



# Franchise

in 30 jurisdictions worldwide

# 2014

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# Czech Republic

Barbara Kusak and Halka Pavlíková

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## Overview

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

A franchisor usually does business as a sole proprietor, or via a limited liability company (sro). Limited liability companies are the most frequently used corporate entity in the Czech Republic. The advantages of an sro include that liability is limited to the company, that there is a relatively easy process of establishment connected with low financial costs and the limited administrative burden.

Other than an sro, Czech law recognises other entities, which may also be used to conduct business, including franchises in the Czech Republic:

- joint-stock company (as);
- European joint-stock company (SE);
- general partnership (vos); and
- limited partnership (ks).

### 2 What laws and agencies govern the formation of business entities?

The Civil Code (Act No. 89/2012, in practice referred to as the New Civil Code) and the Act on Business Corporations (Act No. 90/2012), which will both take effect from 1 January 2014 and which will replace the current law (especially Act No. 40/1964, the Civil Code, and Act No. 513/1991, the Commercial Code), are the main legal rules that govern the formation of business entities.

The European joint-stock company is regulated by Act No. 627/2004 on the European Company.

All companies as well as their branches need to be registered in the Commercial Register kept by the applicable register court. The jurisdiction of the register court depends on the registered office of the company (ie, that register court, in whose district the company has its registered office, has local jurisdiction).

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

Czech law distinguishes between two basic steps for the establishment of a company. The first step is the execution of foundation documentation (foundation deed or a memorandum of association), which in case of the capital companies (sro and as) shall be in the form of a notarial record. The foundation deed must contain certain minimum information (eg, the company's name, numbers and identification of shareholders or members, field of business, etc.). The second step is the registration of the new created company in the relevant commercial register. This registration must take place within six months of the execution of foundation documentation. The company is able to commence operating on its registration, although some preliminary transactions can be carried out beforehand. Within 15 days after the registration in the commercial register, the company must also be registered for corporate income tax with the Financial Authority.

In the process of registration certain documents are required by the registration court. Other than the foundation document, a confirmation from a bank that the registered capital has been paid in the amount set out by law or the foundation deed, is required. Further, an extract from the Trade Licensing Office (or another state authority), which shows that the company has the relevant licences in order to undertake business will be needed. The Commercial Code also requires affidavits from future members of the company's statutory organs demonstrating that they fulfil conditions set out by law and documents concerning identification of shareholders.

The maintenance of the company mainly requires preparation of annual financial statements and an annual general meeting of shareholders (through which the financial statement is approved). In some cases auditors need to be appointed. Annual financial statements must be filed with the commercial register.

### 4 What restrictions apply to foreign business entities and foreign investment?

In principle, foreign persons or entities may carry out entrepreneurial activation in the territory of the Czech Republic on the same conditions and to the same extent as Czech persons or entities. There are certain limitations imposed by law for some specific types of activities, such as operating a lottery or trading in military materials. A foreign entity carries out its business in the Czech Republic through its branch or enterprise located in the territory of the Czech Republic. The foreign entity's authorisation to carry out business in the Czech Republic comes into existence in the same manner as the authorisation of the Czech entity – by registering the foreign entity, or its branch or enterprise, in the Commercial Register.

### 5 Briefly describe the aspects of the tax system relevant to franchisors. How are foreign businesses and individuals taxed?

The Czech Republic is a member state of the EU and important features of the Czech tax system have therefore been harmonised with EU tax law, including direct taxes, VAT, excise duties, mutual assistance and administrative cooperation.

#### Income taxation

A business vehicle is a tax resident if it has a registered office or place of management in the Czech Republic. Subject to an applicable double taxation treaty, a tax resident business vehicle is subject to Czech taxation on its worldwide income.

Corporations (in the Czech Republic, a limited liability company (sro) and a joint-stock company (as)) are taxed at the regular corporate income tax rate of 19 per cent.

Tax losses can be carried forward for five years. The use of losses is limited if a substantial change in the direct shareholding of the company occurs, unless the company passes the 'income structure test' (ie, at least 80 per cent of the income has been generated by

the same activities as the activities performed in the year the loss accrued).

Dividends are generally subject to a 15 per cent withholding tax (tax rate of 35 per cent applies in relation to tax havens). Dividends distributed to a resident of an EU or EEA member state can be under certain conditions tax exempt. The withholding tax can be also reduced or eliminated under a double tax treaty.

Non-tax resident business vehicles are subject to limited tax liability on their Czech source income. Income received through a Czech permanent establishment is regarded as Czech source income and, therefore, subject to income tax at the general rate. Other types of Czech source income include income from the collection of receivables purchased from third parties and fees for certain services. If income from a permanent establishment is paid to non-EU/EEA residents, a tax security advance must be withheld from the income at the rate of 10 per cent (one per cent for collection of receivables).

Royalties paid to non-tax residents are generally subject to a 15 per cent withholding tax (a special 35 per cent tax rate applies to payments in relation to tax havens). The withholding tax can be reduced or eliminated under the rules resulting from the EU Interest-Royalties Directive or under an applicable double tax treaty. Residents of other EU or EEA countries can file a tax return and claim a deduction for any related expenses. The withholding tax is considered an advance payment. This may result in a reduction of the tax burden as withholding tax is levied on a gross basis.

#### Other taxes

Supplies of goods and services in the Czech Republic by an entrepreneur are generally subject to value added tax. The standard rate is 21 per cent. Some supplies are taxed at the reduced rate of 15 per cent (eg, food and special health-care products) and some supplies are tax exempt (eg, financial services). Taxation of imports and exports depends on whether the goods are supplied within the EU or outside.

Real estate acquisition tax at the rate of 4 per cent is levied on the transfer of real estate. As of 2014, the tax is levied from the purchaser.

The ownership of real estate situated in the Czech Republic is subject to real estate tax.

Road tax is levied on cars used for business purposes.

- 6 Are there any relevant labour and employment considerations for typical franchisors? What is the risk that a franchisee or employees of a franchisee could be deemed employees of the franchisor? What can be done to reduce this risk?

Both the franchisor and franchisee are separate and independent entrepreneurs. No employment relationship between the franchisor and franchisee, or the franchisee's employees, is permitted. Regarding the definition of an entrepreneur pursuant to section 420 of the (New) Civil Code, this means that in order for the franchisee not be considered an employee, they have to carry out their activities based on a trade or a similar licence aimed at generating income on a continuous basis, on their own behalf and at their own risk. A franchisee organised in the form of a corporate entity (for example, a limited liability company or a joint-stock company) will not run the risk of being qualified as an employee under any circumstances.

- 7 How are trademarks and know-how protected?

In the territory of the Czech Republic, protection is granted to:

- national trademarks under Act No. 441/2003, the Trademarks Act;
- Community trademarks pursuant to Council Regulation (EC) No. 207/2009 on the Community trademark;
- international trademarks under the Madrid Agreement on the Madrid system for the international registration of trademarks; and

- 'trademarks generally known' in the territory of the Czech Republic within the meaning of the Paris Convention for the Protection of Intellectual Property of 20 March 1883.

The national Industrial Property Office (the Office) keeps a trademarks' register (www.upv.cz). The filing of an application to register a trademark in the trademarks register kept by the Office establishes the applicant's right of priority over any person who files an application for registration of a trademark that is similar or likely to cause confusion for the same or similar products or services. On the basis of the registration, the trademark owner acquires the exclusive right to mark its products or services using the registered trademark and to use the trademark in connection with its products and services. The registration of a trademark is valid for 10 years and may be renewed. Protection against unjustified interference is granted by Act No. 221/2006 on the enforcement of industrial property rights.

Know-how does not enjoy any special protection, but may be protected as a trade secret, subject to its compliance with the conceptual features of a trade secret. The breach of the trade secret is considered to be unfair competition under section 2976 of the (New) Civil Code. The following possibilities of protection against unfair competition (ie, breach of the trade secret) or against unauthorised interference with trademark rights are available under the law. A court may be requested to order the breaching party:

- to refrain from such unauthorised acting; and
- to remove the defective situation.

Further, a claim exists to:

- a reasonable satisfaction that may be paid in money;
- compensation for damage; and
- surrender of unjust enrichment.

Certain elements of know-how may also be protected by intellectual property legislation, namely by Act No. 121/2000, the Copyright Act.

- 8 What are the relevant aspects of the real estate market and real estate law?

Czech law does not provide for any special franchise-related regulations concerning the real estate market or real estate law.

As far as the economic situation is concerned – one can say that, at present, it is not difficult for a franchisee to find suitable non-residential premises in the Czech Republic at a reasonable price to operate and develop its business.

From a legal point of view, it is necessary to mention that the ownership title and other rights in rem to real estate are subject to registration in the Cadastral Register. If a transaction is carried out on the basis of a real estate transfer agreement, such agreement must be in writing and must contain the expression of the parties' will on the same instrument.

From 1 January 2014, leases and subleases of non-residential premises will be governed by the (New) Civil Code (Act No. 89/2012), but one has to mention that the parties have a wide contractual freedom to agree on their arrangements. Both the lease and sublease agreement mandatorily require a written form.

#### Laws and agencies that regulate the offer and sale of franchises

- 9 What is the legal definition of a franchise?

There is no legal definition of franchising in Czech law. The Czech Franchise Association took over the definition from the European Code of Ethics For franchising, according to which franchising is a system of marketing goods, services or technology based upon a close ongoing collaboration between legally and financially separate and independent undertakings (ie, the franchisor and its individual franchisees) whereby the franchisor grants its individual franchisee

the right, and imposes obligations upon them, to conduct business in accordance with the franchisor's concept.

In one of its previous decisions, the Higher Court in Prague defined franchising as a:

*vertical long-term relationship between independent entrepreneurs who carry out their business on their own responsibility and risk, in which the rights and duties of the partners correlate. A granted licence authorises the licensee to operate its own business; while the licensor is entitled to a one-off fee for granting the licence, and a continuous franchise fee set out as an amount in per cent of the turnover or profits.*

**10** Which laws and government agencies regulate the offer and sale of franchises?

There are no specific laws or governmental agencies regulating the offer and sale of franchises in the Czech Republic.

Franchise agreements as such, are not specifically regulated under Czech law. Rather, they constitute an 'unspecified type of contract' according to section 1746 (2) of the (New) Civil Code (Act No. 89/2012), which can contain elements of different types of contract, especially of a licence agreement, an agreement for the transfer of know-how, a rental or leasing contract, a commercial agency agreement, a contract of sale (where goods are supplied) or a contract for the provision of services. General principles such as principles of good morals (bono mores) and principles of fair business conduct shall also apply.

**11** Describe the relevant requirements of these laws and agencies.

Given the lack of any specific statutory provisions, no special requirements are set out. Compliance with the general prerequisites for entering into an 'unspecified type of contract', such as sufficient specification of the subject matter of the obligation, and with other business-related legislation (the Trades Licensing Act, (New) Civil Code, Competition Act, etc) is required.

There is no specific franchisors' register in the Czech Republic into which franchisors would have to register. If a franchisor (or a franchisee) is a legal entity – a company organised under Czech law – it is subject to registration in the Commercial Register kept by the applicable regional court. Individuals – entrepreneurs, who fulfil certain conditions regarding the amount of their turnover – must also register.

If a franchisor (or a franchisee) is a sole trader (ie, carries out a trade under the Czech Trades Licensing Act), it is necessary for them to register with the Trades Licensing Authority and obtain a relevant trade licence (authorisation) to perform their activities, and to announce the location of the establishment where they perform such activities.

**12** What are the exemptions and exclusions from any franchise laws and regulations?

As there is no special regulation of franchise agreements under Czech law, there are no exceptions.

However, it is noteworthy that not all business relationships, in which one contracting party provides the other with know-how, are considered as regulated by a franchise agreement. For instance, the mere provision of a licence for manufacturing activities, transfer of technology, consent to the use of a logo or of a commercial brand, is not a franchise agreement.

**13** Does any law or regulation create a requirement that must be met before a franchisor may offer franchises?

There is currently no law in the territory of the Czech Republic that would regulate the requirements to be fulfilled by a franchisor before it starts offering its franchise on the market, inform the franchisee

or register with the franchise association. According to general legislation, a franchisor's proposal to enter into a franchise agreement should be sufficiently specific ie it should clearly state who is making the proposal, what the subject is and should indicate the franchisor's will to be bound by such an agreement if the proposal is accepted. The Czech Franchise Association ([www.czech-franchise.cz](http://www.czech-franchise.cz)) lists numerous guiding principles in its Code of Ethics:

- the franchisor must have successfully run a business concept for an appropriate period of time and with at least one pilot project before founding his franchise network;
- the franchisor must be the owner or legitimate user of the company name, trademark or any other special labelling of his network; and
- the franchisor must carry out initial training of the individual franchisee and must ensure ongoing commercial or technical support or both to the franchisee during the entire term of the contract.

Naturally, the franchisor may freely conduct negotiations on the execution of a franchise agreement. If, however, the franchisor initiates or continues with such negotiations without having an intention to enter into the agreement at all, they shall be liable for damage incurred by the franchisee as a result of that. Similarly, the franchisor will be liable for damage if they decide not to conclude the agreement without any rightful reason although the negotiations of the agreement have reached such an advanced phase that the franchisee deemed its conclusion to be very likely. The same obligation to compensate damage also applies in relation to the franchisee. The 'rightful reasons' will depend on specific circumstances, and certain interpretation rules will undoubtedly be made more accurate by the decision-making practice of courts.

**14** Are there any laws, regulations or government policies that restrict the manner in which a franchisor recruits franchisees or selects its or its franchisees' suppliers?

There are no specific laws or government policies regulating the recruitment of the franchisee or selection of its or franchisees' suppliers.

**15** 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?

As Czech law does not regulate a franchise agreement as a special type of contract, it does not contain any express specification of rights and obligations between a master franchisor, master franchisee (sub-franchisor) and a sub-franchisee. As a result, Czech law does not expressly regulate the pre-contractual phase of entering into the franchise agreement, including any franchisor's duty to provide information (the same shall apply to sub-franchising contracts between sub-franchisor and sub-franchisee). Naturally, the general statutory requirements as to the specificity of all legal acts apply here, too (see also question 13).

Regarding the requirement of the specificity of legal acts the master franchisee (sub-franchisor) must disclose basic information to sub-franchisees not only about itself and the subject matter of agreement but also basic data regarding the franchisor's identity, including evidence of its existence (eg, by submitting an applicable extract from the Commercial Register) and to prove to sub-franchisees that the master franchisee has the requisite permits and licences for sub-franchising at its disposal.

**16** What is the compliance procedure for making pre-contractual disclosure in your country? How often must the disclosures be updated?

See question 15.

**17** What information must the disclosure document contain?

This issue is not expressly regulated by Czech law.

One can generally say that the information provided by the franchisor to the franchisee before entering into the agreement should be sufficiently specific to give the franchisee the option to freely decide whether or not it wants to enter into the agreement. Before the execution of the agreement, the franchisor may not deceive the franchisee, namely by providing it with deceitful or misleading information.

The specific extent of disclosure documents therefore depends on the agreement between the parties.

During the process of entering into an agreement, the law provides for the protection of confidential information that has been mutually provided between the parties. If, during the process of negotiating an agreement, the parties provide each other with confidential information, the party to which such information has been divulged may not disclose it to any third party or use it for its own needs in breach of its purpose, regardless of whether or not the agreement is concluded at the end. A breach of this obligation results in a duty to surrender any enrichment obtained by such breach. The obligation to compensate damage may also be claimed.

**18** Is there any obligation for continuing disclosure?

As stated above, Czech law does not contain any express regulation of franchise agreements as a type of contract, and thus does not expressly regulate a franchisor's obligation for continuing disclosure. Determining the obligations for cooperation is at the franchisor's and franchisee's discretion.

As a rule, a franchisor's obligations to provide advice and information relating to system development, information about market development in the applicable region and updated information about the sales and marketing strategy are incorporated in the contents of the franchise agreement. The general principles such as principles of good morals (*bono mores*) and principles of fair business conduct shall also apply.

**19** How do the relevant government agencies enforce the disclosure requirements?

Czech law does not require the franchisor to disclose information relating to the franchise after the execution of the agreement. If such an obligation is included in the franchise agreement by agreement between both contracting parties, but the franchisor fails to discharge it, the franchisee may request its remedy before a court (there are no state agencies that would enforce the fulfilment of such an obligation), in other words, sue for performance of a contractual obligation. A franchisee may also claim damages caused by a franchisor's failure to comply with its contractual obligation of continuing disclosure.

**20** What actions can franchisees take to obtain relief for violations of disclosure requirements? What are the legal remedies for such violations? How are damages calculated? If the franchisee can cancel or rescind the franchise contract, is the franchisee also entitled to reimbursement or damages?

As stated above, Czech law does not contain any express regulation of disclosure requirements or violations of disclosure requirements.

Generally, the issue of compensation for damage between a

franchisor and franchisee, as two independent businesses, would be governed by the applicable provisions of the (New) Civil Code (Act No. 89/2012) regarding compensation for damage (section 2909 et seq.). If a franchisor breaches its obligation under a contractual relationship, it must compensate damage caused by it to a franchisee. A precondition for compensation for damage is a breach of a legal obligation (either statutory or contractual), damage incurred and their causation. Damage caused by a breach of any contractual obligation is objective (ie, regardless of fault). The breaching contracting party is always liable for damage, unless it proves that the breach of obligation was caused by circumstances excluding liability. The damaged party must prove the quantum of damage; no rules are set for its calculation. The damage is compensated above all in restoring the items to their original conditions. If this not possible, financial compensation will be claimed. A franchisee (or franchisor, if it is the franchisee which breaches the obligations) would file an action for compensation for damage with a general civil law court. The local jurisdiction of the court depends on the registered office or residential address of the defendant.

Generally, if a franchisee cancels a franchise contract, it will not be entitled to damages unless the termination is due to a previous breach by the franchisor. As a result of a breach of a franchisor's disclosure obligation, a franchisee may rescind an agreement provided that the franchise agreement sets out or provides that such a franchisor's breach constitutes a material breach of its contractual duties (a material breach is a breach when the breaching party knew, or could have presumed given the purpose of the agreement, at the time of executing the agreement that the other party would not be interested in performing the agreement in the event of such a breach). Notice of rescission must be given to the other contracting party without undue delay after the entitled party learns of the breach of obligation. A franchisor and franchisee may also agree on the possibility of terminating the agreement on the basis of the payment of a certain amount of compensation.

**21** 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, the breaching party is liable for such a breach. Only the sub-franchisor is liable under the contractual relationship with the franchisee. This means that the sub-franchisor is primarily responsible for a failure to comply with an obligation in relation to the franchisee. In certain conditions, a sub-franchisor may have the right to recourse for damages from the franchisor.

Members of statutory organs, CEOs or employees of the franchisor or sub-franchisee have generally no personal liability for a breach of obligations undertaken by their employer (ie, by a franchisor or sub-franchisee), even if such an obligation has been breached as a result of their act or omission. If such an obligation has been breached as a result of their act or omission, and they acted on behalf of their employer, they are generally liable just towards their employer (ie, the franchisor or sub-franchisee) and not towards the other contractual party. However, there are some exemptions and, under certain conditions, the franchisor or sub-franchisee may have the right of recourse in relation to all of these persons.

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

The entry into a franchise agreement is governed by general civil law rules for entry into contracts. The general private law principles, which also apply to a franchise agreement, include primarily

the principles of contractual freedom, bona fides and fair business conduct. The process of entry into a franchise agreement should be consistent with the European Code of Ethics for Franchising, which only has an advisory nature (ie, it is not binding, just recommended).

**23** Other than franchise-specific rules on what disclosures a franchisor should make to a potential franchisee or a franchisee should make to a sub franchisee regarding predecessors, litigation, trademarks, fees etc, are there any general rules on pre-sale disclosure that might apply to such transactions?

There are no general rules on pre-sale disclosure under Czech law. However, the statutory requirements as to the specificity of all legal acts (that implicitly includes all necessary information the franchise agreement has to contain in order to be specific enough) and basic legal principles as good morals and fair business conduct also apply.

**24** What actions may franchisees take if a franchisor engages in fraudulent or deceptive practices in connection with the offer and sale of franchises? How does this protection differ from the protection provided under the franchise sales disclosure laws?

If a franchisee suspects, or if it has been proved, that a franchisor has engaged in fraudulent or deceptive practices that relate to the offer or sale of a franchise, it is obliged to file a criminal complaint. If the suspicions prove to be true, the franchisor may be indicted for, and later charged by the prosecutor with the crime of fraud, breach of the law on the rules of economic competition, and misrepresentation of data on economic results and business assets, infringement of trademark and other brand rights.

On the level of civil law, claims may be raised in the event of a franchisor's acts constituting unfair competition – then a franchisee may request reasonable satisfaction, compensation for damage and surrender of unjust enrichment. If, in connection with the offer and sale of franchises, any misleading information is given, the franchisee may contest the contract.

#### **Legal restrictions on the terms of franchise contracts and the relationship between parties in a franchise relationship**

**25** Are there specific laws regulating the ongoing relationship between franchisor and franchisee after the franchise contract comes into effect?

As stated above, a franchise agreement is an 'unspecified type of contract' under Czech law, which is in general regulated by Act No. 89/2012, the (New) Civil Code. There is no special Czech legislation that would regulate the relationship between the franchisor and franchisee after the franchise agreement comes into effect. However, every relationship must always comply with the general provisions and basic principles of Czech law. Some of the leading principles on which civil law is based are good morals and fair business conduct. See also questions 10 and 36.

**26** Do other laws affect the franchise relationship?

The most significant legislation in force in the Czech Republic, which regulates the legal relationship between a franchisor and franchisee after the effective date of a franchise agreement, is as follows:

- Commission Regulation (EU) No. 330/2010, on the application of article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices;
- Act No. 89/2012, the New Civil Code (effective from 1 January 2014);
- Act No. 90/2012, the Act on Business Corporations (effective from 1 January 2014);

- Act No. 513/1991, the Commercial Code (will apply to the rights and obligations which occurred before 1 January 2014 based on or in connection with the contracts concluded before 31 December 2013);
- Act No. 40/1964, the Civil Code (will apply to the rights and obligations which occurred before 1 January 2014 based on or in connection with the contracts concluded before 31 December 2013);
- Act No. 143/2001, on the Protection of Economic Competition;
- Act No. 441/2003, the Trademarks Act;
- Act No. 207/2000, on the Protection of Industrial Designs;
- Act No. 527/1990, on Inventions, Industrial Designs and Rationalisation Proposals;
- Act No. 455/1991, the Trades Licensing Act;
- Act No. 143/2001, the Competitions Act;
- Act No. 586/1992, the Income Taxes Act;
- Act No. 235/2004, the Value Added Tax Act;
- Act No. 216/1994, on Arbitration Proceedings and Enforcement or Arbitral Awards; and
- Act No. 99/1963, the Civil Procedure Code.

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

The Czech Franchising Association (the Association) is a non-profit, professional organisation for franchising providers – franchisors and specialists dealing with franchising. Membership of the Association is not compulsory for the franchisors. The Association is a member of the European Franchise Federation. The Association is focused on supporting the development of current franchise systems and creating better conditions for the growth of this type of business. Any opinions of the Association are only of an advisory nature. Given that membership of the Association is regarded as an indication of quality for a reputable franchise business, many franchisors adhere to the guidelines in order to become and remain members of the Association.

**28** 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?

A franchise agreement may be entered into for a specified or unspecified period of time. A franchise agreement, which has been entered into for a specific period of time, terminates upon the expiry of the agreed term.

A franchise agreement with an unspecified duration may be terminated by either party, as specified in the franchise agreement. If the parties do not agree on terminating the agreement by notice, any franchise agreement of an unspecified duration may be terminated without providing reasons, on three months' notice ending at the end of a calendar quarter.

Generally, as concerns the termination of both fixed-term and indefinite-term agreements, the principle of freedom of contract applies (within the confines of the principle of good faith, ie, the contractual parties may agree on the termination periods and termination reasons).

A franchisor and franchisee may also rescind an agreement, provided that the franchise agreement allows it or if any of the contracting parties has breached its obligations in a material manner. A material breach of an agreement is a breach where the breaching party knew, or could have presumed given the purpose of the agreement stemming from the contents of the agreement or circumstance of its execution, at the time of executing the agreement that the other party would not be interested in performing the agreement in the event of such a breach.

**29** In what circumstances may a franchisee terminate a franchise relationship?

The facts stated in question 28 apply to a notice of termination of a franchise agreement by the franchisee.

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

If the contracting parties have entered a franchise agreement for a specified period of time, the extension of an agreement is at the sole discretion of the contracting parties. If either of the contracting parties (eg, the franchisor) is not interested in the extension, the franchise agreement terminates upon its expiration. Nevertheless, it should be noted that a franchisor's freedom of choice is limited in terms of claims for damages. For example, where a franchisor has announced its intention to renew the franchise contract and the franchisee has therefore invested in the refurbishment of the business premises on the verge of contract expiry, then a refusal to renew the franchise agreement without good reason may entitle the franchisee to claim damages.

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

Yes, provided that the franchisor has agreed to such provisions with the franchisee in the agreement. However, there is no right to prevent a franchisee from transferring its corporate entity anchored in law. A franchisor and franchisee may agree on a franchisor's preemptive right if the franchisee decides to sell its corporate entity or a share of such corporate entity.

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

Czech law does not regulate the fees connected with a franchise agreement, and leaves their structure, amount or distribution schedule to the will of the contracting parties. Similarly due dates for fees are, as a rule, set out in the agreement. Only general principles apply, according to which fees should correspond to market conditions and follow the rule that the relationship between a franchisor and franchisee is that of two independent entrepreneurs.

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

Yes, the default interest rate is limited by the principle of good morals or fair business conduct. However, neither the minimum nor the maximum amounts of default interest are expressly set. According to the law, default interest shall be paid in the same currency as the main debt.

**34** 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 limitations on payments by a franchisee made in a foreign franchisor's currency.

**35** Are confidentiality covenants in franchise agreements enforceable?

When granting a franchise, a franchisor discloses its know-how, so the execution of a confidentiality agreement is recommended. If the disclosed information has the nature of a trade secret within the meaning of the Czech law, then it enjoys legal protection against a breach or threat of a breach such as unfair competition (protection

means being able to request that the infringer desist from such conduct and request the elimination of this improper state of affairs, and appropriate satisfaction, which may be rendered in money, damages and surrender of unjust enrichment). According to Czech law, if the franchisor and the franchisee mutually exchange confidential information when negotiating a franchise agreement, then the franchisor or the franchisee may not disclose such confidential information to a third party or use it contrary to its purpose for its own needs unless there is a legal title to such disclosure. Anyone breaching this duty shall be obliged to surrender any enrichment he or she obtained due to the breach. The obligation to compensate damage is not excluded either.

**36** Is there a general legal obligation on parties to deal with each other in good faith? If so, how does it affect franchise relationships?

Yes, the principles of bona fides and fair business conduct constitute significant legal principles and apply to the pre-contractual phase, during the entire term of the franchise agreement and after its termination. According to the provisions of Czech law, no one may take advantage of his or her unfair or illegal act. Abuse of law does not enjoy legal protection.

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

No. Pursuant to Czech law (Act No. 634/1992, on consumer protection), a consumer is only an individual who does not act within the scope of their business activities or independent performance of their profession. However, the (New) Civil Code includes a principle of weaker party's protection that can be applied to the franchisor-franchisee relationship (section 433 of the New Civil Code). According to this principle, an entrepreneur who deals with any other person within its business activities may not misuse his or her expertise and business status in order to take advantage of dependency of the weaker party or in order to achieve an imbalance in the mutual rights and duties in the relationship. Otherwise, the weaker party has the right to claim damages and cannot waive this right (section 2898 of the New Civil Code).

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

The law does not stipulate a language to be used in a franchise agreement. According to the European Codex of Ethics, the franchisee shall be provided with a franchise agreement in the language of the country where they have a registered office, or with a certificated translation. However, the Codex of Ethics is not a binding legal act. The Czech Association of Franchising took over this Codex of Ethics, and the members of the Association expressed their will to be bound by it.

From a strictly legal point, the parties may use a foreign language for the franchise agreement as long as both parties are able to read and understand that language. However, for the avoidance of all doubt concerning good faith and the certainty of the drafted documents in general, it is advisable to also provide a Czech version. Also, in the event of any disputes held before a Czech court, such translation would be necessary.

**39** What restrictions are there on provisions in franchise contracts?

The following principles primarily apply to entering into a franchise agreement: contractual freedom, fair business conduct and good faith.

Certain limitations are imposed by competition legislation, such as a ban on determining sale prices for which the franchisees supply goods or services to their customers. There are also certain

limitations for negotiating a non-competition clause in the event of termination of a franchise agreement. A franchisee may be prevented from manufacturing, purchasing, selling or reselling goods or services for only one year after the expiration of a franchise agreement, provided that such obligation relates to goods or services which compete with the contractual goods or services of the franchisor, that it is limited to the premises in which a franchisee has operated during the contractual term, and that it is necessary for the protection of know-how delivered to a franchisee by a franchisor. Certain limitations are also imposed by competition law on the mandatory purchase of goods by the franchisee from the franchisor.

As far as territorial exclusivity is concerned, a franchisor may agree with a franchisee on a specific area in which no other franchisee or franchisor may do business. Other franchisees may only be prevented from 'active' sales in the exclusive territory (ie, direct active approach to customers/offering goods or establishing branches or warehouses), not from passive sales (ie, reacting to a customer's request).

**40** Describe the aspects of competition law in your country that are relevant to the typical franchisor. How are they enforced?

Competition law plays an important role also in the area of franchise agreements.

Following the Czech Republic's accession to the European Union on 1 May 2004, EU competition law has direct effect. Franchise agreements that interfere with or breach economic competition are prohibited by virtue of article 101(1) of the Treaty on the Functioning of the European Union. In the franchise sector, Commission Regulation (EU) No. 330/2010, on block exemptions for vertical agreements and on concerted practices, is of importance.

In terms of Czech antitrust legislation, the negotiation of franchise agreements is mainly governed by the Act on the Protection of Economic Competition (Czech Competition Act, No. 143/2001), in which section 3 prohibits all agreements that interfere with competition, unless their influence on the market is negligible.

The conditions for awarding a statutory exception from the general ban on agreements interfering with competition are regulated in section 3(4) of the Czech Competition Act. According to that provision, agreements which serve to improve the manufacturing or distribution of goods, or which further support technical or economic development, are exempt from the ban provided that consumers can adequately profit from these benefits, and provided the agreements only contain restraints on competition that are essential for achieving the above objectives. Agreements that do not allow competitors to impede competition within a core segment of the market for goods that constitute the subject matter of the relevant agreement are not covered by the ban either. Under section 4 of the

Czech Competition Act, the ban under section 3 of the Act does not apply to those agreements, which may not have any influence on trading among EU member states, but which meet the other conditions set out in the EC block exemption (such as Regulation No. 330/2010), either.

Compliance with antitrust provisions is monitored by the Office for the Protection of Economic Competition, which is located in Brno, and by the EU Commission following accession to the European Union. The parties must now verify and decide whether the requirements for a statutory or community exemption have been met.

From the point of view of competition law, the regulation of unfair competition conduct, contained in the Commercial Code, is also important for franchise agreements.

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

Proceedings on disputes arising from business relationships fall within the jurisdiction of a court in accordance with Act No. 99/1963, the Civil Procedure Code (CPC).

The Czech judicial system has three instances. In a majority of cases, the court with jurisdiction for dispute resolution in the first instance is a district court. However, the law may set exceptions to that rule (see sections 2, 3, 4 and 9 of the CPC) and determine that the court with jurisdiction is the Regional Court (known as the municipal court in Prague). The territorial jurisdiction of the court stems from the provisions of section 84 et seq of the CPC – if no exception applies, the court with territorial jurisdiction is, as a rule, the court in whose district the defendant has their registered office or residential address. A review of a decision of a first instance court is an appeal, which is heard at a regional or higher court (if, in the first instance, the matter was resolved by the regional or municipal court, respectively). The court with exclusive jurisdiction over an extraordinary remedy, being an extraordinary appeal, is the Supreme Court.

Before the proceedings are initiated, or during their course, a preliminary injunction may be ordered if it is necessary to ensure that the relationship between the participants is regulated on a temporary basis. Court proceedings in the Czech Republic are very formal. Disputes from franchise agreements will be the subjects of contentious litigation, where, in order to be successful in the case, the plaintiff has to bear their burden of evidence in respect of the facts alleged by it. This means that the parties to the dispute are obliged to actively search for and put forward evidence in support of their allegations. The average duration of first instance court proceedings is approximately one to two years. Franchisors and franchisees are also entitled to submit all or certain disputes to arbitration. Therefore, each of the parties may challenge the court's jurisdiction by reference



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to a valid arbitration agreement. An arbitration clause can also be included in the franchise agreement. Mediation is also increasingly recognised as a form of joint dispute resolution. Nevertheless, given that mediation does not end with an enforceable judgment for one of the parties, franchisors and franchisees usually agree on mediation proceedings as only the first stage of dispute resolution.

**42** Describe the principal advantages and disadvantages of arbitration for foreign franchisors considering doing business in your jurisdiction.

The main advantages of arbitration proceedings are their speed, lower costs, informal nature and privacy (ie, they may not be attended by the public). Another significant advantage is the wide enforceability of arbitral awards according to the New York Convention of 1958. Arbitration proceedings may also be more just, since they may be decided according to equity principles.

The most important disadvantages of arbitration proceedings lie in the disharmony in the decision-making by arbitrators as a result of their independence and the absence of any higher instance organisation that would unify the decision-making system. Another problem is a narrower jurisdiction during evidence-taking, as arbitrators cannot enforce a procedural obligation against third parties (witnesses, experts) who may only be heard if they appear voluntarily. Arbitrators may not issue preliminary injunctions.

Arbitration proceedings are single-instance proceedings, which may bring both advantages and disadvantages. An arbitral award is final and no appeal against it may be filed, except in extraordinary situations concerning the procedural errors.

**43** In what respects, if at all, are foreign franchisors treated differently from domestic franchisors?

Foreign franchisors are not treated any differently from domestic franchisors.

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