

FRANCHISE

Israel



Franchise

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Quick reference guide 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.

Generated 21 July 2022

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MARKET OVERVIEW

Franchising in the market

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 rather 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 - 20 July 2021

Associations

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 - 20 July 2021

BUSINESS OVERVIEW

Types of vehicle

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 - 20 July 2021

Regulation of business formation

What laws and agencies govern the formation of business entities?

Business entities such as companies (including branches) or partnerships are formed under the Company Law 1999 or the Partnership Ordinance 1975, respectively, and registered in the respective register.

Law stated - 20 July 2021

Requirements for forming a business

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

Establishing a business entity in Israel requires establishing a company (or partnership). Any international company

wishing to conduct business in Israel should be registered either as a branch or by way of establishing a subsidiary. In any case a local address is required.

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

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

Law stated - 20 July 2021

Restrictions on foreign investors

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 VAT representative whose permanent place of residence is in Israel and who assumes full responsibility for handling all value added tax (VAT) matters, if applicable.

Law stated - 20 July 2021

Taxation

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

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

As of 2018, Israel is party to over 50 double tax treaties, essentially following the OECD 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 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.

Labour and employment

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

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

As long as a clear separation between the franchisee and the franchisor is kept under the franchise agreement and is de facto, the risk that the franchisee's employees will be considered as the franchisor's employees is rather 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 - 20 July 2021

Intellectual property

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

Any domestic or foreign franchisor may apply to register its trademarks for goods and services with the Israeli trademark office to ensure its exclusive right to use it. The trademark registration is valid as long as it is used in Israel.

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

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

Law stated - 20 July 2021

Real estate

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

There are no legal restrictions relating to foreign or domestic franchisors in respect of purchasing or leasing real estate.

Law stated - 20 July 2021

Competition law

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

Competition in the Israeli market is regulated under the Commercial Competition Law 1988 (formerly known as the Restrictive Trade Practice Law). Franchise agreements are exempted from the prohibitions under the Law in accordance with a specific block exemption unless the parties to the agreement are actual competitors; a party has

monopoly power in the relevant product market or in an adjacent market; or the agreement's duration is 10 years or longer.

Franchise contracts, which are covered unless the franchisee's market share exceeds 30 per cent, can control resale prices without restriction and may also restrict the franchisee from engaging in active sales promotion outside the assigned franchise territory.

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

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

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

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

Law stated - 20 July 2021

OFFER AND SALE OF FRANCHISES

Legal definition

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 in the regulations is as follows:

Law stated - 20 July 2021

Laws and agencies

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

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

Franchise agreements may be exempted from the Commercial Competition Law 1988 under a block exemption and are, thus, not considered restrictive arrangements banned under the Law, provided that the agreements comply with the requirements in the rules for franchise agreements.

The exemption under those rules will not apply where:

- the parties to the agreement are actual competitors;
- a party has monopoly power in the relevant product market or in an adjacent market;
- the agreement's duration is 10 years or longer; or
- when the agreement includes restrictive stipulations, such as:
 - restriction of the franchisor from using licensed know-how after the term of the agreement, even when the know-how is in the public domain;
 - prevention of the franchisee from initiating judicial review of the validity of the rights in know-how transferred

- from the franchisor to the franchisee or other intellectual property rights;
- prevention of the franchisee from selling or supplying goods to consumers outside the territory defined in the agreement; and
- other restrictions that are only meant to reduce competition or are not necessary to fulfil its principal.

The Commercial Competition Law 1988 deems arrangements whose restrictions involve the right to use a patent, trademark, copyright or proprietary right as not restrictive, provided that the arrangement is made between the owner of the right and the party who receives authorisation to use the right and where the right is subject to registration by law and is registered accordingly.

Law stated - 20 July 2021

Principal requirements

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

Not applicable.

Law stated - 20 July 2021

Franchisor eligibility

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 - 20 July 2021

Franchisee and supplier selection

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 - 20 July 2021

Pre-contractual disclosure – procedures and formalities

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.

Pre-contractual disclosure – content

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 - 20 July 2021

Pre-sale disclosure to sub-franchisees

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 sub-franchising contract.

Law stated - 20 July 2021

Due diligence

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 - 20 July 2021

Failure to disclose – enforcement and remedies

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.

Failure to disclose – apportionment of liability

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 - 20 July 2021

General legal principles and codes of conduct

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 - 20 July 2021

Fraudulent sale

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 - 20 July 2021

FRANCHISE CONTRACTS AND THE FRANCHISOR/FRANCHISEE RELATIONSHIP**Franchise relationship laws**

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 - 20 July 2021

Operational compliance

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 - 20 July 2021

Amendment of operational terms

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 - 20 July 2021

Policy affecting franchise relations

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

No.

Law stated - 20 July 2021

Termination by franchisor

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

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

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

Law stated - 20 July 2021

Termination by franchisee

In what circumstances may a franchisee terminate a franchise relationship?

In the same circumstances as applicable to the franchisor.

Law stated - 20 July 2021

Renewal

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 - 20 July 2021

Refusal to renew

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 - 20 July 2021

Transfer restrictions

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 - 20 July 2021

Fees

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 - 20 July 2021

Usury

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 - 20 July 2021

Foreign exchange controls

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 - 20 July 2021

Confidentiality covenant enforceability

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 - 20 July 2021

Good-faith obligation

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 - 20 July 2021

Franchisees as consumers

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 - 20 July 2021

Language of the agreement

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 in order to estop any argument based on misunderstanding of the stipulations of the agreement.

Law stated - 20 July 2021

Restrictions on franchisees

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

It is customary to include in franchise agreements restrictions such as

- exclusive territories;
- restrictions on sources from whom a franchisee may purchase or lease goods or services (restrictions on the purchase of goods and services from other franchisees of the same franchisor or restrictions on the source of goods, even if those in line with the franchisee's business are forbidden under the block exemption of franchise agreements);
- restrictions on the customers to whom the franchisee is entitled to sell the franchisor's products or services;
- restrictions on advertisement of 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 franchisee to the franchisor;
- restriction on the use of intellectual property assets other than in accordance with the license 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 franchisor's intellectual property.

Law stated - 20 July 2021

Courts and dispute resolution

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 magistrate courts (acting as first instance for most cases in Israel).

There are also courts for traffic offences, family courts, juvenile courts and national and regional labour courts.

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

Governing law

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 - 20 July 2021

Arbitration – advantages for franchisors

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 - 20 July 2021

National treatment

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.

UPDATE AND TRENDS

Legal and other current developments

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, despite an apparent initiative of the bar association in 2008, which did not mature.

The information contained in this chapter is accurate as at 20 July 2021.

Jurisdictions

	Australia	Norton Rose Fulbright
	Canada	Lapointe Rosenstein Marchand Melançon LLP
	China	Jones & Co
	Finland	ADVOCARE Law Office
	France	Bersay
	Germany	Taylor Wessing
	India	G&W Legal
	Israel	Gilat Bareket & Co, Reinhold Cohn Group
	Italy	Rödl & Partner
	Japan	Anderson Mōri & Tomotsune
	Malaysia	Wong Jin Nee & Teo
	Mexico	Gonzalez Calvillo SC
	Netherlands	Parker Advocaten
	New Zealand	Stewart Germann Law Office
	Norway	CLP
	South Africa	Spoor & Fisher
	South Korea	Lee & Ko
	Switzerland	Kellerhals Carrard
	Turkey	Özdağıştanlı Ekici Attorney Partnership
	United Kingdom	Ashtons Legal
	USA	Lathrop GPM