws, including the Patent Law, Copyright Law and Trademark Law. These laws have been revised multiple times to align with international standards and to support China's innovation goals. China operates a first-to-file system for trademarks and patents, which means owners of trademarks and patents will be, in most cases, unable to protect such assets before they obtain registrations for such trademarks and patents in China. By contrast, copyright registrations are voluntary, and any original and creative works that are created in any member state of the Berne Convention will be eligible for protection in China, although copyright registrations could facilitate enforcement. IP protection in China is enforced through both administrative and judicial channels. Administrative departments can take action against infringers, while courts can handle civil and criminal cases related to trademark infringement.

Know-how is often protected as a trade secret under China's Anti-Unfair Competition Law. The 2019 amendment to this law strengthened the protection of trade secrets by clarifying the burden of proof and increasing penalties for violations. Additionally, know-how can be protected as a contractual obligation of the receiving party in the franchising practice under the confidentiality clauses of a franchise contract.

Law stated - 20 June 2025

Real estate

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

For both domestic and foreign franchisors, leasing or acquiring real estate ownership for franchise operations is a common practice, though certain distinctions may exist across different industry sectors.

However, the legal regime governing real estate imposes strict restrictions on foreign entities entering the Chinese real estate market. Without a Chinese establishment, a foreign franchisor is not able to purchase or lease commercial real estate. To get around this issue, a Chinese enterprise should be incorporated to purchase or lease commercial real estate.

Law stated - 20 June 2025

Competition law

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

The legal regime for competition law is primarily covered by the Anti-Unfair Competition Law and the Anti-Monopoly Law. These two laws provide the following restrictions on price and use of intellectual property, which are related to typical franchise transactions.

Price

The Anti-Monopoly Law prevents the following activities:

- a monopoly agreement that fixes prices for resale;
- limits on the output or sale of products; and
- limits on the developments of new products or new technology.

IP

The Anti-Unfair Competition Law prevents the following activities:

- using another party's registered trademark;
- inducing confusion by using the same or a similar name, packaging or distinctive characteristics of a well-known product;
- using the name of another business to confuse consumers; and
- using the certificate of another business on merchandise.

A franchisor will not be considered to be in violation of the Anti-Unfair Competition Law and the Anti-Monopoly Law unless there is an abuse of market position, impairment of public interest and interference of a franchisee's lawful business activities. Conversely, if a franchising transaction's purpose is to create market barriers, sell unmarketable goods or abuse a position of power, then it will be construed as a violation of unfair competition legislation. The offending franchisor can be punished by fines or other penalties.

Law stated - 20 June 2025

OFFER AND SALE OF FRANCHISES

Legal definition

12 | What is the legal definition of a franchise?

A 'franchise' refers to a business activity where an enterprise that possesses registered trademarks, enterprise logos, patents, proprietary technology or other types of operational resources allows, by way of a contract, such operational resources to be used by another business operator under a uniform business model for purposes of business operations, with franchising fees payable according to the franchise contract (Administrative Regulations on Commercial Franchising promulgated by the State Council on 6 February 2007 and effective from 1 May 2007 (Franchising Regulation)).

Law stated - 20 June 2025

Laws and agencies

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

The following laws primarily regulate the offer and sale of franchises:

- the Franchising Regulation;
- the Administrative Measures for the Record Filing of Commercial Franchises (promulgated by the Ministry of Commerce of the People's Republic of China (MOFCOM) with the latest amendments effective from 29 December 2023) (Measures for Record Filling); and
- the Administrative Measures for Information Disclosure of Commercial Franchises (promulgated by MOFCOM and effective from 1 April 2012) (Measures for Information Disclosure).

Additionally, as franchising constitutes a civil and commercial activity, the offer and sale of franchises must also comply with the relevant provisions of the Civil Code (promulgated by the National People’s Congress and effective from 1 January 2021), the Anti-Unfair Competition Law (promulgated by the Standing Committee of the National People’s Congress with the latest amendments effective from 23 April 2019) and the Anti-Monopoly Law (promulgated by the Standing Committee of the National People’s Congress with the latest amendments effective from 1 August 2022).

MOFCOM and its local counterparts are the government agencies that primarily regulate the offer and sale of franchises.

There are no exemptions or exclusions under the current legal regime governing franchises.

Law stated - 20 June 2025

Principal requirements

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

The principal requirements are outlined below.

The 2+1 requirement

Franchisors must have owned and operated at least two units under the franchise brand for at least one year. In practice, local regulators may allow the two units to be owned either directly by the franchisor or by an affiliate, provided that the affiliate is 1) a direct subsidiary of the franchisor and the franchisor holds a majority equity interest in the subsidiary; 2) the parent company of the franchisor who holds a majority equity interest in the franchisor; or 3) a sister company of the franchisor who is under the common control of another company with the franchisor.

Franchisor filing and annual filing

Within 15 days of signing its first franchising agreement in China, the franchisor files as a franchisor with MOFCOM or its local counterparts (foreign franchisors file with MOFCOM, while Chinese franchisors file with MOFCOM's local counterpart in the province where the franchisor is established). In the first quarter of each year, the franchisor files with MOFCOM or its counterparts an annual report that notes the following:

- the number of franchise contracts in the preceding annual report filed with MOFCOM, that were signed, revoked, terminated, renewed after the previous annual report and the total number of franchise contracts in performance;
- the number of franchised units and turnover of such units; and
- the number of directly owned units and turnover of such units.

Modification of filing information

If there are any changes in the following filing information of a franchisor, the franchisor must, within 30 days of the date on which the change occurs, apply to the filing authority to modify its information on file:

- commercial registration details of the franchisor;
- information concerning operational resources; or
- addition or closure of franchised units within the territory of China.

Contract term

Franchisors and franchisees must sign written franchising contracts with an initial term of at least three years, unless the franchisee consents to a shorter term.

Disclosure

Thirty days before the franchisor and the franchisee sign a franchising contract, the franchisor must disclose to the franchisee designated categories of information in accordance with the Franchising Regulation and the Measures for Information Disclosure, and provide a sample of the franchising agreement to the franchisee.

Cooling-off period

The franchisor must give the franchisee a cooling-off period to allow the franchisee to unilaterally terminate the franchise contract within a certain period of time after signing the contract. If no such period is provided in the franchise contract, the franchisee will be entitled to a reasonable period of time, subject to a wide discretion of the court or arbitration tribunal.

Manual and support

The franchisor must provide a franchise practice manual to the franchisee and must provide continuous support and training to the franchisees.

Law stated - 20 June 2025

Franchisor eligibility

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

Before a franchisor offers a franchise in China, it must satisfy the following requirements:

- have been incorporated and in legal existence for more than one year;
- have a mature business model, which is essentially the 2+1 requirement introduced above; and
- have obtained registration for at least one type of IP asset in China.

Law stated - 20 June 2025

Franchisee and supplier selection

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

There are no restrictions imposed on franchisors when recruiting franchisees.

Law stated - 20 June 2025

Pre-contractual disclosure – procedures and formalities

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

The franchisor must produce a disclosure document in writing and deliver the same to the prospective franchisee no later than 30 days before the signing of the franchise contract.

Subsequently, if there is any material change to the information disclosed, the franchisor should notify the franchisee of such change in a timely manner.

Law stated - 20 June 2025

Pre-contractual disclosure – content

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

The franchisor must disclose the following to its prospective franchisees at least 30 days before signing of the franchise contract.

Basic information concerning the franchisor and its commercial franchise business

- Name, mailing address, contact information, legal representative, general manager, registered capital and scope of business, and information of its directly managed stores.
- General situation and overview of the franchisor's engagement in the commercial franchise business.
- Information on the franchisor's completion of franchise filling in China.
- Information on related parties of the franchisor that will provide products or services to the franchisees.
- Information concerning the franchisor's or its related party's bankruptcy or applications for bankruptcy within the past two years.

Basic information concerning the franchisor's operational resources

- Written descriptions of the franchisor's registered trademarks, corporate logo, patents, proprietary technology, business models and other operational resources.
- If a related party to the franchisor owns a business resource of the franchisor, basic information on the related party and the contents of the authorisation made by the related party to the franchisor; the franchisor also needs to explain how the franchise system will be dealt with if the licence agreement between the franchisor and the related party regarding the business resource is suspended or terminated ahead of schedule.
- Information regarding any legal proceedings or arbitration involving the franchisor's registered trademarks, corporate logo, patents, proprietary technology or any other operational resources.

Information about franchise fees

- Types of charges, amounts, rates collected by the franchisor for itself or for a third party and the method of payment. If the franchisor is unable to disclose such information, an explanation must be provided. Where there is no uniform fee standard, a range should be provided, along with an explanation.
- Conditions for the collection and refund of security deposits, when and how to refund the deposits.
- Where the franchisee is required to make payments before entering into the franchise contract, an explanation indicating usage, purpose of such fees and the conditions and manner of a refund should be given to the franchisee.

Information on the prices and conditions of the products, services and equipment provided for the franchisee

- Whether franchisees must purchase products, services or equipment from the franchisor (or from a related party) and if so, the relevant prices and conditions.

- Whether franchisees must purchase products, services or equipment from suppliers designated (or approved) by the franchisor and if so, the relevant prices and conditions.
- Whether franchisees have the right to choose other suppliers and if so, the requirements for such suppliers.

Franchisor's continuous provision of services to the franchisee

- Specific business training content, provision method and implementation, including where, how and when such training is to be held.
- Specific content of technical support provided and the method of provision and implementation, including the name and type of operational resources and the type of products or equipment.

Method and content of guidance and supervision on the business operations of franchisees

- Content of guidance to be provided for the business operations of the franchisees, how it is provided and implemented, including site selection, decor, store management, advertising, promotion and product configuration.
- Method and terms of supervision, obligations of the franchisees and liabilities of the franchisees in event of failure to fulfil its obligations.
- Division of responsibility and liability between franchisor and franchisee for complaints by consumers and for compensation paid out to consumers.

Investment budget for the franchise business

- Investment budget, which could include franchise fees, training expenses, expenditures for real estate and decoration, equipment, office supplies, furniture, starting inventory, hydro, electric or gas fees, expenses to obtain a valid business licence or other governmental approvals, and working capital for start-up.
- Basis for the budget estimate and sources for the above data.

Information on the franchise business in China

- Quantity, geographical location and scope of authorisation of existing and expected franchisees; and whether there is exclusive authorisation for franchisees in a specific geographical region (if yes, provide details).
- Operating status of existing franchisees, including actual investment amount, average sales volume, costs, gross and net profit; and the sources of the data provided.

Financial statements

- Abstracts of the franchisor's audited financial statements for the previous two years.

Litigation and arbitration history

- Information on litigation or arbitration involving the franchisor within the previous five years in relation to the franchise business, including cause of action, location of the proceeding, pleadings and outcome.

Records of unlawful business operation by the franchisor or its legal representative

- Records of any administrative fine of more than 300,000 yuan.
- Any criminal liability investigated by the authorities.

The franchise contract

- Sample of the contract.
- Sample of other franchise-related contracts to be entered into between the franchisor (or a related party) and the franchisee at the request of the franchisor.

Law stated - 20 June 2025

Pre-sale disclosure to sub-franchisees

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

Under a sub-franchising structure, it is the sub-franchisor that is obliged to provide the pre-sale disclosure. The sub-franchisor must disclose the same categories of information as those for the franchisor. Additionally, the sub-franchisor must disclose to the sub-franchisee that it has obtained the necessary authorisations from the franchisor to grant sub-franchises.

Law stated - 20 June 2025

Due diligence

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

Under current Chinese law, there are no statutory obligation requiring either franchisors or franchisees to conduct formal due diligence prior to establishing a franchise relationship.

However, due diligence is always advisable, both for the franchisor and the franchisee, before entering a franchise relationship.

Law stated - 20 June 2025

Failure to disclose – enforcement and remedies

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

In case of the franchisor's failure to make the required disclosures, an administrative complaint can be submitted to MOFCOM or its local counterparts, which will have the authority to issue administrative penalty decisions, ordering the franchisor to make necessary corrections and imposing a monetary fine of between 10,000 yuan and 50,000 yuan on the franchisor, or up to 100,000 yuan in cases of a serious violation. Additionally, MOFCOM or its local counterparts may also make a public announcement regarding the violation.

If the failure to disclose adversely affects performance of the franchise contract, making it impossible to achieve the purpose of the franchise contract, the franchisee could also seek to rescind the franchise contract and claim for damages. Damages may be calculated based on the negative effect of such failure to disclose, but is usually confined to the franchisee's direct loss.

Law stated - 20 June 2025

Failure to disclose – apportionment of liability

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

Only the sub-franchisor, not the franchisor, is required by the regulation to provide disclosure to sub-franchisees. Hence, in principle, the sub-franchisor would be held liable to the sub-franchisee for its disclosure violations. However, if the disclosure violations are attributable to the franchisor, the sub-franchisor may seek damages from the franchisor.

Under the current legal framework, individual officers, directors or employees of either the franchisor or the sub-franchisor will not be exposed to liabilities for the violation of the disclosure requirement, provided that there is no intentionally fraudulent or deceptive practice by such individual.

Law stated - 20 June 2025

General legal principles and codes of conduct

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

Offering and selling franchises, being one type of civil conducts, is also subject to the following major general principles provided under the Civil Code.

Fairness principle

Contract parties should observe the principle of fairness in defining their respective rights and obligations. In particular, the franchisor is prohibited from misusing its advantageous position in the relationship to harm the interests of the franchisees.

Good-faith principle

Contract parties should observe the principle of good faith in exercising their rights and performing their obligations. No fraudulent representations, concealment of truth and malicious breach of contracts are allowed under this principle.

Law stated - 20 June 2025

Fraudulent sale

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

Franchisees may report such fraudulent or deceptive practices of the franchisor to MOFCOM or its local counterparts, which will have authority to issue the following administrative penalties:

- a fine of between 10,000 yuan and 300,000 yuan, depending on the severity of the offence;
- a public announcement of such violation; and
- if a crime has been committed, transfer the case for criminal investigation and prosecution.

The franchisee may also seek to terminate or rescind the franchise contract by filing a civil litigation. Damages can be claimed.

Law stated - 20 June 2025

FRANCHISE CONTRACTS AND THE FRANCHISOR/FRANCHISEE RELATIONSHIP

Franchise relationship laws

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

In China, the Franchising Regulation and the Measures for Information Disclosure are the two major regulations governing the ongoing relationship between franchisor and franchisee.

Some of the specific rules on the franchise relationship are:

- a franchisor should provide an operations manual to its franchisees, as well as ongoing business guidance, technical support and business training to the franchisees according to the stipulated contents and methods provided in the franchise contract and operations manual;
- a franchisor must use the funds collected from the franchisees for promotion and publicity activities only for the purposes stipulated in the franchise contract. Details concerning the use of such funds should be disclosed to the franchisees in a timely manner; and
- without the consent of the franchisor, a franchisee may not transfer the franchise to a third party.

The Civil Code is also applicable to the franchise relationship as such legal pronouncements govern the validity, interpretation and performance of the franchise contract.

Law stated - 20 June 2025

Operational compliance

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

Generally speaking, inspection and audit rights and reporting requirements are commonly adopted mechanisms to ensure franchisees’ compliance with brand standards. The franchisor may require audits of the franchisee's operations or demand reports on specific aspects of the operations. If a failure to meet brand standards is found, the franchisor may request rectifications accordingly.

Additionally, unified procurement is also an important means to ensure operational consistency, especially when the suppliers of such goods or services are the franchisor and its affiliates, or have otherwise been pre-approved by the franchisor.

Law stated - 20 June 2025

Amendment of operational terms

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

This is subject to contract. If the agreement expressly grants the franchisor unilateral amendment rights, the franchisor may at its sole discretion modify the operational terms and standards during the franchise relationship.

Law stated - 20 June 2025

Policy affecting franchise relations

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

The Ministry of Commerce of the People's Republic of China (MOFCOM) and its local counterparts are the government authorities in charge of the administration of franchise activities. Other general commercial matters are supervised by the State Administration for Market Regulation (SAMR).

The China Chain Store & Franchise Association (CCFA) is the industry association for the franchise business. However, CCFA is not a government body and it does not have supervising authority over franchise relationships.

Law stated - 20 June 2025

Termination by franchisor

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

Termination of the franchise contract by a franchisor can be allowed based on the provisions of the franchise contract. A termination clause can be included, with the mutual consent of both franchisor and franchisee. In the absence of contractual provisions, the franchisor may terminate the franchise contract if:

- it is impossible to achieve the purpose of the franchise contract due to an event of force majeure;
- prior to the expiration of the period of performance, the franchisee expressly states, or indicates through its conduct, that it will not perform its main obligation;
- the franchisee delayed performance of its main obligation, and fails to perform within a reasonable period after such performance has been demanded; or
- the franchisee delays performance of its obligations, or otherwise breaches the franchise contract, rendering it impossible to achieve the purpose of the franchise contract.

Law stated - 20 June 2025

Termination by franchisee

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

The Franchising Regulation provides a mandatory cooling-off period during which the franchisee is entitled to terminate the franchise relationship without cause.

After the cooling-off period, the franchisee may terminate a franchise contract in accordance with the termination clause of the franchise contract. In addition, the franchisee may also terminate the franchise relationship in the event if:

- it is impossible to achieve the purpose of the franchise contract due to an event of force majeure;
- prior to the expiration of the period of performance, the franchisor expressly states, or indicates through its conduct, that it will not perform its main obligation;
- the franchisor delayed performance of its main obligation, and fails to perform within a reasonable period after such performance has been demanded; or
- the franchisor delays performance of its obligations, or otherwise breaches the franchise contract, rendering it impossible to achieve the purpose of the franchise contract.

Law stated - 20 June 2025

Renewal

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

Renewal of franchise agreements are not subject to any mandatory requirement, either in form or substance. Typically, the franchisor will set forth in the franchise contract conditions and procedures for renewal.

Law stated - 20 June 2025

Refusal to renew

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

Yes, unless such refusal is negated by the automatic renewal clause of the franchise contract.

Law stated - 20 June 2025

Transfer restrictions

33 |

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

Yes, it is a common practice to include clauses restricting transfer of the franchise by the franchisee and transfer of ownership interests in a franchisee entity in the franchise contract.

Law stated - 20 June 2025

Fees

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

The parties are free to negotiate the amount and terms of payment of the franchise fees, royalties and any other payments payable by the franchisee to the franchisor, save that franchise fee arrangement between affiliated parties may be subject to the transfer pricing rules.

That said, if a franchisor requests prepayment of the franchise fees before the execution of a franchise contract, the franchisor must explain to the franchisee in writing the purpose of the payment as well as the conditions and manners for a refund. In addition, the amount collected by a franchisor for promotion or advertising may be used only for the purpose agreed in the franchise contract, subject to mandatory disclosure on use of such fund.

Law stated - 20 June 2025

Usury

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

It is possible to charge interest for overdue payments if the franchise contract has expressly provided for such interest payment.

If there is dispute over the interest rate in court or in arbitration, the adjudicator may adjust the interest rate provided in the franchise contract if the adjudicator believes the interest rate was excessive and not in compliance with legal requirements.

Law stated - 20 June 2025

Foreign exchange controls

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

No, so long as there is a franchise contract in writing.

Law stated - 20 June 2025

Confidentiality covenant enforceability

37 | Are confidentiality covenants in franchise agreements enforceable?

Confidentiality covenants in franchise contracts are enforceable. In addition, if the confidential information at issue is eligible for protection as a trade secret, it is also an option to file a trade secret misappropriation claim with a competent court in lieu of enforcing the confidentiality covenants.

Law stated - 20 June 2025

Good-faith obligation

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

The Civil Code provides a general obligation for parties to deal with each other in good faith. This general principle is applicable to franchise contracts, and will govern the franchise relationships.

Additionally, if a party is found to be deliberately concealing important facts, providing false information, or performing other acts that violate the principle of good faith, such party will be responsible for all damages caused to the other party thereof. In addition, if a contract is concluded by one party against the other party's good faith by the use of fraud, the other party is entitled to rescind the contract.

Law stated - 20 June 2025

Franchisees as consumers

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

No, the Consumer Protection Law defines 'consumer' as one who purchases goods or services for his or her own consumption. As a franchisee purchases materials or services from the franchisor for business purposes (not for its own consumption), a franchisee will not be deemed as a consumer.

Law stated - 20 June 2025

Language of the agreement

40 |

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

Chinese law does not require the franchise documents to be in Chinese. However, to avoid potential disputes with local franchisees and for the purposes of franchise filing with the local authorities, it is advisable to produce a Chinese version of the franchise documents. In addition, the franchisee's bank may also require the Chinese version of the franchise contract in order to process the payment requests.

Law stated - 20 June 2025

Restrictions on franchisees

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

Commonly paced restrictions include restrictions on duration and renewal of the contract, termination, transfer of the franchise, change of control, non-compete, non-solicitation, and limitations as to the sources from whom franchisees may purchase products, equipment or supplies.

Law stated - 20 June 2025

Courts and dispute resolution

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

The court system in China consists of four levels: district people's courts, intermediate people's courts, the higher people's courts (the highest court in each province) and the Supreme People's Court (the highest court in China). China has a civil law system and thus prior cases are not binding.

In some areas of China, the government has established intellectual property courts or intellectual property tribunal, which have jurisdiction to hear disputes related to or arising from franchise contracts.

In terms of dispute resolution procedures, franchise transactions are treated no differently from other commercial disputes. Besides the court system, parties are free to resolve disputes through mediation and/or arbitration.

Pursuant to the Arbitration Law, the parties may select arbitration as the dispute resolution mechanism as long as they enter into a valid arbitration agreement or if there is an arbitration clause in the mutually agreed agreement. The arbitration body must be expressly identified for the arbitration agreement or arbitration clause to be valid. In the event that the franchisor is a foreign entity, it is also permissible for the foreign franchisor and the domestic franchisee to choose a foreign arbitration body and a foreign venue.

Law stated - 20 June 2025

Governing law

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

For franchise contracts entered into between two Chinese parties, the contracts must be governed by Chinese law. When the franchisor is a foreign entity, a foreign law may be elected as the governing law, provided that such election does not violate Chinese mandatory rules or public policy.

If foreign law is designated without valid foreign-related elements, the choice-of-law clause may be deemed invalid, potentially impairing the enforceability of contractual terms or related arbitral awards in Chinese courts.

Law stated - 20 June 2025

Arbitration – advantages for franchisors

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

For foreign franchisors, it is generally advisable to resolve legal disputes through arbitration, because 1) arbitration proceedings are generally private, allowing parties to keep sensitive business information and disputes confidential; 2) arbitration can be quicker than litigation due to fewer procedural hurdles; 3) parties can select arbitrators with specialised knowledge in franchise law or the subject matter, leading to more informed and accurate decisions; 4) arbitral awards are generally final and binding, with limited grounds for appeal, providing a more definitive resolution to disputes; and 5) the arbitration process can be tailored to the parties' needs, including the choice of venue, language and procedural rules. However, compared with litigation, arbitration could be more expensive and the procedures could be more complex.

Within China's dispute resolution framework, no particular ADR procedure is systematically favoured or disfavoured. Both franchisors and franchisees retain the freedom to select appropriate mechanisms based on either contractual provisions or statutory requirements.

Law stated - 20 June 2025

National treatment

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

In general, foreign franchisors are treated similarly to domestic franchisors from a legal standpoint.

From a regulatory standpoint there are some minor differences in how foreign franchisors are handled. One example is that the franchisor filing requirements, including the following, are slightly different:

- domestic franchisors must file with the local MOFCOM counterpart, whereas foreign franchisors are required to file with MOFCOM; and
- application and filing documents submitted by foreign franchisors must be notarised and legalised, as most of these documents are produced out of China.

Law stated - 20 June 2025

UPDATE AND TRENDS

Legal and other current developments

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

The Franchising Regulation was enacted almost two decades ago, and has been widely criticised for not conforming to the present status of the franchise business in China and challenges that franchise businesses are encountering. In response, the Ministry of Commerce of the People's Republic of China (MOFCOM) has hosted multiple rounds of consultations and discussions on possible amendments to the Franchising Regulation, yet no draft amendment has been put forward. We do not expect that amendments will be made in the near term.

Due to geopolitical issues and the economic downturn in China, we have observed a number of US brand owners withdrawing from China. Notably, although many of them have shut down their own direct Chinese operations, they have entered into master franchise arrangements to allow the brands to continue to operate (by their master franchisees) in the Chinese market. It appears that franchising has become an attractive alternative to international brands that are impacted by the geopolitical and economic challenges.

Law stated - 20 June 2025

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Summary

FRANCHISE CONTRACTS AND THE FRANCHISOR/FRANCHISEE RELATIONSHIP

UPDATE AND TRENDS

MARKET OVERVIEW

Franchising in the market

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

The latest statistics for 2024 of the German Franchise Association eV show ongoing positive developments in the franchise sector: approximately 1,000 franchise systems nationwide counted over 148,000 franchise partners (an increase of 0.9 per cent on the previous year), reaching an overall turnover of more than €149 billion (an increase of 1.1 per cent on the previous year). The most franchised industries are services (27 per cent), followed by trade on a par with gastronomy (20 per cent), then crafts, construction and refurbishment (17 per cent), and health and care (9 per cent), as well as fitness and leisure (7 per cent) – all within markets that are strongly driven by consumer needs.

Franchising continues to be economically viable in Germany, supported by a generally stable legal framework and a resilient business climate. According to the Franchise Climate Index, the economic sentiment within the industry remained stable at 133 per cent in 2024 and even increased up to 136 points at the end of 2024. However, there are still challenges to be considered, such as a tense financing climate, bureaucratic hurdles, a shortage of suitable franchise partners and overall economic uncertainty.

The 2024 figures are the most recent official statistics available; current indications suggest that the German franchise sector continues to grow steadily.

Law stated - 16 June 2025

Associations

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

The primary national franchise association in Germany is the German Franchise Association , established in 1978 in Berlin. With over 400 member companies, including franchisors, franchisees and affiliated experts such as consultants and legal advisers, the German Franchise Association represents the interests of the German franchise industry at economic, political and social levels.

The German Franchise Association actively engages in shaping the legal and regulatory environment for franchising in Germany. It maintains close contact with key institutions, including the Federal Ministry for Economic Affairs and Energy, the German Bundestag and the Chambers of Commerce and Industry.

On an international level, the German Franchise Association is a member of the European Franchise Federation and the World Franchise Council, contributing to the development of franchising standards and policies across Europe and globally. Furthermore, it issues guidelines and practical advice on newly introduced franchise-related laws or regulations.

Membership to the German Franchise Association requires adherence to its Code of Ethics, which is based on the European Code of Ethics for Franchising and outlines principles for fair and transparent cooperation between franchisors and franchisees, including issues such as pilot projects, rights of use regarding the corporate identity, and training for franchisees. Prospective full members must undergo a system check, an evaluation process to assess the quality and sustainability of the franchise system. This form of voluntary self-regulation promotes high standards and credibility among members. However, the Code of Ethics is neither legally binding nor a legal requirement for operating a franchise in Germany, even though adhering to it is widely regarded as a mark of quality and professionalism.

Law stated - 16 June 2025

BUSINESS OVERVIEW

Types of vehicle

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

The choice of legal form for franchisors in Germany primarily depends on the obligations and liability risks to be undertaken, the seed capital, and the business assets and tax implications connected thereto. The most common structure for medium or large businesses is the flexible private company with limited liability (GmbH), requiring a minimum share capital of €25,000 and limited liability with regard to creditors to the company's assets. Larger businesses might choose the corporation (AG), a public limited company that requires a minimum share capital of €50,000. As an alternative, the entrepreneurship (UG), also known as 'mini GmbH', allows for limited liability, with a minimum share capital of €1. If the franchise system is to be set up in different states of the European Union, another option is the Societas Europea (SE), a public limited company with a minimum share capital of €120,000. Franchisors often combine these corporate forms with partnerships (eg, GmbH & Co KG or AG & Co KG) for tax optimisation purposes. These hybrid structures allow for limited liability while benefiting from the tax advantages of partnerships.

Law stated - 16 June 2025

Regulation of business formation

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

The formation of business entities in Germany is governed by different statutes depending on the legal form. Partnerships are regulated by the German Civil Code and the German Commercial Code. The Limited Liability Company Act applies to GmbHs and UGs, while the

Stock Corporation Act governs AGs. The formation of an SE is based on Council Regulation (EC) No. 2157/2001.

Registration with the commercial register at the local district court is required for most entities. In the case of corporations, notarisation of the articles of association is mandatory for valid incorporation.

Law stated - 16 June 2025

Requirements for forming a business

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

Compared to the AG, the GmbH and, in particular, the UG are less formalised, easier and cheaper to form and thus offer a more flexible and cost-efficient framework for incorporation, especially for small or medium-sized businesses. One-person foundations are permitted and founders can be either German or foreign natural and even legal persons.

The articles of association must include, at a minimum:

- the company name and registered office;
- the business purpose;
- the amount of share capital; and
- the shareholders' capital contributions.

The incorporation requires notarisation by a German notary. Once certified by a notary, the company must be registered with the German Commercial Register by the competent local court. Only upon registration does the entity gain full legal personality. The company's entry is published in the Electronic Federal Gazette.

To maintain a business entity, ongoing obligations include:

- annual financial statements (for most entities);
- changes to shareholders or managing directors being registered and notarised;
- compliance with tax and commercial law; and
- regular filings with the commercial register, where applicable.

Law stated - 16 June 2025

Restrictions on foreign investors

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

In principle, foreign business entities are free to operate and invest in Germany.

However, foreign direct investments may be subject to screening by the German Federal Ministry for Economic Affairs and Energy, particularly if they involve the acquisition of stakes in sectors relevant to public order or security, such as defence, IT, telecommunications and critical infrastructure. These review and notification obligations are governed by sections 55 to 62 of the Foreign Trade and Payments Ordinance. Exemptions generally apply to investors from the European Union, the European Economic Area (the European Union plus Iceland, Liechtenstein and Norway) and Switzerland.

In addition, Regulation (EU) 2019/452 established a cooperation mechanism for the screening of foreign direct investments across the European Union. This regulation was implemented in Germany through amendments to the Foreign Trade and Payments Act.

Law stated - 16 June 2025

Taxation

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

Once registered with the Commercial Register, German tax-resident business entities are automatically assigned a tax number by the competent local tax authority. To avoid penalties, franchisors must comply with regular filing obligations: tax returns must be submitted by 31 July of the following year or by 28 February of the following year if filed by a tax adviser.

Income tax, which is usually the highest tax, is calculated based on the profits indicated in the most recent tax declaration and depends on the legal form of the franchisor: AGs and GmbHs are subject to a corporate income tax of 15 per cent plus a solidarity surcharge of 5.5 per cent on the tax amount, while partnerships and sole proprietors are not subject to corporate income tax but pay progressive personal income tax that can reach up to 45 per cent. Additionally, trade tax applies to most business entities, with exceptions primarily for liberal professions. Trade tax is levied locally and typically ranges between 7 per cent and 18 per cent.

If the franchisor employs staff, wage tax must be withheld and paid monthly on behalf of the employees.

In addition, franchising transactions involving goods or services are typically subject to value-added tax at a standard rate of 19 per cent or a reduced rate of 7 per cent for specific sectors such as public transport, hotels or certain food services.

Law stated - 16 June 2025

Labour and employment

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

Yes. As specified both in the franchise agreement itself and in any additional regulations, in particular the franchise manual, franchisors should not limit the franchisee's freedom too much in order to avoid subjecting the franchisee to the highly protective employment and social security laws. To mitigate this risk, the franchise agreement – along with the franchise manual and daily practice – must allow the franchisee sufficient entrepreneurial independence, both legally and practically. The franchisor shall draft and practically implement the franchise agreement in a way that leaves the franchisee with sufficient leeway to exercise a self-employed activity, avoiding any implications that the franchisee is personally and economically dependent on the franchisor.

Key factors include avoiding excessive control over business operations, working hours, pricing and staff-related decisions. If the franchisee is found to be personally and economically dependent on the franchisor, courts may requalify the relationship as employment, regardless of the contract's wording. According to the German Federal Court of Justice (11 October 2018, VII ZR 298/17), actual practice prevails over written terms (see Rohrßen, *ZVertriebsR* 2019, 323). Therefore, franchisors must not only draft agreements carefully, but also consistently implement them in practice to avoid unintended employment status.

Law stated - 16 June 2025

Intellectual property

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

Franchising, trademarks and know-how go hand in hand and their protection is therefore of central importance. Trademarks are protected by registration or, in some cases, by acquisition of market recognition or notoriety. Registration at the national level is a relatively quick and inexpensive process, with filing available online and in paper form with the German Patent and Trade Mark Office in Munich.

To obtain protection throughout the European Union, applications must be submitted to the European Union Intellectual Property Office in Alicante. For international protection, the application shall be registered with the World Intellectual Property Organization in Geneva under the Madrid System. In all cases, protection begins on the filing date and initially lasts for 10 years, with unlimited renewals possible in further 10-year periods upon payment of the renewal fee.

Innovations may be protected by patents, but operational know-how – such as handbooks or best practice manuals – rarely meets the necessary technical requirements for patentability. Therefore, such know-how is best protected through non-disclosure agreements, supported by Directive (EU) 2016/943 on the protection of undisclosed know-how and business information (trade secrets) against their unlawful acquisition, use and disclosure, implemented in Germany by the Act on the Protection of Business Secrets of 18 April 2019.

In terms of enforcement, trademark owners may seek a preliminary injunction – often without an oral hearing and within a very short time. However, any delay in initiating proceedings may result in the loss of this remedy. In court proceedings, both parties must be represented before the court by a German qualified lawyer.

Law stated - 16 June 2025

Real estate

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

In Germany, franchisors and franchisees usually lease commercial space rather than purchase it, because leasing offers more flexibility and lower upfront costs. Lease agreements for business premises are governed by the German Civil Code and are shaped by contractual freedom, although some protective provisions apply. A reform under discussion (Fourth Bureaucracy Relief Act) would allow commercial leases to be concluded in text form, potentially removing the current requirement for written form for leases exceeding one year.

Unless the franchise operates exclusively online, the franchisor typically has a strong interest in securing a strategically favourable location for the franchise outlet. If the franchisor owns or leases the shop directly, the termination scenarios of both the franchise agreement and the (sub)lease agreement should be contractually aligned. The main downside of this structure is that the franchisor bears the financial risk in case of non-payment by the franchisee.

An advantage, however, lies in competition law: under article 5(1)(a) and (2) of the Vertical Block Exemption Regulation 2022 (VBER), the general five-year limitation for post-term non-compete obligations does not apply if the franchisee has occupied the premises leased or sub-leased from the franchisor (for details, see Rohrßen, *VBER 2022*: *EU Competition Law for Vertical Agreements* (Springer, 2023), Chapter 5.2 on non-competes and Chapter 7 on franchising). This allows the franchisor to impose more extended non-compete obligations, which would otherwise not be enforceable under standard EU rules. In other constellations, post-term non-compete obligations may still be permissible if they are necessary for the functioning of the franchise system.

If, instead, the lease agreement is concluded directly between the franchisee and a third party, the franchisor usually requires a contractual subrogation . This right, to be expressly agreed with the lessor, allows the franchisor to step into the lease in case of termination of the franchise agreement. It helps secure continuity of operations either by taking over the location or transferring it to a new franchisee.

Law stated - 16 June 2025

Competition law

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

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

Enforcement is carried out by both the Federal Cartel Office and the European Commission, depending on the geographic scope and market impact. The Federal Cartel Office monitors national franchise networks and can initiate investigations, impose fines or declare contractual clauses void if they violate competition law. Private enforcement through courts is also available, particularly where anti-competitive clauses lead to damages or claims for nullity.

Law stated - 16 June 2025

OFFER AND SALE OF FRANCHISES

Legal definition

12 | What is the legal definition of a franchise?

German law does not provide a definition of 'franchise', and neither does EU law (see the report issued in 2016 by the Directorate-General for Internal Policies of the European Union on Franchising, p. 185; Kieran McLoone, 'Germany: The Self-Regulated Franchising Haven', in *Global Franchise*, Issue 6.4 of 2021, p. 46). Nevertheless, there is a common understanding that the term defines the set of rights granted by a franchisor to a legally and financially independent and self-employed party, the franchisee, with the aim of a cooperative distribution system. A franchise entitles and obliges the franchisee, against a direct or indirect financial compensation, to undertake, under the franchisor's supervision, the marketing system of goods, services or technology conceived by the franchisor (ie, the franchise system), which includes the franchisor's confidential know-how and ongoing technical and economic support, as well as the specific business concept and the intellectual and industrial property rights related to it. This arrangement creates a coordinated, yet decentralised, distribution or service network.

Law stated - 16 June 2025

Laws and agencies

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

There is no specific German franchise law. Instead, the offer and sale of franchises are governed by a combination of general contract law, competition law and sector-specific rules. The key legal sources include:

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

Enforcement and supervision fall under the responsibility of competition authorities, most notably the Federal Cartel Office and, in EU matters, the European Commission.

Law stated - 16 June 2025

Principal requirements

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

While there is no specific franchise statute in Germany, the offer and sale of franchises are primarily governed by general civil and commercial law principles. The key requirements include:

- pre-contractual disclosure obligations based on the duty of good faith (sections 242 and 311 of the Civil Code);
-

compliance with standard form contract rules to avoid unfair terms (sections 305 to 310 of the Civil Code), because franchise agreements are pre-drafted contractual rules provided by the franchisor for multiple franchisees;

- avoidance of clauses contrary to public policy or protective statutes (sections 134 and 138 of the Civil Code);
- in certain cases, a statutory right of withdrawal for franchisees acting as start-up entrepreneurs (section 491 et seq of the Civil Code; German Federal Court, 14 December 1994, Case No. VII ZR 46/94, *Ceiling Doctor*);
- adherence to competition law rules under EU and national law (article 101 of the TFEU; section 1 of the Competition Act);
- compliance with provisions for commercial agents under the German Commercial Code (section 84 et seq of the Commercial Code if the franchisees' interests are similar to those of a commercial agent (German Federal Court, 12 November 1986, Case No. I ZR 209/84, *Beverage delivery service*);
- compliance with the laws for commission agents (section 383 et seq of the Commercial Code), especially of the franchisor aims to set the resale price;
- the Act Against Unfair Competition as regards advertising (unfair commercial practices – eg, misleading advertising – are illegal, and subject to claims for cease and desist, damages, confiscation of profits); and
- government agencies that regulate franchise business, which exist only in the form of competition authorities.

Law stated - 16 June 2025

Franchisor eligibility

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

German law does not provide eligibility requirements for franchisors. However, practical standards are set by self-regulatory frameworks, most notably the European Code of Ethics for Franchising issued by the European Franchise Federation and its national implementation by the German Franchise Association in its updated German version. While non-binding in legal terms, these rules are widely regarded as best practice or fair dealings between franchisors and franchisees. Accordingly, the franchisor shall:

- have operated the franchise concept successfully for a reasonable period with at least one pilot project;
- be the owner or lawfully authorised user of the franchise corporate identity associated with the system (company name, trademark or other specific identification of its network); and
- provide both initial and follow-up training and support to franchisees.

Franchisors not following these principles may face reputational risks or disputes with franchisees, particularly if the franchise concept proves insufficiently tested or inadequately supported. Membership to the German Franchise Association may further require adherence to these standards.

Law stated - 16 June 2025

Franchisee and supplier selection

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

No, there are no franchise-specific legal restrictions in Germany regarding the recruitment of franchisees or the selection of suppliers. In principle, franchisors are free to select their franchisees and their suppliers at their own discretion. However, certain general legal limitations may apply if the franchisor is a dominant undertaking or has relative or superior market power (which must not be abused, see article 102 of the TFEU and sections 19 and 20 of the Competition Act) or pursuant to anti-discrimination laws (franchisors must not, generally speaking, discriminate on grounds of race or ethnic origin, sex, religion, disability, age or sexual orientation; see sections 19 to 21 of the General Act on Equal Treatment).

From a practical standpoint, franchisors should:

- apply transparent and objective selection criteria to avoid reputational or legal risks;
- choose franchisees with adequate financial resources and business experience to uphold the brand's standards; and
- select suppliers based on consistent quality, reliability and compliance with relevant laws (eg, product safety, labour laws), especially if supply is centralised or mandatory within the system.

Law stated - 16 June 2025

Pre-contractual disclosure – procedures and formalities

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

In Germany, there is no statutory obligation or uniform procedure for pre-contractual disclosure. However, according to established case law (notably, Higher Regional Court of Munich, 16 September 1993, Case No. 6 U 5495/92), franchisors are required to disclose any circumstances that may affect the agreement's purpose within a reasonable period (two to four weeks may suffice) before concluding the franchise agreement (or any preliminary contract with binding effect, including area development franchise agreements or master franchises). Practically, it is strongly recommended that disclosures be made in writing and, ideally, also in secure digital form (eg, encrypted or password-protected) to protect trade secrets and provide evidence in the event of a dispute.

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

Law stated - 16 June 2025

Pre-contractual disclosure – content

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

The scope of required disclosure is governed by the general principle of good faith. It is up to every franchisee to inform themselves about the risks and opportunities of entering into a business relationship with the franchisor and to independently assess their market prospects (Higher Regional Court of Frankfurt, 1 December 2021, Case No. 12 U 7/21). However, according to the prevailing legal opinion, the franchisor is obliged to inform the prospective franchisee truthfully about the franchise system from the outset. Generally binding requirements for what the franchisor must specifically disclose and present to the franchisee prior to the conclusion of the contract do not exist (Higher Regional Court of Frankfurt, 3 June 2016, Case No. 13 U 107/14). The scope of the franchisor's duty to disclose information is determined by the specific circumstances of the individual case, depending on the specific pre-contractual information requirements of the potential franchisee in question (Higher Regional Court of Brandenburg, 28 September 2005, Case No. 4 U 37/05). The franchisor must inform the prospective franchisee about all facts that are known only by the franchisor and are material to the franchisee's decision, meaning that the franchisor is not required to investigate or research on behalf of the franchisee and is not expected to act as a start-up consultant (Higher Regional Court of Düsseldorf, 25 October 2013, Case No. I-22 U 62/13). The obligation is, instead, limited by the franchisor's legitimate interest in protecting trade secrets and essential know-how prior to the conclusion of the agreement.

As practical guidance, franchisors may refer to the German Franchise Association 's guidelines on pre-contractual information and the – rather extensive – list in the UNIDROIT's Model Franchise Disclosure Law (not enacted in Germany, however).

According to German case law, circumstances to be disclosed include in particular the franchise system's:

- mode of operation (see Higher Regional Court of Munich, 11 July 1996, Case No. 24 U 63/95);
- profitability or achievable turnover on the basis of generally applicable facts (see Regional Court of Hamburg, 17 May 2018, Case No. 334 O 14/18);
-

necessary labour and capital input (see Higher Regional Court of Düsseldorf, 30 June 2004, Case No. U (Kartell) 40/02); and

- advantages of the cooperation within the franchise network, if applicable (eg, purchasing benefits – see German Federal Court, 20 May 2003, Case No. KZR 19/02, *Apollo Optics*).

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

Law stated - 16 June 2025

Pre-sale disclosure to sub-franchisees

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

Within a sub-franchising structure, it is the sub-franchisor – as the direct contractual partner of the sub- franchisee – that bears the obligation to make pre-sale disclosure (section 311 of the Civil Code). The scope of this obligation depends on what the prospective sub-franchisee needs to know to decide about joining the franchise system. The information to be disclosed concerns, in particular:

- key information about the franchise system (business concept, mode of operation, support services, brand rights etc);
- the allocation of responsibilities and tasks between the franchisor (also known as the master franchisor), the sub-franchisor and the sub-franchisee; and
- the basic content of the master franchise agreement, especially the licensing framework, which allows and limits sub-franchisors installing of sub-franchisees and implementing of the franchise, including the consequences if the master franchise agreement is terminated.

In practice, sub-franchisors should also ensure that their disclosure aligns with the overarching obligations and limits arising from the master franchise agreement to avoid exposing both themselves and the master franchisor to legal or reputational risks.

Law stated - 16 June 2025

Due diligence

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

Before entering into a franchise relationship, both parties should carry out thorough due diligence.

Franchisors should assess whether the franchisee is a good fit for the franchise system. To be more precise, this includes whether the franchisee is personally (characteristics, (professional) experience, competencies and ambition) and economically suitable (minimum capital requirements, creditworthiness, territory available).

Franchisees should critically review the entire franchise system, including its concept, the franchise agreement, the information disclosed pre-contractually, the competition situation and market analysis, the territory and location. A prudent franchisee should also consider contacting existing or former franchisees to gain insight into the day-to-day realities of the system.

Law stated - 16 June 2025

Failure to disclose – enforcement and remedies

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

If a franchisor fails to meet its (pre-contractual) disclosure obligations, franchisees – and, where applicable, relevant courts or authorities – may take various actions depending on the severity and consequences of the breach.

Except in minor cases or unclear deficiencies, where franchisees may simply request supplementary information or clarification for any missing or apparently inaccurate information, franchisees have the following options:

- terminate the franchise agreement for cause (section 314 of the of the Civil Code) within a reasonable period – typically around two months – from gaining knowledge of the material breach of contract (see, for commercial agents and distributors, German Federal Court, 29 June 2011, Case No. VIII ZR 212/08). A prior warning is generally not required, provided such event profoundly disrupts the trust between the parties;
- void the agreement due to fraudulent misrepresentation if the franchisor deliberately withheld or misrepresented essential information (section 123 of the Civil Code); and
- claim for damages to be put in the position they would have been in had proper disclosure occurred (section 249 of the Civil Code). Damages can be calculated by comparing the operating costs (system costs and rent or lease paid, insurance contributions, wages and social security contributions, costs for service providers) and losses in value (eg, the equipment, the warehouse) with the revenues. In addition to compensation for financial losses minus any income earned by the prospective franchisee the claim for damages includes the cancellation and rescission of the entire contractual relationship if the franchisee would not have concluded the franchise agreement had the franchisor duly informed the franchisee (see German Federal Court, 27 July 2006, Case No. 23 U 5590/05,

juris-paragraph 30). The prospective franchisee is to be placed in the same position as if the franchise agreement had never been concluded. If the franchise contract is rescinded, all transactions will be reversed (ie, each party will return what it has received from the other). The worst-case scenario in practice is that such breach may induce further, not very successful, franchisees to terminate their franchise agreement.

Systemically, non-disclosure or misrepresentation can have a rippling effect: it may lead to group-wide distrust, potentially encouraging other franchisees to exit the system or initiate legal actions, thus damaging the franchisor's brand and economic foundation.

There are no administrative fines or penalties by government agencies specifically for lack of disclosure in franchising. Enforcement occurs via civil litigation, and franchisees must assert their rights before civil courts.

Law stated - 16 June 2025

Failure to disclose – apportionment of liability

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

In principle, liability for (pre-contractual) disclosure violations in a sub-franchising structure lies solely with the sub-franchisor, as the disclosure obligation arises from the direct contractual relationship between the sub-franchisor and sub-franchisee (section 311 of the Civil Code).

However, by way of exception, the franchisor can be liable towards the sub-franchisee:

- directly in the case of tort or product liability (eg, for providing defective products); or
- indirectly if the franchisor breaches its contractual obligations toward the sub-franchisor (eg, if the franchisor negligently provided incorrect information) and this breach leads the sub-franchisor to commit disclosure errors. The franchisor thus bears all consequential damages, including those the sub-franchisor has to bear due to the franchisor’s breach of contract and may be indirectly liable for the sub-franchisee's losses through indemnity claims by the sub-franchisor.

Individual officers, directors and employees of either the franchisor or sub-franchisor are, in principle, not personally liable for disclosure violations. By way of exception, they can be exposed to liability, especially if they have claimed a particular position of special trust and expertise for themselves and then provided wrong information, and more so where this occurred with wilful intent or gross negligence, especially with the intention of causing financial loss/economic harm.

Law stated - 16 June 2025

General legal principles and codes of conduct

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

In addition to any specific laws or agencies, the general principles of German contract law apply to the offer and sale of franchises. Offering and selling franchises must, like any other transaction, comply with the duty of good faith, specifically with regard to negotiation (culpa in contrahendo). Accordingly, pre-sale disclosure of all material information relevant to a prospective franchisee's decision to enter into a franchise agreement is mandatory as it may, if omitted or incorrectly done, allow the franchisee to reverse the whole franchise agreement or result in claims for damages. Although Germany has no franchise-specific disclosure legislation, various industry codes of conduct provide guidance, including the European Code of Ethics for Franchising at the European level and the German Franchise Association at the national level. Moreover, there is the rather extensive list in the UNIDROIT's Model Franchise Disclosure Law, which is widely referenced as a best-practice standard (even though it is not enacted in Germany,).

Under prevailing case law, circumstances regarding the franchise system to be disclosed include in particular:

- all circumstances that are recognisably of particular importance for the conclusion of the contract by the other party (see Higher Regional Court of Brandenburg, 28 September 2005, Case No. 4 U 37/05);
- the mode of operation (see Higher Regional Court of Munich, 11 July 1996, Case No. 24 U 63/95);
- the profitability or achievable turnover on the basis of generally applicable facts (see Regional Court of Hamburg, 17 May 2018, Case No. 334 O 14/18);
- the necessary labour and capital input (see Higher Regional Court of Düsseldorf, 30 June 2004, Case No. U (*Kartell*) 40/02); and
- the competitive advantages of cooperation within the franchise network if applicable (eg, purchasing benefits, German Federal Court, 20 May 2003, Case No. KZR 19/02, *Apollo Optics*).

However, these obligations are not absolute. Generally binding requirements for what the franchisor must specifically disclose and present to the franchisee prior to the conclusion of the contract do not exist (Higher Regional Court of Frankfurt, 3 June 2016, Case No. 13 U 107/14). The scope of the franchisor's duty to disclose information is determined by the specific circumstances of the individual case, depending on the specific pre-contractual information requirements of the potential franchisee in question (Higher Regional Court of Brandenburg, 28 September 2005, Case No. 4 U 37/05).

Law stated - 16 June 2025

Fraudulent sale

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

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

Law stated - 16 June 2025

FRANCHISE CONTRACTS AND THE FRANCHISOR/FRANCHISEE RELATIONSHIP

Franchise relationship laws

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

There are no franchise-specific statutory provisions in Germany governing the ongoing relationship between franchisor and franchisee. As a result, it is essential and best practice to regulate the relationship comprehensively in the franchise agreement. The applicable legal framework is composed primarily of general laws, including the German Civil Code (especially the rules on standard form contracts in section 305 et seq of the Code and the general principle of good faith in section 242), the German Commercial Code and the competition (antitrust) rules (article 101 of the Treaty on the Foundation of the European Union; sections 1, 19 and 29 of the Competition Act; and the Act Against Unfair Competition).

Law stated - 16 June 2025

Operational compliance

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

To ensure operational consistency and adherence to brand standards across the franchise network, franchisors typically incorporate a combination of contractual and practical mechanisms to operate a uniform network according to the corporate identity guidelines and deliver a consistent brand message and experience to the customer, including:

- clear definition of brand and operational standards, usually set out in the franchise manual or operating guidelines, which form an integral part of the franchise agreement;
-

designation of a compliance contact person (franchise compliance officer or franchise compliance coordinator) dedicated to checking and clearing issues at the earliest convenience, supporting franchisees in meeting system requirements and ensuring timely enforcement of the standards when needed;

- regular reporting obligations (eg, periodic reports on product sales or services rendered, monthly net turnover, etc), particularly for calculating the franchise fees;
- inspection and audit rights for the franchisor and third parties sworn to secrecy;
- contractual penalties or liquidated damages clauses to emphasise the importance of compliance and deter violations; and
- incentive mechanisms, such as 'franchisee of the year' awards or performance-based bonuses to promote adherence and motivate excellence.

Law stated - 16 June 2025

Amendment of operational terms

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

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

If, however, the franchise agreement does not provide a unilateral right to change the operational terms, the franchisor may not, in principle, unilaterally change the operational terms. Exceptions are possible only in rare cases under the legal doctrine of frustration of contract (section 313 of the Civil Code), where maintaining the original terms becomes unreasonable due to a fundamental change in circumstances.

Law stated - 16 June 2025

Policy affecting franchise relations

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

Yes. While there are no additional binding government policies specifically affecting franchise relationships beyond general law, trade association policies, particularly those of the German Franchise Association, can significally influence franchise practice. The

German Franchise Association – the most important franchise association in Germany, representing over 400 member companies at the economic, political and social level – requires its members to comply with its Code of Ethics, stipulating practical guidelines on best practices and fair dealings between franchisors and franchisees, and regulating issues such as pilot projects, rights of use regarding the corporate identity, and training for the franchisees.

Although not legally binding on non-members, the Code is widely regarded as a benchmark for ethical and professional franchise conduct in Germany.

Law stated - 16 June 2025

Termination by franchisor

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

The franchisor's ability to terminate a franchise relationship depends on the term and provisions of the franchise agreement, subject to general contract law and case law principles under German law.

If the franchise agreement is entered into for an unlimited period (indefinite-term agreement), it can be terminated with cause or without cause, namely ordinarily ('for convenience'), according to the contractually agreed notice periods.

If no such provisions exist, the statutory provisions for commercial agents (section 89 of the Commercial Code) may apply by analogy (see German Federal Court, 23 July 1997, Case No. VIII ZR 130/96, *Benetton*: likely, but not yet ruled out) as follows:

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

Fixed-term agreements, instead, generally cannot be terminated without cause unless expressly provided for in the contract. In the absence of such a clause, they may be terminated only for cause (see also section 89a of the Commercial Code). Typical grounds for termination for cause by the franchisor include the franchisee's non-payment of the franchise or advertisement fees, unauthorised competitive practices, serious breaches of operational standards or the franchise system directives or violation of the reporting and information obligations.

Furthermore, a franchise agreement may be terminated extraordinarily according to section 314(1) of the Civil Code if the relationship between franchisor and franchisee has been so fundamentally damaged that continuation of the agreement is no longer reasonable for the terminating party. This statutory right to terminate for cause cannot be excluded by contract.

Termination for cause (extraordinary termination) generally requires a careful balancing of interests and a prior warning as termination is considered a last resort (and hence default of payment alone does not necessarily suffice; see Higher Regional Court of Berlin, 21 November 1997, Case No. 5 U 5398/97, *Burger King*). Relevant considerations include the severity of the breach, the duration of the contractual relationship, and the investments made by the franchisee.

Lastly, the parties can always agree on an amicable termination of the franchise agreement. As a last resort and only in exceptional circumstances, the franchisor can also just let the franchisee's business run dry. However, to protect the franchisor's brand image and corporate identity, this is only advisable when the franchisor is withdrawing from a particular territory or market; for example, if the franchisor gives up the whole franchise.

Law stated - 16 June 2025

Termination by franchisee

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

A franchisee may terminate a franchise relationship under the following circumstances:

- If the franchise agreement is concluded for an unlimited period, it may be terminated ordinarily (for convenience) in accordance with the agreed notice periods. If the agreement is silent on such periods, the notice periods applicable to commercial agents (section 89 of the Commercial Code) may apply by analogy.
- If the franchise agreement is for a fixed term, ordinary termination is not permitted, unless explicitly provided for in the contract. In such cases, termination is possible only for cause (extraordinary termination), with immediate effect.

Typical grounds for extraordinary termination by the franchisee may include the franchisor's breach of territorial exclusivity, unjustified reduction of the assigned territory agreed upon or direct competition by the franchisor in the protected territory.

The franchisee also retains the option of extraordinary termination of good cause in accordance with section 314 of the Civil Code if continuation becomes unreasonable for the terminating party.

The parties can, of course, always agree on an amicable termination of the agreement.

Law stated - 16 June 2025

Renewal

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

Renewals of franchise agreements are typically effected in writing, primarily because this is required by the franchise agreement and because a written renewal provides clear evidence of the agreed-upon terms and the parties' intent to continue the contractual relationship. However, the parties may also renew the agreement tacitly, by simply continuing to perform it after its expiration date without signing a new contract or formal renewal. In this case, the contract may be deemed implicitly renewed under the same terms. This can create a de facto extension of the original agreement. Therefore, to avoid unintended consequences (eg, if there are ongoing negotiations with a new franchisee), both parties should ensure that all commercial activities cease upon the expiry date, unless a renewal is clearly agreed upon.

While no statutory form requirement exists under German law for renewals, formal requirements may arise from the original franchise agreement. Substantively, the renewal should address any updates to the franchise system or brand standards, adjusted fees, new obligations, and the revised term and termination conditions.

Law stated - 16 June 2025

Refusal to renew

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

Yes, a franchisor may, in principle, refuse to renew a franchise agreement. There is no legal entitlement for the franchisee to the extension of a fixed-term franchise agreement. In particular, the franchisor is free to let the agreement expire and deny its renewal without giving further reasons, provided that the agreement does not stipulate otherwise.

However, this freedom is not absolute. If the franchisor has, shortly before the expiration, led the franchisee to believe that the agreement would be renewed – for example, by making positive statements or entering into concrete negotiations – and the franchisee relied on this by investing additional resources, the franchisor’s sudden refusal to renew may give rise to claims for compensation (eg, for frustrated investments).

Moreover, where the franchisor holds a dominant market position, or where its conduct violates the principle of good faith, franchisor's freedom to renew or not may be legally restricted. In such cases, the franchisor may be liable for damages or required to reimburse investments that could not be amortised due to the unexpected end of the contractual relationship.

Law stated - 16 June 2025

Transfer restrictions

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

Yes, a franchisor may restrict a franchisee’s ability to transfer the franchise or ownership interests in the franchisee entity. The transfer of the franchise and of the rights and obligations connected therewith to a third party requires the franchisor’s consent by law (section 415 of the Civil Code), regardless of whether it occurs in the form of sale, lease, pledge or other. If the franchisee proceeds with such a transfer without the franchisor's consent, the franchisor may be entitled to terminate the agreement extraordinarily for cause (see German Federal Court, 26 November 1984, Case No. VIII ZR 214/83). Further conditions for the transfer, including the franchisor's right of pre-emption, are usually – and best – stipulated in the franchise agreement. The transferability of the franchise can also be contractually excluded, particularly to protect the franchisor's brand, know-how and competitive image, especially from competitors. Exceptions may apply where the transferred rights are not substantially linked to the franchisee's person or where such transfer does not jeopardise the integrity of the franchise system.

Law stated - 16 June 2025

Fees

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

No specific laws or regulations in Germany directly govern the nature, amount or payment modalities of franchise fees . These matters are subject to the contractual freedom of the parties. Accordingly, franchisors and franchisees are generally free to agree on the type, structure and amount of fees payable under the franchise agreement.

Nevertheless, the franchise fees must not violate the general principles of German law, in particular the principle of public policy (section 138 of the Civil Code). A franchise fee may be deemed excessive and thus void if it is grossly disproportionate to the value of the services or benefits provided by the franchisor (for details on the franchisee fees to be stipulated under German law and an overview on the fees required by different systems on the German franchise market, see Rohrßen, *ZVertriebsR* 2022, 139–151).

Law stated - 16 June 2025

Usury

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

Yes. Interest rates must not be usurious, but comply with the general principles of public policy (section 138 of the Civil Code). In business-to-business transactions, the statutory default interest rate is 9 percentage points above the base rate (section 288(1) of the Civil Code); for transactions involving consumers, the interest rate is 5 percentage points above the base rate (section 288(2) of the Civil Code).

In addition to interest, the creditor is entitled to claim a lump sum of €40 as compensation for the payment delay (section 288(5) of the Civil Code).

Law stated - 16 June 2025

Foreign exchange controls

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

No, there are no such restrictions under German law. However, cross-border payments over €12,500 or the corresponding amount in the foreign currency must be reported to the German Central Bank (section 11 of the German Foreign Trade and Payments Act in conjunction with section 67 et seq of the German Foreign Trade and Payments Ordinance).

Law stated - 16 June 2025

Confidentiality covenant enforceability

37 Are confidentiality covenants in franchise agreements enforceable?

Yes, confidentiality covenants in franchise agreements are generally enforceable under German law. They serve as an essential tool to protect the franchisor's know-how, trade secrets and competitive edge. As part of such a confidentiality agreement, it is typically stipulated that the prospective franchisee is required to keep all information disclosed during the contract negotiations strictly confidential, and may share such information with third parties only if the franchisor has given prior written consent (section 183 of the Civil Code). The obligation does not apply to information that is publicly available or generally accessible.

To strengthen enforceability, franchise agreements often include a contractual penalty clause, which simplifies proof and the calculation of damages in the case of breach. Moreover, the breach of confidentiality may also constitute a violation of the German Act Against Unfair Competition. A serious breach of confidentiality obligations can give rise to extraordinary termination of the franchise agreement for cause, particularly where the breach undermines the trust essential to the franchise relationship.

Law stated - 16 June 2025

Good-faith obligation

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

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

The good-faith obligation typically requires franchisors to treat franchisees fairly and equally and avoid actions that could jeopardise the franchisee's economic viability, particularly where such risks arise from internal system competition. According to case law, such a duty may even give rise to injunctive relief for the franchisee if the franchisor's conduct endangers the franchisee's economic existence (Higher Regional Court of Düsseldorf, 10 February 2012, Case No. 16 W 62/11, juris-paragraph 39, *Kentucky Fried Chicken*; Higher Regional Court of Celle, 28 August 2008, Case No. 13 U 178/08-, juris-paragraph 15).

Additionally, if the franchise agreement qualifies as general terms and conditions (ie, if it was drafted unilaterally and offered to the counterparty on a take-it-or-leave-it basis), any clause contrary to the principle of good faith is invalid under section 307 of the Civil Code. Moreover, according to case law, a breach of the obligation to act in good faith may also justify extraordinary termination of the franchise agreement for cause (German Federal Court, 10 February 1993, Case No. VIII ZR 48/92, section IV.2(b), *Computer-Peripherie*).

Law stated - 16 June 2025

Franchisees as consumers

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

In principle, no – franchisees are not considered consumers under German law. They generally qualify as traders (section 14 of the Civil Code) and are, therefore, not entitled to consumer rights (German Federal Court, 24 February 2005, Case No. III ZB 36/04-). Nevertheless, the franchisee may, if considered as a founder, be entitled to withdraw from the franchise agreement within the first 14 days regardless of any reason. For this withdrawal period to begin, the franchisor must properly inform the franchisee of the right to withdraw, typically in the agreement or its annexes.

Law stated - 16 June 2025

Language of the agreement

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

No, there is no legal requirement in Germany for franchise disclosure documents or agreements to be drafted in German. However, all documents should be provided in a language the franchisee understands, both for practical and legal reasons, as this helps prevent misunderstandings and may reduce the risk of disputes between the parties over the content or meaning of the agreement. This is also a requirement of the European Code of Ethics for Franchising issued by the European Franchise Federation. From a legal drafting perspective, the contractual language should ideally align with the applicable law and the language of the competent court or arbitral tribunal. If the agreement is drafted in multiple languages, usually in a dual-column form, it is important to clearly stipulate which version shall prevail in case of discrepancies or disputes over interpretation.

Law stated - 16 June 2025

Restrictions on franchisees

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

Franchise agreements frequently include contractual restrictions to protect the integrity of the franchise system and ensure consistency across the network. The most common restrictions include the following:

- Territorial restrictions: franchisees are often prohibited from actively selling into territories or to customer groups that have been exclusively allocated to other franchisees or reserved by the franchisor. However, restrictions on passive sales, especially those made via websites, may infringe EU competition law and are generally void. Online resale bans and similar limitations have been declared anti-competitive and are subject to fines by the competition authorities (see 'On online sales bans and related internet resale restrictions', Rohrßen, *ZVertriebsR* 2019, 341 et seq with further references; eg, clauses of online resale restrictions, see Rohrßen, *GRUR- Prax* 2018, 39–41; on the new Vertical Block Exemption Regulation, see Rohrßen, *ZVertriebsR* 2021, 293–298). In this regard, EU competition law forms one important block (if not the most important – see Flohr, *ZVertriebsR* 2022, 71, 74) for building franchise agreements.
- Sourcing obligations: franchisees may be required to source the contractual products, services or equipment from the franchisor. Such sourcing clauses are not considered non-compete obligations in the narrow understanding of the Vertical Block Exemptions Regulation (VBER).
- Resale pricing restrictions: franchisors may recommend resale prices or impose maximum prices, but cannot enforce fixed or minimum prices, either directly or indirectly (eg, through pressure or incentives), without violating competition law.
- Poaching clauses: franchisees may be restricted from hiring employees of the franchisor or other franchisees. This aims to protect the franchisor's business secrets and system know-how, especially in the event the franchisee later joins a competitor.
- Non-compete obligations: franchisees are typically bound by non-compete clauses during the term of the agreement and, to a limited extent, after termination.

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

Law stated - 16 June 2025

Courts and dispute resolution

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

Franchisors and franchisees in Germany have access to a well-structured court system and a variety of dispute resolution mechanisms. They can turn to German courts for dispute resolution, including mediation (see section 278(5) and section 278a of the German Code of Civil Procedure) and litigation. Litigation allows for interim injunctions to obtain early relief and includes an expedited payment procedure for uncontested claims. In international cases, proceedings can be conducted in English before the Chamber for International Commercial Disputes in Frankfurt am Main. Arbitration is also common in franchise agreements and may be preferred for confidentiality and speed.

Law stated - 16 June 2025

Governing law

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

Under Article 3 of the Rome I Regulation, parties are generally free to choose the law applicable to their franchise agreement, including foreign law. However, this freedom is limited by the overriding application of mandatory provisions of German law (article 9 of the Rome I Regulation), especially those protecting the franchisee, including the strict rules on standard form contracts (sections 305 et seq of the Civil Code).

Therefore, while a foreign governing law clause is valid, its practical effect may be limited if the agreement is performed primarily in Germany or the franchisee operates within the German market. This is one reason why German franchisors commonly choose German law for their contracts.

For an overview on the various levels of protection of franchisees in various countries worldwide, see Rothermel, *Internationales Kauf-, Liefer- und Vertriebsrecht* (2nd edition, 2021), Chapter H.

Law stated - 16 June 2025

Arbitration – advantages for franchisors

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

Principal advantages over proceedings in court

Arbitration proceedings are conducted as follows:

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

Principal disadvantages over proceedings in court

- Interim measures may not be as quick in arbitration as before German courts. Therefore, franchise agreements should at least stipulate that the German courts have jurisdiction in cases of industrial property rights infringements, thus enabling the franchisor to seek swift injunctive relief.
- Costs are, as a rule of thumb, higher in arbitration than in the German courts, up to an amount in dispute of €5 million. The costs of arbitration may, however, be reduced by limiting the arbitral tribunal from three arbitrators to one, which is advisable especially with regard to smaller cases, where the amount in dispute is, for example, lower than €5 million (eg, cases with single franchisees that are not also sub-franchisors).

Other ADR procedures, such as mediation or ombudsman procedures, are also available and can be initiated through the German Franchise Association. These alternatives are less formal and often preferred for resolving disputes amicably.

Law stated - 16 June 2025

National treatment

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

Legally, foreign franchisors are to be treated the same as domestic franchisors under German law. There are no specific legal distinctions or disadvantages imposed solely based on the franchisor's foreign status.

Practically, however, franchisees often prefer to work with domestic franchisors, as this creates a sense of proximity and familiarity, simply feels 'closer to home', which can facilitate trust and cooperation. For foreign franchisors, in return, establishing a legal entity in Germany can enhance their presence and credibility in the local market, improve communication and support with franchisees, and reduce liability risks for the parent company abroad.

Generally, domestic franchisors draft their agreements under German law – because even if a choice of a foreign law generally is permitted (article 3 of the Rome I Regulation), in practice this choice is often overridden by national mandatory provisions (including the quite strict rules on standard form contracts). For a comparative overview of franchisee protections worldwide, see Rothermel, *Internationales Kauf-, Liefer- und Vertriebsrecht* (2nd edition, 2021), Chapter H.

Law stated - 16 June 2025

UPDATE AND TRENDS

Legal and other current developments

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

The main recent legal development occurred on 1 June 2022, when the revised Vertical Block Exemption Regulation (VBER) and accompanying guidelines (ie, the new EU competition rules for all vertical agreements, including franchise agreements) entered into force. As the VBER provides a safe harbour for vertical agreements, both the VBER and the related Vertical Guidelines 2022 are to be taken into account when setting up franchise systems. Generally, franchising differs from other distribution systems in terms of uniformity requirements (business name and business methods are required for the functioning of franchising systems and thus, as far as necessary, fall outside the scope of article 101(1) of the Treaty on the Functioning of the European Union; see Vertical Guidelines 2022, paragraph 166). Franchise agreements are exempt under the VBER as long as neither the franchisor's nor the franchisee's market share exceeds 30 per cent and the agreement is free from the hardcore restrictions set out in article 4 of the VBER. The fundamental rules applying to franchise agreements under the new VBER are very similar to the previous VBER of 2010. The new VBER, however, grants more leeway as regards protecting exclusive and selective distribution systems, while it provides more rules for online intermediation services. In the case of dual distribution (ie, where the franchisor competes with its franchisees on the retail level through its own outlets), the strict rules on information exchange under article 2(4) and (5) of the VBER must be observed: the exchange of information shall be directly related to the implementation of the vertical agreement and necessary to improve the production or distribution of the contract goods or services to qualify for exemption. The Commission's Vertical Guidelines (paragraphs 99 and 100) provide illustrative, non-exhaustive lists of examples that are either likely or unlikely to meet these criteria. For an overview, see Rohrßen, *ZVertriebsR* 2021, 293–298 and Rothermel/Rohrßen, *IHR* 2022, 221–230; for details, see Rohrßen, *VBER 2022: EU Competition Law for Vertical Agreements* (Springer, 2023).

Regarding other legislative developments, there are currently no concrete proposals aimed specifically at regulating franchising in Germany. Earlier discussions, including a parliamentary petition in 2011, have largely faded. This is also due to the results of a comparative study on franchise laws concluding that German case law has developed a relatively clear and balanced framework that has effectively reduced the typical information asymmetry between franchisors and franchisees (Gesmann-Nuissl, *Internationales Franchiserecht*, 2019, p. 18). Consequently, fewer disputes reach courts compared to countries with specific statutory franchise laws, or compared to other distribution forms such as commercial agents or distributors.

Since 2020, the German retail sector, including franchise businesses in particular, has faced significant setbacks due to the Covid-19 pandemic. Consequently, many franchisors were compelled to close underperforming shops permanently. For others, however, it opened the door to reinvention and entrepreneurship. According to the latest survey by the German Franchise Association, along with continued growth and rising sales figures in 2023 and 2024, the franchise industry in Germany remains resilient despite ongoing geopolitical uncertainties (eg, the Ukraine war and Middle East conflicts). Promising growth sectors include home services, education and training, skilled trades, healthcare and tech-related franchises such as electronic device repair, business tech consulting and digital marketing services.

One emerging regulatory trend of particular relevance to franchising is the European Union's Artificial Intelligence Act (AI Act). Expected to be fully adopted and enter into application in stages from 2025 onwards, the AI Act is the first comprehensive legal framework worldwide specifically regulating the development, deployment and use of AI systems. Although the AI Act is not aimed at franchising specifically, it will have indirect but potentially far-reaching effects on franchise systems, especially in the areas of marketing, customer interaction, recruitment and system control. Franchisors that use or provide AI-based tools to their franchisees, such as automated customer engagement platforms, predictive analytics, pricing algorithms or chatbots, will need to determine whether these tools fall under the categories defined by the AI Act (ie, minimal risk, limited risk, high-risk or prohibited). Franchisors and franchisees may thus be subject to compliance obligations, transparency requirements and risk assessments to ensure fairness and consumer protection. This could impact franchise marketing strategies and the use of AI-driven data analytics within franchise systems. Moreover, as consumer protection and data privacy laws such as the General Data Protection Regulation already impose obligations in areas affected by AI, franchisors must prepare for a layered regulatory environment, combining AI-specific and general compliance requirements. Early alignment with the AI Act not only mitigates legal risks but can also serve as a competitive advantage in the eyes of franchisees and customers who value ethical and transparent technology use.

In summary, while no immediate legislative changes specifically targeting franchising are pending, franchise systems in Germany must stay alert to broader regulatory trends – particularly in competition law and emerging fields like AI regulation – that may influence franchise contracts, marketing and operational compliance in the near future. For an overview on the obligations under the AI Act also see Rohrßen, ZfPC 2024, 111-123 and the implementation guide by Germany's digital association Bitkom.

Law stated - 16 June 2025

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Summary

FRANCHISE CONTRACTS AND THE FRANCHISOR/FRANCHISEE RELATIONSHIP

UPDATE AND TRENDS

MARKET OVERVIEW

Franchising in the market

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

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

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

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

Law stated - 9 April 2025

Associations

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

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

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

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

Law stated - 9 April 2025

BUSINESS OVERVIEW

Types of vehicle

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

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

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

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

Law stated - 9 April 2025

Regulation of business formation

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

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

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

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

Law stated - 9 April 2025

Requirements for forming a business

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

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

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

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

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

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

Law stated - 9 April 2025

Restrictions on foreign investors

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

The FDI Policy set out by the Department for Promotion of Industry and Internal Trade dictates the sectors that are open for foreign investments and the conditions subject to which foreign investments can be made in India, including the nature of business entities that can be established by foreign residents in India. There are certain sectors that are prohibited from receiving foreign investments. These sectors include real estate, lottery and chit-fund businesses. Although the government has liberalised the foreign investment regime and most sectors are now open for foreign investment up to 100 per cent without any need for prior government approval, there are certain sectors where prior approval is required. For example, government approval is required for foreign investments in a business operating in the defence sector when the overall foreign investment in the business exceeds 74 per cent. Similarly, any foreign investment in a multi-brand retail trading business requires prior government approval. There are certain sectors in which foreign investment is not permitted beyond a prescribed threshold, such as the print media sector and multi-brand retail trading, where foreign investment is capped at 26 per cent and 51 per cent, respectively. Additionally, the FDI Policy also imposes additional compliance conditions and requirements for FDI in some sectors where up to 100 per cent FDI without government approval is allowed. For example, an Indian company with foreign investment beyond 51 per cent engaged in single-brand retail trading must source 30 per cent of products locally in India.

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

Law stated - 9 April 2025

Taxation

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

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

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

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

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

Law stated - 9 April 2025

Labour and employment

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

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

Law stated - 9 April 2025

Intellectual property

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

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

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

Law stated - 9 April 2025

Real estate

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

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

The major legislation that regulates real estate transactions are the Transfer of Property Act 1882, the Registration Act 1908, the Indian Contract Act 1872 and state-specific stamp duty and rent control legislation. The law requires in most cases that real estate agreements be made in writing and registered with the local authority after payment of the appropriate stamp duty or tax.

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

Law stated - 9 April 2025

Competition law

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

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

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

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

Law stated - 9 April 2025

OFFER AND SALE OF FRANCHISES

Legal definition

12 | What is the legal definition of a franchise?

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

Law stated - 9 April 2025

Laws and agencies

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

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

Law stated - 9 April 2025

Principal requirements

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

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

Law stated - 9 April 2025

Franchisor eligibility

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

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

Law stated - 9 April 2025

Franchisee and supplier selection

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

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

Law stated - 9 April 2025

Pre-contractual disclosure – procedures and formalities

17

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

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

Law stated - 9 April 2025

Pre-contractual disclosure – content

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

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

Law stated - 9 April 2025

Pre-sale disclosure to sub-franchisees

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

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

Law stated - 9 April 2025

Due diligence

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

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

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

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

Law stated - 9 April 2025

Failure to disclose – enforcement and remedies

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

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

Law stated - 9 April 2025

Failure to disclose – apportionment of liability

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

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

Law stated - 9 April 2025

General legal principles and codes of conduct

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

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

Law stated - 9 April 2025

Fraudulent sale

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

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

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

Law stated - 9 April 2025

FRANCHISE CONTRACTS AND THE FRANCHISOR/FRANCHISEE RELATIONSHIP

Franchise relationship laws

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

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

Law stated - 9 April 2025

Operational compliance

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

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

Law stated - 9 April 2025

Amendment of operational terms

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

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

Law stated - 9 April 2025

Policy affecting franchise relations

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

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

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

Law stated - 9 April 2025

Termination by franchisor

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

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

Law stated - 9 April 2025

Termination by franchisee

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

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

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

Law stated - 9 April 2025

Renewal

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

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

Law stated - 9 April 2025

Refusal to renew

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

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

Law stated - 9 April 2025

Transfer restrictions

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

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

Law stated - 9 April 2025

Fees

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

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

Law stated - 9 April 2025

Usury

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

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

Law stated - 9 April 2025

Foreign exchange controls

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

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

Law stated - 9 April 2025

Confidentiality covenant enforceability

37 | Are confidentiality covenants in franchise agreements enforceable?

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

Law stated - 9 April 2025

Good-faith obligation

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

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

Law stated - 9 April 2025

Franchisees as consumers

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

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

Law stated - 9 April 2025

Language of the agreement

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

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

Law stated - 9 April 2025

Restrictions on franchisees

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

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

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

Law stated - 9 April 2025

Courts and dispute resolution

42

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

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

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

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

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

Law stated - 9 April 2025

Governing law

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

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

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

Law stated - 9 April 2025

Arbitration – advantages for franchisors

44

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

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

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

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

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

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

Even if franchisors elect to opt for international commercial arbitration as the dispute resolution mechanism in their agreements, they must ensure that they retain the right to seek injunctive relief from Indian courts if required. This includes having appropriate provisions for the same in the agreement, and the payment of stamp duty on the agreement (a form of indirect tax that is required to be paid on agreements for them to be admissible as evidence in Indian courts).

Law stated - 9 April 2025

National treatment

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

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

Law stated - 9 April 2025

UPDATE AND TRENDS

Legal and other current developments

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

In August 2023, India's central legislature passed the Digital Personal Data Protection Act 2023 (DPDPA), the country's first comprehensive legislation regarding personal data privacy. Although the DPDPA has been passed by the Union Parliament and received presidential assent (and has hence become law), it will be put in force at a future date to be notified by the government. It is also possible that the DPDPA will come into effect in a phased manner with some sections being notified before others, and longer compliance timelines being afforded for some of the more intensive compliance requirements.

The enforcement of the DPDPA is contingent on the establishment of an independent data protection authority – the Data Protection Board of India – as well as the publishing of a multitude of subordinate legislations referred to as 'Rules' that will govern many of the procedural aspects of the law.

A draft of the Digital Personal Data Protection Rules 2025 (DPDP Rules) was published by the Indian government in January 2025 and a public consultation exercise was conducted wherein comments from stakeholders on the DPDP Rules was invited by the Indian government until March 2025.

The DPDPA puts into place specific obligations on data controllers (referred to in the law as 'data fiduciaries') regarding obtaining consent of data subjects (referred to in the law as 'data principals') for processing their personal data, ensuring data minimisation and purpose limitation, data breach notification requirements, and instituting grievance redressal mechanisms for data subjects. The law also provides data subjects with various rights (eg, right to access, correct and erase personal data, and right to withdraw consent) and makes data controllers squarely responsible for ensuring that these rights are provided to data subjects.

Penalties under the DPDPA have also been significantly enhanced from the current regime, with contraventions of the DPDPA punishable with penalties of up to 2.5 billion Indian rupees (approximately US$29 million).

In addition to the above, the draft DPDP Rules provide additional clarity on the obligations of data controllers, such as the contents of the privacy notice to be made available to data subjects, the security measures regarding personal data that data controllers must implement, detailed data breach notification requirements, data retention periods, requirements for verifiable parental consent prior to processing personal data of minors, and data localisation requirements.

Indian franchisees who act as data controllers under the DPDPA, as well as foreign entities who may fall under this classification, would be liable for compliance with the DPDPA once it comes into force. Given the significant monetary penalties and the fact that the DPDPA places all compliance obligations solely on the data controller, franchisors must ensure that adequate contractual provisions are in place in their franchise agreements with Indian franchisees to ensure that they remain compliant with the DPDPA, as well as provisions to safeguard their interests (eg, adequate indemnity provisions and exemptions from any limitation of liability clauses for causing a breach of the DPDPA).

It is likely that the DPDPA and the DPDP Rules will come into force later in 2025. While Indian government officials have previously indicated that some additional time may be granted for data controllers to ensure compliance, it is unclear as to what these timelines might be.

Law stated - 9 April 2025

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Summary

FRANCHISE CONTRACTS AND THE FRANCHISOR/FRANCHISEE RELATIONSHIP

UPDATE AND TRENDS

MARKET OVERVIEW

Franchising in the market

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

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

Law stated - 1 May 2025

Associations

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

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

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

Law stated - 1 May 2025

BUSINESS OVERVIEW

Types of vehicle

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

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

Law stated - 1 May 2025

Regulation of business formation

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

Business entities such as companies (including branches) or partnerships are formed under the Companies Law 1999 or the Partnership Ordinance 1975, respectively, and are registered in the relevant register. Partnerships must be registered under the Partnership Ordinance (New Version) 1975 to do business in Israel. While the registration of a partnership intending to do business is compulsory, the absence of registration does not affect the existence of the partnership itself.

Law stated - 1 May 2025

Requirements for forming a business

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

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

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

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

Law stated - 1 May 2025

Restrictions on foreign investors

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

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

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

Law stated - 1 May 2025

Taxation

7

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

Incorporated businesses are subject to regular income tax (corporate tax) imposed on taxable transactions. Certain transactions trigger payment of VAT. In addition, the aspect of withholding tax on payments to the franchisor should be taken into consideration.

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

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

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

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

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

Law stated - 1 May 2025

Labour and employment

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

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

As long as a clear separation between the franchisee and the franchisor is kept under the franchise agreement as well as de facto, the risk that the franchisee’s employees will be considered as the franchisor's employees is low. A franchise agreement should include a specific indemnification clause to reduce the franchisor's risk of being liable for any payments to the franchisee's employees.

Law stated - 1 May 2025

Intellectual property

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

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

The licence granted to the franchisee to use the franchisor's trademarks should be recorded with the Trademark Register for validation and to ensure that use of the trademark by the franchisee is attributed to its registered owner. Recordation is especially important in cases where the franchisee is authorised to manufacture goods under the franchisor's trademarks.

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

Law stated - 1 May 2025

Real estate

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

There are no legal restrictions relating to foreign or domestic franchisors in respect of purchasing or leasing real estate. The common and recommended model is to lease property rather than to purchase it due to land structure, legal simplicity and financial flexibility.

Law stated - 1 May 2025

Competition law

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

Competition in the Israeli market is regulated under the Commercial Competition Law 1988 (formerly known as the Restrictive Trade Practice Law). Franchise agreements are exempted from the prohibitions under the Law in accordance with a specific block exemption unless:

- the parties to the agreement are actual competitors;
- a party has monopoly power in the relevant product market or in an adjacent market; or
- the agreement's duration is 10 years or longer.

In addition the franchise agreement should not include price fixing, prohibition on sale outside the territory and any other restriction that is not required for the maintenance of the franchise and might harm the competition without due justification.

The block exemption on franchise agreements protects ancillary restrictions included in a franchise agreement, provided that the restrictions are required for the realisation of its objective and do not cause substantial harm to competition.

The block exemption on franchise agreements further disqualifies certain terms barring the franchisee.

The Israel Competition Authority oversees enforcement of the law when it is violated. The enforcement proceedings begin with an investigation, which may lead to financial sanctions or criminal charges.

The franchise agreement should be carefully drafted to comply with the exemption for franchise agreements.

In September 2023, the Commercial Competition Law was amended for the sake of regulating the issue of parallel imports in the aspect of economic competition. The main purpose of the amendment is to prevent harm to competition by way of thwarting or reducing competition from parallel imports by an authorised or licensed importer of goods. This amendment to the law applies to franchise agreements as well once the franchisee is the exclusive or authorised importer of the goods in question. It is thus important to take this amendment into consideration once a franchise agreement is drafted.

Law stated - 1 May 2025

OFFER AND SALE OF FRANCHISES

Legal definition

12 | What is the legal definition of a franchise?

There is no specific legislation regulating franchises in Israel. The only definition of 'franchise agreement' in Israeli legislation can be found in regulations enacted under the Commercial Competition Law 1988, which provide a block exemption to franchise agreements under certain circumstances. The definition of 'franchise agreement' in the regulations is as follows:

> [a] contract under which a franchisor grants the franchisee the right to use the franchise for the purposes of marketing certain goods or types of goods, including each of the following:
>
> (1) use of a uniform trade name or trademark or service mark, and uniform characteristics of the goods being sold or of the sale and execution, which are material to the marketing and sale of the goods;
>
> (2) transfer of knowledge from the franchisor to the franchisee, which is material to the marketing and sale of the goods;
>
> (3) commercial or technical assistance from the franchisor to the franchisee, during the term of the agreement.

Law stated - 1 May 2025

Laws and agencies

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

Israel has no specific laws or regulations for franchises. Franchises in Israel are regulated under contract laws, intellectual property laws and commercial competition law, as well as case law. No government agency regulates franchises in Israel.

Franchise agreements may be exempted from the Commercial Competition Law under a block exemption and are, thus, not considered restrictive arrangements banned under the Law, provided that the agreements comply with the requirements in the rules for franchise agreements.

The exemption under those rules will not apply, among other things, where:

- the parties to the agreement are actual competitors;
- a party has monopoly power in the relevant product market or in an adjacent market;
- the agreement's duration is 10 years or longer; or
- the agreement includes restrictive stipulations, such as:
    - restriction of the franchisor from using licensed know-how after the term of the agreement, even when the know-how is in the public domain;
    - prevention of the franchisee from initiating judicial review of the validity of the rights in know-how transferred from the franchisor to the franchisee or other intellectual property rights;
    - prevention of the franchisee from selling or supplying goods to consumers outside the territory defined in the agreement; and
    - other restrictions that are only meant to reduce competition or are not necessary to fulfil its principal.

The Commercial Competition Law deems arrangements whose restrictions involve the right to use a patent, trademark, copyright or proprietary right as not restrictive, provided that the arrangement is made between the owner of the right and the party who receives authorisation to use the right and where the right is subject to registration by law and is registered accordingly.

Law stated - 1 May 2025

Principal requirements

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

The offer and sale of franchise agreements are regulated under the general contract laws.

Law stated - 1 May 2025

Franchisor eligibility

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

There are no such requirements or guidelines.

Law stated - 1 May 2025

Franchisee and supplier selection

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

There are no specific rules or laws for franchisee selection unless the franchisor is a local government or public body subject to the Mandatory Tender Act 1992.

Law stated - 1 May 2025

Pre-contractual disclosure – procedures and formalities

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

There are no requirements in respect of pre-contractual disclosure except under the general contract law, which requires that the parties negotiate in good faith. There is no specific requirement for updating the disclosure, except if the requirement derives from the duty of the parties to act in good faith for the duration of the agreement.

Law stated - 1 May 2025

Pre-contractual disclosure – content

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

Under general contract law, each party is under the duty to disclose information, the non-disclosure of which might be considered as bad faith or might mislead the other party. When a due diligence process is initiated, all questions posed should be responded to in full transparency.

Law stated - 1 May 2025

Pre-sale disclosure to sub-franchisees

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

There is no specific rule except the requirement to negotiate in good faith. It is advisable to include in the franchise agreement terms and conditions that should be included in a sub-franchising contract.

Law stated - 1 May 2025

Due diligence

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

Customary due diligence should, as in any other transaction, be undertaken.

Before starting to use a new brand in the Israeli market, parties should clear their right to do so, given that under Israeli law, a person may accrue rights in a trademark through use and be entitled to protection, even if the trademark is not registered. Thorough research of the market should be performed before establishing franchises in the market; a search in the database of the Trademark Register alone is not sufficient.

Law stated - 1 May 2025

Failure to disclose – enforcement and remedies

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

Breach of the duty to disclose under the general duty to act in good faith during the pre-contractual period and negotiations entitles the franchisee to damages. The damages are usually punitive, calculated based on the actual loss incurred by the franchisee owing to the negotiations (including full reimbursement of costs); however, in extreme circumstances, such as gross bad faith or intentional deceit, the courts may consider awarding reliance damages calculated on the basis of the expected gain of the franchisee had the agreement been executed.

Law stated - 1 May 2025

Failure to disclose – apportionment of liability

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

The response to this question depends on the parties involved in the negotiations of a sub-franchise agreement. If both the franchisor and the franchisee participate in the negotiations, both are under the duty of good faith; thus, if that duty is breached, each of the parties will bear responsibility.

If the share of each of the parties may not be determined, the liability will be borne by both in equal share. Where the franchisor and the franchisee are legal entities, their representative will bear liability in respect of fraud or wilfully misleading acts.

Law stated - 1 May 2025

General legal principles and codes of conduct

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

The duty of good faith during negotiations, the 'culpa in contrahendo' principle, is applied under the Contract (General Part) Law 1973. The Law does not prescribe the extent of disclosure and requires each negotiating party to act in a ‘customary manner’ and in good faith, thus leaving it to the courts to decide.

The Standard Contract Law 1982 applies when franchisors act under standard agreements. Pursuant to this law, the court may find certain terms to be unreasonable practice, unfair or oppressive. The Law further allows franchisors to seek advance approval of its standard agreement. The approval serves as a declaration that the standard terms are not oppressive.

Law stated - 1 May 2025

Fraudulent sale

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

Given the lack of specific legislation in respect of franchise agreements, a franchisee is considered in the same way as any other party to a contract facing fraudulent or deceptive practices in the framework of negotiations. The law provides for reliance damages; however, in some extreme cases, the Israeli courts have granted performance damages.

Law stated - 1 May 2025

FRANCHISE CONTRACTS AND THE FRANCHISOR/FRANCHISEE RELATIONSHIP

Franchise relationship laws

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

There are no specific laws; however, the Israeli courts regard the franchisor/franchisee relationship to be a trust-based relationship and, therefore, rarely enforce the relationship where a loss of trust transpires between them.

Law stated - 1 May 2025

Operational compliance

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

Where the franchise agreement provides for royalty payments (rather than the case where the franchisee is reselling the franchisor's goods), it is common to require periodic reports and to allow the franchisor to audit the franchisee's business and inspect its books, especially if the royalties are calculated based on the income of the franchise or any other measurable volume of activity. The franchisor is further entitled to inspect the way its intellectual property is used by the franchisee and compliance with its code and standards.

Law stated - 1 May 2025

Amendment of operational terms

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

It depends on the agreement between the parties. Unilateral changes in the agreement terms without a proper mechanism that has been agreed is usually not recognised under Israeli law unless the change is for the benefit of the franchisee.

Law stated - 1 May 2025

Policy affecting franchise relations

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

No.

Law stated - 1 May 2025

Termination by franchisor

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

Termination of a franchise agreement is subject to specific stipulations agreed to by the parties. Under Israeli contract law, any party may terminate an agreement in the event of material breach of the agreement subject to certain conditions (non-payment of royalties was held by a Israeli court to be a material breach of the franchise agreement). An agreement may be terminated if the franchisor was misled by the franchisee in negotiations, and the franchisor may prove that but for the misleading information it would not have entered into the agreement.

Where the agreement is unlimited in duration, any party may terminate it subject to reasonable prior notice or any other condition deriving from the agreement between the parties, such as reimbursement of investment, repurchase of stock or sell-off period.

Law stated - 1 May 2025

Termination by franchisee

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

In the same circumstances as applicable to the franchisor.

Law stated - 1 May 2025

Renewal

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

No formal requirements apply. It is advisable to renew agreements in writing for evidential and certainty purposes.

Law stated - 1 May 2025

Refusal to renew

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

The response depends on the franchise agreement. If the agreement does not provide for renewal, any party may refuse to renew.

Law stated - 1 May 2025

Transfer restrictions

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

Such restriction is allowed (and customary), especially given the fact that Israeli courts consider the franchisor/franchisee relationship to be based on party trust.

Law stated - 1 May 2025

Fees

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

No. It is advisable to consult a local certified public accountant for that matter.

Law stated - 1 May 2025

Usury

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

No, except that the courts have the discretion to lower unreasonable charges, even if the charges were agreed by the parties.

Law stated - 1 May 2025

Foreign exchange controls

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

No; however, all payments should comply with the anti-money laundering regulations applicable to banks in Israel.

Law stated - 1 May 2025

Confidentiality covenant enforceability

37 | Are confidentiality covenants in franchise agreements enforceable?

Yes, as long as the information covered may be regarded as a trade secret as defined in the Civil Torts Law 1999.

Law stated - 1 May 2025

Good-faith obligation

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

Yes. Bad faith may be regarded as breach of the franchise agreement, thus allowing its cancellation under certain conditions.

Law stated - 1 May 2025

Franchisees as consumers

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

No. Under the Defective Products Law 1980, a strict liability standard is imposed on the manufacturer, importer, seller and distributor in respect of personal injury resulting from a defective product. The liability should be covered in the franchise agreement, as should the product liability insurance and its costs.

Law stated - 1 May 2025

Language of the agreement

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

There is no such demand; however, the language of the agreement should be understood by both parties to stop any argument based on misunderstanding of the stipulations of the agreement.

Law stated - 1 May 2025

Restrictions on franchisees

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

It is customary to include in franchise agreements restrictions such as:

- exclusive territories;
- restrictions on sources from which a franchisee may purchase or lease goods or services (restrictions on the purchase of goods and services from other franchisees of the same franchisor or restrictions on the source of goods, even if those in line with the franchisee's business are forbidden under the block exemption of franchise agreements);
- restrictions on the customers to whom the franchisee is entitled to sell the franchisor's products or services;
- restrictions on advertising the goods or services;
- prohibition on franchisees soliciting the franchisor's or other franchisees' employees;
- non-competition;
- confidentiality;
- governing law;
- dispute resolution;
- audit rights;
- insurance;
- indemnification obligations;
- allocation of the goodwill accrued through the use of the brand by the franchisee to the franchisor;
- restriction on the use of intellectual property assets other than in accordance with the licence granted under the agreement (eg, restriction to apply for the registration of the trademarks owned and used by the franchisor or any confusing similar trademark restriction on allocation of domain name using the brand or any part thereof);
- assumption of full liability to the franchisee's employees by the franchisee; and
- post agreement restrictions relating to the use of the franchisor's intellectual property.

Law stated - 1 May 2025

Courts and dispute resolution

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

Israeli courts were established under the Basic Law: the Judiciary, under which a single system of courts of law exists. The courts of law include the Supreme Court, five district courts and magistrates' courts (acting as first instance for most cases in Israel).

The courts are independent and constitute a separate unit under the Ministry of Justice.

Law stated - 1 May 2025

Governing law

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

There is no restriction on applying foreign law in an Israeli court; however, the foreign law should be proved as any other fact (by way of expert opinion). The Israeli courts usually respect foreign governance of law agreed by the parties unless there are reasons not to respect such choice on the ground of public policy. Where foreign governing law is agreed between the parties, the substantive foreign law will be applied rather than the procedural law.

Law stated - 1 May 2025

Arbitration – advantages for franchisors

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

Arbitration is common in franchise transactions in the Israeli market. The advantages of arbitration are:

- the freedom of the parties to choose their arbitrator;
- the possible efficiency of the process; the freedom of the parties to agree that the arbitrator will not be bound by procedural regulations or local evidence law;
- the freedom of the parties to agree that the decision is final and may not be appealed; and
- the freedom of the parties to set in advance the venue and the language of the process.

The disadvantages are:

- the cost of the proceedings, given that the parties should bear the fees of the arbitrator (subject to its final decision);
- the limited enforceability of orders issued by the arbitrator granting interim relief (although the district court is authorised to provide such relief under specific circumstances); and
- the fact that the decision may not be appealed unless the parties agree otherwise (even then, the grounds of appeal are rather limited).

It is advisable to consider business mediation before turning to arbitration or court proceedings.

Law stated - 1 May 2025

National treatment

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

Domestic and foreign franchisors are treated equally by the Israeli legal system.

Law stated - 1 May 2025

UPDATE AND TRENDS

Legal and other current developments

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

During the past two years, there have been no major developments in the field of franchising except for the amendment of the Commercial Competition Law 1988. The law was amended in order to regulate parallel imports to prevent harm to competition by way of thwarting or reducing competition from parallel imports by an authorised or licensed importer of goods. This amendment applies to franchise agreements as well once the franchisee is the exclusive or authorised importer of the goods in question. I

Law stated - 1 May 2025

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Japan

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Summary

FRANCHISE CONTRACTS AND THE FRANCHISOR/FRANCHISEE RELATIONSHIP

UPDATE AND TRENDS

MARKET OVERVIEW

Franchising in the market

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

Franchising is very widespread in Japan. According to the data published by the Japan Franchise Association, for the period from April 2023 to March 2024, the number of chains operating in Japan stood at 1,285 with 252,783 stores and a total turnover of approximately ¥28 trillion. Among other sectors, franchised convenience stores are particularly common in Japan, with a total of 57,019 outlets as at 2023.

Law stated - 23 May 2025

Associations

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

The Japan Franchise Association was established in 1972 for the purposes of planning and promoting the healthy development of the franchise system. It has implemented voluntary rules, such as the Code of Ethics and the Voluntary Standard Regarding Disclosure and Explanation of Information to Prospective Franchisees. In addition to maintaining these voluntary rules, it also conducts research and educational training, and provides consultations.

Law stated - 23 May 2025

BUSINESS OVERVIEW

Types of vehicle

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

Most typical franchisors are organised in the form of a joint-stock company.

Law stated - 23 May 2025

Regulation of business formation

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

The formation of joint-stock companies in Japan is governed by the Companies Act (Act No. 86 of 2005), under the supervision of the Ministry of Justice.

Law stated - 23 May 2025

Requirements for forming a business

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

The formation of a joint-stock company requires articles of incorporation and other incorporation documents to be prepared and registered at a competent legal affairs bureau. After incorporation, it is necessary to prepare financial statements and to hold a shareholders' meeting each year.

Law stated - 23 May 2025

Restrictions on foreign investors

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

Foreign business entities must register their representatives in Japan to conduct business continuously in the country. Once registered, they can carry out business in the same way as domestic entities. In addition, foreign investment is regulated by the Foreign Exchange and Foreign Trade Act (Act No. 228 of 1949). Industry-specific laws may also apply, depending on the business sector of the foreign entities.

Law stated - 23 May 2025

Taxation

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

Franchisors in the form of joint-stock companies need to pay corporate tax, corporate enterprise tax, corporate inhabitant tax and consumption tax. Depending on the nature of the assets held by a franchisor, property tax and automobile tax may also be payable. Foreign businesses' and individuals' income sourced in Japan is generally subject to Japanese taxation.

Law stated - 23 May 2025

Labour and employment

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

Labour regulations generally apply to franchisors with regard to the relationship between franchisors and their respective employees. In a typical franchise arrangement, a franchisee or the employees of a franchisee are not considered to be employees of the franchisor. To avoid the risk that a franchisee could be deemed employees of the franchisor, a franchisor must structure the franchise relationship so that the franchisee is an independent entity and must clearly explain the independent nature of the franchise relationship with the franchisee. In addition, to avoid the risk that employees of a franchisee could be deemed employees of a franchisor, it is advisable that a franchisor is not involved in the hiring process of employees of a franchisee and that it is clearly explained to the candidates that the employer will be the franchisee, not the franchisor. Breach of labour regulations may result in criminal penalties including imprisonment.

Law stated - 23 May 2025

Intellectual property

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

Franchisors can register trademarks to protect such marks from infringing use. Nevertheless, there is no registration system per se for know-how. Know-how that falls within the scope of registrable types of intellectual property – such as patents or designs – may be registered accordingly. In addition, if the know-how falls within the definition of a 'trade secret' under the Unfair Competition Prevention Act (Act No. 47 of 1993), it will be protected against any acts constituting unfair competition.

Law stated - 23 May 2025

Real estate

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

In general, a franchisee leases real estate for its operations directly from a property owner. Disputes may arise when the lessor tries to increase the rent or terminate or refuse to renew the lease agreement. In such situations, protection is available to the franchisee as the lessee under the Land Lease and Building Lease Act (Act No. 90 of 1991) and the doctrine of the destruction of a relationship of mutual trust, which limits a lessor's ability to terminate a lease agreement to the case that the mutual trust relationship is destroyed because of the lessee's violation of the agreement (Supreme Court, 28 July 1964, *Minshu* 18-6, p. 1220; 21 April 1966, *Minshu* 20-4, p. 720).

Law stated - 23 May 2025

Competition law

11 |

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

The Act on Prohibition of Private Monopolisation and Maintenance of Fair Trade (Act No. 54 of 1947) (the Antimonopoly Act) and its relevant regulations and guidelines such as Guidelines Concerning the Franchise System (the Franchise Guidelines) and Distribution Guidelines apply. The guidelines describe what kind of activities or restrictions are problematic under the Antimonopoly Act. In particular, the franchisor must ensure that none of its activities fall under a category of unfair trade practices specified in the Antimonopoly Act or described by the Japan Fair Trade Commission in its Designation of Unfair Trade Practices.

First, the Franchise Guidelines require franchisors to disclose sufficient and accurate information when they are soliciting prospective franchisees; if franchisors fail to do so, their actions can be deemed to be deceptive customer inducement, which is one of the categories of conduct restricted as unfair trade practice (Designation of Unfair Trade Practices, item 8).

Second, the Franchise Guidelines regulate transactions between franchisors and franchisees. The Franchise Guidelines state that it could be an abuse of a superior bargaining position to limit parties with whom franchisees can make transactions, to compel franchisees to buy a designated amount of goods, to restrict the ability of the franchisees to offer discounts to their customers or to restrict competitive activities after the termination of a franchise agreement. It also states what kind of items should be considered in connection with tie-in sales (Designation of Unfair Trade Practices, item 10), dealing on restrictive terms (Designation of Unfair Trade Practices, item 12), and resale price restriction.

If a party's activity is considered to be unfair trade practice under the Antimonopoly Act, the Fair Trade Commission may impose administrative sanctions, mainly a cease and desist order that demands that the breaching party stop the illegal activities, delete the clauses concerned from the agreement, and take any other measures necessary to eliminate such activities. Some categories, such as abuse of a superior bargaining position and resale price restrictions, could be subject to surcharges under the Antimonopoly Act.

Law stated - 23 May 2025

OFFER AND SALE OF FRANCHISES

Legal definition

12 What is the legal definition of a franchise?

There is no uniform definition of a 'franchise' in Japan. Nevertheless, there are three relevant definitions with regard to 'franchise businesses'.

First, the Medium and Small Retail Commerce Promotion Act (Law No. 110 of 1973) (MSRCPA) defines a 'chain business' as a business that, pursuant to an agreement with uniform terms and conditions, continuously sells or acts as an agent for sales of products and provides guidance regarding management, and primarily targets medium and small retailers. In addition, a 'specified chain business' is defined as:

> any chain business the agreement for which includes clauses that permit its members to use certain trademarks, trade names or any other signs, and collects joining fees, deposits or any other money from the member when becoming a member[.]

If a franchise business falls under this definition, the disclosure obligation, among others, under the MSRCPA applies.

Second, the Guidelines Concerning the Franchise System (the Franchise Guidelines) under the Act on Prohibition of Private Monopolisation and Maintenance of Fair Trade (Act No. 54 of 1947) (the Antimonopoly Act) provides the following:

> The franchise system is defined in many ways. However, the franchise system is generally considered to be a form of business in which the head office provides the member with the right to use a specific trademark and trade name, and provides coordinated control, guidance, and support for the member's business and its management. The head office may provide support in relation to the selling of commodities and the provision of services. In return, the member pays the head office.

Third, the Japan Franchise Association (JFA) defines a 'franchise' as:

> A continuing relationship between one business operator (called a Franchisor) and another business operator (called a Franchisee) where a Franchisor and a Franchisee enter into a contractual agreement, the Franchisor granting the Franchisee the right to conduct the product sales and other businesses under the same image, by using the Franchisor's trademark, service mark, trade name or other signs representing the Franchisor's business, as well as the Franchisor's management know-how; the Franchisee paying the consideration to the Franchisor in return, investing the fund necessary for the business, and operating the business under the Franchisor's guidance and assistance.

Law stated - 23 May 2025

Laws and agencies

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

If the franchise business falls within the scope of a specified chain business, the disclosure obligations under the MSRCPA are applicable in relation to the offer and sale of franchises. The Ministry of Economy, Trade and Industry, as well as other ministries depending on the franchise business, have overall responsibility in this regard.

From the perspective of competition law, the Franchise Guidelines regulate the offer and sale of franchises from the viewpoint of the Antimonopoly Act, and the Fair Trade Commission has overall responsibility in this regard.

The JFA has also implemented voluntary rules, such as its Code of Ethics and the Voluntary Standard Regarding Disclosure and Explanation of Information to Prospective Franchisees.

Law stated - 23 May 2025

Principal requirements

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

Under the MSRCPA, franchisors whose businesses fall under the definition of a 'specified chain business' are required to provide a written document that describes prescribed items and to explain the contents of the written documents prior to executing a franchise agreement with prospective franchisees.

The Franchise Guidelines require franchisors to disclose sufficient and accurate information to prospective franchisees and also regulate the ongoing relationship between franchisors and franchisees.

Law stated - 23 May 2025

Franchisor eligibility

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

There is no such requirement in general, except for the disclosure requirements provided in the MSRCPA and the Franchise Guidelines. If the industry in which the franchise operates is regulated by industry-specific laws, it is necessary to check those regulations.

Law stated - 23 May 2025

Franchisee and supplier selection

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

In addition to the MSRCPA, which stipulates the disclosure requirements, the Franchise Guidelines regulate the manner in which a franchisor recruits franchisees or selects its or its franchisees' suppliers. It is recommended that a franchisor, when recruiting a franchisee, discloses sufficient information to the franchisee to avoid any misunderstandings about the business on the part of the franchisor. This disclosure includes but is not limited to matters relating to the terms and conditions of supply of products, such as a system for recommending suppliers, and matters relating to any restrictions applying to the franchisor or other franchisees in setting up similar or identical outlets close to the outlet planned by the franchisee. The Franchise Guidelines also mention that if the franchisor forces the franchisee to trade only with the franchisor or companies appointed by the franchisor regarding the supply of items such as products and raw materials without proper justification, it could be considered abuse of a superior bargaining position.

Law stated - 23 May 2025

Pre-contractual disclosure – procedures and formalities

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

Under the MSRCPA, when a franchisor intends to negotiate a franchise agreement with a prospective franchisee, the franchisor must provide written documents describing the prescribed items and explain the contents of the written documents to prospective franchisees. There are no regulations regarding the frequency of updating disclosures after execution of a franchise agreement.

Law stated - 23 May 2025

Pre-contractual disclosure – content

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

A franchisor whose business falls within the definition of a 'specified chain business' under the MSRCPA is subject to the MSRCPA disclosure obligations.

Information about the following matters, which must include at least the items specified for each matter, must be disclosed to the franchisee:

- matters regarding the initial fee, deposit or any other money that the franchisor will collect at the time when the prospective franchisee becomes a franchisee:
- the amount of money to be paid or the method of calculating the amount;
- the nature of the money to be collected, such as whether it is an initial fee, deposit, equipment fee, etc;
- the timing of payment;
- the method of collection; and
- whether the money will be refunded, and the conditions applicable to such refund;
- matters regarding terms and conditions of sales of products sold to franchisees:

- the type of products that are sold or arranged to be sold to the franchisees; and
- the method of payment for such products;
- matters regarding management instruction:

- whether there will be training or a seminar when joining;
- the content of a training or a seminar, if provided; and
- the method of continuous management instruction to franchisees and how many times such instruction will be conducted;
- matters regarding the trademark, trade name and any other indication that will be permitted to be used:

- trademark, trade name and other indication that will be permitted to be used; and
- if there are any terms and conditions regarding the use of the indication, the content thereof;
- matters regarding the duration of the agreement and renewal and termination of the agreement:

- the duration of the agreement;
- the conditions and procedure to renew the agreement;
- the requirements and procedures to terminate the agreement; and
- the amount of compensatory damages that will accrue on termination of the agreement or the methods to calculate the amount or the content of any other obligation;
- matters regarding changes in the number of franchisees' stores during the most recent three business years:

- the number of franchisees' stores as at the last day of each business year;
- the number of franchisees' stores that began operations during each business year;
- the number of franchisees' stores whose franchise agreements have been terminated during each business year; and
- the number of franchisees' stores whose franchise agreements were renewed during each business year and the number of franchisees' stores whose franchise agreements were not renewed during each year;
- matters regarding income and expenditure of franchisees with similar local conditions – such as the population of the surrounding area and the volume of traffic, among others – during the most recent three business years:

- the following amount of the franchisee recognised by the franchisor:

- the sales amount;
- the sales cost;
- the amount of money to be paid periodically by franchisees, such as royalties for the use of the business name, consulting fees, etc;

- the employment costs;
- any service and general administration expenses; and
- any other factors and figures that form the basis of the calculation of income and expenditure; and
- reasons why the location conditions of the franchisees are considered similar;
- matters regarding any periodic payments:

- the amount of money to be paid periodically or the method of calculating the amount of money to be paid periodically;
- the nature of the payment, such as whether it is a royalty for the use of the business name, a consulting fee, etc;
- the timing of payment; and
- the method of collection of the payment; and
- other matters:

- the name and address of the franchisor, the number of full-time employees and, if the franchisor is a company, the title and names of officers;
- the amount of capital, names of the principal shareholders (those holding more than 10 per cent of the shares directly or indirectly) and, if the franchisor is conducting another business, the type of business;
- the name of any entity in which the franchisor holds a majority of the voting shares;
- the balance sheet and profit and loss statement, or other documents equivalent to these for the past three business years of the franchisor's business;
- the date on which the franchisor began its specified chain business;
- the number of litigation cases in which the franchisor is the plaintiff and a franchisee or ex-franchisee is the defendant with regard to the franchise agreement and vice versa during the past five business years;
- business hours, business days and regular or irregular closing days of franchisees' units;
- whether there is a provision stipulating whether the franchisor will engage in or allow other franchisees to engage in business operations conducting the same or similar retail business near the shops of the franchisee and the contents of the provision, if applicable;
- whether there is a provision that prohibits or restricts the ability of franchisees to conduct businesses, such as prohibiting them from joining other specified chain businesses or from being employed with similar businesses (either during or after termination or expiration of the agreement) and the contents of the provision, if applicable;
- whether there is a provision that prohibits or restricts disclosure of information that the franchisee may know regarding the specified chain business during or after termination or expiration of the agreement and the contents of the provision, if applicable;

- whether the franchisees need to remit all or part of the sale proceeds periodically, and the timing and method thereof;
- whether the franchisor lends or arranges to lend money to franchisees, the interest rate or the method of calculating the rate and any other conditions of the lending or arranging of lending;
- whether the franchisor adds interest to all or part of the remaining amount after setting off the rights and obligations that accrue in connection with a transaction with the franchisor during a certain period, the interest rate or the method of calculating the rate and any other conditions;
- whether the franchisor imposes on franchisees a special obligation regarding the structure, or interior or exterior of stores of franchisees, the contents of the obligation; and
- the amount of money or the method of calculating the amount of money that accrues when the franchisor or a franchisee violates the agreement.

Law stated - 23 May 2025

Pre-sale disclosure to sub-franchisees

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

In the case of a sub-franchise, the relationship between the sub-franchisor and the sub-franchisee needs to be analysed; if it falls within the definition of a 'specified chain business' under the MSRCPA, the sub-franchisor owes a disclosure obligation. In such a case, the information relating to the sub-franchisor must be disclosed. The relationship between the franchisor and the sub-franchisor must also be analysed; if it too falls within the definition of a 'specified chain business', the franchisor has a disclosure obligation as well.

Law stated - 23 May 2025

Due diligence

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

It depends on the particular policy of the franchisor or the franchisee, but a general background check to ensure, among other things, that the counterparty is not an antisocial force and not associated with antisocial forces, is usually conducted.

Law stated - 23 May 2025

Failure to disclose – enforcement and remedies

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

A franchisor or a sub-franchisor whose business falls within the definition of a 'specified chain business' under the MSRCPA owes disclosure obligations and any party that owes such obligations is responsible for any breach thereof. Generally, individual officers, directors and employees of the franchisor or the sub-franchisor are not exposed to a personal liability with regard to the failure of disclosure by the franchisor or the sub-franchisor. Nevertheless, if there are breaches of the duty of care or fault on the part of these individuals, they may face liability accordingly. In addition, there is a risk that a franchisee will name these individuals as defendants in a suit against the franchisor or the sub-franchisor to seek recovery of damages from them.

A franchisor or a sub-franchisor that failed to disclose sufficient and accurate information as required by the Franchise Guidelines could be deemed to have conducted a deceptive customer inducement, in which case, the Japan Fair Trade Commission may investigate and impose administrative sanctions.

Law stated - 23 May 2025

Failure to disclose – apportionment of liability

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

A franchisor or a sub-franchisor whose business falls within the definition of a 'specified chain business' under the MSRCPA owes disclosure obligations and any party that owes such obligations is responsible for any breach thereof. Generally, individual officers, directors and employees of the franchisor or the sub-franchisor are not exposed to a personal liability with regard to the failure of disclosure by the franchisor or the sub-franchisor. Nevertheless, if there are breaches of the duty of care or fault on the part of these individuals, they may face liability accordingly. In addition, there is a risk that a franchisee will name these individuals as defendants in a suit against the franchisor or the sub-franchisor to seek recovery of damages from them.

Law stated - 23 May 2025

General legal principles and codes of conduct

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

Apart from the MSRCPA, the Franchise Guidelines and the JFA's voluntary rules, the general principles of the Civil Code (Act No. 89 of 1896) affect the offer and sale of franchises. For example, franchisees can rescind the franchise agreement in the event of fraudulent disclosure of information or if there is a material misunderstanding about the franchise agreement. If damage has been caused by the violation of the disclosure requirement, franchisees may bring a claim for damages based on contract theory or tort theory.

Law stated - 23 May 2025

Fraudulent sale

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

No special remedy exists for franchisees under the MSRCPA regarding violations of disclosure requirements. Therefore, in the case of fraudulent or deceptive practices of franchisors, franchisees need to base any claims to cancel or rescind on the general principles of contract under the Civil Code. For example, franchisees can rescind the franchise agreement in the event of fraudulent disclosure of information or if there is a material misunderstanding about the franchise agreement. If damage has been caused by the violation of the disclosure requirement, franchisees may bring a claim for damages based on contract theory or tort theory. In addition, franchisees may claim that a franchisor is violating the Franchise Guidelines, thus violating the Antimonopoly Act.

Law stated - 23 May 2025

FRANCHISE CONTRACTS AND THE FRANCHISOR/FRANCHISEE RELATIONSHIP

Franchise relationship laws

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

The Guidelines Concerning the Franchise System (the Franchise Guidelines) under the Act on Prohibition of Private Monopolisation and Maintenance of Fair Trade (Act No. 54 of 1947) (the Antimonopoly Act) regulate the ongoing relationship between franchisors and franchisees, such as the matters relating to restriction on suppliers, forced purchase quota, restriction on bargain sales and amendments to the franchise agreement.

Law stated - 23 May 2025

Operational compliance

26

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

Generally, franchise agreements oblige franchisees to comply with the franchisor's operation manuals and other rules that set forth its brand standards in detail. In addition, various reporting requirements, which must be satisfied on a regular basis, are provided for in the franchise agreement. Franchisors also have inspection rights (also provided for in the franchise agreement) to check the records, etc, of franchisees whenever franchisors deem such inspections necessary.

Law stated - 23 May 2025

Amendment of operational terms

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

It depends on tthe extent to which the franchise agreement and other ancillary agreements give the franchisor the discretion to change operational terms and standards unilaterally. In general, the franchisor reserves the right to change the operational manual unilaterally. Even if such right is reserved, the franchisors must carefully check if such unilateral change is beneficial for franchisees or is limited to a reasonable extent considering the surrounding circumstances.

Law stated - 23 May 2025

Policy affecting franchise relations

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

There are voluntary rules, such as the Code of Ethics and the Voluntary Standard Regarding Disclosure and Explanation of Information to Prospective Franchisees, prepared by the Japan Franchise Association (JFA). If a franchisor is a member of the JFA, its voluntary rules are an important consideration in the franchise relationship.

Law stated - 23 May 2025

Termination by franchisor

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

Usually, the franchise agreement lists the circumstances in which the franchisor may terminate a franchise relationship. In addition, the franchisor may also terminate a franchise relationship based on mutual agreement.

If the franchisor violates the franchise agreement, the franchisor may terminate the franchise agreement prior to the expiration of the term of the agreement, based on the franchise agreement or on the Civil Code (Act No. 89 of 1896). Nevertheless, because franchise agreements are usually continuous long-term agreements, there is a possibility that courts will be more reluctant to terminate these agreements compared to normal agreements.

On this point, it may be useful to refer to the doctrine of the destruction of a mutual trust relationship, which has been established in the area of lease agreements that are also generally considered continuous agreements. With regard to lease agreements, a lessor's ability to terminate a lease agreement is limited to the case that the mutual trust relationship is destroyed because of the lessee's violation of the agreement (Supreme Court, 28 July 1964, *Minshu* 18-6, p. 1220; 21 April 1966, *Minshu* 20-4, p. 720). This means that a lessor may not terminate a lease agreement even if the lessee is violating it, provided that the violation is not sufficiently material to destroy the mutual trust relationship.

In the case of termination of a franchise agreement, a similar consideration could be made by the court to restrict a franchisor's ability to terminate a franchise relationship, depending on the circumstances.

Law stated - 23 May 2025

Termination by franchisee

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

Usually, the franchise agreement regulates the circumstances in which a franchisee may terminate a franchise relationship. In addition, the franchisee may terminate a franchise relationship due to mutual agreement with the franchisor. In cases where there is no clause in the franchise agreement, the same considerations apply as those relating to termination by the franchisor. However, in general, the necessity of protecting a franchisor from termination by a franchisee is not strong, as compared to the necessity of protecting a franchisee from termination by a franchisor, and, therefore, it would be generally easier for franchisees than a franchisor to terminate the franchise agreement.

Law stated - 23 May 2025

Renewal

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

If the franchise agreement provides for an automatic renewal clause, there is no need to enter into a new agreement. If the franchise agreement requires the parties to renew the term, it is then necessary to enter into either a new agreement or an extension agreement.

Law stated - 23 May 2025

Refusal to renew

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

Provisions in the franchise agreement generally determine whether a franchisor may refuse to renew the franchise agreement with the franchisee. In cases where the franchise agreement states that it will not be renewed unless otherwise agreed to between the parties, the franchisor may generally refuse to enter into a new agreement. By contrast, in cases where the franchise agreement states that it will be renewed automatically unless either party notifies otherwise, it is unclear in which circumstances the franchisor may refuse to renew, especially after being renewed for many times. On this point, there is a case in which a court required 'compelling circumstances' that make it difficult to continue the agreement for a franchisor to be able to refuse to renew a continuous agreement (*Hokka Hokka Tei* case, Nagoya District Court, 31 August 1998).

Law stated - 23 May 2025

Transfer restrictions

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

As to the transfer of a franchise, it is possible to include a provision in a franchise agreement that requires the franchisor's consent for the franchisee to transfer its franchise under the agreement. Furthermore, under the Civil Code, when a party to an agreement is going to transfer its status or obligations under the agreement, the other party's consent must be obtained. Therefore, even if there is no clause in the franchise agreement requiring consent for transfer, the franchisor's consent is still necessary.

As to the transfer of an ownership interest in a franchisee entity, the owner of an ownership interest in a franchisee entity is generally free to transfer its ownership interest. Any covenant in a franchise agreement that prohibits the owner to transfer an ownership interest in a franchisee is not enforceable against the owner unless the owner is also a party to the franchise agreement. However, the franchise agreement may indirectly restrict the transfer of an ownership interest in a franchisee entity by making it an obligation of the franchisee to obtain the franchisor's consent or by making the transfer of an ownership interest a termination event.

Law stated - 23 May 2025

Fees

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

There is no specific limitation on the amount or payment of fees. However, if fees are unreasonably high, the obligation to pay the fees may be deemed void because it may be construed to be against good public order and customs as laid out in the Civil Code. It is also possible that, depending on circumstances, imposition of a high fee is considered an abuse of superior bargaining position as laid out in the Antimonopoly Act.

Law stated - 23 May 2025

Usury

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

For interest on loans from a franchisor to a franchisee, the restriction on interest under the Interest Rate Limitation Act (Act No. 100 of 1954) applies; however, if the overdue payment is not in connection with a loan, there is no specific restriction on the amount of interest. If the interest charged is unreasonably high, however, the obligation to pay the interest may be deemed void because it is against good public order and customs as laid out in the Civil Code.

Law stated - 23 May 2025

Foreign exchange controls

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

In general, there are no restrictions on a franchisee's ability to make payments in a foreign currency. International transfer of funds exceeding a certain amount is subject to a reporting requirement under the Foreign Exchange and Foreign Trade Act (Act No. 228 of 1949), and depending on the destination country and purpose of the transfer of funds, stricter restrictions could be applicable.

Law stated - 23 May 2025

Confidentiality covenant enforceability

37 | Are confidentiality covenants in franchise agreements enforceable?

Confidentiality covenants are generally enforceable. If a franchisee breaches confidentiality covenants, a franchisor may seek compensation for the damages caused by such violation or seek a preliminary injunction to avoid any damages in advance.

Law stated - 23 May 2025

Good-faith obligation

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

Under article 1 of the Civil Code, there is a general duty to act in good faith. In addition, if an agreement is unreasonably advantageous to one party, it can be deemed void because it is against good public policy under article 90 of the Civil Code. These clauses affect franchise relationships in various ways. One area where the duty to act in good faith plays an important role is with regard to the franchisor's obligation to disclose information. A court has construed that a franchisor has an obligation to provide prospective franchisees with accurate and adequate information so that they can make decisions (Fukuoka High Court, 31 January 2006, *Shin Shin Do* case, Kyoto District Court, 1 October 1991).

In addition, courts use article 90 of the Civil Code to limit liquidated damages. For example, in the *Honke Kamadoya* case (Kobe District Court, 20 July 1992), a court stated that liquidated damages of an amount equal to 60 months' loyalty payment were significantly out of balance with the expected amount of damages; consequently, the liquidated damages were void to the extent that they went beyond a reasonable amount of damages because such amount was against good public policy.

Law stated - 23 May 2025

Franchisees as consumers

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

In principle, a franchisee would not be protected as a consumer for the purpose of consumer protection laws because the franchisee is doing business and is therefore a business operator. For example, the Consumer Contract Act (Act No. 61 of 2000) defines a 'consumer' as any natural person excluding a natural person who becomes a party to a commercial contract to engage in commercial endeavours. Nevertheless, as demonstrated by the courts' inclination to protect franchisees (eg, the doctrine of the destruction of a relationship of mutual trust), depending on the case, franchisees could be protected by interpretations of the Civil Code or other laws.

Law stated - 23 May 2025

Language of the agreement

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

There is no clear requirement that disclosure documents need to be in Japanese, but since the disclosure obligation is imposed so that prospective franchisees have sufficient information and understand the franchise well, it is prudent to prepare these documents in Japanese. There is no requirement that franchise agreements should be in Japanese.

Law stated - 23 May 2025

Restrictions on franchisees

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

Clauses related to territories, payment of fees, procurement of goods or services, non-compete obligation, governing law and dispute resolution are usually included in franchise contracts. For further details, it would be useful to refer to the matters that are subject to the disclosure obligation under the Medium and Small Retail Commerce Promotion Act (Act No. 110 of 1973).

Law stated - 23 May 2025

Courts and dispute resolution

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

Assuming that both parties to the dispute are doing business in Japan, unless otherwise provided in an agreement, a dispute regarding a franchise relationship may be brought to a district court that has jurisdiction over the dispute under the Code of Civil Procedure (Act No. 109 of 1996). In every prefecture, one or more district courts exist. Decisions by district courts may be appealed to a competent high court, and then to the Supreme Court. In addition to litigation in a courtroom, arbitration is possible if the parties so agree.

Law stated - 23 May 2025

Governing law

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

If the parties agree, it is possible to designate a foreign governing law in franchise contracts. In these cases, the enforceability of the contract is assessed under the specified foreign law. Nonetheless, compulsory regulations such as the disclosure obligations under the Medium and Small Retail Commerce Promotion Act (Act No. 110 of 1973) and the requirements under the Antimonopoly Act must be complied with by all parties to the contract.

Law stated - 23 May 2025

Arbitration – advantages for franchisors

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

Foreign franchisors' principal advantage in choosing arbitration is that the proceedings can be conducted in English or any other language as agreed in the franchise agreement. In the case of litigation in Japanese courts, the language must be Japanese. In addition, arbitrators may be more familiar with franchise business than Japanese judges. The principal disadvantage of arbitration is the generally higher costs due to fees for the arbitrators and the fact that the number of arbitrators familiar with the franchise business in Japan as well as in the jurisdiction where the foreign franchisor mainly operates may be limited.

Law stated - 23 May 2025

National treatment

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

Because of certain restrictions on foreign business entities and foreign investment (eg, the Foreign Exchange and Foreign Trade Act (Act No. 228 of 1949) (FEFTA) and industry-specific laws), foreign franchisors could face different regulations. For example, certain technical licences could be subject to regulatory filing under FEFTA, depending on the contents of the licence. In addition, if the industry of the franchise is regulated by specific laws, such laws may treat foreign franchisors differently.

Law stated - 23 May 2025

UPDATE AND TRENDS

Legal and other current developments

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

The Japan Fair Trade Commission (JFTC) conducted an industry survey about trade practices between franchisors and franchisees of convenience stores. Based on that research, the results of which were released in September 2020, the JFTC Guidelines Concerning the Franchise System (the Franchise Guidelines) were amended. For example, regarding 24/7 operations, the amended Franchise Guidelines recommend disclosing information about shortages of manpower, rising labour costs or other information that may have adverse effects on the management of the franchisee. The Franchise Guidelines also clarify that it could constitute a breach of the Act on Prohibition of Private Monopolisation and Maintenance of Fair Trade (Act No. 54 of 1947) if the franchisor refuses to discuss the shortening of operational hours with the franchisee, although it is contractually permissible by mutual consent.

In addition, the amendment to the Enforcement Regulation of the Medium and Small Retail Commerce Promotion Act (Act No. 110 of 1973) came into force on 1 April 2022. This amendment requires the disclosure of income and expenditure of franchisees with similar local conditions. The Japan Franchise Association updated its guidelines about disclosure documents to give examples of information to be disclosed in relation to the additional disclosure requirements.

Law stated - 23 May 2025

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Summary

MARKET OVERVIEW

Franchising in the market

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

There are approximately 870 franchise formulas operating in the Netherlands, with over 34,200 franchise outlets. Franchise businesses employ over 375,000 people and annual sales are well over €55 billion. This makes the franchise sector crucially important to the Dutch economy. Franchising is found in many industries, with focal points in retail (both food and non-food), services (eg, medical services) and care, and comes in many forms. These vary from soft franchising, where the franchisee has a lot of freedom within the franchise to structure its activities (eg, by making its own selection from a wide range of products available to the franchise), to hard franchising, where the business operations are prescribed by the franchisor down to the smallest detail. In hard franchising, the franchisee is largely unburdened and in exchange, he or she relinquishes some of the freedom of movement in his or her entrepreneurship, as outlined in the explanatory note to the Dutch Franchise Act, effective from 1 January 2021.

Law stated - 1 May 2025

Associations

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

The Dutch Franchise Association (NFV) represents the interests of its affiliated members (ie, franchise organisations). Its main objective is to promote the healthy and balanced development of franchising in the Netherlands. The NFV is a member of the European Franchise Federation, as are franchise associations in almost all European countries. The NFV is also a member of the World Franchise Council, which is a forum where supranational issues can be discussed.

Law stated - 1 May 2025

BUSINESS OVERVIEW

Types of vehicle

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

Franchises may come in the form of any business entity existing under Dutch law, in particular:

- private limited liability companies (BVs);
- public companies (NVs);
- sole proprietorships;
- general partnerships; and
- limited partnerships.

BVs and NVs are legal entities. General partnerships, limited partnerships and sole proprietorships are non-legal entities. The question of whether a business entity is a legal entity or not affects the franchisor's personal liability.

Law stated - 1 May 2025

Regulation of business formation

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

The formation of business entities is governed by Book 2 of the Dutch Civil Code for legal entities and Book 7A of the Dutch Civil Code. There are also several specific relevant laws for business entities, for example, the Works Councils Act. All business entities must be duly registered in the Commercial Register of the Dutch Chamber of Commerce.

Law stated - 1 May 2025

Requirements for forming a business

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

The requirements for forming and maintaining a business entity depend on what form of business entity is incorporated. When a private limited liability is used by the franchisor, the following are required:

- a statement of no objection from the Dutch Ministry of Justice; and
- a notarial deed of incorporation, including the articles of association.

On 1 October 2012, an act for the simplification of private company law entered into force, making important changes to Dutch law applicable to BVs. From this date, the laws with respect to BVs became simpler and more flexible. As a result, it is now possible to deviate more from the statutory rules in the articles of association of the company and a minimum capital of €18,000 is no longer necessary. Furthermore, the mandatory bank and accountants' statements with a contribution in kind have been abolished. A notarial deed of incorporation is still required. The act entered into force with immediate effect and is applicable to all BVs. The act introduced several possibilities to deviate from the provisions of the law in the articles of association, which offered foreign investors more freedom to incorporate or structure their BV as they deem appropriate.

Law stated - 1 May 2025

Restrictions on foreign investors

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

Business entities that are incorporated under foreign law but are active on the Dutch market rather than within their own country are subject to the Companies Formally Registered Abroad Act (CFRA Act). The CFRA Act does not apply to members of the European Union or to countries that are members of the European Economic Area Agreement. All other entities must comply with certain requirements, which also apply to Dutch entities (eg, registration in the Commercial Register, statutory minimum capital and the filing of annual accounts with the Commercial Register where the business entity is registered).

Law stated - 1 May 2025

Taxation

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

In principle, taxable profits realised by corporate entities that are for tax purposes resident in the Netherlands – for example, BVs and NVs – are subject to the Dutch corporate income tax rate. Dividends received and capital gains derived from a shareholding to which the Dutch participation exemption applies are exempt from Dutch corporate income tax. Dividends distributed by a Dutch tax-resident company are generally subject to Dutch dividend withholding tax. A reduced rate or an exemption from Dutch dividend withholding tax may be available; for example, as a result of the application of a tax treaty or if the Dutch participation exemption applies. In principle, dividends distributed to an EU shareholder holding more than 5 per cent are also exempt from Dutch dividend withholding tax. In general, Dutch corporate taxpayers can credit dividend tax withheld against corporate income tax due.

Individual shareholders holding more than 5 per cent in the nominal share capital of a company (substantial interest) are generally subject to Dutch individual income tax in respect of dividends received and capital gains derived from such substantial interest. Individual shareholders holding less than 5 per cent in the nominal share capital of a company are generally subject to Dutch individual income tax.

Individuals performing franchise activities in the Netherlands, either in the form of tax-transparent partnerships or as sole entrepreneurs, are generally subject to income tax at progressive rates. Dutch individual entrepreneurs may apply a number of beneficial tax facilities.

No taxes are levied upon establishing a business in the Netherlands. Dutch capital tax, which was due on the incorporation of a company with capital divided into shares, was abolished on 1 January 2006. The acquisition of Dutch houses is currently subject to real estate transfer tax. For real estate business premises, a Dutch real estate transfer tax applies. In certain circumstances, the acquisition of more than 33.33 per cent of a Dutch real estate company is also subject to Dutch real estate transfer tax.

Wages paid by a Dutch employer are subject to Dutch wage withholding tax and Dutch social security premiums. Dutch wage withholding tax is creditable against the Dutch individual income tax liability in full. Attractive tax benefits are available for foreign employees if these employees have certain specific skills that are scarce in the Netherlands.

Dutch value-added tax (VAT) currently amounts to 21 per cent. Reduced VAT rates of 6 per cent and zero per cent apply for certain supplies, such as the supply of agricultural products. Imports performed by Dutch entrepreneurs are generally subject to Dutch VAT. In principle, the importing entrepreneur may credit or refund the VAT paid on the imported supplies. Exports from the Netherlands are generally exempt from Dutch VAT.

Law stated - 1 May 2025

Labour and employment

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

In principle, franchisees are deemed independent entrepreneurs. Hence, no labour and employment considerations apply. However, franchisees may qualify as employees on the basis that the relationship between the franchisor and franchisee does not correspond with the franchise agreement as it is in fact an employment relationship. If the agreement is considered an employment agreement, the franchisee is, among other things, entitled to holiday allowance and payment during illness. Also, laws regarding termination of the employment agreement apply.

According to tax law, the franchisor is required to withhold income tax and social security benefits if the tax authorities deem the relationship between parties a (fictitious) employment relationship. Each cooperation agreement, such as a franchise agreement, is considered on its own merits. The name and wording of the contract between the parties are not decisive. The courts look at the intention of the parties when entering into the franchise contract, as well as the way in which the parties have given substance to their relationship. An employment relationship can be assumed if the following can be established:

- the franchisee is obliged to perform the agreed duties in person;
- the franchisor pays the franchisee (directly or indirectly) for these duties; and
- a relationship of authority can be established that manifests itself in the right of the franchisor to give instructions that the franchisee must follow.

Particularly in franchise relationships, the following criteria prove to be decisive:

- the equivalence of the contracting parties;
- the ability of the franchisee to let someone else perform the duties (eg, third parties or employees of the franchisee);
- the franchisee bearing the business risk; and

- the economic independence of the franchisee.

Provided that the franchisee is truly a franchisee, pursuant not only to the contract but also to its day-to-day activities, no employment relationship should be deemed to exist. Particularly if the franchisee is contracted via his or her Dutch limited liability company, the risk of an employment relationship is limited, at least from a civil law perspective. The tax authorities have a different view on this.

Law stated - 1 May 2025

Intellectual property

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

Registered trademarks are protected by the Benelux Treaty for Intellectual Property and (or) the European Trademark Regulation. The registrant of a Benelux trademark has exclusive rights for specific classes of goods or services in Belgium, the Netherlands and Luxembourg if a trademark is registered in the public trademark registry of the Benelux Office for Intellectual Property. In addition, the registrant has exclusive rights for specific classes of goods or services in the European Union if a trademark is registered as a community trademark in the public trademark registry of the European Union Intellectual Proterty Office (formerly, the Office for Harmonization of the Internal Market of the European Union).

In principle, know-how is not protected by any intellectual property right. However, trade secrets can be protected by the Act on the Protection of Trade Secrets since 2018. Know-how may also be protected under the general provisions of Dutch unfair competition law (including civil tort). Know-how could be contractually protected by including confidentiality (non-disclosure) obligations in an agreement (eg, a franchise agreement).

Law stated - 1 May 2025

Real estate

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

In the Netherlands, there are no restrictions on the acquisition of real estate by foreigners. Therefore, foreign franchisors would not face difficulties should they wish to purchase real estate to lease to franchisees. However, franchisors must take the protection of lessees under the semi-mandatory Dutch lease law into account, even if the properties have been made available to the franchisees in the franchise agreement and no specific lease agreement has been drawn up.

There are two different tenancy regimes for the lease of commercial premises: the lease of retail space (including shops, restaurants and takeaways) and the lease of the other commercial premises (including travel agencies, cinemas, the ticket offices of lotteries and bank branches). Under the retail space regime, lessees are protected by various conditions of semi-mandatory lease law, including but not limited to:

- the minimum lease term is two to five years and there are limited grounds for termination by the lessor;
- termination or rescission can in principle be effectuated only judicially (also in the event of breach of contract); and
- the turnover rent may be affected by market rent review.

Under the regime of other commercial premises, the lessees only get protection of vacation. The lessees are entitled (within two months of the date of vacation) to request the court to extend the term of vacation. The court can be requested to approve a deviation from semi-mandatory law.

Law stated - 1 May 2025

Competition law

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

Franchising agreements that do not meet the criteria set forth in European Commission Regulation (EU) 2022/270 (the Vertical Block Exemption Regulation (VBER)) and to which no de minimis thresholds apply will be prohibited on the basis of article 6.1 of the Dutch Competition Act (DCA) or article 10 of the Treaty on the Functioning of the European Union (TFEU), unless the four criteria detailing the legal exception of article 6.3 of the DCA or article 101(3) of the TFEU apply.

Competition laws in the Netherlands are enforced both administratively and by means of civil litigation (private enforcement). The Dutch Competition Authority can impose fines if a franchising agreement disregards what is set forth in the VBER, particularly if the agreement contains any hardcore restrictions (eg, resale price maintenance). The maximum statutory fine is 10 per cent of the undertaking's worldwide turnover. A party to a franchising agreement claiming that the agreement infringes article 6.1 of the DCA or article 101(1) of the TFEU can invoke the nullity of the agreement (in whole or in part) before a Dutch court. The court must then decide on the applicability of the VBER or the legal exception of article 6.1 of the DCA or article 101(1) of the TFEU. If it decides in the affirmative, it must subsequently determine whether this leads to nullity of only the infringing clauses or nullity of the agreement in its entirety. The latter will be the case if the court determines that without the infringing clause, the agreement would not (or would not on similar terms) have been concluded. In a few instances, the court has nullified a franchising agreement in its entirety, notably because the franchisor engaged in resale price maintenance.

The Authority for Consumers and the Market (ACM) supervises whether franchise and distribution agreements are disadvantageous to competition and consumers in the Netherlands, in which case such agreements may be prohibited. On 26 February 2019, the ACM published new guidelines for agreements between suppliers and buyers. Around this time, the ACM announced that, in future, it would be more vigilant regarding prohibited price agreements. This also seems to match the new line of the European Commission, which, until recently, did not prioritise this subject either.

Law stated - 1 May 2025

OFFER AND SALE OF FRANCHISES

Legal definition

12 | What is the legal definition of a franchise?

In the Franchise Act, effective from 1 January 2021, the term 'franchise' has not been explicitly defined, but both 'franchise agreement' and 'franchise formula' are defined terms.

A 'franchise agreement' is defined as follows in article 911(1) of the Franchise Act:

> an agreement pursuant to which the franchisor grants a franchisee, in return for a fee, the right and the obligation to operate a franchise formula, in the manner indicated by the franchisor, for the production or sale of goods or the provision of services.

A 'franchise formula' is defined as follows in article 911(2) of the Franchise Act:

- an operational, commercial, and organisational formula for the production or sale of goods or the provision of services that is decisive for a uniform identity and image of the franchise enterprises within the chain where this formula is applied, and that in any case comprises:
- a trademark, model or trade name, house style or design; and
- know-how: i.e. an entirety of practical information not protected by intellectual property rights, derived from franchisor's experience and from the investigations it has carried out, which information is secret, substantial, and identified[.]

Law stated - 1 May 2025

Laws and agencies

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

There were numerous discussions about the need for a franchise law or franchise code in the Netherlands. At the beginning of 2015, the Ministry of Economic Affairs appointed a committee to prepare the Dutch Franchise Code, which was finalised in February 2016. The intention of the Ministry was that franchisors and franchisees in the Netherlands could voluntarily follow this code. However, a large majority of the franchisors opposed and rejected the Franchise Code, refusing to apply it to their franchise contracts.

At the end of 2016, the Ministry proposed a draft franchise bill that would declare the Franchise Code mandatory law. This draft franchise bill was rejected by many stakeholders during the consultation phase. The newly installed Dutch government indicated, in October 2017, that it wanted to introduce new legislation in the field of franchising to enforce the position of franchisees in the pre-competitive phase. On 12 December 2018, Mona Keijzer, the Under-Secretary of Economic Affairs and Climate, presented a new draft bill on franchises to the franchise sector for consultation. It has become an independent act that does not relate any more to the widely criticised Franchise Code. This Franchise Act was adopted by the Dutch parliament and senate in mid-2020 and came into force on 1 January 2021.

Law stated - 1 May 2025

Principal requirements

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

Long a country where franchising was not regulated at all, the Netherlands has become one of the most highly regulated countries in the world with regard to franchising. Of all the requirements under the Franchise Act, seeking consent from the majority of the franchisees to innovate and change the franchise formula but also to start with a derived formula may become the greatest challenge for franchise formulas. According to article 911(2) of the Franchise Act, a 'derived formula' is an operational, commercial and organisational formula that:

- is decisive for a uniform identity and image of the enterprises in which this formula is applied;
- corresponds to a franchise formula in one or more distinctive features that are recognisable to the public; and
- is used directly or through third parties by a franchisor for the production or sale of goods, or the provision of services that are wholly or largely the same as the goods or services covered by the franchise formula within the meaning of the preceding bullet point.

A consequence of a derived formula could be that it competes with a franchisee’s business operation.

Regarding the maintenance of the franchise relationship between franchisor and franchisee, the general obligation for them to behave as a 'good franchisor 'and a 'good franchisee’ toward each other is stipulated in the Franchise Act. Furthermore, the provision of assistance and commercial and technical support by the franchisor to the franchisee is one of the core elements of a franchise relationship.

Other principal requirements are:

- providing prospective franchisees with financial information, either historically if available for the franchisee's location or for similar locations, wherein the franchisor must explain why it has decided that the locations are similar and where it may deviate (this could lead to prognosis claims later on when results at the franchisee's location are lower than projected);
- sharing financial information with franchisees during the co-operation, including how the fees contributed by the franchisees are being spent and arguably also kick-backs or bonuses provided by suppliers, but guidelines on this are not currently explicit;
- agreeing on a goodwill calculation in the franchise agreement; and
- complying with non-compete restrictions.

Law stated - 1 May 2025

Franchisor eligibility

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

There are no specific requirements that must be met before a franchisor may offer franchises.

Law stated - 1 May 2025

Franchisee and supplier selection

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

Good franchising practice suggests that the franchisor should employ a careful process for recruiting and selecting franchisees, as the franchisor and its other franchisees may be negatively impacted by the improper operation of that franchise formula by an incompetent franchisee. This can damage the image and strength of the franchise chain and is therefore not compatible with good franchising practice.

Law stated - 1 May 2025

Pre-contractual disclosure – procedures and formalities

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

The Franchise Act puts far-reaching disclosure obligations on a franchisor in the pre-contractual phase towards the prospective franchisee. This includes any information that is or could reasonably be relevant and this information should enable the franchisee to make a well-considered decision to enter into a franchise agreement. The franchisee provides the franchisor with timely information about its financial position, insofar as it is reasonably relevant to enter into the franchise agreement. According to the explanatory memorandum accompanying the Franchise Act, the information should be clear, comprehensible, unambiguously formulated and tailored to the average franchisee. As an example, the explanatory memorandum suggests the addition of an explanatory note in the franchise agreement that explains the most important rights and obligations in the franchise agreement and their impact. This information should be provided at least four weeks prior to entering into the franchise agreement. During this standstill period, it is not allowed to amend the draft franchise agreement, unless such amendment is to the benefit of the prospective franchisee. It is also not possible for the franchisor to request investments or other payments from the franchisee in view of the upcoming franchise relationship. The standstill period enables the prospective franchisee to fulfil its duty of investigation, to assess all the documents, to engage an expert, and to come to further questions or obtain further consultation about the content and the implementation of the franchise agreement. Since the franchise disclosure document contains the franchisor's confidential information, the prospective franchisee can be obliged to sign a non-disclosure agreement before receiving the franchise disclosure document.

Law stated - 1 May 2025

Pre-contractual disclosure – content

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

The prospective franchisee must provide the franchisor with timely information about his or her financial position if it is reasonably relevant to enter into the franchise agreement. Furthermore, the franchisor must provide the prospective franchisee, in a timely manner, with:

- the draft of the franchise agreement, including its appendices;
- a statement of the content and scope of rules regarding fees, surcharges, or other financial contributions to be paid by the franchisee or regarding the investments required from the franchisee; and
- information about:
    - the manner and frequency of any consultation between the franchisor and the franchisees and, if available, the contact details of the body representing the franchisees;
    - the extent to and the manner in which the franchisor can enter into competition with the franchisee, including whether this may be by means of a derived formula; and
    - the extent to, the frequency with and the manner in which the franchisee will have access to turnover-related data relating to the franchisee or relevant to the franchisee's business operations.

In addition, the franchisor must provide the prospective franchisee with the following information (if available to the franchisor, to a subsidiary or to a group company affiliated with the franchisor) in a timely manner if it is reasonably relevant to the conclusion of the franchise agreement:

- information about the franchisor's financial position; and
- financial data regarding the intended location of the franchise enterprise or, if such information is not available, financial data of one or more enterprises considered by the franchisor to be comparable, along with information from the franchisor making it clear the reasons why he or she considers them to be comparable.

Furthermore, the franchisor must provide the prospective franchisee with all other information that he or she knows, or can reasonably assume, to be relevant for the conclusion of the franchise agreement.

Law stated - 1 May 2025

Pre-sale disclosure to sub-franchisees

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

In the Franchise Act and its explanatory memorandum, the situation of sub-franchising and the rights and obligations of the involved parties are not mentioned. Also, as there is currently no case law available on this subject, it is unclear how courts will address sub-franchising. However, it seems to be most logical that the party who concludes the franchise agreement with the sub-franchisees will be the party obliged to fulfil all disclosure requirements. This will generally be the sub-franchisor.

Law stated - 1 May 2025

Due diligence

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

Good franchising practice suggests that the franchisor must employ a careful process for recruiting and selecting franchisees. After all, the franchisor and other franchisees operating the franchise formula in question may be negatively impacted by improper operation of that franchise formula by an incompetent franchisee. This can damage the image and strength of the franchise chain and is therefore not compatible with good franchising practice.

Incidentally, the provision of information is not a one-way street. The prospective franchisee has an obligation to provide the franchisor with timely information about its financial position 'to the extent reasonably relevant to the conclusion of the franchise agreement', as stipulated in article 913(3) of the Franchise Act. The franchisee also has a special duty of investigation. The franchisee is obliged, within the limits of reasonableness and fairness, to take necessary measures to avoid entering into a franchise agreement under the influence of incorrect assumptions. This is intended to prevent the franchisee from relying solely on communications from the franchisor. In doing so, the franchisee may be expected to maintain a critical attitude. In certain circumstances, this may involve the franchisee seeking external advice from trade associations or other experts.

Law stated - 1 May 2025

Failure to disclose – enforcement and remedies

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

The Franchise Act is mandatory law. Deviating from the main provisions in a franchise agreement to the disadvantage of a franchisee operating in the Netherlands is not permitted. Such deviating clauses are invalid. If the franchise agreement contains deviating clauses, they cannot be invoked. When the franchisor does not provide the franchisee with the required information, either before the conclusion of the franchise agreement or thereafter, this could render the franchisor liable for any decisions that the franchisee makes without knowledge of such information when afterwards the franchisee claims that, with the required information, it would have decided otherwise or maybe would not even have concluded the franchise agreement. Consequently, the franchise agreement itself could be annulled and the franchisor may be compelled to compensate the franchisee for all fees paid, investments and costs made in the execution of the franchise agreement. The franchisee usually has three years to nullify all or part of the franchise agreement, which would require undoing the services rendered back and forth (including all payments, investments and costs made).

Another risk arises when a franchisor does not request the consent of its franchisees for certain changes (eg, changes to the franchise formula, required investments, additional costs, or changes that may impact the revenue of the franchisees or the development and implementation of a derived formula) and the franchisees are of the opinion that those changes will have a negative financial impact. In these cases, the franchisees (either individually or with other franchisees) may claim damages or costs as a result of the decision made by the franchisor. The franchisees may also try to stop the franchisor from implementing new elements, decisions or a derived formula by requesting court intervention, for example, a preliminary injunction, with the argument that the franchisees had not given their consent for these changes. The court could rule that the franchisor is not at liberty to implement certain changes and could be subject to penalties.

Law stated - 1 May 2025

Failure to disclose – apportionment of liability

22

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

In the Franchise Act and its explanatory memorandum, the situation of sub-franchising and the rights and obligations of the involved parties are not mentioned. Also, as there is currently no case law available on this subject, it is unclear how courts will address sub-franchising. However, it seems logical that the party who concludes the franchise agreement with the sub-franchisees will be the party obliged to fulfil all disclosure requirements. This will generally be the sub-franchisor.

Under Dutch law, private companies with limited liability and public companies limited by shares both have legal personality. In principle, therefore, liability rests with the business and not with individual officers, directors or employees. Individual officers or directors are exposed to liability only in the event of improper management on their part that amounts to personal culpability of the directors. The burden of proof rests on the franchisee.

Law stated - 1 May 2025

General legal principles and codes of conduct

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

General civil law principles

In addition to the Franchise Act, the general laws of contract apply, as well as Dutch court decisions. Book 6 of the Dutch Civil Code sets out the requirements relating to the formation of contracts. These provisions must be read in conjunction with the more general rules regarding juridical acts; that is, acts intended to invoke legal consequences provided in Book 3 of the Dutch Civil Code. In the legal literature and jurisprudence, certain rules of law in relation to franchises have been developed. It is important to be aware that all contracts concluded under Dutch law are subject to the general requirements of reasonableness and fairness.

EU and Dutch competition laws

Besides the Franchise Act and general civil law aspects, European and Dutch competition laws play an important role. The new Vertical Block Exemption Regulation is very important in this respect, as well as the Guidelines thereto. The Dutch Competition Authority ensures compliance with European and Dutch competition laws and recently announced it will intensify its efforts to enforce those vertical rules.

European code of ethics

Franchisors who are members of the Dutch Franchise Association are bound by the rules in the European Code of Ethics for Franchising drawn up by the European Franchise Federation.

Law stated - 1 May 2025

Fraudulent sale

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

Besides the options under the Franchise Act and general civil law, a franchisee could benefit from the Acquisition Fraud Act and its possible consequences for the franchise practice. This act provides that a person acting in the course of a profession or business is acting unlawfully towards another professional party if he or she makes statements to the other party that are misleading in one or more respects. Incidentally, it is not only misleading if untruths are told, but also if essential information is omitted, such as information that the other party needed precisely to make an informed decision about the transaction in question. This act dictates that the party that made the announcements must state and prove that the announcements were correct and complete. In contrast to the 'normal' law of evidence, the other party is not obliged to prove that these communications were incorrect or incomplete. This results in a significant easing of the burden of proof for the injured party.

If a franchisor engages in fraudulent or deceptive practices, the franchisee may base a claim for annulment of the contract against the franchisor due to deceit, error or misrepresentation. If the actions or omissions of the franchisor also qualify as a civil tort, which is always accepted in cases of deceit, the franchisor has an obligation to compensate all of the franchisee's damages.

Law stated - 1 May 2025

FRANCHISE CONTRACTS AND THE FRANCHISOR/FRANCHISEE RELATIONSHIP

Franchise relationship laws

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

The Franchise Act, which came into effect on 1 January 2021, also regulates how the parties should act towards each other during the course of the franchise agreement. Namely, the franchisor should provide the franchisee with information during the relationship and both parties need to act as a 'good franchisor' and a 'good franchisee' respectively. This latter concept is comparable with a principle that already existed in Dutch civil law that parties need to act reasonably and fairly towards each other, and take into account the other parties' interests.

Law stated - 1 May 2025

Operational compliance

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

It is common in franchise relationships to incorporate operational procedures and brand standards in manuals with the obligation in the franchise agreement on franchisees to comply with these manuals. In addition, often franchise agreements contain reporting and information obligations on the franchisee. Inspection and audit rights are less common, but can also be part of the franchise agreement.

Law stated - 1 May 2025

Amendment of operational terms

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

If the franchisor intends to alter the franchise formula using a provision contained in the franchise agreement or intends to have a derived formula (operated directly or through third parties) without amending the franchise agreement, and the franchisor requires from the franchisee an investment, fee, surcharge or other financial contribution or can reasonably foresee that the implementation will lead to costs or loss of turnover, the following applies.

If the required monetary contribution exceeds a certain financial threshold set out in the franchise agreement, the franchisor requires prior consent to implement the plan in question from:

- a majority of the franchisees established in the Netherlands with whom the franchisor has concluded a franchise agreement concerning the franchise formula; or
- each of the franchisees established in the Netherlands that are affected by the intended plan.

Examples of an alteration of the franchise formula are the introduction of new product groups or new services (or disposal thereof), focusing the franchise formula on new target groups and exploring new marketing channels. Loss of turnover will likely occur if the franchisor intends to exploit a derived formula within the exclusive territory of the franchisee. In that event, the franchisor competes with its franchisees by using a derived formula directly operated by the franchisor or through third parties. It is advisable to add a financial threshold to the franchise agreement to determine the discretion of the franchisor regarding the alteration of the franchise formula or the use of a derived formula. This amount can be tailored to the type of franchise, the relevant sector and supply chain, and the size of the franchise enterprise. However, the proposed financial threshold requires the consent of the franchisee. If the financial threshold is not specified in the franchise agreement, prior consent will always be required from franchisees, regardless of the extent of the required investment, financial contribution, or costs or loss of turnover. The franchisor can benefit from the presence of a representative body of franchisees to obtain the necessary consent from the majority (ie, at least 50 per cent) of the franchisees. This could be less time-consuming than obtaining consent from the individual franchisees concerned.

Law stated - 1 May 2025

Policy affecting franchise relations

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

The European Franchise Code (EFC) implemented by the Dutch Franchise Association (NFV) may affect the franchise relationship when the franchisor is a member of the NFV. For example, the EFC stipulates that the franchisor must provide the franchisee with initial training and continuing commercial and technical assistance during the entire term of the agreement.

Law stated - 1 May 2025

Termination by franchisor

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

Either party may have cause to terminate the franchise agreement in the case of a serious breach of obligations by the other party. The criteria for what constitutes a serious breach should be carefully considered before actually terminating, because Dutch courts have the discretion to decide that a certain circumstance does not qualify as a sufficiently serious breach, notwithstanding the fact that this may have been agreed by the parties in the franchise agreement.

In the case of termination of the franchise agreement by the franchisee without cause, a legal distinction should be made between contracts concluded for a definite and an indefinite duration. Contracts of definite duration can generally not be terminated before the end of the contract term unless the possibility to terminate early – without cause – has been specifically agreed upon. Early termination, in most situations, results in liability of the terminating party. If a franchisee terminates a contract for a definite term prematurely without cause, the franchisor can claim continued performance or damages. The damages could consist of lost royalties of the franchisor, calculated over the remaining term of the contract, and costs and investments that the franchisor was not able to redeem owing to the premature termination.

In the case of a contract for an indefinite duration, the leading view recently affirmed by the Dutch High Court is that the contract may in principle be terminated by either party. However, the franchisee must respect a reasonable notice period, the length of which depends on the circumstances of the matter. If the franchisee terminates a contract without cause or does not respect a reasonable notice period, the franchisor could claim continued performance during the period that should have been respected by the franchisee, or instead claim financial compensation for damages.

Law stated - 1 May 2025

Termination by franchisee

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

Either party may have cause to terminate the franchise agreement in the case of a serious breach of obligations by the other party. The criteria for what constitutes a serious breach should be carefully considered before actually terminating, because Dutch courts have the discretion to decide that a certain circumstance does not qualify as a sufficiently serious breach, notwithstanding the fact that this may have been agreed by the parties in the franchise agreement.

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Law stated - 1 May 2025

Renewal

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

In practice, franchise agreements are often continued without the conclusion of a new formal agreement, dependent on the arrangements in the pending franchise agreement. Under Dutch law, no formal or substantive requirements apply.

Law stated - 1 May 2025

Refusal to renew

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

Whether a franchisor may refuse to renew the franchise agreement with a franchisee depends primarily on the content of the agreement. Often, the possibilities and conditions for renewal are specified in the agreement. When there is no contractually agreed renewal mechanism, a franchisor may be able to terminate the relationship by not renewing the franchise agreement if it complies with a reasonable notice term. The franchisor may sometimes be required to compensate costs and investments of the franchisee and, in exceptional circumstances, a 'good reason' will be required. Furthermore, where the franchisor can prove that the franchisee is in breach of its material obligations, the franchisor may refuse to renew the agreement on the basis of breach of contract. In certain circumstances, the franchisor will be obliged to compensate the franchisee upon termination; for example, if the franchisor or a new franchisee takes over the franchise business, based on the Franchise Act the franchisor would be required to pay the franchisee a goodwill compensation. The calculation of the goodwill compensation should be specified in the franchise agreement.

Law stated - 1 May 2025

Transfer restrictions

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

A general provision regarding contract transfers is set out in the Dutch Civil Code. A contracting party may, only with the consent of the other party, transfer its rights and obligations under the contract to a third party. Therefore, a franchisee may transfer the franchise only with the franchisor's consent. Often the franchise agreement contains a right for the franchisor to refuse a transfer on objective grounds such as certain capabilities or its financial position. A franchisor will not normally refuse such a transfer where the third party meets the selection criteria. It can be contractually arranged that the franchisee should first offer the business to the franchisor on the same terms as those that the franchisee would offer to the third party. Based on the Franchise Act, the franchisor must pay the franchisee a goodwill compensation in the event that it takes over the franchise business.

Law stated - 1 May 2025

Fees

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

Franchising fees are not regulated by law. In practice, however, different types of franchise fees can be distinguished, for example:

- an entrance fee, which is a one-off payment that the franchisee pays to the franchisor and that represents a contribution towards the costs that the franchisor has incurred in the expansion of its chain and establishment of goodwill;
- a continuing franchising fee, which is a regular fee for the use of the franchise system, usually based on a percentage of profits that the franchisee has realised within a given term;
- a marketing fee, to cover marketing and promotion expenses; and
- IT fees for the use of certain technology or hardware.

When specific costs are being charged, according to the Franchise Act the franchisor is obliged to show and substantiate that those costs have actually been made.

Law stated - 1 May 2025

Usury

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

Under freedom of contract between professional parties, in principle, the parties are free to agree on the interest rates to be applied. If the parties did not agree on any interest rate, Dutch statutory trade interest applies automatically in the event of late payment. If no payment term has been agreed, then it is set automatically at 30 days after having received the invoice. On 16 March 2013, a new act entered into force, implementing Directive 2011/7/EU to prevent payment delays in commercial agreements. This act gives creditors more opportunities to recover their claims. Even though professional parties can agree upon payment terms, the act dictates that only in exceptional circumstances can a payment term longer than 60 days be agreed upon. When acting with governmental agencies, the maximum payment term should be 30 days and only in exceptional circumstances can it be longer than this, but it may never exceed 60 days. Based on this act, a creditor can claim a minimum compensation of €40 for the costs of recovery. Under this act, the statutory trade interest is increased by 1 per cent. This act does not apply to transactions with private consumers.

The Dutch statutory interest rate in commercial matters as of 1 January 2025 amounts to an annual percentage of 11.15 per cent. For transactions with consumers, a lower annual interest rate of 6 per cent applies.

Law stated - 1 May 2025

Foreign exchange controls

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

In principle, there are no laws or regulations restricting this ability, unless there are sanctions in place regarding certain states or the inhabitants thereof.

Law stated - 1 May 2025

Confidentiality covenant enforceability

37 | Are confidentiality covenants in franchise agreements enforceable?

Confidentiality covenants in franchise agreements are, in principle, enforceable. The franchisee typically commits itself for the duration of the contract (and following its termination) to keeping all details of the franchisor's business operations confidential. This typically extends to non-patented know-how materials. The franchisee is legally obliged to treat certain information received from the franchisor as confidential, according to the law on the protection of business secrets that has been in force since 17 October 2018. This law is based on Directive 2016/943/EU on the protection of undisclosed know-how and business information (trade secrets) against their unlawful acquisition, use and disclosure. Although there may be a legal obligation to keep certain information confidential, it is still recommended to include a clear confidentiality clause in the franchise agreement, including a penalty clause in the event of confidentiality breaches. The courts have the right to mitigate such penalties and this right cannot be contractually excluded.

Law stated - 1 May 2025

Good-faith obligation

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

In the Netherlands, general civil law is governed by the principles of reasonableness and fairness. In the Franchise Act, this is made specific with the introduction of the obligation that the franchisor must act as a 'good franchisor' and the franchisee must act as a 'good franchisee'. Those principles may not only supplement the existing contract and relationship, but may also derogate from the contract that the parties agreed upon at an earlier stage, in the event that such provision is, in the given circumstances according to the principle of reasonableness and fairness, unacceptable. The standard required to derogate from an agreed provision is high. Franchisors in particular should be aware that a provision in an existing contract that is very one-sided (eg, a provision that the franchise relationship may be terminated by the franchisor at any given moment, respecting a notice term of only 30 days), could be set aside by the principle of reasonableness and fairness, if such provision is unacceptable in the given circumstances.

It is not possible to predict what kind of provisions may be set aside, if any, as the courts consider all relevant circumstances, including:

- the economic power of each party;

- the dependency of the parties from each other;
- the duration of the contract;
- the investments made by either party;
- what each party could reasonably expect from the other party; and
- all other relevant circumstances.

As a general rule, Dutch courts tend to protect weaker or smaller parties at the expense of economically stronger or larger parties. However, this certainly does not mean that, simply by being a weaker party, certain clauses will be set aside. This depends on all the circumstances of the matter.

Law stated - 1 May 2025

Franchisees as consumers

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

When dealing with a very small franchisee, there is a possibility that general conditions – even potentially including a standard franchise agreement, or a part thereof – may be annulled because of reflex action of articles 6:236 to 6:238 of the Dutch Civil Code. Those articles deal with the 'black' and 'grey' lists, which set out prohibited clauses in general conditions for consumers.

Law stated - 1 May 2025

Language of the agreement

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

The parties may agree to draw up contracts in whichever language they choose. However, based on the Franchise Act, it is arguable that disclosure documents, the franchised agreement and any related documentation should be made available in a language that the franchisee understands.

Law stated - 1 May 2025

Restrictions on franchisees

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

Some provisions (eg, exclusive territories, restrictions on sources from whom a franchisee may purchase or lease goods or services, prohibitions on franchisees soliciting the franchisor's or other franchisees' employees, non-competition, governing law, dispute resolution, etc) are commonly placed on the franchisees in a franchise agreement. However, based on EU and Dutch competition laws, certain provisions would be void, for example, restrictions on the group of customers or price fixing.

Law stated - 1 May 2025

Courts and dispute resolution

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

Franchise agreements generally contain a dispute resolution clause, in which a competent court or a form of arbitration is explicitly chosen. Arbitration through the Netherlands Arbitration Institute (NAI) is well regarded and is generally less expensive than the internationally better-known International Chamber of Commerce (ICC) arbitration.

In cases where there is no valid arbitration provision, the sub-district court is competent in smaller claims (ie, for amounts less than €25,000) and for particular issues, such as employment and rent-related disputes. Larger claims may be brought before the civil judge of the district court.

Qualified registered mediators can assist with mediation for parties seeking out-of-court remedies.

The Netherlands Commercial Court (NCC) was created on 1 January 2019. It is a chamber of the Amsterdam District Court before which parties may litigate in the English language. A matter may be submitted to the NCC where:

- the Amsterdam District Court or Amsterdam Court of Appeal has jurisdiction;
- the parties have expressly agreed in writing that proceedings will be in English before the NCC;
- the action is a civil or commercial matter within the parties' autonomy; or
- the matter concerns an international dispute.

Law stated - 1 May 2025

Governing law

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

Franchisors cannot derogate from the Franchise Act in a franchise agreement, even if foreign law has been agreed upon, when franchisees are operating in the Netherlands. If Dutch law is applicable but a franchisee is located outside the Netherlands, the franchisor may deviate from the franchise agreement to the detriment of a franchisee.

Law stated - 1 May 2025

Arbitration – advantages for franchisors

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

The principal advantages of arbitration are as follows:

- Arbitration offers a choice regarding the language of proceeding – the regular courts in the Netherlands accept only the Dutch language (with the exception of the NCC);
- It is possible to agree on the country and area where the proceedings will be conducted;
- It is possible to choose the number of arbitrators and the time limitations;
- Arbitration is, generally speaking, finalised more quickly than regular court procedures;
- Arbitration may be dealt with by appointed experts instead of or in addition to lawyers; and
- Parties involved can agree to observe secrecy in arbitration, whereas regular court proceedings are public.

The principal disadvantages of arbitration are that, in general, arbitration is much more expensive than regular court proceedings, regular court proceedings offer the possibility of appeal whereas arbitration does not, and the quality of arbitration may not always be ensured. This depends on the arbitration forum, although NAI and ICC arbitration in general is of good quality.

Law stated - 1 May 2025

National treatment

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

In principle, there is no difference in the treatment of foreign and domestic franchisors. However, the Franchise Act states that franchisors with franchisees operating outside the Netherlands should be able to deviate from the binding provisions in the Franchise Act, even when Dutch law is applicable to the franchise agreement. Franchisors with franchisees operating in the Netherlands are not allowed to deviate from the binding provisions in the Franchise Act, even when another (foreign) law system is applicable to the franchise agreement.

Law stated - 1 May 2025

UPDATE AND TRENDS

Legal and other current developments

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

The Franchise Act has been in effect since 1 January 2021 and is enforceable from that date onwards against all new franchise agreements, as well as for renewals. The transitional period of two years has expired and since 1 January 2023, all franchise agreements, including already existing franchise agreements, must fully comply with the Franchise Act.

Law stated - 1 May 2025

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Summary

FRANCHISE CONTRACTS AND THE FRANCHISOR/FRANCHISEE RELATIONSHIP

UPDATE AND TRENDS

MARKET OVERVIEW

Franchising in the market

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

Franchising is common place in South Korea and is growing every year. According to statistical data provided by the Korea Fair Trade Commission (KFTC), in 2024 there were 12,377 registered brands owned by 8,802 franchisors and operated at 365,014 franchised units. Statistical data demonstrates a 0.5 per cent increase in the number of franchisors and a 3.4 per cent increase in the number of franchised units compared to 2023. The number of registered brands decreased for the first time since 2019. Meanwhile, the industries with the highest growth rate of franchising were the food services industry, followed by the services (eg, transportation, hair salons) and retail industries (eg, convenience stores).

Law stated - 15 May 2025

Associations

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

The Korea Franchise Association (KFA) is a non-profit organisation licensed by the Ministry of Trade, Industry and Energy. Its role is to promote the sound development of the franchise industry, enable mutual growth between franchisors and franchisees, and assist with the globalisation of national brands. A franchisor that has registered its disclosure document with the KFTC can join the KFA and must comply with the KFA's rules of ethical conduct.

Law stated - 15 May 2025

BUSINESS OVERVIEW

Types of vehicle

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

In South Korea, the business forms relevant to a typical franchisor are stock companies, limited liability companies and limited companies. While the most common type of business entity in South Korea is a stock company, foreign investors occasionally opt for limited liability companies or limited companies.

Law stated - 15 May 2025

Regulation of business formation

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

The Korean Civil Act and the Commercial Act are the main statutes governing the formation of business entities. In addition, the Foreign Investment Promotion Act relates to the formation of business entities from foreign investment.

The Korean Court Registry Office, the National Tax Service and the Ministry of Trade, Industry and Energy are the main agencies related to the formation of business entities in South Korea.

Law stated - 15 May 2025

Requirements for forming a business

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

A business entity is established on registration with the Korea Court Registry Office and National Tax Service by submitting the required documents. There is no minimum paid-up capital for a stock company, a limited liability company or a limited company. To enjoy benefits as a foreign-invested company under the Foreign Investment Promotion Act, the amount of invested capital must be at least 100 million won, and the foreign investment must be reported to the Ministry of Trade, Industry and Energy. In practice, the reports are received by designated foreign exchange banks or the Korea Trade-Investment Promotion Agency.

Law stated - 15 May 2025

Restrictions on foreign investors

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

A foreigner may freely carry on foreign investment activities in South Korea without being subject to any restrictions unless otherwise specifically restricted by the Foreign Investment Promotion Act or other laws or regulations.

Although general foreign investment is not prohibited or restricted, a foreigner cannot make an investment in South Korea in the following circumstances:

- where it interferes with national security or disrupts public order;
- where it causes harm to the health and safety of nationals or is markedly contrary to public morals and decency; or
- when it violates South Korean laws and regulations.

Law stated - 15 May 2025

Taxation

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

The principal taxes affecting business enterprises in South Korea include corporate income tax, individual income tax, value-added tax, customs duties and the local income tax levied on corporate income tax. Specifically, non-resident corporations with a permanent establishment in South Korea are taxed only to the extent of their South Korea-sourced income, while non-resident corporations without a permanent establishment in South Korea are generally taxed through a withholding tax on each separate item of income that is subject to withholding tax. Thus, a non-resident franchisor without a local presence is subject only to withholding tax, with the relevant tax rates limited to the rates stipulated in the tax treaty between South Korea and the country in which the franchisor resides.

Law stated - 15 May 2025

Labour and employment

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

Under the Korean Civil Act, an employer is vicariously liable to third parties for damages caused by the acts or omissions of employees committed during the performance of work that is directed or supervised by the employer. Therefore, if a franchisee or its employee is deemed to be an employee of the franchisor, the franchisor may be held liable for damages to a third party caused by the franchisee or the franchisee's employee during the performance of his or her work.

To reduce the risk of such liability, it is advisable for the franchisor not to be involved with the specifics of the franchisee's management and to specify in the franchise agreement that the franchise will be operated by the franchisee as an independent entity from the franchisor. Given that a franchisor and a franchisee are generally independent entities, and therefore the franchisee is not subject to the direction or supervision of the franchisor, it is unlikely that the above liability will be imposed on the franchisor.

Law stated - 15 May 2025

Intellectual property

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

South Korea is a first-to-file jurisdiction. In principle, the Trademark Act does not protect unregistered marks. Therefore it is advisable for franchisors to register their trademarks with the Korean Intellectual Property Office (KIPO) pursuant to the Trademark Act when seeking to enter into franchise arrangements in South Korea. To be eligible for registration, a trademark must have a distinctive feature that enables traders and consumers to distinguish the goods or services to which it applies from another party's goods or services. In addition, when filing a trademark application, the trademark applicant is required to designate goods or services according to the Nice Classification (34 classes of goods and 11 classes of services under the 11th edition of the Nice Classification). Once the registration is granted, the trademark owner may seek to enforce the trademark rights against third-party infringements by seeking injunctive relief against further infringement, damages or an order for the destruction of the infringing goods.

It is not mandatory for the trademark licence to be registered (ie, recorded) with the KIPO. However, if recorded, the trademark licence becomes effective against any third party that subsequently acquires the trademark right or an exclusive licence.

In addition to the Trademark Act, the Unfair Competition Prevention and Trade Secret Protection Act is available to protect well-known but unregistered trademarks, trade secrets and know-how.

Law stated - 15 May 2025

Real estate

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

Foreign nationals can acquire real property located in South Korea with a simple report of the acquisition to the relevant local government office under the Act on Report on Real Estate Transactions. If a foreign national is a non-resident as stipulated in the Foreign Exchange Transactions Act, he or she would also need to make a report on real estate acquisition to a foreign exchange bank, with a few exceptions where a report must be submitted to the Bank of Korea.

In practice, most franchisees lease, rather than own, the real estate in which they operate their franchised units.

Law stated - 15 May 2025

Competition law

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

The Monopoly Regulation and Fair Trade Act is the primary competition statute in South Korea, and it applies to franchise relationships (eg, establishing resale price maintenance, prohibiting product tying and imposing minimum sales targets).

Law stated - 15 May 2025

OFFER AND SALE OF FRANCHISES

Legal definition

12 | What is the legal definition of a franchise?

Under the Fair Transactions in Franchise Business Act (the Franchise Act), a 'franchise' is defined as:

> a continuous business relationship in which a franchisor allows the franchisee to use its own trademarks, service marks, trade names, signs, or any other trademarks (collectively, 'Business Marks') in selling goods (including raw materials and auxiliary materials; hereinafter the same shall apply) or services in compliance with certain quality standards or business methods, and supports, trains, and controls its franchisees in regards to relevant management and business activities, and in which franchisees pay required payments to their franchisor in return for the use of the Business Marks and the support and training provided for their management and business activities.

Law stated - 15 May 2025

Laws and agencies

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

The Franchise Act, which was enacted on 1 November 2002 and most recently amended on 21 January 2025 with immediate effect, and its Presidential Decree are the primary statutes applicable to the franchisor/franchisee relationship. Additionally, the Monopoly Regulation and Fair Trade Act and regulations promulgated by the Korea Fair Trade Commission (KFTC) are generally applicable. In 2024, the KFTC also issued a set of Guidelines for Assessing Unfair Business Practices in the Franchise Industry (the Franchise Guideline), effective from 24 March 2024. The Franchise Guideline provides an overview of unfair trade practices in the franchise industry through specific examples of each type of unfair trade practice in violation of the Franchise Act.

The KFTC regulates franchises in South Korea. It maintains a franchise-specific department, the Korea Fair Trade Mediation Agency, and has the authority to impose administrative measures against franchisors that engage in unfair activities. In this regard, the KFTC has the discretion to determine the unfairness or reasonableness of the activities of the franchisor, to levy penalties and to issue corrective orders against those violators depending on the nature and degree of the unfair activity. However, the violator may seek a district court's judicial review of the KFTC's findings.

Law stated - 15 May 2025

Principal requirements

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

The Franchise Act is a pre-sale disclosure and registration law and is the primary law governing the franchisor/franchisee relationship in South Korea. It seeks to provide a framework for building a fair and equal business relationship between the parties involved in franchising.

Law stated - 15 May 2025

Franchisor eligibility

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

Pursuant to the Franchise Act, only franchisors with experience operating at least one directly managed store (either inside or outside of South Korea) may offer a franchised business to others. This threshold requirement must be satisfied for a franchisor to prepare and register a franchise disclosure document to engage in the sale of franchises in South Korea.

However, this amendment provides exceptions for the following cases:

- franchisors that operate franchised businesses with permission or licence under other laws and regulations;
- franchisors that have at least one year of experience in operating a business in the same industry as the franchised business inside or outside of South Korea; and
- franchisors whose businesses have been verified by the KFTC even if they have no experience in operating directly managed stores.

Law stated - 15 May 2025

Franchisee and supplier selection

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

The Franchise Act requires a franchisor to expressly grant a franchisee an exclusive business territory in the franchise agreement. Specifically, the franchisor must define the business territory for the franchised unit pursuant to an agreed-upon criterion (eg, geographic scope) and stipulate the business territory in the franchise agreement. During the term of the franchise agreement, the franchisor cannot establish a company owned, affiliate-owned or franchised unit of the same type of business within the protected business territory of the franchisee.

The 'same type of business' means a business that would be considered the same as the franchise business in light of various factors, including the target class, territorial boundary, population boundary, types of products and services sold, and business manner and method, and is determined on a case-by-case basis.

The Franchise Act does not provide particular restrictions on the franchisor's selection of suppliers. However, the Presidential Decree requires the franchisors to disclose information on any items that must be purchased either from the franchisor or its designated suppliers, including any price obtained by the franchisor that exceeds the reasonable wholesale price. The Franchise Act requires for franchise agreements to specify the types of mandatory purchase items and their supply price. Furthermore, in June 2024, the KFTC issued the Guidelines on Specifying Mandatory Purchase Items and Supply Price Calculation Method in the Franchise Agreement, which illustrate how to specify the mandatory purchase items, their supply price, the criteria for setting the supply price, the reasons for and frequency of adjusting the supply price, and the effective date of the supply price in franchise agreements. In addition, the Presidential Decree, effective since 5 December 2024, introduced a new requirement for franchisors to consult with franchisees prior to making unfavourable modifications to transaction conditions for mandatory purchase items.

Law stated - 15 May 2025

Pre-contractual disclosure – procedures and formalities

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

The Franchise Act requires a franchisor to register a disclosure document and provide it to its prospective franchisees, master franchisees and area developers before entering a franchise relationship. The disclosure procedure is as follows:

- a franchisor must provide a disclosure document even if the franchisee does not specifically request it in writing;
- in providing the disclosure document to a prospective franchisee, a franchisor must register the disclosure document with the KFTC and, thereafter, provide the registered disclosure document to the prospective franchisee; and
- the acceptance of franchise fees or execution of a franchise agreement is prohibited unless the franchisor has provided the registered disclosure document and 14 days (seven days if the prospective franchisee has been advised by counsel or a franchise broker) have elapsed from the date of providing the registered disclosure document.

The disclosure document may be delivered to a prospective franchisee by:

- providing the disclosure document (hard copy) directly or sending it by content-certified mail to the prospective franchisee;
- providing the disclosure document via access to the internet; or

- emailing the disclosure document in an electronic file to the prospective franchisee that is capable of a 'read-receipt' confirmation.

Regarding the update of the disclosures, a franchisor must register (or report) any changes in the disclosure document with the KFTC. Depending on the type of information that has been changed, deadlines for filing the report thereto range from within 30 days of the occurrence of the cause of the change to within 30 days of the expiration of the quarter in which the cause of the change has occurred. Furthermore, the franchisor has an obligation to update the disclosure document on an annual basis within 120 days of the expiry of each fiscal year.

Law stated - 15 May 2025

Pre-contractual disclosure – content

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

The disclosure document must disclose the following broad categories of information:

- information regarding the franchisor's general status;
- information regarding the current status of the franchisor's franchise (eg, the total number of company owned and franchised units in operation as of the most recent fiscal year's end);
- information regarding any legal violations of the franchisor and its executives;
- information regarding the franchisee's obligations;
- information regarding the conditions of, and restrictions on, the franchised business operations;
- detailed information regarding the procedure and period required to commence the franchised business;
- information regarding the franchisor's support regarding the management and operation of the franchised business;
- information regarding the franchisor's education and training; and
- information regarding the franchisor's directly managed stores.

In addition to delivering the disclosure document, the franchisor must prepare two additional documents to satisfy its pre-contractual disclosure obligations under the Franchise Act, respectively:

- a document containing information regarding the projected minimum and maximum sales revenue of the franchised unit for a period of one year after commencing operations, including the distance between the franchised units that served as the basis for calculating the sales projection and the prospective franchisee's contemplated franchised unit; and
- a document containing information regarding the 10 closest franchised units (eg, contact information, business name and location of the franchised units).

Law stated - 15 May 2025

Pre-sale disclosure to sub-franchisees

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

In a sub-franchising structure, the sub-franchisor must make pre-sale disclosures to sub-franchisees. The master franchisor need not provide a disclosure document to a sub-franchisee if the master franchisor is not in a contractual relationship with the sub-franchisee. In other words, a master franchisor has no obligation to provide a disclosure document if it is not a party to the franchise agreement or any other agreements with a sub-franchisee.

While a disclosure on the general status of the franchisor must be included in a disclosure document, neither the Franchise Act nor its Presidential Decree specifically requires that the information concerning the master franchisor be included in the disclosure document. However, given that the information on the contractual or other relationship between the master franchisor and the sub-franchisor may relate to the 'description of general status of the franchisor', depending on the circumstances it could be appropriate to include a brief summary of such information on the sub-franchising structure in the disclosure document.

Law stated - 15 May 2025

Due diligence

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

For franchisors seeking to offer their concepts in South Korea, it is advisable to carry out due diligence on the relevant market, business considerations, legal and regulatory materials (eg, registration and pre-contractual disclosure, and the franchisee's permits, licences or approvals for carrying out the franchise business) and the prospective franchisee (eg, full registered name and address, organisational structure, financial capability, involvement in past civil, criminal or administrative proceedings).

Law stated - 15 May 2025

Failure to disclose – enforcement and remedies

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

If there is a violation of any disclosure requirements, the franchisee may report such violation to the KFTC, and a franchisor that fails to register the disclosure document may face liability under the Franchise Act. First, the franchisor must refund any franchise fees collected if the franchisee makes a request for a refund within four months of the date of executing the franchise agreement. If a refund is due, the franchisor must make the refund within one month of the date of the franchisee's request. Second, the KFTC may order a corrective measure, which would include ordering the franchisor to register or carry out the disclosure of the disclosure document. The four possible corrective measures are an administrative warning, a recommendation to correct, a corrective order and an administrative fine. The administrative warning is the least severe corrective measure, and the administrative fine is the most severe. With respect to the administrative fine, the KFTC may impose a fine of up to 2 per cent of the total sales of the franchisor to the specific franchisee in South Korea for the duration in which the franchisor was not in compliance. In determining the amount of the administrative fine, the Franchise Act stipulates that the KFTC should consider the nature, severity, duration and frequency of the infraction, as well as the profits that the franchisor derived as a result of its non-compliance. Where the franchisor's total sales during the period of non-compliance are difficult to calculate, the Franchise Act provides that an administrative fine of up to 500 million won may be imposed.

Failure to comply with the requirement does not lead to automatic rescission or cancellation of the franchise agreement. However, the franchisee may bring a lawsuit for damages and cancel or rescind the franchise agreement under general principles of tort or contract law in accordance with the Korean Civil Act. If the franchisee is not adequately compensated through cancelling or rescinding the franchise agreement, the franchisee may be entitled to additional damages.

In connection with criminal penalties, the most severe penalty is reserved for fraud. The provision of false or exaggerated information or the omission of important items in a disclosure document required under the Franchise Act carries a penalty of up to five years' imprisonment or a fine of not more than 300 million won. Refusal to comply with the KFTC's orders to provide disclosure, if such orders are given, is also potentially subject to a serious penalty. Where disclosure is not provided, or where the disclosure is later reviewed by the KFTC upon the franchisee's request and found to be insufficient (but not fraudulent), the KFTC may demand that the franchisor provide proper disclosure materials. Failure to do so following the KFTC's corrective order may be punished with up to three years' imprisonment or a fine of up to 100 million won. Execution of a franchise agreement or acceptance of franchise fees within 14 days (seven days if the prospective franchisee has been advised by counsel or a franchise broker) of the delivery of the disclosure document is subject to a possible term of imprisonment of up to two years or a fine of up to 50 million won.

Law stated - 15 May 2025

Failure to disclose – apportionment of liability

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

A master franchisor has no duty to provide a disclosure document if it is not a party to the franchise agreement or any other agreement with a sub-franchisee. In this case, the sub-franchisor is solely liable for violations of any disclosure requirements.

The sub-franchisor's individual officers, directors and employees in principle have no responsibility for disclosure requirements. Having stated that, if they wilfully or negligently engage in a disclosure violation, they would be jointly liable with the sub-franchisor for civil damages, and if directly engaging in fraudulent or deceptive practices regarding disclosure, such individuals may face criminal penalties.

Law stated - 15 May 2025

General legal principles and codes of conduct

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

The general fair trade principles under the Monopoly Regulation and Fair Trade Act may affect the offer and sale of franchises. Also, the franchise agreement should not be contrary to the Act on the Regulation of Terms and Conditions. No rules, regulations, government agency codes or industry codes other than those of the KFTC may affect the offer and sale of franchises in South Korea.

Law stated - 15 May 2025

Fraudulent sale

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

In the case of a disclosure violation, the franchisee can report such violation only to the KFTC. However, fraudulent or deceptive practices by a franchisor may constitute fraud as stipulated under the Korean Criminal Code, and the franchisee may directly file a criminal complaint with the prosecutors.

The franchisee's remedies against the franchisor for deceptive or fraudulent business practices include:

- filing a civil suit for damages against the franchisor, with or without cancelling or rescinding the franchise agreement itself;
- reporting it to the KFTC so that the KFTC can determine whether to initiate criminal proceedings;
- requesting the KFTC to issue a corrective order or a fine against the franchisor; and
- directly filing a criminal complaint to the Prosecutor's Office.

Law stated - 15 May 2025

FRANCHISE CONTRACTS AND THE FRANCHISOR/FRANCHISEE RELATIONSHIP

Franchise relationship laws

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

The Franchise Act regulates the ongoing relationship between a franchisor and its franchisee after the franchise agreement comes into effect. Moreover, the general provisions of the Monopoly Regulation and Fair Trade Act apply in regulating the franchise relationship (eg, establishing resale price maintenance, prohibiting product tying and imposing minimum sales targets). Also, the newly introduced Guidelines for Assessing Unfair Business Practices in the Franchise Industry give an overview of unfair trade practices in the franchise industry.

Additionally, all business relationships are governed by the general principles set out in the Korean Civil Act and the Korean Commercial Act.

Law stated - 15 May 2025

Operational compliance

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

Generally, the franchisor includes inspection rights (eg, access to the premises of franchised units) and audit rights (eg, review of the accounts, books and records of the franchisee) in the franchise agreements as the primary mechanisms for ensuring operational consistency and adherence to brand standards.

Law stated - 15 May 2025

Amendment of operational terms

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

A franchisor may not unilaterally change operational terms and standards in a way that may be considered disadvantageous to the franchisee, as such conduct could be seen as an unfair trade practice under the Franchise Act.

Law stated - 15 May 2025

Policy affecting franchise relations

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

Primarily, the Korea Fair Trade Commission's (KFTC) guidelines affect the franchise relationship.

Law stated - 15 May 2025

Termination by franchisor

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

The Franchise Act does not provide specific grounds for terminating a franchise agreement. However, it stipulates the procedure that must be complied with to terminate a franchise relationship.

To terminate a franchise agreement in accordance with the Franchise Act, a franchisor is required to provide a first notice of breach (which states the grounds for the breach, requests a cure for such breach, and states that failure to cure will result in termination) to the franchisee. Once this first notice is given, a two-month cure period begins to run (and the franchisee's obligation to cure arises at this point). During the cure period, the franchisor must send another notice of the same breach to the franchisee. If the franchisee fails to cure the breach, the franchisor may terminate the franchise agreement at the end of the cure period.

Meanwhile, the Presidential Decree provides for nine exceptions to the above termination procedure and thereby allows for immediate termination of the franchise agreement by the franchisor. No other grounds for immediate termination are permitted under the Franchise Act. The nine exceptions are:

- a petition for bankruptcy is filed with respect to the franchisee (either by the franchisee or by a third party), the franchisee is adjudicated bankrupt, or rehabilitation or foreclosure proceedings commence against the franchisee;
- there occurs a suspension of payment of notes and cheques issued by franchisee, due to insolvency, etc;
- the franchisee cannot continue with the operation of any franchised unit in the territory due to an event of force majeure;
- the franchisee clearly damages the franchisor's reputation or credit, and causes significant harm to the franchise business, by receiving an administrative disposition for violating the applicable laws relating to the operation of franchised units, including:
    - an administrative order requiring the franchisee to remedy the violation;
    -

an administrative order imposing a penalty surcharge or fine on the franchisee for the violation; or
- an administrative order mandating the suspension of operation of the franchise business;

- the franchisee violates laws or regulations relating to the operation of any franchised unit and receives a cancellation order of qualifications, licence or approval, a business suspension order exceeding 15 days, or another administrative order that in nature cannot be corrected – provided that this shall not apply where an administrative fine, etc, has been imposed on the franchisee in lieu of such administrative order pursuant to any laws or regulations;
- the franchisee, after having cured the breach of the franchise agreement pursuant to the request from the franchisor, subsequently repeats the same breach within a period of one year, despite the franchisor having notified the franchisee in the notice of request to cure the first breach that, in the case of the same breach occurring after the cure, the franchise agreement could be terminated without providing the opportunity to cure;
- the franchisee has been subjected to criminal punishment for an act related to the operation of a franchise unit;
- the franchisee operates a franchised unit in a manner or form that clearly poses an imminent threat to public safety or health, and it is difficult to await corrective orders from the relevant authority; or
- the franchisee suspends business operations of any franchised unit for seven or more consecutive days without justifiable cause (as determined by the franchisor acting in good faith).

In addition, article 168-10 of the Commercial Act allows each party to terminate the franchise agreement under unavoidable circumstances by providing a prior notice to the other party within a set reasonable period, regardless of the duration of such franchise agreement. Therefore, the franchisor may terminate the franchise agreement based on the grounds that the purpose of the franchise agreement has been frustrated as a result of unforeseeable circumstances.

Law stated - 15 May 2025

Termination by franchisee

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

Under the Franchise Act, there are no restrictions with respect to franchisees terminating their franchise relationships. However, the franchisee may terminate a franchise agreement under the circumstances stipulated therein or in the case of default by the franchisor. Also, article 168-10 of the Commercial Act provides that a party to a franchise agreement may terminate the agreement under unavoidable circumstances by providing a prior notice to the other party within a set reasonable period, regardless of the duration stipulated in the franchise agreement. Therefore, the franchisee may terminate the franchise agreement based on the grounds that the purpose of the franchise agreement has been frustrated due to unforeseeable circumstances.

Law stated - 15 May 2025

Renewal

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

There are no formal (eg, stamp duty, notarisation or witnesses) or substantive requirements for renewals of franchise agreements.

Law stated - 15 May 2025

Refusal to renew

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

Under the Franchise Act, if a franchisee requests to renew a franchise agreement during the 90 to 180-day period prior to the expiration of such agreement, a franchisor may not deny such request without just cause. As exceptions, the franchisor can refuse renewal of the franchise agreement in the following cases:

- the franchisee has been in breach of a payment obligation;
- the franchisee rejects common obligations and duties that are generally accepted by other franchisees; or
- the franchisee has failed to observe important business policies of the franchisor that are deemed necessary for maintaining the franchise business, such as matters pertaining to the procurement of a store or necessary facility, or matters pertaining to the observance of production methods or service methods.

If the franchisee requests a renewal, the notice of refusal stating the reasons for non-renewal must be provided within 15 days of receipt of the renewal request. If the notice of refusal is not provided to the franchisee, or a written notice of non-renewal or change in terms and conditions for the renewal is not provided to the franchisee between 90 and 180 days prior to the expiration of the franchise agreement, the franchise agreement will be deemed to have been renewed under the same terms and conditions.

However, the franchisor's obligation to grant the renewal applies only if the term of the applicable franchise agreement, including the initial term and any subsequent renewal terms, does not exceed 10 years. If 10 years have elapsed, the franchisor may refuse to renew the franchise agreement regardless of its reasons.

Law stated - 15 May 2025

Transfer restrictions

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

The Franchise Act provides that the franchisee must first obtain prior written consent from the franchisor to assign the franchised business. The Commercial Act further states that, except for special circumstances, the franchisor must consent to the proposed transfer.

However, unless the parties have specifically agreed not to allow for the transfer of ownership interests in a franchisee, there are no restrictions on the franchisee's right to transfer ownership interests.

Law stated - 15 May 2025

Fees

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

The payment and receipt of certain types of fees are strictly regulated under the Franchise Act. Specifically, the Franchise Act proscribes the franchisor from receiving 'direct' payment of the following fees from the franchisee, which are referred to as 'initial franchise fees':

- consideration that the franchisee pays to the franchisor for management rights such as the permission to use the business marks or support and education for its operating activities, such as application fee, membership fee, franchise fee, education and training fee or down payment; and
- consideration that the franchisee pays to the franchisor to secure payment for goods supplied by the franchisor or compensation for damages.

The Franchise Act stipulates that the franchisor must require the franchisee to deposit – in escrow – the initial franchise fees to a financial institution prescribed by the Presidential Decree. Thereafter, the franchisor may request payment of the initial franchise fee from the financial institution either when the franchisee has commenced operations (eg, opened its franchised restaurant) or when two months have passed from the execution date of the franchise agreement, whichever is earlier.

Notwithstanding the foregoing, the franchisor may receive the above fees directly from the franchisee without depositing the initial franchise fee to a financial institution if:

- the franchisor subscribes to a compensatory insurance policy for loss to the franchisee; or
- the franchisor and the franchisee agree that the franchisor will receive the initial franchise fee after two months from the date of executing the franchise agreement, or after the franchisee commences operation (eg, opens its franchise unit), whichever is earlier.

In practice, it is difficult, if not impossible, to find a financial institution that will open an escrow account for the benefit of a foreign franchisor. Furthermore, with regard to compensatory insurance, there is only one insurance provider in South Korea – Seoul Guarantee Insurance Company – that will issue an insurance policy. To subscribe, the foreign franchisor must have a guarantor located in South Korea (an individual or a business entity) that would guarantee the amount of the insurance policy being purchased, but in practice, it is almost impossible for a foreign franchisor to get the insurance policy from Seoul Guarantee Insurance Company.

Given the difficulties in finding a South Korean financial institution and subscribing to compensatory insurance in South Korea, foreign franchisors seeking to receive the above fees directly from the franchisees often choose to defer the payment of those fees until two months have elapsed from the date of executing the franchise agreement or the franchisee commences operation of its franchised unit, whichever occurs earlier.

Law stated - 15 May 2025

Usury

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

No specific restrictions exist on the amount of interest that can be charged on overdue payments. However, if the interest is deemed excessive, it can be reduced by the South Korean courts if challenged.

Law stated - 15 May 2025

Foreign exchange controls

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

There are no laws or regulations restricting the ability of a franchisee to make payments to a foreign franchisor in the franchisor's domestic currency.

Law stated - 15 May 2025

Confidentiality covenant enforceability

37 Are confidentiality covenants in franchise agreements enforceable?

In principle, confidentiality covenants in franchise agreements are enforceable.

Law stated - 15 May 2025

Good-faith obligation

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

The parties to a franchise agreement have a general obligation to act in good faith. More specifically, the franchisee's duties are stipulated as follows under the Franchise Act:

- make sincere efforts to maintain the integrity of the franchise business and the reputation of the franchisor;
- maintain proper inventory levels and display goods in an appropriate manner in accordance with the franchisor's supply plan and consumer demand;
- meet appropriate quality standards of goods or services, as required by the franchisor;
- use commodities provided by the franchisor, if alternatives of the same quality do not exist;
- meet appropriate equipment of business facilities, exterior and transportation requirements imposed by the franchisor;
- consult in advance with the franchisor when it is considering a change of goods, services or business activities;
- maintain and provide data necessary for unified business management and sales strategy formulation by the franchisor to assist the franchisee;
- allow the entry of the franchisor's officers and employees or its designees to the franchisee's business premises to inspect books and records, among other things;
- refrain from relocating its place of business or transferring the franchise to a third party without the consent of the franchisor;
- refrain from engaging in a competitive business as the franchisor during the term of the franchise agreement;
- notify the franchisor of any infringements of business technology or trade secrets; and
- notify the franchisor of any business marks that may have been revealed to a third party and cooperate with the franchisor in protecting its business marks.

The franchisor's duties defined under the Franchise Act are as follows:

- devise business plans;
- make efforts to continue to develop the quality, products and sale management functions of the franchise;
- provide franchisees with equipment for franchised units, goods, or services at reasonable prices;
- provide training and education to franchisees and their employees;
- provide ongoing advice to franchisees on the management and operation activities;

- refrain from establishing directly managed stores in competition with the franchisee within the business territory; and
- make sincere efforts to resolve disputes arising with the franchisee.

Law stated - 15 May 2025

Franchisees as consumers

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

Franchisees are in general deemed to be independent entities from franchisors; therefore, there are no laws that specifically treat franchisees as consumers for the purposes of consumer protection.

Law stated - 15 May 2025

Language of the agreement

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

While no express provision in the Franchise Act requires the franchisor to draft the disclosure document in a certain language, the general practice of the KFTC is to only accept Korean-language versions of the disclosure document for registration. Thus, the franchisor must prepare the disclosure document in Korean.

Likewise, the Franchise Act does not require that the franchise agreement be written in Korean. However, it is advisable for foreign franchisors to offer Korean translations of franchise agreements to make it easier for South Korean franchisees to understand. In addition, as the KFTC requires a Korean translation in the case of a template franchise agreement being written in a foreign language, it is necessary to translate the template franchise agreement and all ancillary documents into Korean when filing for registration.

Law stated - 15 May 2025

Restrictions on franchisees

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

Franchise agreements often contain restrictions that regulate the protected business territories of each franchised unit, as well as non-competition, governing law and dispute resolution. However, there are no notable restrictions imposed by the Franchise Act on the franchisees on the provisions in franchise agreements.

Law stated - 15 May 2025

Courts and dispute resolution

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

Most franchising disputes in South Korea are resolved in the courts. The South Korean judiciary system is three-tiered and consists of the Supreme Court, the high courts (the appellate courts) and the regional district courts (the courts of first instance).

As an alternative method of dispute resolution, the parties may choose mediation or arbitration. Under the Franchise Act, a franchise transaction dispute mediation committee was set up. The committee may mediate matters related to disputes over franchise transactions if requested by the KFTC or by the parties in dispute.

The Korean Commercial Arbitration Board (KCAB) is the principal arbitration forum for arbitrating disputes. Arbitration before the KCAB is an alternative way of producing impartial and fair resolutions to commercial disputes.

Law stated - 15 May 2025

Governing law

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

There is no requirement for franchise documents to be governed by local laws. In fact, South Korean courts readily enforce foreign governing laws. However, some compulsory provisions of South Korean law might apply irrespective of the governing law as agreed by the parties in their contract.

Law stated - 15 May 2025

Arbitration – advantages for franchisors

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

Unlike litigation before the South Korean courts, arbitration awards are not appealable as arbitration resolves a dispute through a single proceeding. In addition, as arbitration procedures are not public, important information regarding the franchise transaction may be kept confidential.

Foreign companies contracting with South Korean companies tend to choose arbitration over court litigation for its perceived advantage as a neutral dispute resolution forum. In litigation, a party who is resident in or a national of the jurisdiction of the court is likely to be more familiar with its court system than a foreign party. In addition, as the judicial system in South Korea is based on a three-tier system, arbitration is usually regarded as more efficient in terms of time and money.

That said, arbitration proceedings can sometimes incur higher costs than court litigation. For example, when an arbitration related to a highly specialised area is being conducted, the cost of inviting expert witnesses and extensions of the arbitration period are the main causes of rising arbitration costs.

Law stated - 15 May 2025

National treatment

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

Aside from minor differences in connection with the obligation to report real estate acquisitions under the Act on Report on Real Estate Transactions and the relevant requirements under the Foreign Investment Promotion Act, foreign franchisors are not treated any differently from domestic franchisors.

Law stated - 15 May 2025

UPDATE AND TRENDS

Legal and other current developments

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

Modifications to Transaction Terms Regarding Mandatory Purchase Items

Effective from 5 December 2024, the amended Presidential Decree to the Franchise Act introduces a new requirement for franchisors to consult with franchisees before making unfavourable modifications to transaction terms. In relation to the foregoing, the Korea Fair Trade Commission issued an announcement to specify the types of modifications that are considered "unfavourable" to franchisees and illustrate the method of consultation with franchisees.

The announcement provides seven types of modifications that are considered unfavourable to franchisees:

- a modification that requires franchisee to purchase certain product from a specific counter-party when they previously were not required to;
-

a modification that increases the unit price of mandatory purchase item (excluding an automatic increase of supply price in accordance with the calculation method set out in the franchise agreement);

- a modification to the supply price calculation method of mandatory purchase item to the disadvantage of franchisee;
- a modification lowers the quality of mandatory purchase items;
- a modification that reduces the number of designated suppliers for mandatory purchase items;
- a modification by the franchisor's designated supplier that changes the price, quantity, quality, etc of mandatory purchase items to the disadvantage of franchisee; and
- any other modification that unfavourably changes the transaction terms, such as requiring a franchisee to bear additional expenses for mandatory purchase items or unfavourably changing the conditions for product return or payment terms.

According to the announcement, any unfavourable modifications must be made after consultation with all franchisees. To satisfy the requirement of prior consultation with franchisees, franchisor must 1) provide an advance notice of the modifications to the transaction terms and plans for consultation, 2) consult on the modifications to trasnaction terms,and 3) provide notice of the outcome of the consultation.

Law stated - 15 May 2025

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Summary

FRANCHISE CONTRACTS AND THE FRANCHISOR/FRANCHISEE RELATIONSHIP

UPDATE AND TRENDS

MARKET OVERVIEW

Franchising in the market

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

No official statistics are available on the extent of franchising in Switzerland. According to the Syndicate Unia, there were estimated to be approximately 20 franchisors with 400 franchisees in the early 1970s and 150 franchisors, mainly foreign, in 2000. The market continued to increase significantly to reach 250 to 300 franchisors (with up to five franchisees each) in 2015, the vast majority of which is expected to grow in the future according to a study conducted by the Swiss Franchise Association, which has recently been rebranded to become Swiss Distribution.

However, the difficulty for franchisees to obtain a bank loan to finance their market entry does not facilitate market access.

According to Swiss Distribution, franchising is primarily present in retail, health and wellness, followed by gastronomy and fashion. The consulting and real estate sectors also count franchises, though to a lesser extent.

Law stated - 21 June 2024

Associations

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

Swiss Distribution is the leading association in the Swiss franchise industry. Franchise associations have a limited impact on the development of statutory laws and regulations. During the consultation procedure on preliminary drafts of new legislation affecting franchising activities, franchise associations and various stakeholders from civil society (political parties, interest groups, non-governmental organisations, etc) may express their opinions on the proposed bill.

Swiss Distribution has developed its Code of Conduct, which is binding for its members only (soft law). The Code of Conduct provides specific pre-contractual disclosure obligations and the specific duties of the parties to a franchise agreement. Indeed, a franchisor must demonstrate that it has successfully operated its franchising concept for a reasonable period of time (proof of concept) and must provide adequate initial training as well as commercial and technical support throughout the term of the franchise agreement.

Law stated - 21 June 2024

BUSINESS OVERVIEW

Types of vehicle

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

When it comes to setting up business in Switzerland, franchisors have a variety of legal forms from which to choose. However, the prevailing form of corporate vehicle established by a typical franchisor is the company limited by shares (AG), followed by the limited liability company (GmbH). Both AG and GmbH limit the personal liability of their holders for the debts of the company to their share of the corporate stock. However, only the AG may list on the Swiss stock exchange (the SIX Swiss Exchange or the BX Swiss).

Law stated - 21 June 2024

Regulation of business formation

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

In Switzerland, no regulations apply specifically to franchises and franchise relationships. The relevant legislation is, therefore, to be identified on a case-by-case basis.

In terms of the formation of business entities, the Swiss Civil Code (CC) and the Swiss Code of Obligations (CO) are relevant. The technical aspects of registration required for the formation of an AG or a GmbH are governed by the Commercial Register Ordinance.

Law stated - 21 June 2024

Requirements for forming a business

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

The forming and maintaining of a business entity depend on the legal corporate form chosen. Nevertheless, the process follows the same steps for an AG and a GmbH. The business entity may be formed by one or more natural or legal persons (regardless of domicile or nationality) during an assembly, known as a constitutive assembly, in a notarial deed.

The articles of association must contain in particular the company name, registered office and objects, the form of the company's external communications, the total amount of the capital, the extent to which it is paid up and the nominal value of shares. Irrespective of the size of the company, the minimum capital value of an AG is 100,000 Swiss francs, divided into shares with a nominal value that must be greater than zero Swiss cents, while that of a GmbH is 20,000 Swiss francs, divided into shares with a nominal value that must be greater than zero Swiss cents as well.

The franchisee is then registered in the public commercial register of the canton of its registered office. The commercial register indicates, in particular, a list of the members authorised to act on behalf of the company. In the case of a GmbH, all listed individuals have management powers. The franchisee as a legal entity is liable for the actions of publicly registered members authorised to act on its behalf.

Function and residency requirements apply to those registered people. At least one member of the board of directors of the AG, respectively a managing director of the GmbH or a member of the top management entitled to represent the company with sole signing power, must reside in Switzerland. If the signature power is joint, two members with joint signing power must reside in Switzerland.

Law stated - 21 June 2024

Restrictions on foreign investors

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

The franchise company must be represented by a person with sole signing power (namely, a member of the board of directors or a managing director) who is domiciled in Switzerland. In the case of joint signing power by two, the franchise company must be represented by two persons with joint signing power who are domiciled in Switzerland.

Foreign franchisors must also be aware that, according to the Federal Act on the Acquisition of Real Estate by Persons Abroad, natural and legal persons with their registered office or domicile abroad as well as persons acting on their behalf may only acquire real estate in Switzerland after an authorisation procedure. However, the purchase of real estate for commercial use (eg, hotels, shops, offices and production halls) does not require authorisation.

As at the time of writing, no other restrictions apply to foreign business entities or foreign investment.

Law stated - 21 June 2024

Taxation

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

In terms of taxation, the Swiss federal system implies that tax powers and revenues are shared between the Swiss Confederation, the cantons and the municipalities. Businesses and individuals are therefore taxed on all three levels. While the Swiss Confederation is competent exclusively in areas that the Swiss Constitution provides for, the cantons are sovereign in tax matters, which means in particular that they have a general competence to collect taxes, determine tax-exempt amounts, and set tax scales and rates. Thus, the level of taxation and the tax burden varies between cantons and each canton has the power to influence its tax competitiveness directly. This system has developed a domestic tax competition, which has led to relatively low tax rates in Switzerland in comparison with other jurisdictions.

Natural persons residing or staying for a certain period of time in Switzerland are subject to income and wealth tax. Foreign persons not benefiting from a permanent residency permit (the C permit) are, in principle, taxed on their income from Swiss sources by means of a withholding tax. However, admission fees and royalties paid to foreign franchisors are generally not taxed by withholding.

Legal entities, such as franchisees formed in AGs or GmbHs, residing in Switzerland are subject to tax as soon as they are entered into the commercial register or if they have their effective place of management in Switzerland. Income tax is levied at the federal, cantonal and municipality levels (namely, by the Swiss Confederation, the relevant canton and the relevant municipality). Relative tax rates are, for the majority of the cantons, flat tax rates applying on the taxable profit of a legal entity (progressive tax rates are the exception).

Depending on the location, it is not unusual to expect a rate between 14 and 17 per cent for income tax. Taxable income is determined through the statutory accounts or, in the case of a foreign company, the subsidiary accounts. The assessment for income tax is made on net profit after tax (tax expenses being deductible in Switzerland) as shown in the statutory financial statements that must be made according to the CO accounting standards. Companies that are not registered per se in Switzerland but are active in the country through a permanent establishment or a subsidiary are only taxed on profits generated by the Swiss activity or on real estate assets located in Switzerland. According to a judgment of the Federal Supreme Court (BGer 134 I 303), the activity of a franchisee does not, however, constitute a permanent establishment of the franchisor, even if the premises belonging to the franchisor in Switzerland are leased to the franchisee. Except for the taxation of an eventual rental income, no tax obligations arise for franchisors in the cantons where their franchisees are domiciled with regard to the franchise agreement as such.

After the rejection of earlier reform packages, the Swiss electorate agreed in May 2019 on a major tax reform, which had been debated at length. The reform aimed to align the Swiss tax system with international standards regarding corporate taxation. In general, the reform has increased the tax burden of large companies while reducing that of small and medium-sized enterprises. It implied the suppression, as of 1 January 2020, of special privileges granted to internationally active companies. To maintain Switzerland as a tax-efficient business location, the fiscal reform offered, among other things, the possibility to introduce a deduction of up to 50 per cent of research and development costs on the cantonal level and a 'patent box' system allowing profits from inventions to be taxed at a reduced rate at the cantonal level.

Swiss value added tax (VAT) is only collected at the federal level.

Since January 2019, foreign persons with a turnover of at least 100,000 Swiss francs through physical deliveries of products to Swiss-based customers have been subject to domestic tax.

Taxable persons are required to register and are responsible for declaring the tax due. As of 1 January 2024, the standard VAT rate is 8.1 per cent. Reduced rates are applied to some services and products, namely accommodation (at a rate of 3.8 per cent) and essential goods and services such as non-alcoholic beverages, food, medicines and books (at a rate of 2.6 per cent). In this framework, services related to franchise relations are subject to ordinary VAT.

Law stated - 21 June 2024

Labour and employment

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

In Switzerland, franchisees are considered independent entrepreneurs rather than employees of the franchisor. However, the franchise contract is not regulated as such by Swiss law but is an 'innominate' or 'mixed' contract, which means that it consists of elements of several contracts regulated by the CO. It is, therefore, necessary for each matter in dispute to identify the predominant elements of the contractual relationship to determine the regime specifically applicable to the given case. On the basis of these principles, the Federal Supreme Court confirmed, in its judgment BGer 118 II 157, the application by analogy of labour law provisions providing for compensation of the employee in the event of wrongful termination in a case where the franchisor held a particularly dominant position in relation to the franchisee, which was limited in its entrepreneurial freedom. This risk can be limited by ensuring that the franchisee enjoys genuine and broad entrepreneurial freedom. However, the risk of equating the franchise relationship with a relationship of subordination remains in two respects.

On one hand, in the case BGer 134 III 497 concerning a distribution contract, the Federal Supreme Court ruled that the agent's protective provisions provided for in the provisions governing the commercial agency contract were applicable by retaining a relationship of subordination between the licensor and the distributor. This judgment may suggest that a franchisee might, in the same way, be protected as an agent even in the case of tenuous subordination to the franchisor. On the other hand, if a non-competition agreement has been concluded, part of Swiss legal literature states that the franchisee may be entitled to special remuneration when the franchise agreement is terminated. The Federal Supreme Court has neither decided on nor outlined the answer to either of the latter two points.

Law stated - 21 June 2024

Intellectual property

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

The Swiss Trade Mark Protection Act (TmPA) provides that any sign (such as words, letters, numbers and graphics) distinguishing the goods or services of one company from those of another may be registered as a trademark. Registration grants the holder an exclusive right to use the mark on the registered goods and services and the protection of their right for a 10-year period, which may be renewed an unlimited number of times. However, well-known trademarks within the meaning of article 6-bis of the Paris Convention benefit from protection not only for registered goods and services, but also for any non-registered ones. The Swiss Federal Institute for Intellectual Property is in charge of processing applications for registration. The application may be filed by more than one person intended to be a holder of the right to use the trademark, without any requirement as to residence, headquarters or nationality being applicable. Since Switzerland is a party to the Madrid International Trademark System, the national registration can be supplemented by an international registration handled by the World Intellectual Property Organization in Geneva.

No proof of use of the trademark is required for registration. However, to avoid trademarks being registered as a reserve, the trademark must be used for its protection to take effect. If the owner does not use the trademark during the five years following registration, their right shall be forfeited if non-use is not justified and action may then be brought to cancel the registration.

Unauthorised use of a trademark identical or confusingly similar to a registered trademark shall be deemed to be an infringement. In such a case, Swiss law provides injunctive or prohibitive civil actions as well as other protective measures. The owner of the trademark may also demand financial compensation by means of a request for royalties, compensation of damages or the repayment of profits made by the infringer. Furthermore, the TmPA provides for criminal sanctions, upon complaint, of any unlawful use of another's trademark by a sentence of up to one year's imprisonment. In addition to civil and criminal remedies, the TmPA enables the owner of a trademark to oppose the entry in the register of an infringement of their trademark within three months following the publication of said infringement's registration.

In Switzerland, know-how is neither protected by specific legislation nor by Swiss regulations protecting intellectual property. However, in the case of unfair competition through the use of know-how developed by the franchisor with respect to its franchising concept, the Federal Act against Unfair Competition allows the franchisor to file a complaint. The case of unfair competition is then punishable by a pecuniary penalty or a sentence of up to three years' imprisonment. Know-how may also be protected by a clause in the franchise contract qualifying it as confidential information. The disclosure of the know-how could then be pursued through the legal means available in the case of breach of contract. In addition, the Swiss Criminal Code punishes, upon complaint, the breach of manufacturing or trade secrecy with a pecuniary penalty or imprisonment of up to three years.

Law stated - 21 June 2024

Real estate

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

Franchisees do not usually own their own premises and usually lease them in the main cities of Switzerland. The franchisor may sometimes be the owner of the premises where the franchising activities are to be operated by the franchisee. In this specific set-up, the franchise contract also deals with the lease of the premises, and the franchisor-franchisee relationship may become a hybrid one combining franchising and commercial lease aspects.

Swiss law does not provide for specific legislation on commercial leases, but rather for one-off changes to the regime applicable to any lease contract. Local franchisors, as well as foreign franchisors, are free to enter into and arrange their lease relationships provided that mandatory tenants' protection provisions are complied with. As any lessee, franchisors are thus protected against abusive rent rates as well as by provisions requiring compliance with specific formalities upon the termination of the lease. Given the depreciation period of investments made and the inconveniences associated with moving a business, commercial leases are often longer than residential leases and must be terminated with at least six months' notice. If the landlord terminates the lease, the tenant may request an extension of the lease for a period of up to six years provided the circumstances justify it. It should also be noted that the installation and alteration of premises by lessees must be authorised by the owner or lessor and may give rise, at the end of the lease, to compensation for the lessee who financed them. It is, nevertheless, recommended that this matter be addressed more closely in the lease contract.

The CO requires the notarisation of the 'promise to sell' and the 'purchase of real estate'. When purchasing a building plot or changing the use to which the purchased property is to be put, land planning regulations and authorisation processes must also be taken into account.

In addition to these regulations, foreign franchisors must observe the restrictions imposed by the Federal Act on the Acquisition of Real Estate by Persons Abroad (BewG). According to the BewG, 'persons abroad', which are physical or legal persons domiciled or having their registered office abroad, as well as persons acting on their behalf, may acquire real estate in Switzerland under conditions verified in an authorisation procedure.

However, according to the BewG, the purchase of real estate for commercial use is not subject to authorisation. Hotels, retail premises, offices and manufacturing halls, for instance, are considered properties for commercial use.

Law stated - 21 June 2024

Competition law

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

Franchising activities are governed by Swiss competition law, namely the Federal Cartel Act, the Federal Act on Price Supervision and the Federal Act against Unfair Competition. Indeed, a franchise agreement qualifies as a vertical restraint between two entities and is subject to the same legal assessment as a traditional distribution contract. Swiss competition law tends to be compatible with Commission Regulation (EU) No. 2022/720 of 10 May 2022 (replacing Commission Regulation (EU) No. 330/2010 of 20 April 2010) and general European practice. However, in the *Gaba* case (BGer 143 II 297), the Federal Supreme Court refused to apply an EU regulation on technology transfer agreements under Swiss law, so as to take into account the specific legal and economic conditions of Switzerland.

On 12 December 2022, the Swiss Competition Commission (ComCo) published a notice concerning the assessment of vertical agreements (CommVert; thus replacing the previous version of the CommVert that was into force as of 22 May 2017) and related guidelines containing detailed rules that may also apply in franchise relationships (eg, cross-supplies, non-compete obligations, know-how and resale prices).

A franchise agreement is deemed to contain illegal price restrictions if it provides for a minimum or fixed price for a product, or for the allocation of territory between different franchisees by preventing passive sales by other franchisees into those territories. A general prohibition of online sales in franchise agreements qualifies as an illicit hardcore restriction, as internet sales are considered passive sales pursuant to the CommVert (which may not be subject to an absolute prohibition) unless the website specifically targets customers in an individual territory (active sale).

Other restrictions may also qualify as hardcore restrictions, such as technical geoblocking measures, rerouting customers or restricting sales to customers located outside the contractual territory based on the information provided (eg, foreign credit cards) as those restrictions achieve the same goal of restricting passive sales to customers located outside a contractual territory.

In the latest development in the *Pfizer* case (BGer 147 II 72), the Federal Supreme Court held that recommended resale prices issued by Pfizer and made available to pharmacies through a third-party database that was directly connected to the cash registers of the pharmacies qualified as unlawful resale price maintenance. Notably, 89.3 per cent of the pharmacies supplied by Pfizer had fully or partly applied the recommended resale prices. The compliance of 50 per cent of the retailers appears to be sufficient for there to be a concerted practice. The fact that Pfizer has never exerted pressure on or offered special incentives to the pharmacies was not relevant. Pursuant to this judgment, non-binding price recommendations may be seen as problematic in Switzerland, especially when those recommendations are repeatedly and automatically communicated in the retailers' cash register systems. This ruling is stricter than the corresponding rules under European competition law.

The exposure of the parties to a franchise agreement that breaches Swiss competition law may be important. If a franchise agreement is found to contain illegal clauses, the parties may be fined up to 10 per cent of the turnover achieved in Switzerland in the preceding three years, without prejudice to potential civil claims.

Finally, a revision of the Federal Cartel Act and the Federal Act against Unfair Competition came into force on 1 January 2022. This revision implements the Fair Price Initiative, which aims to enable the purchase of products outside of Switzerland in potentially more favourable purchasing conditions. The revision establishes various new behavioural obligations for companies that are powerful relative to their market, prohibits discrimination while procuring goods and services abroad, and prohibits practices of geoblocking. The revised provisions may have a material impact on franchising activities in Switzerland.

As of 1 July 2023, a new revision of the Federal Cartel Act has extended the limitation periods to prosecute violations of amicable settlements and administrative orders (now seven years instead of five years), as well as violations of the obligation to provide information and violations relating to concentrations of undertakings (now four years instead of two years).

Law stated - 21 June 2024

OFFER AND SALE OF FRANCHISES

Legal definition

12 | What is the legal definition of a franchise?

As Swiss law does not specifically define franchising, the concept has been developed by case law and legal literature. According to a leading decision of the Federal Supreme Court (BGer 118 II 157), in concert with the legal literature and the Swiss franchising association Swiss Distribution, a franchise agreement consists of the distribution of goods or services by independent entrepreneurs (the franchisees) according to a uniform concept of sale and advertising provided by the franchisor. For this purpose, the franchisee receives the right to use the franchisor's name, trademarks, equipment or other material or immaterial property rights as well as ongoing assistance, advice and training from the franchisor. Although the franchisee acts on its own behalf and at its own risk, the franchisor reserves, as a general rule, the right to give instructions and exercise control over the franchisee's business activity. The Federal Supreme Court stated, however, that the variety of forms in which franchise agreements are drawn up makes it impossible to define a franchise agreement 'with sufficient precision'. In any event, the relationship involves very close cooperation between the franchisor and the franchisee.

Law stated - 21 June 2024

Laws and agencies

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

The offer and sale of franchises are not specifically governed by any law in Switzerland. In terms of law, the general provisions of the Swiss Civil Code (CC) and the Swiss Code of Obligations (CO) apply, as well as the United Nations Convention on Contracts for the International Sale of Goods, if not waived. The General Data Protection Regulation of the European Union, the Swiss Federal Act on Data Protection and the Swiss laws on intellectual property may also apply to the offer and sale of franchises. The important role of the principle of good faith in relation to the behaviour of the parties, who must act in a serious manner (serious intent to contract), as well as the disclosure of information during contractual negotiations, should also be stressed.

Where general terms and conditions (GTC) are involved, although the general rules of the CC and the CO apply, case law of the Federal Supreme Court has developed specific rules regarding the adoption and interpretation of the GTC, which must also be taken into account. In particular, the GTC must be validly incorporated in the contract to be effective and, in any case, the agreement between the parties has priority over the GTC's content. Moreover, the Federal Act against Unfair Competition prohibits the use of GTCs that provide for a significant and unjustified imbalance between the rights and obligations of a business and a consumer to the latter's detriment.

Accordingly, there is no government agency regulating franchises. However, Swiss Distribution, which is a self-regulated private commercial organisation with no governmental function, provides a framework for its members.

Law stated - 21 June 2024

Principal requirements

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

This is not relevant in Switzerland.

Law stated - 21 June 2024

Franchisor eligibility

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

Swiss law does not provide for such requirements. However, Swiss Distribution does require franchisors and master franchisees aspiring to become members to meet certain requirements, such as a proof of concept, a minimum of two years of franchising and a franchise system comprising of at least two franchisees. It should, moreover, be noted that franchisees cannot join Swiss Distribution.

Law stated - 21 June 2024

Franchisee and supplier selection

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

Swiss law does not provide for any special regulations in this area and gives free scope to contractual freedom. Franchisors and master franchisees may, with the consent of their co-contractor, apply possible restrictions. Notwithstanding the foregoing, the new provisions of the Federal Cartel Act provide for new behavioural obligations for companies with relative market power.

In line with EU rules, if the franchisees' network qualifies as a selective distribution system based upon quantitative or qualitative criteria, or both, franchisors are required to apply those criteria in a uniform and non-discriminatory manner when selecting the candidates to a franchise agreement.

Law stated - 21 June 2024

Pre-contractual disclosure – procedures and formalities

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

The procedure for making pre-contractual disclosure in connection with franchise contracts is not regulated by special statute under Swiss law. However, according to the principle of good faith, not only must all of the information disclosed during the pre-contractual phase be true, but the prospective franchisee must receive all the necessary information concerning the projected contractual relationship. In this context, Swiss Distribution has issued its Code of Conduct, supplemented by specific advice concerning the pre-contractual phase. Regulations issued by Swiss Distribution are binding only to its members and, in the case of its Code of Conduct, apply only to the relationship between franchisor and franchisee. However, as this information is available on Swiss Distribution's website, it can serve as an illustration for franchisor or master franchisee.

In general, for evidentiary reasons, it is recommended to keep a written record of any information transmitted.

Law stated - 21 June 2024

Pre-contractual disclosure – content

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

There are no specific pre-contractual statutory disclosure regulations pursuant to Swiss law in a franchise context. According to the principle of good faith, the prospective franchisee must receive all the necessary information concerning the contemplated franchising activities prior to the execution of the franchise agreement. In addition, all of the information disclosed during the pre-contractual phase is to be true and not misleading. For evidentiary reasons, it is recommended to keep a written record of any information transmitted.

In its Code of Conduct, Swiss Distribution lays out specific pre-contractual disclosure obligations that are binding for its members only (soft law). The franchisor member of Swiss Distribution is thus required to provide the prospective franchisee with full written information concerning the terms of the franchise agreement within a reasonable period of time before the execution of the franchise agreement. Moreover, all information provided to the franchisor must be factually correct and void of ambiguity and misleading information.

Law stated - 21 June 2024

Pre-sale disclosure to sub-franchisees

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

Under Swiss law, sub-franchise relationships are not governed by a special statute or monitored by a specific agency. Therefore, according to the principle of freedom of contract applicable under Swiss law, the parties to the sub-franchising structure decide by consensus which of them will make pre-sale disclosures to sub-franchisees.

Law stated - 21 June 2024

Due diligence

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

Under Swiss Distribution's Code of Conduct, which is applicable to its members, the franchisor must conduct an investigation to determine whether a potential franchisee has the required qualities to operate the franchise in question (in other words, adequate training, financial capacity and personal qualities).

Since the reputation of the franchisor is directly linked to that of its franchisees, it is also necessary to ascertain the practices of the prospective franchisee in its business activity and in particular, if the prospective franchisee has employed staff, to ensure compliance with labour law obligations.

However, the franchisee is advised to carefully examine the franchise it is interested in. In this regard, the Swiss Federal Department of Economic Affairs, Education and Research recommends that potential franchisees consider the following questions:

- How long has the franchisor been on the market?
- What skills and experience does management have?
- Are there any references?
- How is the financial situation presented?
- How is the company image presented?
- How many franchise managers are there and how long have they been franchise managers?
- Does the franchisor perform an aptitude test with applicants?
- Is the franchisor a member of a professional association?
- Is the franchisor trying to manipulate prices?
- Do you have to buy the merchandise and production resources from the franchisor?
- Is professional and commercial knowledge necessary?
- Is there comprehensive training and good preparation for the business?

- Is there a manual on how to manage the business?
- Are help and advice available if required?
- What services does the franchisor offer in terms of buying, advertising and public relations?

Swiss Distribution further invites prospective franchisees to consult the selection criteria applicable to franchisees and to answer a series of questions to determine whether they are ‘fit to buy’. Likewise, a ‘fit to sell’ test is available for franchisor self-assessment. In addition, Swiss Distribution’s advice on the pre-contractual phase included in its Code of Conduct is relevant.

Law stated - 21 June 2024

Failure to disclose – enforcement and remedies

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

Swiss law recognises and applies the culpa in contrahendo (eg, ff the franchisor, in breach of the principle of good faith, hides information that would have discouraged the franchisee from entering into the franchise contract with the franchisor) and the ‘error as to the basis of the contract’ doctrines (eg, if a franchisee enters into a franchise agreement based on a material misrepresentation of the operation), the franchisee may rescind or cancel the franchise agreement.

The damage to be claimed by the franchisee arising out of a culpa in contrahendo is equivalent to the difference between the current wealth of the franchisee in its capacity as the injured party and the wealth it would hypothetically dispose of without the damaging event (namely, the conclusion of the franchise agreement). However, claims based on culpa in contrahendo are only admitted exceptionally by the Swiss courts.

If a franchisee rescinds a franchise agreement based on an error as to the basis of the contract resulting from its own negligence (eg, by not requesting sufficient information before entering into the franchise agreement), the franchisee may be liable to pay damages to the franchisor amounting to the negative interest (namely, the amount of useless cost suffered by the franchisor that was caused by negotiating and entering into the cancelled franchise contract).

Law stated - 21 June 2024

Failure to disclose – apportionment of liability

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

Unless the parties have contractually provided otherwise, a sub-franchisor is liable to its sub-franchisee for disclosure violations in the same way that the franchisor is liable to the sub-franchisor. The franchisor is, in principle, not liable to the sub-franchisee. However, on the basis of the reasoning followed in judgment BGer 118 II 157, where the sub-franchisor is in a relationship of subordination to the franchisor, then the franchisor could assume liability for violations by the sub-franchisor in the same way that an employer bears liability for the violations committed by its employee under the provisions governing employment law.

In Switzerland, the liability of individual officers or directors of a franchisor or sub-franchisor is limited if the business is formed as a company limited by shares or a limited liability company. Such executives would only be held directly or indirectly liable in the case of an intentional or negligent breach of duty of care. For damages caused by employees in the performance of their work, liability is generally borne by their employers. Furthermore, where disclosure violations infringe a criminal provision, for instance in matters of unfair competition, individual officers, directors and employees may incur direct liability.

Law stated - 21 June 2024

General legal principles and codes of conduct

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

The offer and sale of franchises are not specifically governed by any law in Switzerland. General provisions of Swiss law remain applicable. However, the CC and the CO apply, as well as the United Nations Convention on Contracts for the International Sale of Goods, if not waived by the parties. Those statutory provisions may impact the terms of the franchise contract; the General Data Protection Regulation of the European Union, the Swiss Federal Act on Data Protection and the Swiss laws on intellectual property may also apply to the offer and sale of franchises. Moreover, the Federal Act against Unfair Competition prohibits the use of general terms and conditions that provide for a significant and unjustified imbalance between the rights and obligations of a business and a consumer to the latter's detriment.

Pursuant to Swiss law, the principle of good faith plays an important role with respect to the conclusion and the performance of a franchise contract, in particular in relation to the behaviour of the parties, which must act in a serious manner (serious intent to contract), as well as the disclosure of information during contractual negotiations.

In contrast to common law jurisdictions, the interpretation of franchise contracts pursuant to Swiss law tends to focus on the real intention of the parties rather than on the terms of the contract. Indeed, should a provision of a franchise contract require interpretation, a judge will first seek to establish the real and common intention of the parties, adopting an empirical approach. When the actual intent of the parties cannot be ascertained on the basis of factual evidence, the provision is to be interpreted in accordance with the principle of trust and in accordance with the rules of good faith. The judge then gives the unclear provision the meaning that a person placed in similar circumstances, having a similar background as that of the parties, would reasonably do.

There is no government agency regulating franchises. However, Swiss Distribution provides a framework for its members, including its Code of Conduct. Even though the rules and regulations of Swiss Distribution are not binding (at least for non-members of this association), they can serve as an illustration for a franchisor or franchisee.

Law stated - 21 June 2024

Fraudulent sale

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

In the case of fraud or deceptive practice, several possibilities are, depending on the circumstances, open to the franchisee. The franchisee may take civil action for breach of contract and claim damages, rescind or terminate the franchise contract as well as claim damages or challenge the franchisor on the basis of the unfair competition act.

The franchisee may also file a criminal complaint if the franchisor's conduct can be qualified as escroquerie or fraud within the meaning of the Swiss Criminal Code. The criminal complaint is, in principle, directed against a physical person. However, if the failing organisation of the incorporated franchisor does not make it possible to determine which person is responsible for the escroquerie or fraud, then the company may be sanctioned with a fine of up to 5 million Swiss francs.

Law stated - 21 June 2024

FRANCHISE CONTRACTS AND THE FRANCHISOR/FRANCHISEE RELATIONSHIP

Franchise relationship laws

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

The general rules of the Swiss Civil Code (CC) and the Swiss Code of Obligations (CO) regulate the ongoing relationship between franchisor and franchisee. Depending on the structure of the contractual relationship between a franchisor and franchisee, the topical regulation of various specific contracts provided for in the CO may additionally apply, in particular the provisions on employment contracts and agency contracts.

Law stated - 21 June 2024

Operational compliance

26

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

The right to direct and control the franchisee is reserved to the franchisor in a typical franchise agreement. In this context, the concrete control mechanisms implemented by the franchisor usually consist of an inspection of the franchisee's premises and control of the franchisee's accounts. Usually, the franchisee is also required to report periodically to the franchisor on the conduct and impact of its business. Such reports may cover all matters relating to quality, health, safety, security and environmental friendliness. This could include, for example, customer satisfaction and the labour conditions of employees, if any. In consideration of the long-term nature of the franchise relationship, additional reporting could be provided for, in the case of, for instance, internal incidents, audits or new directives given by the franchisor. The scope of the mechanisms varies according to the standards applicable to the franchise branch. For example, in the gastronomy and food retail sector, a daily report of food freshness and quality management may be introduced and the inspection of the cleanliness of the premises must be particularly thorough to protect the customers' health as well as the reputation of the company.

Law stated - 21 June 2024

Amendment of operational terms

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

Unilateral modifications of the operational terms and standards are admissible if they are contractually provided for by the parties and do not amount to a modification of the contract in itself. Indeed, the contractual freedom of the parties and the principle of pacta sunt servanda are limited by the fundamental principle in Swiss law according to which the conclusion and modification of a contract can only take place through the expression of the concordant will of the parties.

Law stated - 21 June 2024

Policy affecting franchise relations

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

Swiss Distribution's Code of Conduct applies to franchise relationships. These principles are, however, only compulsory for members of the association. Although optional, membership of Swiss Distribution represents a guarantee of professionalism and is notable for its positive impact on the business practice and reputation of the franchisor.

Law stated - 21 June 2024

Termination by franchisor

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

Franchise agreements may be concluded for a fixed or indefinite period. In the first case, the relationship expires at the end of the agreed term without the intervention of the franchisor, unless the parties have agreed otherwise.

Franchise agreements are usually for a fixed period of time, at the end of which the contract is automatically or tacitly extended. In such a case, the contract is then considered to be of indefinite duration and comes to an end, if the parties have not provided otherwise, by termination with six months' notice (by analogous application of the rules on partnership contracts, according to the majority of the legal literature), by mutual agreement or, exceptionally, by the invocation of a motive (good cause) justifying the immediate termination of the relationship (on the basis of the BGer 4A_241/2017 judgment). According to case law of the Federal Supreme Court concerning an exclusive distribution contract (BGer 107 II 216), the contract must in any case extend over a sufficiently long period of time for the franchisee to make a return on its initial investment of capital and preparatory work. Should the franchisee not be exclusively related to the franchisor, a court might take into account the reduced scope of the relationship compared to an exclusive relationship.

Even in the absence of an express rule, the immediate termination of the relationship for good cause is presumed to be justified when the continuation of the contractual relationship would, according to the rules of good faith, be deemed unacceptable to the terminating party. Notice of immediate termination must reach the other party within a relatively short period of time after the occurrence of the good cause. To provide guidance to the parties, the contract may define and illustrate the notion of good cause. However, in a case concerning a franchise agreement (BGer 4A_148/2011), the Federal Supreme Court stated that such clauses do not bind the judicial authorities if they limit the possibility of immediate termination when a good cause that is not listed, or that does not correspond to the definition of the parties, arises. While the Federal Supreme Court has recognised the principle of immediate termination of a franchise agreement for good cause, it has not yet had the opportunity to decide on the effects of such termination in the absence of any valid good cause.

The case law of the lower courts as well as the Swiss legal literature consider that the absence of good cause prevents the immediate termination of a franchise agreement. The parties, therefore, remained bound to fulfil their contractual obligations, failing which a civil injunction could be issued against the recalcitrant party (BGer 125 III 451). If the concrete relationship between the parties justifies the application by analogy of the provisions of the CO on employment contracts, an unjustified immediate termination would still be effective and the franchisee would be entitled to compensation, the amount of which, determined according to all the circumstances of the case, would correspond at most to the amount that the franchisor would have earned if the contract had been terminated at the agreed expiry or after the applicable notice period. Likewise, any other type of abusive termination entitles the franchisee in a relationship of subordination towards the franchisor to claim compensation (BGer 118 II 157).

In the event of non-renewal of the franchise agreement or termination with notice, the franchisee may also claim compensation for, depending on the situation, loss of customers and not amortised investments. However, the issue remains in doubt because the Swiss Federal Supreme Court has not ruled on the matter and there is no unanimity among the Swiss legal literature in this regard. However, the compensation due to the franchisee in such a case can be expected to vary according to the regime applicable by analogy to the concrete situation.

Law stated - 21 June 2024

Termination by franchisee

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

Regarding the termination of contractual relations, the franchisee disposes of the same means and is subject to the same rules as the franchisor. It should be pointed out, however, that in the event of non-renewal of the franchise agreement or termination with notice, it is unlikely that the franchisor would be eligible for compensation for customer loss since clientele tend to remain loyal to the brand rather than to the franchisee.

Law stated - 21 June 2024

Renewal

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

Unless the parties have provided for a particular form or substantive requirement, the common will of the parties to renew a franchise agreement of limited duration must be expressed in the same form as the initial agreement or by means of an amendment. Nevertheless, if the parties continue to perform their respective services after the expiry of the contract, the latter may be deemed to be tacitly renewed. If the franchise agreement is of unlimited duration or renews itself from year to year without the intervention of the parties, no formal renewal is necessary.

Law stated - 21 June 2024

Refusal to renew

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

By virtue of the contractual freedom of the parties, the franchisor is in principle entitled to refuse to renew an agreement with a franchisee. However, the refusal to maintain business relationships by a franchisor with a dominant market position could be unlawful according to the Federal Cartel Act. In such a case, the franchisor’s refusal to renew the franchise agreement would not be legally justifiable. The new provisions of the Federal Cartel Act introduce new obligations for entities with relative market power. Indeed, companies upon which other companies are dependent in terms of supply or demand, even though they do not reach a 40 to 50 per cent market share threshold on the relevant market, are subject to the existing provisions regarding the abuse of a dominant position and therefore may be restricted in their capacity to refuse to deal with dependant companies. A company may be considered a dependant of an entity with relative market power if it does not have sufficient or reasonable possibilities to switch to other companies.

Furthermore, regardless of their position in the market, should franchisors refuse to renew the franchise agreement, they may be liable to compensate any investments that the franchisee may have made in good faith (namely, on the basis of a promise or intention to renew the franchise agreement expressed by the franchisor). Along the same lines, one must also take into consideration the potential compensation due to the franchisee if the term of the contract was not sufficiently long to allow for the amortisation of the franchisee's investments.

Law stated - 21 June 2024

Transfer restrictions

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

Such restrictions are admissible to the extent provided for in the franchise agreement.

Depending on the will of the parties, the restrictions may consist of a prohibition, such as a right to terminate the entire franchise agreement in the event of a transfer of ownership (change of control clause), or a limitation on any transfer of ownership, including pledges, by requiring the franchisor's approval. The requirement for prior written approval from the franchisor for transfers is, however, the most common modality in practice.

Law stated - 21 June 2024

Fees

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

The nature, amount or payment of fees generally depends on the choice of the parties expressed in the franchise agreement. However, the provisions and general principles applicable to contracts subject to Swiss law allow the franchisee to terminate the contract within one year of its conclusion and claim for the reimbursement of the entry fees paid under two conditions (which are strictly assessed):

- the fee to be paid by the franchisee is manifestly disproportionate to the franchisor's counter-performance to the detriment of the franchise; and
- such disparity results from the exploitation by the franchisor of the franchisee's distress, inexperience or thoughtlessness.

Law stated - 21 June 2024

Usury

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

The general provisions of the CO provide for an interest rate of 5 per cent. However, the franchise agreement may provide for a lower or higher interest rate. In such a case, the rate must not be excessive, otherwise, it is considered as usury punishable by a pecuniary penalty or imprisonment for up to 10 years. This limit is estimated to range between 10 per cent and 15 per cent.

Law stated - 21 June 2024

Foreign exchange controls

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

No, provided that the parties have agreed upon the chosen currency.

Law stated - 21 June 2024

Confidentiality covenant enforceability

37 Are confidentiality covenants in franchise agreements enforceable?

Confidentiality covenants in franchise agreements are enforceable. In the case of a breach of contract, the damaged party may initiate a civil action to order compliance with the clause and claim damages. It is recommended to add to the contract, in addition to the confidentiality clause, a penalty clause stipulating that any breach of contract will be punished through the payment of a predefined fee or any other contractual penalty. Besides encouraging the parties to comply with the contract, such a clause helps to avoid the additional difficulty often encountered in proving the amount of damages in civil proceedings by fixing a lump-sum compensation in advance.

Depending on the information revealed to a third party, a breach of confidentiality may also constitute a criminal act.

Law stated - 21 June 2024

Good-faith obligation

38

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

Objectively, good faith is the foundation of loyalty in business and governs the whole area of contract law. The idea is that everyone involved in a legal relationship is bound by general duties that dictate their conduct, which means that everyone must behave in the same way as an honest, loyal and respectful person would behave towards others. The principle is therefore based on social ethics and on a sense of justice. The normative consequences of this principle are mostly developed by case law. Good faith thus has many applications. For example, BGer 125 III 257 developed the prohibition of contradictory behaviour of the parties to a partnership agreement on the basis of good faith. Such reasoning could apply to franchise agreements as well.

Subjectively, good faith is the feeling of acting lawfully despite the existence of a legal irregularity. It may represent a legal requirement or influence the burden of proof.

Law stated - 21 June 2024

Franchisees as consumers

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

As a general rule, franchisees are treated as entrepreneurs and not as consumers under Swiss law and jurisdiction. Franchisees who are considered a weak party with respect to their franchisor's position may benefit from the protection afforded to employees, but are not entitled to consumer protection.

Law stated - 21 June 2024

Language of the agreement

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

Disclosure documents and franchise documents must be made in a language understood by the parties. Franchisors and franchisees are free to choose which of these official languages they wish to use in their contracts. The parties must nevertheless be aware of the consequences of their choice on possible legal proceedings.

Law stated - 21 June 2024

Restrictions on franchisees

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

By virtue of freedom of contract, restrictions placed on franchisees are subject to the parties' will. Restrictions may consist of a prohibition of performance by substitution, or an obligation to obtain supplies principally or exclusively from the franchisor and to apply, where appropriate, the prices indicated or recommended by the franchisor. However, such restrictions are regulated by the Federal Cartel Act. Furthermore, the principle of good faith as well as the CC and the CO may protect the franchisee against excessive or overly restrictive commitments.

Law stated - 21 June 2024

Courts and dispute resolution

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

The Swiss Court system distinguishes between civil, criminal and administrative courts.

Legal proceedings are conducted in one of the three official languages: German, French or Italian. The language is, in principle, that of the place where the proceedings were initiated. Evidence in a language other than the language of the proceedings must be translated. However, some courts (the Federal Patent Court, if the parties to the proceedings agree, and some commercial courts) may accept the filing of evidence in English.

Typically, proceedings may be conducted successively in three levels of courts. The cantons usually provide for two courts. In civil matters, the cantons may introduce commercial courts as the sole cantonal instance for commercial matters. Sole cantonal instances further exist in all cantons for disputes in connection with intellectual property rights, antitrust and unfair competition law. In addition, certain cases are directly and exclusively handled by a federal authority. For example, this is the case for patent disputes, for which the Federal Patent Court has exclusive jurisdiction.

The Federal Supreme Court, the highest court in Switzerland, acts as the last ordinary Swiss court of appeal.

The majority of Swiss judges are professionals. However, some of them are laymen (namely, they have not received any legal training). Some cantons provide for specific commercial courts, composed of specialised lay judges, chosen for their expertise in the relevant area of litigation. Technical cases can thus be handled with a combination of legal and technical expertise.

Although the Swiss court system is exhaustively governed by the applicable law, franchisors and franchisees have the right to elect a forum and a law applicable to their dispute. When making such a choice, however, the Federal Act on Private International Law (PILA) and the Lugano Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters (applicable in Switzerland) must be taken into account. Thus, despite a choice of court, a breach of competition rules by one of the parties in the performance of the contract could, for example, be subject to proceedings before the court of the place where the damage occurred, provided that the contractual aspect of the dispute is not preponderant (CCIV.2017.3 judgment of 25 September 2018 by the Cantonal

Court of the Cant
on of Neuchâtel).

In lieu of Swiss courts, the parties may agree to arbitrate their disputes.

Law stated - 21 June 2024

Governing law

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

The parties to a franchise agreement are generally free to agree on the governing law and to choose a foreign governing law. The choice of law may be made or amended at any time. If a choice of law is made after the execution of the contract, it has a retroactive effect as of the time of conclusion of the contract (article 116, paragraph 3 of the PILA).

Although it is not recommended, disputes arising from franchise agreements governed by a foreign law may be subject to the Swiss courts, provided they have jurisdiction. In such case, it is the responsibility of the parties to prove the content of the chosen foreign law. However, Swiss courts will not apply foreign governing law if it breaches Swiss public policy or Swiss mandatory laws that, by reason of their special purpose, are applicable regardless of the chosen governing law (articles 17 and 18 of the PILA).

Law stated - 21 June 2024

Arbitration – advantages for franchisors

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

Arbitration has the advantage of providing a tailor-made dispute resolution system because the parties are free to determine the terms of the procedure. In cases where the award is not subject to appeal and the documents are not in one of the official Swiss languages, arbitration may enable the parties to save time. Moreover, arbitration is particularly suitable for disputes that the parties wish to resolve with all available confidentiality.

Swiss law fully recognises the coexistence of state judgments and arbitral awards, whether they are rendered to parties based in Switzerland or abroad. Arbitral awards are also taken into account, recognised and even protected by the Federal Supreme Court. Indeed, according to consistent federal case law, only a gross violation of fundamental rights (such as the right to be heard and the right to a fair trial) constitutes grounds for appeal against an arbitral award before the Federal Supreme Court. The legal remedies available to challenge arbitrators' decisions are thus particularly limited. Furthermore, the Swiss Arbitration Centre (successor of the Swiss Chambers' Arbitration Institution), offers means of dispute resolution based on the Swiss Rules of International Arbitration. It is probably for these reasons that Switzerland is a particularly popular place for arbitration.

However, the Swiss courts have a good reputation and solutions that are particularly suitable for commercial disputes are available. Before opting for arbitration, foreign franchisors should evaluate whether arbitration would be advantageous in their particular situation. For example, the costs of arbitration remain high (despite the absence of appeal) even where a dispute involves a small monetary amount. Moreover, arbitration requires the agreement of the parties as well as a supplementary prior investment by the parties in its organisation.

In short, even if Switzerland is particularly attractive for arbitration proceedings, it is recommended to reserve this mode of dispute resolution for disputes involving large sums of money or that must be kept secret.

Law stated - 21 June 2024

National treatment

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

In Switzerland, foreign franchisors are treated differently from domestic franchisors with respect to the acquisition of real estate and, only for natural persons, with respect to obtaining residence and work permits.

Owing to the particularly close relations between Switzerland and other European countries, citizens of EU and EFTA countries benefit from the free movement of persons and, therefore, have an advantage over other foreign nationals in obtaining residence and work permits.

Law stated - 21 June 2024

UPDATE AND TRENDS

Legal and other current developments

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

Increased reporting and due diligence requirements

On 29 November 2020, the Swiss electorate rejected the Responsible Business Initiative, which aimed to legally oblige corporations based in Switzerland to incorporate respect for human rights and the environment into their business activities in Switzerland and abroad. A counterproposal from the government, with similar objectives but less intrusive sanctions, has been adopted. Consequently, Swiss companies of public interest (namely, listed companies and companies in the financial sector supervised by the Swiss Financial

Market Supervisory Authority) that have at least 500 full-time equivalents on an annual average (together with the companies they control in Switzerland and abroad) and that exceed either total assets of 20 million Swiss francs or an annual turnover of 40 million Swiss francs, have increased their reporting and due diligence requirements to ensure that their business activities comply with human rights and international environmental standards.

These companies must report annually on certain non-financial matters (environment, social and governance reporting (ESG)) including environmental concerns (eg, carbon dioxide emissions), social and employee concerns, human rights and the fight against corruption.

An implementing ordinance on due diligence and transparency in relation to minerals and conflict-affected areas and child labour (the Due Diligence and Transparency Ordinance) entered into effect on 1 January 2022 together with the new articles 964a et seq of the Swiss Code of Obligations. The new due diligence requirements apply for the first time for the financial year beginning in 2023. Consequently, the first ESG reporting must be issued in the first semester of 2024 with respect to financial year 2023. In that context, the Swiss government also published in March 2022 a draft ordinance that specifies the climate-related reporting obligations to be integrated into the general ESG report. The ordinance is scheduled to enter into force on 1 January 2024.

Draft legislation for partial revision of the Federal Cartel Act

On 24 November 2021, the Swiss government published a preliminary draft for the revision of the Swiss Federal Cartel Act and opened the consultation process. The main objective of the proposed revision is the modernisation of Swiss merger control, by changing the current qualified market dominance test to the significant impediment to effective competition (SIEC) test. The merger control regulations are to be adapted to the standards already prevailing in the European Union and the threshold for prohibiting a transaction will thus become lower.

In addition, the proposed revision clarifies the assessment of hardcore agreements by reintroducing the effects control of hardcore anticompetitive agreements. In reaction to the introduction by the *Gaba* case of the concept of per se significance of certain agreements, a parliamentary motion requested to take into account both qualitative and quantitative criteria when assessing the significance of hardcore anticompetitive agreements.

The preliminary draft aims also to strengthen the civil enforcement of competition law and to modify the cartel administrative procedure. Indeed, the revision contemplates extending the possibility of civil action to end customers suffering damage resulting from unlawful agreements between undertakings.

The public consultation on the preliminary draft ended on 11 March 2022. On 24 May 2023, the Federal Council unveiled its draft legislation for partial revision of the Swiss Federal Cartel Act and adopted the related dispatch. This draft legislation is now being deliberated in the Swiss Parliament. Entry into force is expected in 2025 at the earliest.

Draft legislation on the transparency of legal entities

On 22 May 2024, the Federal Council adopted its message concerning the draft Federal Act on the Transparency of Legal Entities, which aims to enhance the fight against money laundering. This draft legislation addresses a global issue: legal entities and trusts are often misused to conceal assets not only for the purpose of evading sanctions but also for money laundering, terrorist financing or corruption. As a major financial centre, Switzerland is also exposed to these risks. Therefore, to account for the evolving risks, the Federal Council proposes to strengthen the current anti-money laundering framework.

This draft legislation notably includes the introduction of a federal register – the transparency register – in which companies and other legal entities must disclose the identity of their beneficial owners. Associations and foundations, as well as other forms of companies such as single-shareholder companies and limited liability companies (GmbH), among others, will be subject to a simplified reporting procedure. This register will enable law enforcement authorities to more quickly and reliably determine who is actually behind a legal structure, thereby preventing legal entities from being used in Switzerland for money laundering or asset concealment purposes. The register, which will not be public, will be maintained by the Federal Department of Justice and Police, leveraging the existing infrastructure and expertise of the commercial registry authorities.

In case of non-compliance with this reporting obligation, the draft legislation provides for a system of penal fines.

This draft legislation will be submitted to the Federal Parliament. As for its entry into force, it is expected to take place in 2026 at the earliest. The proposed measures align with the international standards of the Financial Action Task Force concerning the fight against money laundering and terrorist financing, as well as the recommendations of the Global Forum on Transparency and Exchange of Information for Tax Purposes.

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Summary

FRANCHISE CONTRACTS AND THE FRANCHISOR/FRANCHISEE RELATIONSHIP

UPDATE AND TRENDS

MARKET OVERVIEW

Franchising in the market

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

Franchising in the United Kingdom remains in good health and we have clear evidence that the sector has recovered well from the covid-19 pandemic.. According to the last franchise industry survey published in October 2024 by the British Franchise Association (BFA) together with NIC, it is estimated that the sector contributed in excess of £19.1 billion to the UK economy – an increase of £2 billion since the survey was last undertaken in 2018. The number of franchise businesses operating in the United Kingdom is now over 50,000. A majority of franchisors (66 per cent) are reporting that they are trading above pre-pandemic levels.

Given its strong economy and relatively benign regulatory environment, coupled with the fact that English is widely spoken throughout the rest of the world, the United Kingdom is internationally recognised as a popular destination for franchisors from outside of the United Kingdom looking to expand their overseas operations.

There are now over 1,000 franchise systems in the United Kingdom. The personal services sector, including children's activities, pet care and domiciliary care have seen 380 franchise systems added (a 53 per cent rise) since the previous survey. However, not all sectors have fared so well with transport and vehicle services and store retailing seeing a 34 per cent and 25 per cent decline in the number of franchise operations, respectively.

Given the continuing uncertainty of the global economic landscape, the success of the franchise industry is bound to the banks' ability to lend. However, the banks in the United Kingdom look more favourably on lending to franchised businesses as opposed to independent businesses.

Law stated - 15 May 2025

Associations

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

The BFA is the main voluntary self-regulatory body in the franchise sector. The aim of the BFA is to promote ethical franchising in the United Kingdom. The BFA also acts as a spokesperson for the interests of the sector both on a domestic and international level. It has, for many years, successfully argued that the regulation of franchising through legislation is not necessary and would do more harm to the franchising sector than good.

Its members agree to be bound by the Code of Ethics, which, at its core, promotes fair dealing between the franchisor and the franchisee from the outset of the franchising relationship through to its termination.

Law stated - 15 May 2025

BUSINESS OVERVIEW

Types of vehicle

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

In the United Kingdom, it is usual for a franchisor to operate as a limited liability company. This is also true for most substantial businesses operating outside of the franchising sector. A company is a separate legal entity, distinct from its directors and shareholders, which enables it to enter into contracts in its own name.

A franchisor may also operate as a limited liability partnership (LLP). An LLP combines the flexible structure of a partnership with the benefits of limited liability for its members. Like a company, an LLP has a legal personality separate from that of its members, one of which must be a natural person.

The franchisor may also operate as a sole trader or as an unlimited partnership. Unlike an LLP, an unlimited partnership is not a distinct legal entity from its partners and, therefore, its partners are jointly and severally responsible for the business's debts and liabilities.

Law stated - 15 May 2025

Regulation of business formation

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

Companies are formed under and governed by the Companies Act 2006, and LLPs are formed under and governed by the Limited Liability Partnership Act 2000. Unlimited partnerships are governed by the Partnership Act 1890.

Law stated - 15 May 2025

Requirements for forming a business

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

Companies must be registered at Companies House. To incorporate a company, those looking to set one up will need to pick a suitable company name, identify an address that will act as the registered office address of the company, have at least one director who is a natural person and have at least one shareholder. Companies also need to adopt a set of articles of association, which are the written rules that will govern the running of the company and the relationship between the shareholders. Companies generally use standard model articles, but these can be tailored to the company's structure or business. Once incorporated, Companies House will issue an incorporation certificate and company number. A set of company books must be maintained that detail certain information about the company and should be updated to reflect any changes. Certain changes and information will need to be filed at Companies House, including confirmation statements (detailing the shareholders) and company accounts. When incorporating, companies are required to identify and record the people who own or control the company, known as people with significant control (PSC). Information about a company's PSC is kept within a central public register at Companies House and should be updated to reflect any changes to the PSC. The PSC register helps to increase transparency over who owns and controls UK companies.

Limited liability partnerships must also be registered at Companies House. They are also required to file annual confirmation statements, annual accounts and update Companies House of any changes to its membership or registered office address. There is no specific requirement within the Limited Liability Partnerships Act 2000 for an LLP to have an LLP agreement. In the absence of such an agreement, the governance of the LLP is detailed in the default provisions set out in the Limited Liability Partnerships Regulations 2001. It is unlikely that the default provisions set out in those Regulations would be adequate for the governance of most modern LLPs. LLPs are also required to provide information about its PSC to Companies House.

Under the Economic Crime and Corporate Transparency Act 2023, which is gradually coming into force throughout the course of 2025, all new and existing company directors, persons of significant control, members of LLPs and those filing on behalf of companies or LLPs will be subject to identity verification requirements.

Unlimited partnerships are not registered at Companies House and are deemed to have been formed once they satisfy the definition of a partnership under the Partnership Act 1890. The governance of a partnership is detailed in the Act, except where the provisions of the Act have been amended by any partnership agreement entered into between the partners. As with LLPs, it is unlikely that the provisions set out in the Act would be adequate for the governance of most modern partnerships.

Law stated - 15 May 2025

Restrictions on foreign investors

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

The United Kingdom is a popular destination for foreign businesses seeking to expand overseas. Business regulation in the United Kingdom is relatively light-touch, as evidenced by its approach to franchising.

The Department for International Trade promotes foreign businesses trading in the United Kingdom and encourages investment from overseas. In general, there are no restrictions on ownership by foreigners of UK assets and foreign businesses and individuals are allowed to be both shareholders and directors in UK companies. UK immigration laws highlight how foreign investment is encouraged, allowing individuals from overseas to apply for visas based on their investment into certain UK companies. Of course, since Brexit, citizens of EU member states no longer have the automatic right to live and work in the United Kingdom, which may make franchising more complicated in some instances. Brexit has certainly had an impact on the domiciliary care sector in this regard.

Law stated - 15 May 2025

Taxation

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

Companies resident in the United Kingdom are required to pay corporation tax on their worldwide profits. Companies are taxed based upon their accounting reference period and can choose when their accounting period ends. Companies are required to file their annual accounts with a tax return with His Majesty's Revenue and Customs (HMRC) within 12 months of the accounting reference period end. The accounts must also be filed with Companies House (there is reduced disclosure for smaller companies) and, therefore, the accounts become a matter of public record.

A company that is not resident in the United Kingdom will not be liable to tax merely as a result of trading with United Kingdom businesses. However, when a non-resident company is trading through a permanent establishment in the United Kingdom, it will be subject to corporation tax on the profits made by that permanent establishment, measured on an arm's-length (market value) basis. A company not resident in the United Kingdom may be able to claim relief for tax suffered in the United Kingdom under the laws of the territory in which it is based, or under any double tax treaty (DTT) between the territory and the United Kingdom. In some cases, accounts from the permanent establishment are also required to be filed at Companies House.

Where a franchisor establishes a UK-resident subsidiary, that company will be taxed in its own right, as set out above. Transfer pricing rules of the United Kingdom or of the territory in which the franchisor is resident may apply to require transactions between the franchisor and UK subsidiary to be computed on an arm's-length (market value) basis for the purposes of tax computations.

If a company not incorporated in the United Kingdom is centrally managed and controlled in the United Kingdom, HMRC may seek to claim that the company is resident in the United Kingdom for tax purposes and subject to corporation tax in the United Kingdom on its worldwide profits. The territory that would ultimately have taxing rights could be determined under any DTT between the United Kingdom and that other territory, but in the absence of a DTT the company could become dual tax resident with associated complications.

LLPs are not subject to corporation tax, but members, as with partners in a partnership, will be taxed individually.

The tax year for individuals ends on 5 April and an individual is taxed by reference to the profits of his or her accounts attributable to that tax year (transitional provisions may apply).

He or she can choose when his or her accounting year ends although for simplicity many individuals and partnerships align their accounting date with the tax year end. The accounts are required to be filed with a tax return with HMRC on or before 31 January following the end of the tax year.

Individuals are now subject to a statutory residency test that determines if that person is resident in the United Kingdom or not. The test is based on both the number of days of physical presence in the United Kingdom and some further connection factors.

An individual resident in the United Kingdom is taxed on his or her worldwide profits and capital gains. Before 6 April 2025 an individual who was resident but not domiciled in the United Kingdom could potentially have been taxed only on profits remitted to the United Kingdom. From 6 April 2025 individuals who are still within their first four years as a UK tax resident following at least a 10-year period as a non-UK tax resident may also potentially be taxed only on profits remitted to the United Kingdom. As a general rule, individuals who are non-resident in the United Kingdom will be liable to income tax on profits arising in the United Kingdom. However, any DTT with the country in which they reside should determine which country has the taxing rights and any income tax suffered in the United Kingdom is likely to be relievable against tax in their domestic country under any such DTT.

A non-resident company or individual generating royalties, licence fees or interest in the United Kingdom may suffer a withholding tax on that income retained and paid to HMRC by the paying company. Any DTT between the United Kingdom and the company's or individual's country of residence may reduce the rate of the withholding tax. The non-resident may be able to recover this withholding tax against their own domestic tax.

The franchise agreement therefore should stipulate whether the franchisee is obliged to gross up any payment or cooperate with the franchisor in recovering any sums paid to HMRC (where appropriate) under any DTT.

Law stated - 15 May 2025

Labour and employment

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

There are a number of employment law duties and discrimination protections that franchisors must be mindful of in relation to their own businesses and when providing support to their franchisees. Some are 'time served' protections, such as unfair dismissal rights that accrue after two years, and others are 'day one' employee rights, such as the protection from discrimination. As the landscape of work continues to evolve franchisors should also be mindful that some staff, although not considered employees, may hold 'worker' status, which provides certain basic employment rights, such as holiday pay and working time protections. Franchisors engaging individuals on a self-employed contractor basis should also be mindful of challenges that arise with this, such as ensuring an arms-length relationship to avoid the contractor being considered either an employee or worker.

Franchisors are not considered to be the employers (or joint employers) of franchisees' employees. However, in the context of franchisors and franchisees, employment status has been a fast-moving area of case law development in recent years and it is entirely possible, if the relationship is not structured and documented correctly, for a relationship described as that of franchisor and franchisee to be deemed to be one of employer and employee (or worker).

In the post-Brexit era, there are business immigration controls for franchisors to consider. Employers must now sponsor non-British or Irish nationals to work in the United Kingdom if they are not 'settled workers' or do not have some other immigration permission allowing them to work in the United Kingdom. Often this may require sponsorship as 'skilled workers', for which the employing entity will need to hold a sponsor licence.

Law stated - 15 May 2025

Intellectual property

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

Trademarks in relation to goods or services can be registered at the Intellectual Property Office (IPO).

Anyone considering franchising in the United Kingdom should ensure that its trademarks are registerable, as the registration of the trademark normally gives the owner the exclusive right to prevent others from using the mark and there is a market expectation that any trademark being licensed is registered or is at the very least in the process of being registered.

The registration of trademarks at the IPO is a relatively simple and inexpensive process so long as no opposition to the registration is lodged.

As a result of Brexit, with effect from 1 January 2021, the IPO created a comparable independent UK trademark for every registered EU trademark, which has the same legal status as if registered under UK law. The UK trademark will keep the original EU trademark filing date.

Where a franchisor has either not yet registered or cannot register a trademark, the franchisor may have a claim for 'passing off' if a competitor imitates the goods or services it offers in such a way that the public believes them to be those of the franchisor. A claim will be successful if there is goodwill and a reputation attached to the goods or services it offers, and the franchisor has suffered a loss.

Know-how relating to the franchise system will invariably be detailed in the system's manual. It cannot be protected by registration and is, therefore, protected through the franchise agreement. The franchise agreement will contain a requirement on the franchisee to keep any know-how and other confidential information belonging to the franchisor confidential both during and after the currency of the franchise agreement.

Law stated - 15 May 2025

Real estate

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

Property law in England and Wales is based on the common law system and, as such, proprietary interests in land derive from either freehold (where the freeholder owns the property outright and is free to dispose of it) or leasehold (where the leaseholder is entitled to occupy the premises for an agreed period subject to the terms of the lease including an obligation to pay rent to the landlord) interests. How the property from which the franchise business operates is occupied usually depends on the franchisor's business model and it is crucial that the agreements to occupy any premises dovetail with the franchise agreement.

It is common for a franchisee to take a direct lease, in which case the franchisor may require step-in rights, which can usually be exercised (depending on the terms of those step-in rights) in the event of default by the franchisee of the terms of the lease or termination of the franchise agreement, and a right of pre-emption, which would benefit the franchisor if the franchisee wanted to assign its interest in the lease. These would allow the franchisor to take on the franchisee's rights and obligations under the lease.

Where the premises are critical to the success of the franchise, the franchisor may take a head lease and grant a sublease to its franchisee. This allows the franchisor to have more control over the premises, but comes with an increased financial risk.

If the franchisor owns the freehold itself and grants a direct lease to its franchisee or is granting a sublease to the franchisee, it is crucial that the security of tenure provisions otherwise conferred by the Landlord and Tenant Act 1954 are excluded, so that the franchisor retains an element of control over the occupation of the premises, otherwise the franchisee tenant can benefit from a right to occupy the premises after expiry of the lease, and even have a right to request a new lease. This legislation does not apply in Scotland, which has a different real estate system.

Law stated - 15 May 2025

Competition law

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

Chapter I of the Competition Act 1998 prohibits agreements that may affect trade within the United Kingdom, and have as their object or effect the prevention, restriction or distortion of competition within the United Kingdom. In practice, post-Brexit, franchisors operating within the United Kingdom initially saw no substantive change to the competition law regime, as Chapter I was modelled on article 101 of the Treaty of the Functioning of the European Union. Although article 101 no longer applies in the United Kingdom, it will apply to UK businesses that enter into agreements that have an effect in the European Union.

Whether a franchise agreement falls within the scope of Chapter I of the Competition Act 1998 will depend on a number of factors, including the parties' relevant market share. In practice, most franchisors draft their domestic agreements so that they benefit from the Vertical Agreements Block Exemption Order (the Block Exemption Order). This replaced the European Union's Vertical Block Exemption Regulation following Brexit. If a franchise agreement falls within the terms of the Block Exemption Order, it will be exempt under Chapter I of the Competition Act 1998. For example, a five-year initial term is common in franchise agreements, as they typically contain in-term non-compete restrictions, which, if longer than a five-year period, will not benefit from the Block Exemption Order.

Furthermore, any hardcore restrictions contained in the franchise agreement will lead to the exclusion of the franchise agreement from the scope of the Block Exemption Order. These include an obligation on franchisees to sell goods or services for a minimum price (resale price maintenance) or restrictions on franchisees from responding to unsolicited requests from customers to provide goods or services (passive sales) outside of an agreed territory. Restrictions on passive sales also prevent franchisors from prohibiting franchisees from operating their own websites, but not from requiring that such websites meet certain specifications.

Competition issues are regulated domestically by the Competition and Markets Authority. Sanctions include financial penalties or the voiding of provisions within the franchise agreement.

Law stated - 15 May 2025

OFFER AND SALE OF FRANCHISES

Legal definition

12 | What is the legal definition of a franchise?

There is no legal definition of franchising under UK law, which is indicative of the absence of regulation in the sector. However, the British Franchise Association's (BFA) Code of Ethics adopts its definition of franchising from the European Code of Ethics for Franchising and describes franchising as:

> A system of marketing goods and/or services and/or technology that is based upon a close and ongoing collaboration between legally and financially separate and independent undertakings, the franchisor and its individual franchisees, whereby the franchisor grants to its individual franchisees the right, and imposes the obligation, to conduct a business in accordance with the franchisor's concept.
>
> In exchange for fees or other financial consideration, the franchisor grants a franchisee the right to use the franchisor's trade name, know-how, technology and systems and other intellectual property rights, supported by continuing provision of commercial and technical assistance, within the framework of a written franchise agreement.

Law stated - 15 May 2025

Laws and agencies

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

There are no government agencies or specific legislation that regulate the offer and sale of franchises.

However, the BFA Code of Ethics places obligations on member franchisors in relation to the offer and sale of franchisees. Membership of the BFA is voluntary.

Franchising arrangements may be subject to the Trading Schemes Act 1996 and the Trading Schemes Regulations 1997, which were enacted to tighten up the existing legislation regulating pyramid selling through trading schemes, namely the Fair Trading Act 1973. Franchisors must be mindful of the legislation owing to its broad drafting.

The Trading Schemes Regulations 1997 (the Regulations) do not place a prohibition on trading schemes. However, if the franchising relationship is considered a trading scheme, then the Regulations place obligations on franchisors in relation to advertising and can impose contractual requirements, including a cooling-off period. These requirements would make franchising an unattractive business model. Therefore, in practice, franchise networks in the United Kingdom are structured to ensure that a franchisor is exempt from the legislation.

A franchisor can ensure that it is exempt from the legislation by either operating as a single tier (namely by having one level of franchisee) or by being, and making certain that all the franchisees (and all other relevant participants) are, value added tax-registered.

If the franchisor is unable to benefit from one of the exemptions and subsequently breaches the legislation, it may become subject to criminal sanctions, or find itself subject to civil claims from a franchisee for breach of its statutory duties. In addition, any obligation on the franchisee to pay fees to the franchisor will be unenforceable.

Law stated - 15 May 2025

Principal requirements

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

There are no laws governing the offer and sale of franchises. However, where franchisors are members of the BFA, they are required under the terms of their membership, but not as a matter of law, to comply with the Code of Ethics to ensure that all advertising for the recruitment of franchisees is free of ambiguity and misleading statements.

Law stated - 15 May 2025

Franchisor eligibility

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

There are no specific laws or regulations.

The BFA Code of Ethics requires that, prior to franchising, the franchisor has operated at least one pilot franchise operation, has the right to use its brand, and provides its franchisees with initial training and continuing assistance.

It is important to note that where, as part of the process of offering and subsequently awarding the franchise, the franchisor requests that the franchisee pays a deposit, the BFA Code of Ethics stipulates that the deposit must be refundable, subject to the franchisor retaining any quantifiable directly related expenses incurred by it and that the terms upon which any deposit is taken are set out in writing.

Law stated - 15 May 2025

Franchisee and supplier selection

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

No, there are no such laws or regulations.

However, the BFA Code of Ethics states that the franchisor may select and accept only franchisees who appear to possess the basic skills, education, personal qualities and financial resources to carry on the franchise business.

Law stated - 15 May 2025

Pre-contractual disclosure – procedures and formalities

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

There is no legal requirement to disclose information to a prospective franchisee and as such there are no procedural formalities.

The BFA Code of Ethics requires that franchisees are provided with an up-to-date copy of the Code, along with a full and accurate written disclosure of all information material to the franchise relationship within a reasonable time prior to execution of the franchise agreement.

Even where a franchisor is not a member of the BFA, it should consider preparing some form of disclosure document to give to prospective franchisees to enable it to give accurate and consistent responses to due diligence enquiries.

Law stated - 15 May 2025

Pre-contractual disclosure – content

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

Although there is no legal requirement as to what information is disclosed to a prospective franchisee, the BFA Code of Ethics sets out the types of information that its members are required to disclose.Even where a franchisor is not a member of the BFA, it should consider preparing some form of disclosure document providing similar information.

Under the BFA Code of Ethics, franchisors must give prospective franchisees all information that they require to be able to make a properly informed decision about whether to invest in a franchise. This will include:

- the financial status of the franchisor;
- how long the franchisor has been operating and franchising;
- information about the franchisor's directors and key individuals within the franchise;
- a description of the franchise's business model;
- proper verifiable financial forecasts of the franchise model;
- information about the performance of the network;
- details of franchisees;
- details of any 'purchasing incentives' or commissions; and
- a copy of the franchise agreement.

Law stated - 15 May 2025

Pre-sale disclosure to sub-franchisees

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

There is no legal requirement to disclose information to a prospective sub-franchisee.

Where the sub-franchisor is a member of the BFA, it would be obliged under the Code of Ethics to provide franchisees with a full and accurate written disclosure of all information material to the franchise relationship within a reasonable time prior to execution of the franchise agreement. This would include disclosure of the fact that the sub-franchisor is licensed by the franchisor to grant franchises and a clear explanation of the sub-franchisor's relationship with the franchisor.

Law stated - 15 May 2025

Due diligence

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

The franchisor should satisfy itself that franchisees are of suitable character, and have the necessary skills base and (if applicable) qualifications to operate the franchise. Franchisors should also ensure that franchisees have sufficient funding to both open and operate the franchise. It is important to ensure that the individuals who will be operating the franchise have the legal right to reside in the United Kingdom throughout the term of the franchise agreement.

A franchisee should review in detail any disclosure document provided by the franchisor, to ensure an understanding of the costs involved in running the franchise and the expected financial returns. A franchisee should check that the franchisor has the right to license the relevant trademarks to the franchisee, and it is market practice for a franchisee to instruct a lawyer to prepare a report on the franchise agreement highlighting its key commercial terms and any issues that should be raised with the franchisor. A franchisee should enquire about the number of franchises within the network, including the number of franchise failures, and speak to existing franchisees to understand their views on operating within the network.

Law stated - 15 May 2025

Failure to disclose – enforcement and remedies

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

A franchisor could find itself the subject of a claim for misrepresentation from a franchisee. Such a claim would arise if the franchisor were to make an untrue statement of fact that induces the franchisee to enter into a franchise agreement. This would typically be some form of earnings claim with little basis in fact. Depending on the circumstances in which the statement is made, the franchisor may then be subject to a claim for one or more of innocent, negligent or fraudulent misrepresentation. Such statement can be made either orally or in writing. In the case of a successful claim for misrepresentation, depending on the facts, the franchisee may be able to rescind the agreement or, where it has suffered loss, claim for damages, or both. If the misrepresentation was innocent, then the court may rescind the agreement or award damages in lieu of recession, but not both. In the case of fraudulent or negligent misrepresentation, a court can award damages and rescind the agreement. If an agreement is rescinded, the parties are restored to the position in which they would have been had the agreement never been entered into.

The franchisor will invariably insert provisions into the franchise agreement to restrict or exclude liability for misrepresentation. The effectiveness of such clauses is subject to both statute and common law. Where a clause seeks to limit liability for misrepresentation, it would be subject to the test of reasonableness under the Unfair Contracts Terms Act 1977. Any clauses seeking to restrict or exclude liability from fraudulent misrepresentation will be ineffective. The case of *Papa Johns (GB) Ltd v Doyley* [2011] makes it clear that the courts are reluctant to allow franchisors to benefit from such provisions due to the inequality of bargaining power and, as such, franchisors should ensure that they are careful and organised about the information provided to franchisees rather than solely relying on exclusion or limitation of liability clauses.

Law stated - 15 May 2025

Failure to disclose – apportionment of liability

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

Where a sub-franchisee has a claim for misrepresentation, it will be against the sub-franchisor and not the franchisor. On the assumption that the franchisor or the sub-franchisor is a limited liability entity then individual officers, directors or employees will not generally be exposed to personal liability.

Law stated - 15 May 2025

General legal principles and codes of conduct

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

The offer and subsequent sale of franchises will be subject to general principles of contract and tort law, and therefore the laws relating to misrepresentation will offer protection to franchisees.

The parties must be mindful of the concept of caveat emptor (buyer beware) and, therefore, carry out an appropriate level of due diligence. The concept of culpa in contrahendo, common in civil jurisdictions, places a duty to negotiate with care that could extend to making pre-contract disclosures, but this concept does not apply in the United Kingdom. Nor is there, as the law currently stands, a general implied duty of good faith.

Law stated - 15 May 2025

Fraudulent sale

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

A franchisee can claim against the franchisor for fraudulent misrepresentation and, if successful, may rescind the agreement, or claim damages, or both.

Any clauses in the franchise agreement that seek to restrict or exclude liability from fraudulent misrepresentation will be ineffective.

Law stated - 15 May 2025

FRANCHISE CONTRACTS AND THE FRANCHISOR/FRANCHISEE RELATIONSHIP

Franchise relationship laws

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

There are no specific laws that regulate the ongoing relationship between the franchisor and the franchisee after the franchise contract comes into effect.

Law stated - 15 May 2025

Operational compliance

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

Franchise agreements will normally contain an obligation on franchisees to provide the franchisor with financial information including management accounts, annual accounts and value added tax returns (if applicable) enabling the franchisor to both monitor the franchisee's financial performance and provide guidance and feedback on it. In practice, franchisees generally allow franchisors (through the terms of the franchise agreement) online access to this data. Franchisees may also be required to provide the franchisor with a business plan each year.

In addition, there will typically be an ability for the franchisor to carry out a complete audit of the franchisee's business to ensure compliance with operational standards. Where the franchisee's business is falling below those standards, typically there will be a requirement to remedy those failings. If the franchisee fails to do this then such a provision may allow the franchisor to treat the failure as a breach of the franchise agreement, remove a franchisee's territorial exclusivity or terminate the franchise agreement.

Law stated - 15 May 2025

Amendment of operational terms

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

Yes, the franchise agreement, if drafted correctly, will allow the franchisor to unilaterally change the operational terms and standards by amending the manual, with which the franchisee will be required to comply. This assumes that the change does not conflict with the franchise agreement. While the franchise agreement will contain an obligation on the franchisee to comply with the manual in its entirety, where there are key policies and procedures that the franchisor envisages being updated periodically, it is advisable that the franchise agreement makes specific reference to the franchisee's need to comply with those policies and procedures.

Law stated - 15 May 2025

Policy affecting franchise relations

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

There are no mandatory government or trade association policies affecting the franchise relationship.

Franchisors that choose to become members of the British Franchise Association (BFA) are obliged to comply with its Code of Ethics.

Law stated - 15 May 2025

Termination by franchisor

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

The circumstances in which a franchisor may terminate the franchise relationship are detailed in the franchise agreement. Typically, there is a right to terminate the franchise agreement with immediate effect if the franchisee:

- ceases to operate the business;
- brings the brand into disrepute;
- commits a criminal offence;
- is the subject of an insolvent event or insolvency proceedings;
- repeatedly breaches the franchise agreement; or
- fails to remedy a breach within an agreed time frame.

The franchisor also has the right at common law to terminate the franchise agreement in the event of a repudiatory breach of it by the franchisee. A repudiatory breach is essentially a breach that goes to the core of the contract and deprives the innocent party of its benefit.

Law stated - 15 May 2025

Termination by franchisee

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

Generally, a franchise agreement will not contain any express provisions allowing the franchisee to terminate it prior to the expiry of its term. However, the franchisee has the right at common law to terminate the franchise agreement in the event of a repudiatory breach of it by the franchisor.

Law stated - 15 May 2025

Renewal

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

The franchisee will be required on renewal to enter into the franchisor's standard franchise agreement. There are no laws setting out how franchise agreements are to be renewed or containing any requirements to be complied with on their renewal. Typically, there will be an obligation on the franchisee to notify the franchisor that it wishes to renew the franchise agreement during a time period specified in the franchise agreement.

Law stated - 15 May 2025

Refusal to renew

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

There are no laws stipulating whether and on what terms the franchisor must renew the franchise agreement. Furthermore, there is no requirement under the BFA Code of Ethics that there must be a renewal of the franchise agreement.

The basis of renewal is a contractual one and the franchise agreement will set out conditions that must be met for the franchisor to agree to renew it. These will typically include a requirement that the franchisee is not in breach of the agreement, pays a renewal or administration fee and undertakes any required updates of its business operations or premises.

Law stated - 15 May 2025

Transfer restrictions

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

A franchisor can and normally does restrict such transfers. The franchise agreement usually stipulates that the franchisor's consent to any transfer is required, which will be given subject to certain conditions being met. These conditions include the franchisor being satisfied that the prospective purchaser is a suitable candidate as a franchisee and the franchisee paying all sums owed to the franchisor, as well as certain costs associated with the transfer process. These provisions normally contain a right of pre-emption in favour of the franchisor, allowing it to buy the franchise business from the franchisee.

Law stated - 15 May 2025

Fees

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

There are no such laws or regulations.

Law stated - 15 May 2025

Usury

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

A franchisor may impose interest on overdue payments, which is typically specified in the franchise agreement. However, a franchisor must be wary that if the rate of interest is too high it may be considered a penalty clause and, therefore, be unenforceable.

Where no express provision is included in the franchise agreement, the default rate pursuant to the Late Payment of Commercial Debts (Interest) Act 1998 shall apply and the annual rate currently stands at 8 per cent above the Bank of England base rate.

Law stated - 15 May 2025

Foreign exchange controls

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

Generally, there are no such laws or restrictions. However, if a franchisor is operating in a country on which the United Kingdom has imposed financial sanctions, restrictions may apply.

Law stated - 15 May 2025

Confidentiality covenant enforceability

37 | Are confidentiality covenants in franchise agreements enforceable?

Yes, so long as they are clearly drafted.

Law stated - 15 May 2025

Good-faith obligation

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

As the law currently stands, there is no general legal obligation on the parties to a franchise agreement to deal with each other in good faith.

Case law on this has been unsettled on this subject for some time. In *Yam Seng Pte Ltd v International Trade Corporation Ltd* [2013] EWHC 111, the High Court commented on the importance of recognising the concept of good faith in 'relational contracts', including franchise agreements. However, in *Carewatch Care Services Ltd v Focus Caring Services Ltd* [2014] EWHC 2313 (Ch), the High Court dismissed an argument from the franchisee that the franchise agreement contained an implied term that the franchisor and franchisee act in good faith towards each other. The Court took the view that, as the franchise agreement contained detailed terms dealing with all aspects of the franchise relationship, it was not necessary to imply any further terms.

Recent case law has suggested that the courts are becoming ever more willing to imply a duty of good faith into certain contracts, potentially including franchise agreements. In *Sheikh Tahnoon Bin Saeed Bin Shakhboot Al Nehayan v Kent* [2018] EWHC 333 (Comm), it was held that the parties to a joint venture arrangement, entered into orally, owed each other a duty of good faith. Subsequently in *Bates & Ors v the Post Office Ltd* [2019] EWHC 3408 (QB), it was held that a duty of good faith should apply as a matter of law to all 'relational' contracts and provided some guidance as to what a 'relational' contract might be. Under this guidance, franchise agreements may well be classed as relational contracts. However, in the case of *TAQA Bratani Ltd v Rockrose UKCS8 LLC* [2020] EWHC 58 (Comm)), the High Court made it clear that the status of a contract as relational did not automatically imply that the parties owed each other a duty of good faith.

There is no doubt that, while there is not a general implied duty of good faith, the courts are willing to imply a duty of good faith with regard to certain contracts and this continues to be a developing area of law.

The BFA Code of Ethics requires parties to a franchise agreement to exercise fairness in their dealings with each other, and to resolve complaints, grievances and disputes with good faith.

Law stated - 15 May 2025

Franchisees as consumers

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

Franchisees are not currently treated in law as consumers.

Law stated - 15 May 2025

Language of the agreement

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

There is no such legal requirement. However, the BFA Code of Ethics requires that the franchise agreement is translated into the language of the franchisee's country and in which the franchisee is competent.

Law stated - 15 May 2025

Restrictions on franchisees

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

Given the nature of franchise systems and the level of control that franchisors will wish to retain over the network, during the term of the franchise agreement franchisees will typically be subject to a number of restrictions. These include obligations to operate from specific premises or within specific territories, to purchase certain products or services from the franchisor or its nominated suppliers and not to be involved or interested in another business. Franchise agreements may also place restrictions on franchisees from selling goods or services above a particular price.

In addition, after the term of the franchise agreement, franchisors will seek to restrict franchisees from being involved or interested in a competing business from the premises or the territory in which the franchisee previously operated, or from competing with the rest of the network. These may also include restrictions on poaching certain employees or soliciting customers. These restrictions will only be enforceable to the extent that they go no further than is reasonably necessary to protect the franchisor's legitimate business interests.

Law stated - 15 May 2025

Courts and dispute resolution

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

The United Kingdom is made up of more than one legal jurisdiction, with England and Wales along with Scotland being the largest two jurisdictions. Civil claims proceed differently in each jurisdiction, although the burden of proof is the same – namely, the balance of probabilities. In England and Wales, a franchisor would be expected to follow a pre-action protocol prior to commencing proceedings. A claim would be heard in either a local county court or the High Court. The High Court will ordinarily only hear claims with particular complexity, high-value or cross-jurisdictional elements. Claims in Scotland proceed in the local sheriff court or in the Court of Session. Unlike in England and Wales, a claim can be commenced without the need to follow a pre-action protocol.

There is a strong emphasis on resolving disputes without resorting to litigation and different forms of alternative dispute resolution, such as mediation, are encouraged and may well become mandatory in the near future. Unreasonably refusing to engage in alternative dispute resolution can result in a party being punished in costs, regardless of whether they are the successful party at court.

The BFA runs a mediation and arbitration scheme to resolve franchise disputes. It is common for franchise agreements to contain provisions requiring the parties to consider mediation before commencing proceedings, or that disputes are to be resolved by way of arbitration, rather than through the courts. Mediation should therefore be refused only after careful consideration and advice.

Given the length of time that claims take to progress through the court system, which can be years rather than months, some franchisors and franchisees are choosing to resolve their disputes through arbitration.

Law stated - 15 May 2025

Governing law

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

There are no restrictions on designating a foreign governing law in franchise agreements. However, the parties to the agreement will remain subject to certain mandatory laws that will apply notwithstanding the choice of jurisdiction, for example, the Transfer of Undertakings (Protection of Employment) Regulations 2006, which seek to protect employees and workers in business transfers.

Law stated - 15 May 2025

Arbitration – advantages for franchisors

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

The advantages of arbitration in the United Kingdom are similar to most jurisdictions, in that it generally offers a speedier and potentially less costly alternative to court proceedings, hearings are confidential to the parties and if the matter has particularly technical points an arbitrator with relevant expertise can be selected. The London Court of International

Arbitration is recognised as a world-leading institution. The United Kingdom is a signatory to the New York Convention, allowing for enforcement of arbitral awards through convention protocols.

The parties to a franchise agreement may also decide to mediate. The Centre for Effective Dispute Resolution is a respected organisation offering mediation services. Members of the BFA also benefit from its mediation scheme.

Law stated - 15 May 2025

National treatment

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

Foreign franchisors are treated in the same way as domestic franchisors.

Law stated - 15 May 2025

UPDATE AND TRENDS

Legal and other current developments

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

Franchisors should be aware of legislation that has either been passed or is likely to be passed in the near future:

- The Employment Rights Bill was introduced by the government in October 2024 and is currently making its way through Parliament. The Bill, when passed, will result in a widescale overhaul of employment law. Elements that franchisors should be mindful of, including the proposal to make unfair dismissal protection a 'day one' right, changes to the way in which employers will be able to vary contracts of employment for current employees and significant changes to the rights of zero-hours workers and workers generally. This new legislation is currently anticipated to take effect during the course of 2026.
- The Terrorism (Protection of Premises) Act 2025, which is commonly referred to as Martyn's Law, was passed following the Manchester Arena attack. The legislation is designed to improve security and to ensure that organisations have considered how they would respond to a terrorist attack at larger premises or events. If any franchise network is likely to fall within the requirements of the Act, then the franchisor should begin considering the requirements. It is expected that there will be a 24-month implementation period and therefore franchisors will need to comply with its requirements only once the Act is brought into force by regulations. According to the government's factsheet on the Act, a 'premise' will fall within the Act where it is reasonable to expect that at least 200 individuals may be present at the premises at least occasionally and an 'event' will fall within the Act if it is reasonable to expect

that there will be at least 800 individuals present for the event at once at some point during it. The 'responsible person', to be determined in accordance with the Act, will need to notify the Security Industry Authority of the qualifying premises or event by the required time and have in place, so far as is reasonably practicable, appropriate public protection procedures.

Law stated - 15 May 2025

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Summary

MARKET OVERVIEW

Franchising in the market

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

Franchising is woven into the fabric of the US economy. Franchised businesses operate in over 75 business sectors or industries. While restaurants and other food service operations account for approximately one-third of all franchise establishments, franchising is well represented in many sectors, such as automotive services, hotels, retail products and home healthcare services. Franchising is regulated at both the federal and state level, so companies seeking to franchise in the United States must be mindful of a broad array of legal considerations. Nonetheless, due to well-established financial and lending markets, real estate practices and legal systems, franchising has flourished in the United States.

Law stated - 13 May 2025

Associations

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

The pre-eminent franchise association in the United States is the International Franchise Association (IFA), which was founded in 1960. Generally, all franchisors, franchisees, and individuals and companies that supply goods or services to franchise systems can join the IFA. The IFA's mission is to protect, enhance and promote franchising. Membership of the IFA is voluntary. The IFA has adopted a code of ethics, which has no force of law.

There are, and have been, other organisations and associations related to franchising in the United States. Some of these have developed to address certain issues or subgroups (eg, the American Association of Franchisees and Dealers). There are also industry-specific franchise-related associations (eg, the National Auto Dealers Association and the Asian American Hotel Owners Association).

Law stated - 13 May 2025

BUSINESS OVERVIEW

Types of vehicle

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

Franchisors are free to operate in whatever corporate form they choose. Limited liability companies and corporations are the most common forms of business entities used by franchisors. There are tax implications and other legal liability concerns that accompany a franchisor's choice of business entity.

Law stated - 13 May 2025

Regulation of business formation

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

Business entities are almost always formed pursuant to state law, typically by making an application to the relevant secretary of state. Foreign companies are free to choose the state in which they would like to form their business entity, although there are legal, tax and other implications that can impact this decision. It is common for foreign (and domestic) franchisors to choose Delaware as the state of formation. However, all states have enacted laws that govern the formation of business entities. When operating in multiple states, an entity formed in one state must register to do business in another state as a foreign entity, which is a simple ministerial process.

Law stated - 13 May 2025

Requirements for forming a business

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

The requirements vary significantly depending on the type of business entity that a franchisor seeks to form. For instance, a general partnership can be formed by default if two or more individuals or entities operate a business together. Other types of entities, such as limited liability companies or corporations, must be filed with the relevant secretary of state or a similar state agency. The nature and substance of the documentation to be filed vary depending on the type of entity and the state's process. States typically require periodic document filing and fees to maintain the business entity. Commencing in 2025, certain non-exempt entities formed under the laws of a foreign country that have registered to do business in any US state must comply with the Corporate Transparency Act and report certain beneficial ownership information to the Financial Crimes Enforcement Network.

Law stated - 13 May 2025

Restrictions on foreign investors

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

Foreign businesses are generally treated the same as domestic businesses under US laws. There are, however, a variety of laws that apply to foreign investment, many of which were enacted in the interest of national security. For instance, the Exon–Florio Amendment to the Defense Production Act of 1950 provides the federal government with the authority to review foreign investments in the United States for potential national security concerns. The USA PATRIOT Act and Executive Order 13224, which are aimed at deterring terrorism, include restraints on transactions that involve suspected terrorists. Franchisors are prohibited from dealing with individuals included on the Specially Designated Nationals and Blocked Persons List maintained by the US Treasury Department's Office of Foreign Assets Control. Foreign investors are also subject to certain reporting and disclosure requirements under the International Investment and Trade in Services Survey Act of 1976 and the Corporate Transparency Act.

Law stated - 13 May 2025

Taxation

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

Taxes are imposed in the United States by federal, state and local governments. A foreign franchisor is subject to the tax laws of the jurisdictions in which it operates. If the foreign franchisor establishes a US-based subsidiary as the US franchisor, that entity would be subject to US tax laws. Franchisors are subject to income taxes, which are generally assessed on revenues or income after certain deductions and adjustments. The federal tax rate ranges from 10 per cent to 37 per cent of taxable income. State and local taxes vary from zero per cent to 13.3 per cent of income. If the entity that is being taxed is a corporation, double taxation is possible, with income tax also imposed on the shareholders or owners. For certain entities (eg, limited liability companies and partnerships), the tax is passed through to the owners of the entities. The typical revenue received by a franchisor – such as initial franchise fees and royalty fees – are treated and taxed as ordinary income, and not at the lower capital gains rates.

Even if it does not have a physical place of business in the United States, a foreign franchisor is taxed on its US sources of income. If the foreign franchisor operates in the United States or creates a US subsidiary, the state in which the headquarters are located or in which the entity is formed may assess taxes on that entity. In addition, more states are seeking to assess taxes on out-of-state entities that are doing business in the state, even if they are not physically located there. Therefore, some states are seeking to assess income tax on foreign entities that merely have franchises operating in that state. Hence, an out-of-state franchisor may be subject to tax on the royalty income it receives from a franchisee located in a particular state. Out-of-state franchisors may be able to obtain credit on their home state taxes for taxes paid in other jurisdictions. States including California, Arizona, Kansas, New Mexico and Hawaii all take the view that foreign franchisors may be liable for state income tax if the entity has a substantial nexus with a state.

Federal law also requires that the tax on royalties paid to a foreign entity be withheld at the source and paid to the US Internal Revenue Service. However, certain tax payments may be reduced or exempted from withholding under some tax treaties.

Law stated - 13 May 2025

Labour and employment

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

Generally, franchisors and franchisees are not considered to be in an employer-employee relationship. Rather, franchisees are classified as independent contractors and operate as separate legal entities. However, in recent years, some courts have found that franchisees may be deemed employees of their franchisor for purposes of labour, tax and other laws where the franchisor exercises excessive controls over the franchisees. The results in these cases turn on the specific facts at issue and the state-specific analytical frameworks, which vary. There have been several well-known cases that examine alleged employee misclassification and the franchise relationship in the janitorial services industry. Franchisors can mitigate the risk of having their franchisees classified as employees by structuring and implementing the franchise relationship in a manner that is consistent with state independent contractor laws. In addition, some franchisors grant franchises only to business entities, rather than individuals – in part to diminish the risk of misclassification.

In addition, franchisors operating in the United States face the risk that they may be deemed joint employers of their franchisees' employees. If a franchisor is deemed a joint employer, it can be liable for employment-related claims at a franchised business, such as wage and hour claims, harassment or discrimination. As a general rule, franchisors can be at risk of a joint employer determination if the franchisor controls, or has the right to control, the franchisee's employment-related decision-making. This could be either through operational realities, or through language in franchise agreements, franchise disclosure documents (FDD), manuals or other procedures and guidelines. Franchisors can mitigate the risk of joint employment by making certain changes to their franchise documents to emphasise the franchisee's status as an independent contractor and through certain operational practices, such as by providing only voluntary recommendations on employment issues.

Law stated - 13 May 2025

Intellectual property

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

One of the principal means for franchisors to protect their trademarks is through registration. Trademarks can be registered at state and federal level, although nationwide protection can be achieved only through federal registration. Unregistered rights in a trademark are governed by common law and extend only to the geographic territory where the mark is used.

At the federal level, registration with the US Patent and Trademark Office (USPTO) gives the franchisor a nationwide priority of rights in the trademark. Once a trademark is registered with the USPTO, there is a rebuttable presumption that the registrant is the owner of the mark, that the mark is valid and that the registrant has the exclusive right to use it. The trademark owner may license others to use the mark and to pursue enforcement action against infringers. After five years, the registrant's rights in the mark become incontestable, which shields the registrant from certain challenges to the mark's validity.

The US Copyright Office also has a system for registering copyrights. A copyright attaches to an original work of authorship when it is created. While registration with the Copyright Office is not required, if the owner of a copyright wishes to bring a lawsuit for copyright infringement, the owner must register the work before bringing a claim.

Franchisors can take other practical steps aside from registration to protect their trademarks in the United States. For example, franchisors can ensure the continuing strength of their trademarks by using the marks consistently and avoiding changes in their appearance and presentation; using trademark notices (eg, the symbol for federally registered marks and the symbol for all other marks) to demonstrate their ownership rights; and taking action against infringers.

With regard to know-how, US law recognises the value in confidential methods and knowledge that become trade secrets. A trade secret is any information in any form that derives independent economic value from not being generally known or readily ascertainable and is the subject of reasonable efforts to maintain its secrecy. There is no documentation that must be filed with the government for information to be recognised as a trade secret. In 2016, the federal government enacted the Defend Trade Secrets Act for the protection of trade secrets. Forty-nine states have also adopted the Uniform Trade Secrets Act. For information to retain its status as a trade secret, a franchisor must monitor the information and take measures to maintain its secrecy. Anyone who has access to the information should be subject to strict written confidentiality obligations.

Law stated - 13 May 2025

Real estate

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

All US states and many other jurisdictions have laws that address ownership, leasing, sub-leasing and transfers of real estate. These laws are not specific to franchising. However, there are real estate issues that a franchisor may wish to consider. Namely, franchisors should take steps to exercise control over the premises of the franchised business so that, on termination or expiration of a franchise agreement, they do not lose valuable customer exposure, the location or signage.

Frequently, a franchisee leases the franchised premises from a third-party landlord. In that situation, a franchisor may want to require the franchisee to execute a conditional assignment of the lease, through which the franchisee and the lessor agree to assign the property to the franchisor upon termination or expiration of the lease, sub-lease or the franchise agreement. A franchisor may also require a franchisee's lease to contain certain prescribed terms, such as the right to receive notices of default under the lease, the right to cure a franchisee's default under the lease or the right to retrieve property that the franchisee abandons after the end of the lease term.

Law stated - 13 May 2025

Competition law

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

Several aspects of competition law in the United States are relevant to franchising. For instance, sourcing and price controls imposed by a franchisor are subject to certain limitations under federal and state antitrust laws, and under state franchise relationship laws.

It is permissible for a franchisor to require franchisees to buy products and services only from the franchisor, or its designated or approved suppliers. These restrictions must be disclosed in the franchisor's FDD. While a franchisee may challenge those restrictions as an unlawful tying arrangement under antitrust laws, such claims rarely succeed. With some exceptions, provided that the sourcing requirements were disclosed through the FDD or other pre-sale communications with the franchisee, these arrangements do not usually expose franchisors to antitrust liability. However, certain state franchise relationship laws (eg, the Washington Franchise Investment Protection Act) place limitations on sourcing requirements.

In addition, federal and state antitrust laws regulate pricing restrictions. Vertical agreements between franchisors and franchisees setting minimum or maximum resale prices are generally lawful under federal law. State law on this issue varies.

Most modern franchise agreements contain a non-compete covenant. The enforceability of a non-compete is principally governed by state law. Some states do not enforce a non-compete as a matter of public policy. However, many courts will enforce a non-compete if it is reasonable in terms of its durational and geographic restrictions, and necessary to protect the franchisor's legitimate business interests.

In April 2024, the Federal Trade Commission (FTC) issued a rule that generally prohibits non-compete covenants between a 'worker' and an 'employer', which was set to go into effect in August 2024, but it has faced legal challenges and is currently subject to an injunction prohibiting its implementation. However, the FTC specifically excluded from the rule non-compete provisions that apply to franchisees in the context of franchisor/franchisee relationships. The rule would still prohibit non-executive employees of franchisors and franchisees of being subject to non-compete covenants. There are expected to be further legal challenges to the injunction and this rule.

Law stated - 13 May 2025

OFFER AND SALE OF FRANCHISES

Legal definition

12 What is the legal definition of a franchise?

While federal and state jurisdictions share common definitional approaches, there is no universal definition of a franchise. Moreover, each jurisdiction has its own mix of definitional exclusions and exemptions.

Generally, a 'franchise' is defined by the coexistence of three elements:

- a grant of rights to use another's trademark to offer, sell or distribute goods or services;
- the grantor (or franchisor) providing significant assistance to, or exercising control over, the grantee's (franchisee's) business, which may take the form of a prescribed marketing plan; and
- the payment of a required fee.

If these three elements exist, the business arrangement is a franchise and the franchisor must comply with the applicable laws.

Law stated - 13 May 2025

Laws and agencies

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

At the federal level, franchising is regulated by the Federal Trade Commission (FTC) primarily through the FTC's Franchise Rule (the FTC Rule). The FTC also has a Business Opportunity Rule that can apply to franchises.

At state level, 14 states have laws that regulate pre-offer and pre-sale disclosures and require franchise registration. These states are California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Rhode Island, South Dakota, Virginia, Washington and Wisconsin. Oregon has a franchise-specific law that does not require documentation to be filed with the government. In addition, 25 states have business laws that apply to business opportunities or seller-assisted marketing plans. Most of these contain exemptions for franchisors that meet certain criteria. However, of those states, six impose pre-offer and pre-sale documentation filing requirements on franchisors. These states are Connecticut, Florida, Kentucky, Nebraska, Texas and Utah. Also, 25 states and territories have laws that regulate the terms of the franchisor/franchisee relationship (after the grant or sale of a franchise). These states are Alaska, Arkansas, California, Connecticut, Delaware, Hawaii, Idaho, Illinois, Indiana, Iowa, Louisiana, Maryland, Michigan, Minnesota, Mississippi, Missouri, Nebraska, New Jersey, North Dakota, Rhode Island, Virginia, Washington and Wisconsin, as well as Puerto Rico and the US Virgin Islands. State relationship laws typically pertain to franchise terminations, renewals and transfers.

There are many exclusions and exemptions from both the FTC Rule and state laws, which are nuanced. There is no nationwide exemption from franchise laws.

Lastly, the North American Association of Securities Administrators (NAASA) has guidance documents concerning franchise disclosures, which are deferred to by state regulators. Some states elect to codify parts of NAASA's guidance into state law.

Law stated - 13 May 2025

Principal requirements

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

The federal and state franchise laws and regulations are varied and include the following principal requirements:

- federal-level pre-sale franchise disclosure requirements;
- state-level pre-sale franchise registration and disclosure requirements; and
- state-level franchise relationship laws that govern the ongoing relationships between franchisors and franchisees, as well as between manufacturers and dealers or distributors, which impose requirements on terminations, renewals and transfers of franchises.

The federal and state laws regulating the offer and sale of business opportunities or seller-assisted marketing plans may also impose filing or disclosure requirements, or both.

Law stated - 13 May 2025

Franchisor eligibility

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

Neither federal nor state laws impose experience or similar threshold requirements as a prerequisite to offering franchises. However, some of the registration states may require inexperienced franchisors to defer their collection of initial franchise fees until the franchisor has completed its initial obligations and the franchisee has opened for business. Fee deferral may also be required based on a state's analysis of a franchisor's financial condition. Of course, a franchisor must comply with any applicable registration and disclosure requirements before offering franchises.

Law stated - 13 May 2025

Franchisee and supplier selection

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

No. The franchisor is generally free to contract with suppliers and franchisees of its choosing.

Law stated - 13 May 2025

Pre-contractual disclosure – procedures and formalities

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

At the federal level, the FTC Rule requires that franchisors who offer franchises anywhere in the United States must prepare a franchise disclosure document (FDD) and provide the FDD to prospective franchisees at least 14 days before signing a franchise agreement or accepting any consideration for the right to enter into a franchise relationship. The FDD must include 23 disclosure items and certain required appendices. Disclosures must be updated annually 120 days after the franchisor's fiscal year end and within a reasonable time after the close of each quarter to reflect material changes.

Fourteen states have pre-sale franchise disclosure and registration laws, although the disclosure period varies slightly by state. In these jurisdictions, a franchisor may not offer franchises in the state or to that state's residents unless the franchise offering is registered with the state. State laws require that FDDs must be updated at least annually or upon the occurrence of a material change, although what constitutes a material change and the exact timing of the required update varies by state.

Law stated - 13 May 2025

Pre-contractual disclosure – content

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

A US FDD must include 23 specific disclosure items, including:

- information regarding the franchisor and its business experience;
- fees payable by the franchisee;
- an estimate of the initial investment required to begin operations;
- information regarding support provided by the franchisor before and after the business opens; and
- a summary of the key terms of the franchise agreement.

The FDD must also include the franchisor's financial statements, copies of the forms of the franchise agreement and other contracts that a franchisee must sign, and contact information for all existing franchisees in the system.

A franchisor must obtain from the prospective franchisee a signed and dated FDD receipt page as evidence of proper disclosure.

Law stated - 13 May 2025

Pre-sale disclosure to sub-franchisees

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

Both the franchisor and sub-franchisor are jointly liable for compliance with disclosure laws. A sub-franchisor must provide an FDD to prospective franchisees. Certain aspects of the sub-franchisor's relationship with the franchisor must be disclosed in the sub-franchisor's FDD, such as the parties' trademark licensing arrangement. However, the parties' fee arrangement need not be disclosed. Additional disclosures pertaining to the franchisor must be disclosed in the sub-franchisor's FDD, including litigation and bankruptcy information about the franchisor.

Law stated - 13 May 2025

Due diligence

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

Prospective franchisees should review the FDD, franchise agreement and related documents detailing the terms of the franchise relationship to understand the costs involved, the control exercised by the franchisor and the support services offered. Prospective franchisees should also speak to as many of the franchisor's current and former franchisees as possible. Prospective franchisees should also evaluate competing brands. Prospective franchisees should consider engaging financial and legal advisers, as well as industry-specific trade associations, to help assess the franchise opportunity.

Franchisors should establish criteria to assess each prospective franchisee, which should include:

- whether the franchisee is a good fit for the system;
- whether the franchisee has the appropriate experience (eg, in business, management and human resources);
- whether the prospect meets minimum capital requirements;
- whether territory in the franchisee's ideal market is available; and
- whether it makes sense for the franchisor to expand into that region.

Law stated - 13 May 2025

Failure to disclose – enforcement and remedies

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

The FTC may initiate an investigation or enforcement action against a franchisor for violation of the FTC Rule. This action can result in a court order that imposes penalties, such as recission of agreements or payment of fines, and enjoins the franchisor from continuing the violation. There is no private right of action available to franchisees under the FTC Rule. Only the FTC may pursue a violation of the FTC Rule.

States may also initiate an investigation or enforcement action against a franchisor for violation of a state registration or disclosure law (including business opportunity laws). States also routinely impose cease-and-desist orders, and require recission of agreements and payment of fines. Some state laws also provide for criminal liability for violations of state franchise laws.

FTC and state enforcement actions must usually be disclosed in a franchisor's FDD.

Law stated - 13 May 2025

Failure to disclose – apportionment of liability

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

A franchisor is jointly liable with a sub-franchisor for disclosure violations. As in a unit franchising relationship, officers and directors of the franchisor or sub-franchisor may also be held liable.

Law stated - 13 May 2025

General legal principles and codes of conduct

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

There are several general principles that apply to most contracts, such as common law concepts of fraud and misrepresentation.

Law stated - 13 May 2025

Fraudulent sale

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

In registration states, if a franchisor fails to provide proper disclosure or appropriately register, the franchisee may bring a claim under the applicable state law. Remedies available under state franchise laws may include rescission of the franchise agreement and damages. Similar relief is available for violations of business opportunity laws.

In addition, while there is no private right of action available to franchisees under the FTC Rule, states have passed unfair and deceptive trade practices acts, which are sometimes called Little FTC Acts. Many of these Little FTC Acts make violation of the FTC Rule a per se violation of the state's Little FTC Act. Aggrieved franchisees may also bring claims under these little FTC Acts. Common remedies also include recission and damages, including punitive damages.

Law stated - 13 May 2025

FRANCHISE CONTRACTS AND THE FRANCHISOR/FRANCHISEE RELATIONSHIP

Franchise relationship laws

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

Twenty-five states and territories have enacted franchise relationship laws, and many of them govern the manner and procedure by which a franchisor may terminate, decline to renew or consent to a transfer of a franchise. For example, most franchise relationship laws require that a franchisor must have good cause to terminate a franchise and impose certain time periods during which a franchisee may cure defaults. Some of these laws are more limited, such as voiding venue selection clauses that force a franchisee to appear in court outside its home state or prohibiting the imposition of changes among similarly situated franchisees.

Law stated - 13 May 2025

Operational compliance

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

Franchisors generally reserve inspection and audit rights to monitor compliance with brand standards. Such inspections and audits may include formal or informal site visits by a representative of the franchisor, mystery shopper programmes or review of a franchisee's business records through remote access to a computer or point-of-sale system.

Law stated - 13 May 2025

Amendment of operational terms

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

The franchisor is not permitted to unilaterally alter the terms of the franchise agreement. However, franchisors commonly reserve the right to alter the operations manual to modify the brand standards to reflect trends in the marketplace or new marketing techniques, technologies, and products and services.

Law stated - 13 May 2025

Policy affecting franchise relations

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

The International Franchise Association has a code of ethics, but it has no force of law. Other associations that are formed may establish policies, but these policies would not have force of law.

Law stated - 13 May 2025

Termination by franchisor

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

The terms of the franchise agreement establish the grounds on which a franchisor may terminate the franchise agreement. Common defaults include:

- insolvency or bankruptcy;
- abandonment of the franchised business;
- failure to pay amounts due;
- violations of health and safety laws; and
- failure to comply with system standards.

Franchise agreements commonly distinguish between curable and incurable defaults. If applicable, state relationship laws may override the terms of a franchise agreement.

Law stated - 13 May 2025

Termination by franchisee

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

Typically, franchise agreements expressly address when a franchisee may terminate a franchise agreement. In addition, common law may provide the franchisee with a right to terminate the franchise agreement upon a franchisor's material breach. Recission of the franchise agreement is permitted under some state laws if a franchisor failed to comply with disclosure requirements.

Law stated - 13 May 2025

Renewal

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

The terms of the franchise agreement generally establish the renewal requirements. Common renewal conditions include:

- prior notice of the franchisee's intent to renew;
- the payment of a renewal fee;
- execution of a general release of claims;
- good standing;
- a remodel of the premises; and
- the execution of the franchisor's then-current form of franchise agreement.

Disclosure is generally required on renewal if the franchisee would be required to sign a materially different form of franchise agreement than the agreement under which it had been operating.

Law stated - 13 May 2025

Refusal to renew

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

If a franchisee has not complied with the conditions for renewal that are established in the franchise agreement, the franchisor may generally refuse to renew the franchise agreement. If applicable, state relationship laws may impose certain restrictions on a franchisor's refusal to renew.

Law stated - 13 May 2025

Transfer restrictions

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

Yes. Franchisors typically reserve the right to approve or disapprove a sale of the franchised business and any change in ownership of the franchisee entity. The terms of the franchise agreement dictate the processes applicable to a transfer. Common transfer conditions include:

- prior notice of the intent to transfer;
- the payment of a transfer fee;
- a remodel of the premises; and
- execution of a general release of claims.

The transferee must also meet the franchisor's standards for new franchisees, execute the franchisor's then-current form of franchise agreement and complete any required training. Franchisors also commonly reserve a right of first refusal to acquire the franchised business if a franchisee desires to transfer.

Certain state-specific franchise relationship laws may also affect transfers.

Law stated - 13 May 2025

Fees

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

No. Franchisors typically designate standard fees, which are disclosed in the franchise disclosure document (FDD), although franchisees are free to negotiate these fees.

Law stated - 13 May 2025

Usury

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

Laws that limit the interest rate that may be charged (usury laws) have been enacted in all states.

Law stated - 13 May 2025

Foreign exchange controls

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

No. Generally, the United States does not impose currency or exchange controls on the transfer of money by a US-based entity (eg, a US franchisee) to a foreign entity, unless the foreign entity's home country is subject to sanctions. However, intellectual property-based payments to a foreign franchisor, such as royalty payments, may be subject to a 30 per cent withholding tax. If the United States and the foreign country are parties to an income tax treaty, the foreign franchisor may be entitled to a reduction or exemption.

Law stated - 13 May 2025

Confidentiality covenant enforceability

37 | Are confidentiality covenants in franchise agreements enforceable?

Typically, yes. Reasonable confidentiality agreements are often enforced to protect the franchisor's intellectual property, trade secrets and other confidential information.

Law stated - 13 May 2025

Good-faith obligation

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

Courts have held that an implied covenant of good faith and fair dealing generally applies to contracts, including franchise agreements. As applied by many courts, this covenant requires parties to deal with each other honestly and fairly, and a party cannot act to deny the other party the benefit of the bargain. However, the covenant of good faith and fair dealing cannot contradict the express terms of a contract. Therefore, franchise agreements are explicit in their description of each party's rights and responsibilities to reduce potential uncertainty, and to minimise potential claims alleging a breach of this covenant.

Law stated - 13 May 2025

Franchisees as consumers

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

Treatment of franchisees as consumers varies by state. For instance, every state has an unfair and deceptive acts or practices statute, but the protections offered by those laws are state-specific.

Law stated - 13 May 2025

Language of the agreement

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

It is assumed that FDDs and agreements will be provided in English. FDDs and agreements filed in the registration states must be in English.

Law stated - 13 May 2025

Restrictions on franchisees

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

For the protection of the franchisor's brand, franchise agreements typically require the franchisee to closely follow the franchisor's business system. Accordingly, franchise agreements often require franchisees to sell all (and only) the goods or services that the franchisor designates, in accordance with the franchisor's standards and specifications. Usually, the franchisor may prescribe certain approved or designated suppliers, or a process by which a franchisor may vet alternate suppliers. Similarly, franchise agreements often contain tight restrictions on the franchisee's use of the franchisor's trademarks. The franchisor's business system is typically described in greater detail in an operations manual that is expressly referenced throughout the franchise agreement.

It is also typical in the United States for franchise agreements to designate an exclusive territory in which the franchisee must operate, although the size of the territory and level of exclusivity granted varies widely. Restrictions pertaining to confidentiality are also routinely included in franchise agreements, as well as both in-term and post-term covenants against competition (though the enforceability of such covenants varies by state). Franchise agreements also contain lengthy provisions that pertain to dispute resolution, which may include requirements for mediation and arbitration, as well as the franchisor's choice of law and forum selection, which are also subject to state law.

Most franchise agreements contain restrictions relating to the transfer of the franchised business. Franchisors often require that the franchisee first obtain the franchisor's prior approval before transferring the franchise, although these requirements are also subject to state law.

Law stated - 13 May 2025

Courts and dispute resolution

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

The US federal court system, or the judicial branch, is one of three constitutionally prescribed branches of the US government. Due to federalism, US states have also established their own courts. The United States has a common law court system, which involves a formal adjudication process that creates law by establishing precedents.

Alternative dispute resolution methods are also commonly used to resolve franchise disputes. US law strongly favours the enforcement of arbitration agreements and many franchisors include broad arbitration clauses in their franchise agreements covering disputes arising from or relating to the franchise relationship (though some state laws purport to limit these arbitration agreements). Accordingly, a significant percentage of franchise disputes are arbitrated.

In addition, some franchisors and franchisees agree to pre-suit mediation as an alternative means of dispute resolution. Franchise agreements may even require that the parties first engage in mediation before initiating litigation or arbitration, and those provisions are generally enforceable.

Law stated - 13 May 2025

Governing law

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

The parties are generally free to choose the governing law of the franchise agreement. However, some state laws prohibit franchisors from designating a governing law that is different from the franchisee's home state.

Law stated - 13 May 2025

Arbitration – advantages for franchisors

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

Arbitration has traditionally been viewed as offering several advantages over litigation, including:

- greater efficiency and lower costs due to more limited discovery and streamlined pre-hearing procedures;
- the ability to select an arbitrator with specialised experience;
- the ability to have the venue for the arbitration in the franchisor's home state (or country) and not in the franchisee's home state (if the Federal Arbitration Act applies);
- the opportunity to keep the proceedings confidential; and
- the general lack of a preclusive effect of an adverse arbitration award.

However, in practice, arbitration can be as costly and time-consuming as litigation. In addition, arbitration results in a binding decision and there are limited rights to appeal or challenge arbitration awards.

Law stated - 13 May 2025

National treatment

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

US franchise laws apply equally to US and foreign franchisors. One aspect of the US franchise disclosure laws that may affect foreign franchisors relates to financial statements. In its FDD, a franchisor must include its audited financial statements for the three most recent fiscal years (with certain adjustments for start-ups), prepared in accordance with US Generally Accepted Accounting Principles (US GAAP). Therefore, a foreign entity seeking to become a US franchisor must prepare its financial statements under US GAAP or include detailed conversions from international standards to US GAAP.

Law stated - 13 May 2025

UPDATE AND TRENDS

Legal and other current developments

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

Concerns pertaining to joint-employer liability and employee misclassification persist in the United States. The state of the law is very much in flux. In 2023, the National Labor and Relations Board announced a new rule and analysis for determining whether an entity is a joint employer of another party. The new rule was broader in scope and, among other factors, provided that indirect or reserved control, even if never exercised, may result in an entity being classified as a joint employer. A federal court then held that the new rule was unconstitutional in March 2024. As of May 2025, joint-employer status continues to be analysed under the prior rule established in 2020.

In April 2024, the Federal Trade Commission (FTC) issued a rule that generally prohibits non-compete covenants between a 'worker' and an 'employer', which was set to go into effect in August 2024, but it has faced legal challenges and is currently subject to an injunction prohibiting its implementation. However, the FTC specifically excluded from the rule non-compete provisions that apply to franchisees in the context of franchisor/franchisee relationships. The rule still prohibited non-executive employees of franchisors and franchisees of being subject to non-compete covenants. There are expected to be further legal challenges to this rule and the current injunction.

Law stated - 13 May 2025

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