



GETTING THE  
DEAL THROUGH 

# Franchise 2016

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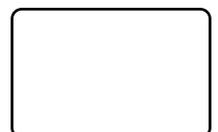


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## CONTENTS

<b>The president of the company just left a message for you...</b>	<b>5</b>	<b>Italy</b>	<b>82</b>
Philip F Zeidman DLA Piper LLP (US)		Roberto Pera and Irene Morgillo Rödl & Partner	
<b>Argentina</b>	<b>7</b>	<b>Japan</b>	<b>89</b>
Diego César Bunge Estudio Bunge – Bunge, Smith & Luchía Puig Abogados		Etsuko Hara Anderson Mōri & Tomotsune	
<b>Australia</b>	<b>12</b>	<b>Malaysia</b>	<b>94</b>
Philip Colman and John Sier MST Lawyers		Jin Nee Wong Wong Jin Nee & Teo	
<b>Belgium</b>	<b>19</b>	<b>Mexico</b>	<b>101</b>
Pierre Demolin, Véronique Demolin, Benoit Simpelaere and Leonard Hawkes DBB		Jorge Mondragón González Calvillo SC	
<b>Brazil</b>	<b>25</b>	<b>New Zealand</b>	<b>107</b>
Paulo Shigueru Yamaguchi, Marco Mello Cunha and Theo Santos Cabral da Hora Tess Advogados		Stewart Germann Stewart Germann Law Office	
<b>Canada</b>	<b>30</b>	<b>Russia</b>	<b>112</b>
Bruno Floriani, Marvin Liebman and Marissa Carnevale Lapointe Rosenstein Marchand Melançon LLP		Vladimir Biriulin and Sergey Medvedev Gorodissky & Partners	
<b>China</b>	<b>38</b>	<b>South Africa</b>	<b>117</b>
Claudio d'Agostino and Paula Cao DLA Piper UK LLP (Shanghai and Beijing)		Eugene Honey Adams & Adams	
<b>Colombia</b>	<b>46</b>	<b>Spain</b>	<b>123</b>
Juan Carlos Uribe Triana, Uribe & Michelsen		Ignacio Alonso Even Abogados	
<b>Finland</b>	<b>52</b>	<b>Switzerland</b>	<b>129</b>
Patrick Lindgren Advocare Law Office		Martin Ammann and Christophe Rapin Meyerlustenberger Lachenal	
<b>France</b>	<b>58</b>	<b>Thailand</b>	<b>135</b>
Emmanuel Schulte Bersay & Associés		Chanvitaya Suvarnapunya and Pattama Jarupunphol DLA Piper (Thailand) Limited	
<b>Germany</b>	<b>64</b>	<b>Turkey</b>	<b>140</b>
Karsten Metzloff and Tom Billing Noerr LLP		Hikmet Koyuncuoğlu and Seza Ceren Aktaş Koyuncuoğlu & Köksal Law Firm	
<b>Guatemala</b>	<b>70</b>	<b>United Kingdom</b>	<b>146</b>
Marco Antonio Palacios Palacios & Asociados		David Bond, Chris Wormald and Vicky Reinhardt Fieldfisher	
<b>Indonesia</b>	<b>75</b>	<b>United States</b>	<b>151</b>
Galinar R Kartakusuma and Reagan Roy Teguh Makarim & Taira S		Michael G Brennan and Philip F Zeidman DLA Piper LLP (US)	

# Germany

Karsten Metzlauff and Tom Billing

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## Overview

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

Franchisors wishing to set up business in Germany have a variety of legal forms (partnerships and limited liability companies) from which to choose. Nevertheless, the most common form of corporate vehicle to be established by a typical franchisor in Germany is a private limited liability company (GmbH). This corporate form requires a minimum amount of capital investment (at least €25,000) and offers limited liability, so only the company's assets are liable to the company's creditors. Furthermore, the GmbH offers a great deal of flexibility as regards internal structures and procedures. Other forms of corporation are the public limited company (AG) that requires a share capital of at least €50,000 and the recently introduced entrepreneurial company (limited liability). The latter is a version of the GmbH and to some extent resembles a private company limited by shares (Ltd) under common law - mostly through the abandonment of a minimum capital requirement.

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

If the business entity is to be classified as a partnership, its formation is governed by the German Civil Code and the German Commercial Code. The incorporation of a private limited liability company is subject to the Limited Liability Company Act, and the formation of a public limited company is regulated by the Stock Corporation Act. Limited liability companies must be registered in the Commercial Register that is maintained by the local courts.

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

A GmbH is incorporated by a shareholder agreement that has to be certified by a notary and registered with the Commercial Register. The agreement, and therefore the registration, has to declare the name and registered office of the company, corporate objects, the amount of share capital and individual contributions of the shareholders.

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

There are no restrictions on foreign business entities and foreign investment in Germany.

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

A business entity that has its registered office or place of management in Germany is considered tax-resident in Germany. Unless otherwise provided for in an applicable double tax treaty, a tax-resident entity is subject to unlimited tax liability in Germany on its worldwide income.

Corporate income tax is payable at a rate of 15 per cent (plus a solidarity surcharge of 5.5 per cent of the corporate income tax). Individuals who conduct business in Germany or are partners in a partnership in Germany are subject to progressive German income tax rates of up to 45 per cent (plus a solidarity surcharge of 5.5 per cent of income tax), depending on their income.

Trade tax is a municipal tax and varies between approximately 12 per cent and 18 per cent. The trade tax base is the taxable profit for income tax or corporate income tax purposes, modified by some add-backs and deductions. To mitigate the double burden of income tax and trade tax, income tax on business income is to a certain extent reduced by trade tax (trade tax rate relief allowance). Trade tax cannot, however, be deducted from corporate income tax.

Non-tax-resident business entities or entrepreneurs are subject to limited tax liability on their domestically-sourced income. Income received from a permanent German establishment is regarded as domestically sourced income and is therefore subject to income tax (for individuals not tax-resident in Germany) or corporate income tax (for companies not tax-resident in Germany), as well as trade tax at the normal rate.

Income tax on domestic taxable income from the licensing of know-how or rights of use of non-tax-resident business entities or entrepreneurs not having a permanent establishment in Germany is levied at source by way of a withholding tax, unless otherwise provided for in an applicable double tax treaty. The withholding tax is normally paid by the debtor (the franchisee) on account of the creditor (the franchisor). The tax rate is 15 per cent. The solidarity surcharge amounts to 5.5 per cent of the income tax or the corporate income tax.

Deliveries and services supplied in Germany against consideration by an entrepreneur are generally subject to German value added tax (VAT). Services relating to licensing of rights or the provision of know-how supplied by an entrepreneur are generally subject to VAT, if the recipient of these services is situated in Germany. Deliveries of goods from abroad are either subject to German VAT on intra-Community acquisition of goods or to German import VAT. The standard rate is 19 per cent; however, some deliveries are taxed at the rate of 7 per cent and some supplies are tax exempt (for example, financial services).

### 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?

Depending on the nature of the relationship between a franchisor and a franchisee, there may be a risk that the franchisee is treated as an employee or a quasi-employee of the franchisor, with the result that employer obligations and employee rights apply. Whether a franchisee will be classified as an independent businessman or as an employee (or quasi-employee) depends on the scope of the control exercised by the franchisor, and on the extent of the entrepreneurial risk assumed by the franchisee.

In this respect, the courts rely on the criteria of personal dependency (employees) or economic dependency (quasi-employees). Dependency exists if the franchisee is excessively bound to the franchisor's instructions regarding the subject matter, conduct, time, length and place of his activity. Self-employment exists where the franchisee is mainly free to determine its activity and bears the entrepreneurial risk. A franchisee organised in the form of a company limited by shares (for example, a limited liability company or a stock corporation) will not run the risk of being qualified as an employee.

### 7 How are trademarks and know-how protected?

Apart from well-known or famous brands, trademark protection in Germany requires registration either with the Patent and Trademark

Office, or a designation of international trademarks for Germany, or registration as a Community trademark. Trademarks such as words, pictures and letters are protected by the Trademark Act.

Although know-how is part of a franchisor's intellectual property rights, the protection of know-how is not subject to specific statutes such as the Trademark Act or the Copyright Act. Even so, franchisors' know-how is confidential information under the franchise agreement or other confidentiality agreements. Breach of business confidentiality constitutes a breach of those agreements and, moreover, is punishable under the Act Against Unfair Competition.

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

German law does not provide for any special franchise-related regulations concerning the real estate market or real estate law. Thus, the general rules of the Civil Code apply. Commercial leases and subleases may be freely concluded between lessor and lessee. Any assignment of ownership must be notarised and registered in the land register.

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

### **9 What is the legal definition of a franchise?**

There is no statutory definition of 'franchising' in Germany. According to the definition of the German Franchise Association that is partly recognised by the courts, franchising is a sales and distribution system by means of which goods, services or technologies are marketed. It is based on close and ongoing cooperation between legally and financially independent and self-employed companies, the franchisor and the franchisees. The franchisor grants its franchisees the right, at the same time as imposing the obligation on them, to run a business according to its concept. This right entitles and obliges the franchisee, in return for direct or indirect remuneration, within the framework and for the duration of a contract signed between the parties, to utilise, under ongoing technical and economical support by the franchisor, the system's name, the trademark, the logo or other intellectual property or protection rights, as well as know-how, economic and technical methods and the business system of the franchisor.

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

There are no specific laws or government agencies that regulate the offer and sale of franchises. Therefore, the offer and sale of franchises is only governed by the general provisions of contract law (the Civil Code), consumer law, commercial law (the Commercial Code) and unfair trade and antitrust law. According to the law, the franchisor must disclose all necessary information to the franchisee (see question 15). In particular, the provisions of the Civil Code concerning standard terms can be applied where the franchisee has signed on a take-it-or-leave-it basis (section 307 of the Civil Code). Accordingly, all contractual provisions need to be reasonable, otherwise they are void (see also question 25). Further, according to German consumer credit law, a franchisee is entitled to revoke the contract within a period of 14 days after closing if it is, on entering into the contract, establishing an independent business enterprise, and the contract contains an obligation to repeatedly take supplies of goods. But such right of revocation does not exist if the total value of the franchisee's investments exceeds an amount of €75,000. The franchisor is obliged to advise the franchisee about its right to revoke the contract. If it does not or does not properly advise the franchisee, the period of possible revocation extends to one year and 14 days after closing of the contract.

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

See question 10.

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

See question 10.

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

German statutory law does not provide for special requirements that a franchisor must meet prior to offering franchises. Nevertheless, the German

Franchise Association ([www.franchiseverband.com](http://www.franchiseverband.com)) lists numerous guiding principles in its code of ethics. Inter alia:

- 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 assure ongoing commercial or technical support or both to the franchisee during the entire term of the contract.

Observance of the stated principles is obligatory in order to become and remain a member of the Franchise Association, and to demonstrate fair business practices.

### **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 such laws, regulations or government policies in Germany.

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

Under German law, pre-contractual disclosure in connection with franchise contracts is not regulated by special statute or monitored by a specific agency. Only the general provisions regarding the opening of contractual negotiations as a result of the principle of culpa in contrahendo apply. Therefore, before the conclusion of the franchise contract, the franchisor must ensure that all the relevant facts have been clearly presented to the potential franchisee. In the case of a violation of the franchisor's duty to present the relevant facts, the franchisee has the right to claim damages. The content and the scope of the duty depend on the individual case, taking the experience and knowledge of the franchisee into account.

The courts have stressed that, as a general rule, the franchisee is obliged to obtain information at his or her own initiative about the general market conditions and the impact of those conditions on the prospective franchise business. Nevertheless, an exception to that rule applies if there are particular circumstances of which only the franchisor is aware and which are recognisably of importance to the other party's decision as to whether to enter the franchise contract or not. It follows from court decisions that the franchisor must refrain from providing misleading information on the franchise system and must disclose all relevant information about it in order to avoid subsequent damage claims. Any lack of information or any misleading information may lead to liability on the basis of a breach of pre-contractual disclosure obligations. A non-binding guideline for franchisors about disclosure in Germany is the German Franchise Association's code of ethics for franchising that is available on the above-mentioned website.

Thus, unlike common law countries, and contrary to the legal situation in, for example, France, Italy and Spain, there is no specific compliance procedure under German law or under German franchise practice. A written standard compliance procedure does not exist. Nevertheless, it would be advisable for franchisors to expressly disclose to their potential partners in writing all information that is deemed necessary according to German case law and to the German Franchise Association code of ethics for franchising (reflecting the actual constitution of the franchise system). German franchise lawyers have developed checklists to ensure such proper disclosure.

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

In the case of a sub-franchising structure, the sub-franchisor must make pre-sale disclosures to sub-franchisees. However, as there are no statutory provisions with regard to pre-contractual disclosure obligations (see also question 15), the scope of disclosure requirements depends on the sub-franchisee's need for information and on the existing possibilities for the sub-franchisee to obtain information. As a result, the sub-franchisor must provide information about the way the franchise system works and its prospects of success.

The sub-franchisor must, at least, offer information about the master-franchise and the allocation of tasks between franchisor and sub-franchisor.

He or she must show the extent of the derivation of rights from the franchisor (particularly as to trademarks and know-how).

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

There is no statutory requirement for specific items for pre-contractual disclosure. Even so, it may be derived from German case law and from the German Franchise Association's code of ethics that at least the following items should be disclosed (see also question 16):

- description of the franchise concept;
- initial and ongoing support by the franchisor;
- date of beginning of the franchise system;
- existence of a pilot business;
- required capital and manpower for the franchisee's business;
- accurate information on the profitability of the franchisee's business;
- actual number of franchisees; and
- pending lawsuits with an impact on the potential franchisee's business.

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

An obligation for continuing disclosure can follow from the principle of good faith that is a basic principle of German law (see question 36). By invoking good faith, a court may establish collateral obligations owed between contracting parties. This may include protective obligations, such as information (disclosure) about developments having an impact on the franchisee's business or on the franchise system in general (for example, the franchisor's trademark being challenged by a third party).

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

This is not relevant for German jurisdiction (see question 15).

#### 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?

If the franchisor infringes its duty regarding disclosure, the franchisee is entitled to claim damages. The franchisor has to put the franchisee in the position it would have been in if the franchisor had fulfilled its disclosure obligation. As the franchisee may have not agreed to the franchise agreement under full disclosure, he or she may rescind the franchise agreement. The franchisor, therefore, can be ordered to consent to the cancellation of the franchise contract, to pay all obtained franchise fees back to the franchisee and to reimburse the franchisee for all expenses incurred in connection with the franchised business. But income earned from the exercise of the franchise has to be deducted.

#### 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, a sub-franchisor is solely responsible for fulfilling its disclosure obligations with regard to franchisees. Nevertheless, the sub-franchisor may have recourse against the franchisor if the sub-franchisor has used and relied on the franchisor's disclosure material containing misleading information. Normally, individual officers, directors and employees of the franchisor are not exposed to liability because they are not supposed to become franchisees' contractual partners. That said, in exceptional cases, those intermediaries or third parties might be held liable for violations of pre-contractual disclosure because the Civil Code provides for the responsibility of third parties when the third party claims reliance for itself to a special extent (inducing special trustworthiness) and thereby substantially influences the contractual negotiations or the conclusion of the contract.

#### 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?

See question 10. For the principle of culpa in contrahendo, which establishes as an obligation of good faith to make pre-sale disclosure mandatory, see question 15.

#### 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?

See questions 15, 16 and 17.

#### 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 franchise sales disclosure laws?

See question 20. The franchisee may file a complaint with the competent public prosecutor's office for fraudulent practices of the franchisor. A conviction for fraud may lead to imprisonment or a fine.

#### 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 well as the offer and sale of franchises, the ongoing relationship between franchisor and franchisee is only governed by the general provisions of the Civil Code, the Commercial Code, and competition and antitrust law (see question 10). In practice, the laws of the Civil Code concerning standard business conditions play an important role for the enforcement of standardised business conditions; for example, regarding franchisees' obligation to effect changes to the franchise system that are introduced by the franchisor during the term of the agreement. This law (in particular, section 307 of the Civil Code) provides that standard terms are null and void if they unduly prejudice the other party contrary to the requirements of good faith. In other words, the standard terms law addresses unfair contract terms that operate unreasonably to the detriment of the other party.

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

Besides the general provisions of contract law, commercial law, competition and antitrust law, the franchise relationship can be affected in particular by laws regarding the protection of intellectual property, such as trademark law and the laws regarding patents.

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

Although the German Franchise Association (the Association) is a non-governmental body and membership is not compulsory, the guiding principles contained in the Association's code of ethics influence franchise relationships at least to some extent. This is mainly owing to the fact that the Association represents a quality association of the franchise business by determining the binding guidelines for member companies, by verifying these before admission into the Association and by checking whether the strict admittance requirements for membership of the Association have been met. 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?

Generally, franchise agreements end as a result of lapse of time, termination with notice or the conclusion of an agreement to annul the franchise relationship. That said, there may be circumstances that lead to sudden friction in the relationship between the franchisor and the franchisee and, as a consequence, one party might wish to terminate the franchise agreement even without notice. Under German law, a termination without notice can only be performed if a good cause exists and the franchisee (or the franchisor) has been formally issued with a warning letter beforehand. Only major infringements of the duties of the franchise agreement constitute good cause for a termination without notice.

Good cause that enables the termination of the agreement without notice is established when serious infringements of the contractual duties

occur: for example, refusal to pay the franchise fees or the repeated breach of important rules of the franchise system (such as the prohibition to cooperate with competitors).

Assessment of whether an action represents good cause requires an overall assessment of the circumstances of each individual case and a weighing of the interests of the franchisor and the franchisee. The termination has to take place within a reasonable time of the occurrence of the activity that led to the friction in the relationship. Finally, it must be noted that, pursuant to German law on standard business conditions, neither the necessity nor the requirements for 'good cause' can be waived in a standard franchise agreement. The same applies to the necessity for a formal reminder before termination without notice.

In the event of unjustified termination of the franchise agreement by the franchisor, the franchisee might be entitled to claim compensation for loss of income that might otherwise have been earned from further business. If so, the compensation can be as high as the average annual income (calculated on the basis of the past five years). However, compensation will not be paid if the contract was terminated by the franchisee or in case of termination without notice because of misbehaviour by the franchisee.

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

The franchisee may also terminate the franchise relationship if good cause arises. For example, good cause has been affirmed by German courts where a franchisor undertakes the contractual obligation to include the franchisee in purchase benefits (such as rebates) that the franchisor receives from its suppliers, but then conceals that it has actually received such benefits.

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

According to German law, the renewal of a franchise contract is exclusively subject to agreement between the parties. Therefore, a franchisor may refuse to renew the franchise agreement without having to give reasons for his or her decision. Nevertheless, it should be noted that franchisors' freedom of decision is limited in terms of claims for damages. For example, where a franchisor has announced his or her intention to renew the franchise contract and in this connection encouraged the franchisee to invest in the (expensive) refurbishment of business premises on the verge of contract expiry, the refusal to renew the franchise contract 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?**

Under German law, it is possible to regulate such restrictions within the franchise contract. Normally, the transfer of the franchise is subject to the franchisor's prior written approval in order to protect the know-how and integrity of the franchise system and to prevent entry of the franchisor's competitors. Likewise, it is possible (and enforceable) to make the franchisee's transfer of ownership (including assignment or pledge) in the franchisee entity subject to the prior approval of the franchisor.

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

There are no specific laws or regulations affecting the nature, amount or payment of fees. These issues are subject to negotiation between the parties. Nevertheless, the amount of fees should reflect the quality and value of the franchise system and franchisor's services, given that fees that are conspicuously disproportionate to the franchisor's performance are considered immoral and are therefore void (section 138 of the Civil Code).

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

According to German law, the rate of interest for demands for remuneration payment is 9 per cent above the base interest rate (currently -0.83 per cent, according to the European Central Bank) for merchants (businesses). Please note that the rate of interest for other demands for payment, namely, payment without remuneration (eg, compensation for damages) is only 5 per cent above the base interest rate. Furthermore, the franchisor is entitled to charge a lump sum payment of €40 for overdue payments.

These provisions are mandatory to the extent that they cannot be waived to the detriment of the franchisor regarding the interest rate of remuneration payment. With regard to other demands for payment as well as agreements on higher interest rates, it should be noted that such agreements are scrutinised by the courts, given that an amount of interest exceeding the amount regulated by law (which is regarded as adequate) must reflect the loss that the franchisor could usually be expected to incur. However, the franchisor is free to claim any actually occurred losses owing to overdue payments.

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

No such laws or regulations exist in Germany.

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

Yes, confidentiality covenants are enforceable. If a franchisee does not comply with its obligation to keep know-how or business secrets confidential, the franchisor may apply for an injunction and claim damages from the franchisee.

### **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?**

German law stipulates that the parties to a contract effect performance in the manner required by good faith (section 242 of the Civil Code). This is a basic principle of German law and a 'general provision', enabling a court to 'tailor' its decision to the circumstances of the particular case (section 307 of the Civil Code regarding the assessment of standardised terms is one particular instance of the basic principle of good faith). The principle of good faith limits the enforcement of existing rights; or, in other words, requires that rights are exercised in a manner consistent with good faith. Although the application of the good faith principle depends on the facts of the individual case, it can be said that, in most cases, the courts make restrained use of this principle and refrain from simply introducing new terms that might be regarded as more appropriate.

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

As a general rule, franchisees are not treated as consumers under German statutory law or jurisdiction. In that respect, the Federal Supreme Court decided on 24 February 2005 that potential franchisees are not to be treated like consumers in connection with the setting-up of the business. Nevertheless, even if a franchisee is not considered as a consumer he might be a 'business founder' who is also entitled to revoke the contract according to section 512 of the Civil Code if he is obliged to purchase goods on a recurrent basis (see question 10).

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

German law does not require an international franchisor to provide the franchisee with pre-contractual information or a franchise agreement drafted in the German language. Nevertheless, in order to avoid misunderstandings and future disputes, it is advisable that the franchisee is at least provided with a translation of the franchise agreement for convenience, as long as it cannot be excluded that the franchisee might have difficulties with the interpretation of the franchise agreement. Moreover, if the franchise agreement provides for the jurisdiction of a German court, a translation of the agreement will become necessary if it is brought before a court, given that the language in court needs to be German (this applies to all documents involved).

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

German law is characterised by the principle of contractual freedom that allows the parties to agree on the provisions of a contract at their discretion. Therefore, restrictions on provisions in franchise contracts are an exemption and mainly follow from antitrust law and the laws regarding conditions in standardised contracts (in particular section 307 of the Civil Code: see questions 10, 25 and 36).

The law regarding conditions in standardised contracts specifies the principle of good faith and bans standardised provisions that unreasonably

### Update and trends

There is an ongoing discussion about the necessity of specific statutory regulations on franchise contracts. Most recently, there seem to be legislative attempts to codify German franchise law, in particular with regard to the requirements of pre-contractual disclosure. The German Federal Ministry of Justice tendered a research project regarding 'Special Statutory Provisions about Franchise Agreements in International Comparison' with focus on 'Pre-contractual Disclosure Obligations of the Franchisor' (see [https://www.bundesjustizamt.de/DE/Aktuelles/Ausschreibungen/Ausschreibungen\\_node.html](https://www.bundesjustizamt.de/DE/Aktuelles/Ausschreibungen/Ausschreibungen_node.html), in German). The deadline to submit tenders has been extended and expires on 29 June 2015.

Before tendering the research project, the German Federal Ministry of Justice had asked the German Federal Chamber of Lawyers as well as several trade associations to submit their statements about such regulations. Most associations spoke against specific statutory regulations on franchise contracts. The opponents argue that specific statutory regulations are not necessary with view to the many forms and the complexity of franchise systems which can barely be reflected by specific regulations. They also believe that the existing case law and guidelines are sufficient to provide legal certainty, in particular with regard to specific disclosure regulations. As an example, see the statement of the German Franchise Association under [www.franchiseverband.com/fileadmin/dfv-files/Presse/Stellungnahme\\_DFV\\_Franchisegesetzgebung.pdf](http://www.franchiseverband.com/fileadmin/dfv-files/Presse/Stellungnahme_DFV_Franchisegesetzgebung.pdf) (in German language). There are, however, voices in favour of specific franchise regulations, too. The proponents argue that specific regulations are necessary to provide legal certainty. The German Federal Chamber of Lawyers, for example, submitted a statement to the German Federal Ministry of Justice speaking for the necessity of such regulations, in particular with regard to disclosure requirements ([www.brak.de/zur-rechtspolitik/stellungnahmen-pdf/stellungnahmen-deutschland/2013/juli/stellungnahme-der-brak-2013-16.pdf](http://www.brak.de/zur-rechtspolitik/stellungnahmen-pdf/stellungnahmen-deutschland/2013/juli/stellungnahme-der-brak-2013-16.pdf), also in German).

There is a further update. Article 7 of the Directive of Unfair Commercial Practice stipulates that misleading omissions in business practices shall be unlawful. This article 7 has been implemented in section 5a of the Act against Unfair Competition (AUC). According to section 5a ss. 3 No. 2 AUC, an advertiser who offers a product for sale must show its identity and address. If therefore a company advertises not only its own brand (pure image advertising) but actual products and their prices, it must reveal itself and in an imprint state from what company the offer originates and where the company is based. In a recent decision the Higher Regional Court of Düsseldorf applied that imprint obligation to franchise systems (see the judgment of the Higher Regional Court Düsseldorf of 5 August 2014, file no. I-20 U 140/11). It held that the franchisor is not only obliged to publish the required information about its own company but also the relevant information about the franchisees of the franchise system in question when

advertising with offers on behalf of the franchise system. The court thereby rejected the so far common practice to refer to the franchisor's website where that required information is usually provided. That practice has been established as it is almost impossible for franchisors to include all the required information into the actual advertisement.

With regard to price-based advertisements, there is the additional problem that cartel law provides that franchisees have to be free in their pricing (see question 39). Therefore, price-based advertisements of the franchisor must not create pressure on the franchisee for uniformity to the effect that the franchisee is de facto compelled to charge the prices in the advertisements. Therefore, franchisors often include a footnote into the advertisement saying 'Non-binding price recommendation' or 'Only at participating dealers'. According to current decisions of the German Federal Cartel Office, such footnote is in line with cartel law provided that franchisors do not check with the franchisees whether they actually comply with the advertised pricing or not.

According to the above-mentioned decision of the Higher Regional Court of Düsseldorf, however, such footnote required for reasons of cartel law may infringe section 5a ss. 3 No. 2 of the German Act Against Unfair Competition because the advertising does not contain the name and address of those franchisees participating in the advertisement by adhering to the recommended price. The court held that cartel law was not decisive for the case as the franchisor could avoid the cartel law problem by refraining from using this form of price-based advertisement in future. Furthermore, the court was of the opinion that the consumer would not be aware of the consequences of such footnotes (ie, that price-advertisements indicates a non-binding price recommendation as a reservation of price changes of the franchisee as the trading company actually selling the respective product).

As a consequence, the franchisors would be obliged to identify the participating franchisees in order to comply with unfair competition law but, at the same time, would infringe cartel law when asking the franchisees about their participation. Thus, unless the franchisor does not decide to refrain from such price-based advertisements at all, the franchisor is forced, according to the decision of the Higher Regional Court of Düsseldorf, to choose between the infringement of cartel law or the infringement of unfair competition law. Additionally, in case the franchisor decides to ask the franchisees about their participation (and therefore infringes cartel law), the problem of whether the respective information must be provided in the advertisement itself or can be provided on the franchisor's website remains.

Eventually, the outstanding decision of the Federal Court of Justice (file no. I ZR 194/14) in the appeal against the decision of the Higher Regional Court of Düsseldorf may provide a practical way in which franchisors can conduct price-based advertisements for participating franchisees.

disadvantage the franchisee in a manner contrary to the requirements of good faith. For example, a provision stipulating that the duration of the franchise agreement shall be 30 years would presumably be considered void, given that it unreasonably restricts a franchisee's entrepreneurial freedom. On the other hand, a duration that is too short (for example, one year) could also be regarded as unreasonable, as it would be practically impossible for the franchisee to recover the costs of its investment in setting up the franchise business within the agreed term.

The second source for legal restrictions on provisions in franchise contracts is antitrust (competition) law. In 2005, German antitrust law was completely harmonised with European antitrust law. All forms of competition restraints contained in distribution agreements, such as non-compete clauses, price-fixing and guaranteed exclusive areas, are now treated in full compliance with European antitrust law. European antitrust law (article 101(1) of the Treaty on the Functioning of the European Union (TFEU)) prohibits agreements between undertakings that may affect trade between member states and that have as their object or effect the prevention, restriction or distortion of competition within the common market. Exemptions are made either on an individual basis or, if applicable, under a block exemption. Vertical restraints such as those typically encountered in franchise agreements can be, to some extent, exempted under the EC Block Exemption Regulation No. 330/2010 (BER).

### Non-compete clauses

Franchise agreements often provide for non-compete obligations prohibiting the franchisee, during the term of the agreement, from carrying

on competing business in the market to which the franchise agreement applies. Such non-compete obligations are generally subject to competition law, as their effect is to restrict the franchisee's freedom of business activities and to prevent other franchisors from distributing their products or services through the franchisee involved. Provisions in franchise agreements that are essential in order to protect the franchisor do not constitute restrictions of competition for the purpose of article 101(1) TFEU (European Court of Justice, judgment of 28 January 1986, case 161/84, ECR 1986, 353, Pronuptia). If a non-compete clause is not essential for the protection of the franchisor, the BER can still apply. According to the BER, non-compete clauses during the term of the agreement must not be agreed for more than five years, while non-compete clauses after the termination of an agreement may not last for more than one year. These exemptions are only available to franchisors and franchisees with a market share of less than 30 per cent. If the market share is higher, the block exemption does not apply and the clause is invalid.

According to the BER, post-term non-compete clauses are generally invalid. Nevertheless, there are several exemptions: according to the BER, non-compete clauses can be agreed for one year if they only apply to competing products or services, are essential for the protection of know-how and are restricted to sites from which the franchisee was doing business during the term of the agreement. It can always be agreed that the franchisee is not allowed to use the know-how that was provided by the franchisor after the term of the agreement, provided that the know-how is not publicly known. There are no time restrictions for such clauses.

**Price fixing**

Basically, every form of direct or indirect price fixing is prohibited by German and European antitrust law. The franchisee must be free to determine at what price he or she wants to sell his or her products or render his or her services. The exemptions of the BER do not apply to agreements with price-fixing clauses. The franchisor is only entitled to set a maximum for the prices at which the product or service of the franchise system are to be sold. Additionally, the franchisor is entitled to issue non-binding price recommendations. Nevertheless, fixed resale prices may be permissible to organise a coordinated short-term low-price campaign in a franchise system (two to six weeks in most cases).

**Guaranteed exclusive area**

Under European and German antitrust law, a franchisor cannot be provided with a completely exclusive area. Nevertheless, there is a large array of exemptions to that rule. Exclusivity can be provided in the sense that the franchisees can be forbidden to actively distribute outside their exclusive areas. Active distribution is defined as all forms of marketing where the franchisee actively approaches potential customers. Passive distribution cannot be prohibited; passive distribution being all forms of marketing where the franchisee does not actively approach potential customers. Therefore, the franchisee cannot be forbidden from delivering goods or rendering services at the request of his or her customer even if this customer is located outside of the exclusive area. The establishment of an internet homepage is expressly deemed by the European Commission to be passive distribution. The franchisee cannot therefore be deprived of the right to present itself on the internet.

**Restrictions of cross-supplies**

It is often agreed in franchise agreements that the franchisee is only allowed to acquire goods from the franchisor and not from other sources, including other franchisees. This is considered a restraint of competition that can have negative effects on price competition. The BER prohibits restriction of cross-supplies between distributors within a selective distribution system. Under European and German antitrust law, most franchise systems have to be considered as selective distribution systems. Therefore, franchisees have to be allowed to acquire cross-supplies from other franchisees.

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

See question 39.

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

Civil and commercial matters are dealt with by the civil courts. Unlike countries in which parallel court systems exist on both the federal and state levels, only one uniform court system is in place in Germany (consisting of the local courts, the regional courts, the higher regional courts and the Federal Supreme Court). Unless there is exclusive jurisdiction (such as for disputes relating to real property or antitrust law), German law acknowledges agreements on jurisdiction between the parties as to international and local jurisdiction. 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 to a valid arbitration 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.**

Arbitration in Germany offers a number of advantages, such as significant flexibility (for example, number of arbitrators, place and language of the arbitration proceedings), potential cost and time efficiencies, greater confidentiality and a binding, enforceable and non-appealable resolution of the dispute. But arbitration proceedings may be more expensive than court proceedings, particularly if the matter in dispute is of relatively low value. In those cases, additionally, the parties may find it difficult to appoint their favoured (namely, highly specialised) arbitrators, given the relatively low arbitrators' fees following on from the low value of the dispute.

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

Under German law there is no difference between franchisors from EU and non-EU member states.

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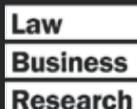
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