



Franchise

in 30 jurisdictions worldwide

2014

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Hong Kong

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Overview

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

Most franchisors in Hong Kong operate as limited liability companies incorporated under the Companies Ordinance.

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

Sole proprietorships can be set up by registering the business with the Inland Revenue Department Business Registration Office and obtaining a business registration certificate from the office. The business must be registered within one month from the date the business commences.

A partnership is formed under the Partnership Ordinance, and is subject to the ordinance as well as general common law rules, such as laws on misrepresentation as stipulated in contract law.

A limited partnership is formed if the business entity registers with the registrar of companies under the Limited Partnerships Ordinance. Otherwise, the business entity will, by default, be a (general) partnership.

A limited liability company is incorporated in Hong Kong under the Companies Ordinance by registration with the Companies Registry.

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

Sole proprietorships are not subject to any specific legislation save for the requirement to obtain a business registration certificate from the Inland Revenue Department Business Registration Office in relation to their formation. Sole proprietorships are subject to profits tax like other business entities.

The formation and maintenance of partnerships are governed by the Partnership Ordinance, which lays down the rules for determining whether a partnership exists. A partnership is defined as the relation subsisting between persons carrying on a business in common with a view of profit.

The Limited Partnership Ordinance contains governing rules for limited partnerships, such as limiting the maximum number of partners in a limited partnership to 20 and requiring the existence of at least one general partner whose liability for the firm's debts is unlimited.

Limited liability companies are incorporated under the Companies Ordinance. This Ordinance stipulates the requirements for the formation and maintenance of private and public companies. Under the Ordinance, companies are required to have a certain minimum number of subscribers and shareholders prepare, file and audit accounts, file annual returns and register annually under the Business Registration Ordinance.

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

In general, no distinction is made between local and foreign companies by the government of the Hong Kong SAR. No special regulatory regimes or restrictions apply to foreign business entities and foreign investments in Hong Kong. Foreign businesses can be set up in the same way as locally incorporated ones. Foreigners may own 100 per cent of companies, with an exception for a selective few business sectors, such as banking, civil aviation, television broadcasting and sound broadcasting.

As enshrined in the Basic Law, there is 'free movement of goods, intangible assets and capital' in Hong Kong, and no particular investment approval procedures are required for foreign investors.

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

In compliance with the Inland Revenue Ordinance, all types of businesses in Hong Kong are subject to profits tax, and a territorial system of taxation is adopted. Hence, foreign-sourced income ('off-shore profits') is completely tax free, since only the income sourced from within Hong Kong can be taxed.

Moreover, Hong Kong has one of the lowest corporate tax rates in Asia, as it is capped at a maximum rate of 16.5 per cent on assessable profits. The same rate applies to both local and foreign. Apart from corporate and individual income taxes, there are no other taxes such as dividends tax or capital gains tax, etc.

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?

Labour and employment matters pertaining to franchisors are governed by the Employment Ordinance and the Minimum Wage Ordinance. A franchise agreement usually requires the franchisee to comply with all the laws and regulations in the jurisdiction, including employment legislation.

Franchisors may seek to state explicitly whether they consider the franchisee or the franchisee's employees as their employees in the franchise agreement. However, in the absence of any special circumstances, it is unlikely for franchisees or employees of a franchisee to be treated as employees of the franchisor within the meaning of the employment legislation in place in Hong Kong.

7 How are trademarks and know-how protected?

While intellectual property laws in Hong Kong are domestic in nature, Hong Kong also adheres to various international intellectual property conventions, including the Paris Convention, the Universal Copyright Convention, WIPO Copyright Treaty and the WIPO Performances and Phonograms Treaty.

Intellectual property laws in Hong Kong apply equally to residents of Hong Kong and foreign entities.

The Trade Marks Ordinance protects trademarks, certification marks, collective marks and well-known trademarks. It also specifies procedures for trademark registration and trademark revocation. The Trade Descriptions Ordinance prohibits the use of false trade descriptions (including the forging of a registered trademark) and misleading information. The common law rule of passing off applies in Hong Kong, which can be used to enforce unregistered trademark rights. The Patents Ordinance protects patents registered in Hong Kong. Under the reregistration patent system in Hong Kong, an applicant may obtain patent protection by obtaining a patent grant at one of the designated patent offices, namely, the State Intellectual Property Office in the PRC, the UK Patent Office and the European Patent Office.

Intellectual property laws are enforced by the Intellectual Property Investigation Bureau, which is part of the Customs and Excise Department.

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

Land in Hong Kong is held in two ways: freehold and leasehold. All land held by private persons is leasehold. Some franchisors may take a lease and grant the franchisees a sublease of the premises, for which the Landlord and Tenant (Consolidation) Ordinance applies.

Laws and agencies that regulate the offer and sale of franchises

9 What is the legal definition of a franchise?

There is currently no legal definition of a franchise or franchise-specific legislation enacted in Hong Kong. However, a number of franchisors in Hong Kong are members of the Hong Kong Franchise Association (HKFA) (www.franchise.org.hk), established in 1992 as a committee within the Hong Kong General Chamber of Commerce.

The HKFA defines franchising as follows:

Franchising is a method of marketing goods and services. The basic features of a typical franchising arrangement include:

- (1) *the franchisor allowing the franchisee to use its name or brand;*
- (2) *the franchisor exercising continuing control over the franchisee;*
- (3) *the franchisor providing assistance to the franchisee; and*
- (4) *the franchisee making periodical payments to the franchisor.*

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

There is no franchise-specific legislation that governs the offer and sale of franchises in Hong Kong. Neither are there exchange controls, antitrust laws, foreign equity participation or local management participation regulations in place at the moment. Franchises in Hong Kong are not required to register with the government of the Hong Kong SAR or any trade associations. Hence, the offer and sale of franchises is subject to the common law (with special regard to contract law principles), where the principle of caveat emptor applies.

11 Describe the relevant requirements of these laws and agencies.

While there is no franchise-specific legislation, and no regulatory regimes concerning franchises in place in Hong Kong, various pieces of consumer protection legislation are applicable to franchise agreements.

Such legislation includes restrictions that apply to contracts in general. For example, the Control of Exemption Clauses Ordinance

sets out the law pertaining to the validity of exemption clauses applicable to franchises. Another example is the Unconscionable Contracts Ordinance, which governs unconscionable provisions and unreasonable restraints of trade.

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

At present there are no franchise laws or regulations in place in Hong Kong.

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

No legal requirements that govern franchise operations exist in Hong Kong.

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?

No laws, regulations or government policies that restrict franchise operations are in place in Hong Kong, save for general principles of contract law, where the principle of caveat emptor applies, meaning that a franchisee should exercise its own discretion when entering into franchise agreements.

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?

There are no requirements for pre-sale disclosures that must be made to sub-franchisees in the case of a sub-franchising structure, because no specific legislation provides for the operation of franchises in Hong Kong at present.

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

No specific legislation that provides for pre-contractual disclosure exists in Hong Kong. However, franchisors may be expected to adhere to the Code of Ethics published by the Hong Kong Franchising Association (HKFA), which stipulates that franchisors should provide full and accurate written disclosure of all information that is material to the franchisee relationship to prospective franchisees within a reasonable time prior to contract.

Franchisees are, on the other hand, expected to provide full and frank disclosure of all information considered material in order to facilitate the franchisor in choosing an appropriate franchisee.

17 What information must the disclosure document contain?

Not applicable.

18 Is there any obligation for continuing disclosure?

Not applicable.

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

Disclosure requirements specified in the Code of Ethics drawn up by the HKFA are not legally binding in nature, and as such are not subject to enforcement by government agencies.

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?

Not applicable.

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?

Not applicable.

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 offer and sale of franchises is not governed by any specific legislation or government agency, but the general principles of contract law apply. The Code of Ethics published by the Hong Kong Franchising Association also provides general principles that franchisors and franchisees should adhere to in franchise agreements, although the Code is not legally binding.

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?

In general, there are no rules on pre-sale disclosure in Hong Kong that apply to franchise transactions. However, franchisors and franchisees are expected to make full and honest pre-sale disclosure in accordance with the laws on misrepresentation (see question 24).

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 the franchisor has made a fraudulent representation that has induced the franchisee to rely on the misrepresentation and enter into a franchising agreement, the franchisee may rescind the contract and sue the franchisor for damages on grounds of misrepresentation. If the misrepresentation has led to losses suffered the franchisee is further entitled to damages arising from the fraudulent act under section 3 of the Misrepresentation Ordinance.

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?

Hong Kong does not require franchisors or franchisees to perform any official act subsequent to the franchise agreement, such

as registering the franchise agreement or filing annual reports. The contractual terms of the franchise agreement usually set out fully and expressly the legal obligations by which the parties are bound to perform. The franchise contract will be enforced under and governed by common law, mainly contract law.

26 Do other laws affect the franchise relationship?

There are no specific laws relating to franchising in Hong Kong. Franchise agreements are treated the same way as other commercial contracts. However, certain areas of law, for instance, contract law, play a larger role in franchise relationships.

The Personal Data (Privacy) Ordinance protects individuals' right to privacy by regulating the handling of personal data. It applies to any individual or organisation, both public and private, that processes, collects and holds personal data. Hence, all business operations in Hong Kong, including franchises, are subject to the regulations on the handling of private data as stipulated in the Ordinance, as long as they handle personal data. Breach of the Ordinance attracts both criminal and civil liability.

In a franchise agreement, data protection laws may be violated when the franchisor requires the franchisee to provide them with customer information. Hence, care should be taken when the franchisor and the franchisee handle personal data provided by customers.

Moreover, it is not uncommon for franchise agreements to contain clauses that aim to exempt or limit franchisor's liability for pre-contractual representations made to franchisees. Clauses contained in franchise agreements, like other commercial contracts, are governed by the Control of Exemption Clauses Ordinance and will only be valid if they are fair and reasonable.

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

The Hong Kong government implements a laissez-faire policy to facilitate and protect a free-market system.

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 usually contains express provisions that govern termination by either party in the event of a repudiatory breach by a franchisee. Some agreements also contain provisions for the franchisee to rectify the breach within a certain period.

At common law, the franchisor has the right to terminate the franchise agreement where there has been a repudiatory breach and where it is clear that the party in breach no longer wishes to fulfil part of the agreement.

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

A franchise agreement usually contains provisions governing termination by either party. In the absence of such express provisions, termination is available to the franchisee in the following events:

- Repudiation: A franchisee is entitled to terminate the agreement in the event of a repudiatory breach by the franchisor, and vice versa. A repudiatory breach is a fundamental breach of contract that permits the non-breaching party to terminate the contract as well as claim damages.
- Misrepresentation: A misrepresentation is a false statement of fact that induced an innocent party into contractual relations. A franchisee has the right to rescind a franchise contract entered into under fraudulent, negligent or innocent misrepresentation of the franchisor. It is also possible to claim damages for misrepresentation under the Misrepresentation Ordinance.
- Frustration: Both parties have a common law remedy to

Update and trends

At present there are no proposals for new legislation or regulation, or to revise existing legislation or regulation, in relation to franchising in Hong Kong.

terminate the franchising agreement if the occurrence of an unforeseen event has rendered the performance of the contractual obligations impossible.

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

A franchising agreement usually contains express provisions on the option to renew a franchise, setting out the circumstances and conditions in which the option may be exercised.

- 31** 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 prevent a franchisee from assigning its franchise or ownership to third parties, provided the relevant restrictions are made express in the franchise agreement. Such restrictive terms are enforceable. Most franchise agreements contain an express term to limit assignment by requiring the franchisor's consent to authorise transfer.

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

There is no law or regulation in Hong Kong affecting the nature, amount or payment of fees. It depends solely on contractual terms expressly agreed upon by the franchisor and franchisee.

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

Most franchise agreements contain a provision for the amount of interest that can be charged by the franchisor on any late payments, as agreed between the parties. However, under section 24 of the Money Lenders Ordinance (Cap. 163), an agreement for the payment of interest is unenforceable if the effective rate of interest exceeds 60 per cent per annum.

- 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 is no law or regulation restricting the currency in which payments are to be made by a franchisee to a franchisor. It is open to the parties to incorporate a contractual term to govern the matter.

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

Confidentiality covenants are usually incorporated into a franchise agreement to protect trade secrets and know-how of the franchisor. The obligation usually continues to bind the parties after termination of the franchise agreement. Enforcement action may be brought by the franchisor or the franchisee as a contractual breach entitling the relevant party to accept it as a repudiatory breach.

- 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?

There is no general legal obligation on the parties to the franchise agreement to deal with each other in good faith. The Hong Kong Franchising Association (HKFA), affiliate of the Hong Kong General Chamber of Commerce (HKGCC), has however published a Code of Ethics (the Code) on its website, setting out provisions requiring franchisors and franchisees to act in good faith and goodwill during both the pre-contractual and post-contractual stages. Section 9 of the Code requires the pre-contractual negotiation to be conducted in a fair manner. Section 18 requires a franchisor to allow a franchisee sufficient time to remedy losses in any event of breach. The Code, however, is not legally binding.

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

It is unlikely for franchisees to be treated as consumers in Hong Kong for the purposes of consumer protection or other legislation.

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

There is no legislation regulating the use of language in disclosure documents and franchise agreements. The validity of an agreement depends on its compliance with the law in force in the jurisdiction rather than the language employed. The official languages of Hong Kong are English and Chinese. In practice, translation may be required to enforce a franchise agreement made in languages other than in English or Chinese.



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39 What restrictions are there on provisions in franchise contracts?

There is no legal restriction on provisions in franchise contracts. As long as the contractual terms reflect the intention of both the franchisor and franchisee, they are enforceable under the contractual rules of common law.

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

On 14 June 2012, the Legislative Council of Hong Kong passed the Competition Bill to implement the first ever set of competition laws in Hong Kong – the Competition Ordinance. Although the Ordinance is on the statute book, the commencement date of the full ordinance has yet to be announced, and its provisions are not expected to be in force before 2014.

The Competition Rules are to be enforced by the Competition Commission, an independent statutory body set up in early 2013. The Competition Tribunal, a specialist tribunal for the purpose of adjudicating on the Commission's findings, will be established after August 2013.

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

In Hong Kong, there is no dispute resolution protocol that is specific to disagreements pertaining to franchising. If the parties are unable to settle a claim, they may initiate court proceedings. However, they are encouraged to consider alternative dispute resolution (ADR) before doing so. Franchise agreements may contain clauses that bind each party to consider ADR before initiating court proceedings to settle disputes. Options include mediation and arbitration as discussed below.

Mediation is a completely voluntary process wherein parties decide whether to settle and on what terms. A settlement from mediation produces an agreement instead of the enforceable award obtained from arbitration.

Arbitration, on the other hand, allows for the issuing of an award to the party whose civil rights have been infringed. In Hong Kong, arbitration is governed by the Arbitration Ordinance. Arbitration can only take place with the agreement of both parties. An arbitrator assists the parties in reaching an agreement, reviews the case and imposes a decision that is legally binding on both sides. The decision of an arbitration is final.

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

Hong Kong is a popular venue for arbitration. The Arbitration Ordinance provides a legal framework for arbitrations based largely on the UNCITRAL Model Law. Under the Arrangement Concerning Mutual Enforcement of Arbitral Awards between the Mainland and the Hong Kong Special Administrative Region and the New York Convention, arbitral awards made in Hong Kong are enforceable in mainland China and in over 140 jurisdictions worldwide.

Facilities and support services in relation to arbitration are provided by the Hong Kong International Arbitration Centre (HKIAC).

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

Foreign franchisors and domestic franchisors receive identical treatment legally.

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