

# Franchise 2021

Contributing editor  
Philip F Zeidman



**Publisher**

Tom Barnes

tom.barnes@lbresearch.com

**Subscriptions**

Claire Bagnall

claire.bagnall@lbresearch.com

**Senior business development manager**

Adam Sargent

adam.sargent@gettingthedealthrough.com

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# Franchise 2021

**Contributing editor****Philip F Zeidman**

DLA Piper LLP (US)

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Lexology Getting The Deal Through is delighted to publish the fifteenth edition of *Franchise*, which is available in print and online at [www.lexology.com/gtdt](http://www.lexology.com/gtdt).

Lexology Getting The Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique Lexology Getting The Deal Through format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes new chapters on China and Italy.

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Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Lexology Getting The Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editor, Philip F Zeidman of DLA Piper LLP (US), for his continued assistance with this volume.



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For further information please contact [editorial@gettingthedealthrough.com](mailto:editorial@gettingthedealthrough.com)

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# Germany

Dr Benedikt Rohrßen and Giorgia Carandente

Taylor Wessing

## BUSINESS OVERVIEW

### Types of vehicle

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

The franchisors' choice depends especially on the obligations and liability risks to be undertaken, the seed capital and business assets and tax implications connected thereto. Most popular for medium or large businesses is the company with limited liability (GmbH), a flexible private limited liability company, which requires a minimum share capital of €25,000 and limits liability with regard to creditors to the company's assets. Even bigger businesses might choose the corporation (AG) namely, a public limited company that requires a minimum share capital of €50,000. As an alternative, the entrepreneurship (UG), also known as 'mini GmbH', also provides for limited liability, but with a share capital of €1. If the franchise system shall be set up in different states of the European Union, another option is the Societas Europea (SE), a public limited company requiring a minimum share capital of €120,000. For tax reasons, such corporations are often combined with partnerships (eg, as GmbH & Co KG or AG Co KG).

### Regulation of business formation

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

The Civil Code (BGB) and the Commercial Code (HGB) regulate the incorporation of partnerships, while the Limited Liability Company Act (GmbHG) governs the formation of a GmbH or a UG, the Stock Corporation Act (AktG) the formation of the AG and the Council Regulation (EC) No. 2157/2001 of the SE.

### Requirements for forming a business

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

Compared with an AG, the GmbH and even more the UG are less formalised, easier and cheaper. One-person foundations are allowed and founders can be German or foreign natural and legal entities. The incorporation agreement requires as minimum information: the full name and registered office of the company, object of the enterprise, amount of the share capital, and the shareholders' contributions. Once certified by a notary, it must be registered with the Commercial Register by the competent local court (Amtsgericht). The entries in the Register of Commerce are published in the Electronic Federal Gazette.

### Restrictions on foreign investors

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

In principle, foreign business entities are free to do business and invest in Germany. However, thorough reviews by the German Federal Ministry for Economic Affairs and Energy and notification obligations apply to acquisitions in specified industry sectors related to public order and security, such as defence, IT, telecoms and critical infrastructure, unless it is made by individuals or business entities based in the European Union, Iceland, Liechtenstein, Norway (the European Economic Area) or Switzerland (based on sections 55-62 of the Foreign Trade and Payments Ordinance). Moreover, the EU and its member states are cooperating on the screening of foreign direct investments into the Union (Regulation (EU) 2019/452), for which the German Federal Ministry for Economic Affairs and Energy issued a Draft Act on 30 January 2020 amending the Foreign Trade and Payments Act.

### Taxation

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

Further to the entry in the Commercial Register, all German tax-resident business entities are automatically registered with the Tax Authorities. To avoid penalties, tax declarations must be submitted by 31 July or by tax accountants by 28 February thereafter. The income tax, which is usually the highest tax, is calculated based on the profits indicated in the last tax declaration: For AGs or GmbHs, a corporate income tax of 15 per cent of the taxable income is due, while individuals or partnerships are subject to a progressive income tax of up to 45 per cent. Most companies are also subject to a trade tax, whose amount usually varies between 7 and 18 per cent and is determined on a local basis by the competent municipality.

If the franchisor employs workers, a wage tax is due with the monthly pay slip. If the object of the franchise is goods or services, a VAT of 7 per cent (limited to the taxi, hotel or public transport industry) or 19 per cent, applicable to most sectors, is due on the net price.

### Labour and employment

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

Yes, franchisors must take care – both in the franchise agreement itself and in any additional rules, especially the franchise manual – not to limit the franchisee's freedom too much, thus avoiding making the franchisee subject to the highly protective employment and social security laws. The franchisor must also take care to live up to the contract accordingly, as the parties' conduct prevails over the wording of their contract (cf German Federal Court, 11 October 2018, Case No. VII ZR 298/17; Rohrßen, *ZVertriebsR* 2019, 323).

To reduce this risk, the franchisor shall draft and practically implement the franchise agreement in a way that leaves the franchisee sufficient leeway to exercise a self-employed activity, avoiding any implications that the franchisee was personally and economically dependent on the franchisor. If there is a contradiction between the agreement and its actual implementation, the latter is decisive.

## Intellectual property

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

Franchising, trademarks and know-how go hand in hand and therefore their protection is of utmost importance. Trademarks are protected by registration, by acquisition of market recognition or notoriety. The registration at national level is a quite speedy and inexpensive process and is filed, online or with a paper-based application, with the German Patent and Trade Mark Office (DPMA) in Munich. To obtain protection across all member states of the European Union, the filing shall be submitted to the European Union Intellectual Property Office (EUIPO) in Alicante. For international protection, the application shall be filed with the World Intellectual Property Organization (WIPO) in Madrid. In all cases, the protection starts on the filing date and initially lasts 10 years. It can be renewed for further 10-year periods, upon payment of the renewal fee. Innovations can be patented, but all the know-how contained, for example, in handbooks and best practice guidelines does not always meet the necessary technical requirements. Therefore, it can be best protected by non-disclosure agreements, subject to Directive (EU) 2016/943 on the protection of undisclosed know-how and business information (trade secrets) against their unlawful acquisition, use and disclosure, implemented by a German Act (Law on protection of business secrets) published on 18 April 2019.

## Real estate

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

Unless the franchise is set up as pure online business, the franchisor should protect its interest in a strategic location of the franchise shop. If the franchisor owns or leases the shop, the termination scenarios of both the franchise and the lease or sublease contract should be synchronised. The downside of such scenario is that the franchisor bears the risk of non-payment of the lease. As an upside, the franchisor can clearly require the franchisee not to compete beyond the five-year limit of general EU competition law, as the limit does not apply if the franchisee (sub-)leased the premises from the franchisor (cf article 5.1 (a), 2 Vertical Block Exemptions Regulation; in all other cases, the franchisee may nevertheless, according to case law, be subject to a non-compete obligation where it is necessary for the functioning of the franchise system). If, instead, the lease agreement is entered into by the franchisee with a third party, the franchisor usually requires to be granted a right of subrogation as lessee (to be contractually agreed upon with the lessor in the lease contract) in the event of termination of the franchise contract. This way the franchisor can ensure the continuation of the franchise personally or through another franchisee.

## Franchising in the market

### 9 | How widespread is franchising in your jurisdiction? In which sectors is franchising common?

The latest statistics for 2019 of the German Franchise Association e.V. show positive developments in the franchise sector: circa 1,000 franchise systems nationwide counted circa 140,000 franchise partners, with an increase of 5 per cent compared to the previous year,

and reaching an overall turnover of €129 billion. The most franchised industries are services (43 per cent), followed by trade (29 per cent), gastronomy, tourism and leisure (20 per cent) and crafts, construction and refurbishment (8 per cent).

## LAWS AND AGENCIES REGULATING THE OFFER AND SALE OF FRANCHISES

### Legal definition

#### 10 | What is the legal definition of a franchise?

German law does not provide a definition of franchise and neither does EU law (cf Directorate-General for Internal Policies, Franchising, 2016, p17). Nevertheless, there is a common understanding that the term defines the set of rights granted by a franchisor to a legally and financially independent and self-employed party, the franchisee, with the aim of a cooperative distribution system. A franchise entitles and obliges the franchisee, against a direct or indirect financial compensation, to undertake, under the franchisor's supervision, the marketing system of goods, services or technology conceived by the franchisor (ie, the franchise system), which includes the franchisor's confidential know-how and ongoing technical and economic support, as well as the specific business concept and the intellectual and industrial property rights related to it.

### Franchise laws and agencies

#### 11 | Which laws and government agencies regulate the offer and sale of franchises?

There is no specific German franchise law. Instead, the offer and sale of franchises are regulated by:

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

## Principal franchise requirements

### 12 Describe the relevant requirements of these laws and agencies.

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- government agencies that regulate franchise business, which exist only in the form of competition authorities.

## Exemptions

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

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- government agencies that regulate franchise business, which exist only in the form of competition authorities.

## Franchisor eligibility

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

No, German law does not create such requirements. However, self-regulatory rules exist, collected and laid down by the European Franchising Federation in their European Code of Ethics for Franchising and its member German Franchise Association eV in their updated German version (Ethikkodex). Even if they only bind their members, these rules contain practical guidelines on best practice or fair dealings between franchisors and franchisees. Accordingly, the franchisor shall (1) have exercised the franchise concept already for a reasonable period with at least one pilot project; (2) be the owner or lawful authorised user of the franchise corporate identity (company name, trademark or other specific identification of its network), and provide both (3) initial and (4) follow-up trainings to the franchisees.

## Franchisee and supplier selection

### 15 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, there are no franchise-specific laws. In principle, franchisors are free to select their franchisees and their suppliers. Restrictions, however, may apply where the franchisor is a dominant undertaking or has relative or superior market power (they must not abuse it, see article 102 TFEU and sections 19, 20 GWB) or from anti-discrimination laws (they must, generally speaking, not discriminate on grounds of race or ethnic origin, sex, religion, disability, age or sexual orientation, sections 19-21 of the General Law on Equality (AGG).

## Pre-contractual disclosure

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

In Germany, there is no standard procedure. Case law (starting with the Higher Regional Court of Munich, 16 September 1993, Case No. 6 U 5495/92), requires the franchisor to disclose within a reasonable period (two to four weeks may suffice) before concluding the franchise agreement (or any preliminary contract with binding effect, including area development franchise agreements or master franchises): those circumstances that may affect the agreement's purpose. For the sake of proof, franchisors should make a disclosure in writing – also digitally, with special encryption and restricted access to protect business secrets.

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

## Pre-sale disclosure to sub-franchisees

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

Within a sub-franchising structure, the sub-franchisor, as future contractual partner of the franchisee, must make pre-sale disclosure (cf section 311 BGB). Its extent depends on what the franchisee needs to know to decide about joining the franchise system. The information to be disclosed especially concerns:

- information about the franchise;
- how tasks are allocated among the franchisor (aka master franchisor), the sub franchisor and the sub-franchisees; and
- the basic content of the master franchise agreement, especially the licence, which allows and limits sub-franchisors installing of sub-franchisees and implementing of the franchise, including the consequences if the master franchise agreement is terminated.

## Due diligence

- 18 | What due diligence should the parties undertake before entering a franchise relationship?

Franchisors should check whether the franchisee fits into the franchise system. To be more precise, this includes whether the franchisee is personally a good fit (characteristics, experience, abilities and ambition), and economically suitable (minimum capital requirements, territory available).

Franchisees should check the franchise system, its concept, the franchise agreement, the information disclosed pre-contractually, the competition situation, the territory and location.

## What must be disclosed

- 19 | What information must the disclosure document contain?

The necessary information depends on the general principle of good faith. However, the franchisor only has – according to the prevailing legal opinion – to inform about issues known to the franchisor, meaning that the franchisor does not need to perform researches for the franchisee as the franchisor is not obliged to provide services as a start-up consultant. The obligation is, instead, limited by the franchisor's legitimate interest in protecting its trade secrets and essential know-how prior to the conclusion of the agreement.

As first aid may serve the guideline published by the German Franchise Association eV on pre-contractual information and the – rather extensive – list in the UNIDROIT's Model Franchise Disclosure Law (not enacted in Germany, though). Circumstances to be disclosed include in particular the franchise system's:

- mode of operation (cf Higher Regional Court of Munich, 11 July 1996, Case No. 24 U 63/95);
- profitability/achievable turnover on the basis of generally applicable facts (cf Regional Court of Hamburg, 17 May 2018, Case No. 334 O 14/18);
- necessary labour and capital input (Higher Regional Court of Düsseldorf, 30 June 2004, Case No. U (*Kartell*) 40/02); and
- the advantages of cooperation within the franchise network if applicable (eg, purchasing benefits, German Federal Court, 20 May 2003, Case No. KZR 19/02, *Apollo Optics*).

The information given – and answers to questions asked by the franchisee – must accurately reflect the realities of the franchise system in question as the necessary basis for any suitable profitability forecast

(cf also Higher Regional Court of Düsseldorf, 25 October 2013, Case No. I-22 U 62/13)).

## Continuing disclosure

- 20 | Is there any obligation for continuing disclosure?

Though not by statutory law, franchisors may nevertheless be obliged to provide continuing disclosure to current franchisees, as contractual partners generally must take care of the counterparty's interests (section 241, paragraph 2 BGB). Accordingly, the franchisor can be obliged to inform if there are risks to the franchisee's (creditor's) interest in implementing the franchise agreement that the franchisee is not aware of, also during the franchise agreement. Such events could be any changes in the master franchise agreement or the franchise concept that influence the sub-franchise agreement.

## Disclosure requirements – enforcement

- 21 | How do the relevant government agencies enforce the disclosure requirements?

As no such agencies exist, it is up to the franchisee to enforce the disclosure requirement.

## Disclosure violations – relief for franchisees

- 22 | 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?

Franchisees may do the following (except in minor cases where they may simply ask for any information missing or apparently inaccurate):

- terminate the franchise agreement for cause (section 314 BGB), within a reasonable period from having learned about such material breach of contract, typically two months (cf, for commercial agents and distributors: German Federal Court, 29 June 2011, Case No. VIII ZR 212/08). A prior warning is often not necessary, provided such event profoundly disrupts the trust between the parties, or
- void the agreement if entered into by a mistake willingly induced by the franchisor (section 123 BGB), and
- claim damages.

The franchisee can demand to be placed in the same position he would have been in if the franchisor had not breached the disclosure obligation (section 249 BGB). Damages can be calculated by comparing the operating costs (system costs and rent/lease paid, insurance contributions, wages and social security contributions, costs for service providers) and losses in value (eg, the equipment, the warehouse) with the revenues. Alternatively, the franchisee can choose to rescind the entire franchise agreement retroactively if the franchisee had not concluded the franchise agreement had the franchisor duly informed the franchisee (cf German Federal Court, 27 July 2006, Case No. 23 U 5590/05, juris-paragraph 30). In the case of rescinding the franchise contract, all transactions will be reversed (ie, each party will return what it has received from the other). The worst-case scenario in practice is that such breach may induce further, not very successful, franchisees to terminate their franchise agreements.



### Disclosure violations – apportionment of liability

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

In principle, liability for disclosure violations is not shared between franchisor and sub-franchisor, but the sub-franchisor alone will be liable towards the franchisee – because the disclosure requirement only exists within their relationship. By way of exception, the franchisor can be liable to the sub-franchisee:

- directly in case of tort or product liability (eg, providing defective products); or
- indirectly, namely when the franchisor is liable in regard to the sub-franchisor for breach of contract (eg, if the franchisor negligently provided incorrect information) and thus bears all consequential damages, including those the sub-franchisor has to bear caused by the franchisor's breach of contract.

Individual officers, directors and employees of the franchisor or the sub-franchisor are, in principle, exempt from liability for disclosure violations. By way of exception, they can be exposed to liability, especially if they have claimed a particular position of trust and expertise for themselves and then provided wrong information, and more so where this occurred with wilful intent and with the intention of causing financial loss.

### General rules on offer and sale

24 | 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?

Offering and selling franchises must, as with any transaction, comply with the obligation of good faith, specifically under the principle of good faith in negotiation (*culpa in contrahendo*). Accordingly, pre-sale disclosure is mandatory as it may, if omitted or incorrectly done, allow the franchisee to reverse the whole franchise agreement.

### General rules on pre-sale disclosure

25 | 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 Germany, there are no franchise-specific laws. Instead, pre-sale disclosure emanates from the general principle of good faith.

### Fraudulent sale

26 | 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?

Beyond the general protection against missing or inaccurate franchise sales disclosure – claiming damages or rescinding the contract – the franchisee may in the case of fraudulent or deceptive practices revert to the 'tools' of criminal law and criminal procedure: the franchisee may file

a criminal complaint, thus having the law enforcement investigate the case, gather proof and potentially resulting in a conviction – which may serve as proof in the damages claims before the civil courts (sections 415 and 286 Code of Civil Procedure).

## LEGAL RESTRICTIONS ON FRANCHISE CONTRACTS AND THE RELATIONSHIP BETWEEN THE PARTIES

### Franchise relationship laws

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

No, there are not, and therefore it is best practice to stipulate the relationship in detail in the franchise agreement. When designing or developing the franchise system, the general rules of the German Civil Code (especially on standard form contracts: they need to be reasonable) and of the Commercial Code, the general good faith requirement and the competition (antitrust) rules must be observed.

### Operational compliance

28 | What mechanisms are commonly incorporated in agreements to ensure operational compliance and standards?

To ensure franchise compliance, (ie, that the franchisees operate a uniform network according to the corporate identity guidelines and deliver a consistent brand message and experience to the customers) franchisors use the following tools:

- clearly identify the standards;
- establish a contact person (franchise compliance officer or franchise compliance coordinator) dedicated to checking and clearing issues at the earliest convenience, and if not, enforcing the standards – and introduce that person to the franchisee;
- provide for regular reporting duties, (eg, products sold or services rendered, monthly net turnover, etc), especially those items that are relevant for calculating the franchise fees;
- provide for inspection and audit rights, for the franchisor and third parties sworn to secrecy;
- underline the importance of compliance by stipulating contractual penalties or liquidated damages in the case of a breach; and
- reward the best examples among the franchisees ('franchisee of the year', etc).

### Amendment of operational terms

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

Yes, provided that the franchise agreement contains valid 'change-of-terms provisions', especially to modify the relationship to develop the franchise system, the contractual products or the services and adapt to technological, legal or other changes. Such clauses are permissible and reasonable for the franchisee if they are sufficiently precise, stipulate the respective circumstances for change, adequately safeguard the interests of the sales intermediary and provide reasonable time before the change comes into effect (cf sections 310, 307, 308 No. 4 BGB; cf German Federal Court, 06 October 1999, Case No. VIII ZR 125/98 *Kawasaki*).

If, however, the franchise agreement does not provide a unilateral right to change the operational terms, the franchisor and franchisee remain, in principle, bound by the franchise agreement. By way of exception, the franchise agreement or its operational standards, or both, might be changed if the franchise agreement were otherwise frustrated (section 313 BGB).



## Other laws affecting franchise relations

### 30 | Do other laws affect the franchise relationship?

Apart from the general rules of the German Civil Code (especially on standard form contracts), the Commercial Code, and the competition (antitrust) rules, also the Act Against Unfair Competition (as regards advertising) and intellectual property (IP) related laws (protecting the IP, providing the rules for licensing) (eg, the Trade Mark Act, the Act on the Legal Protection of Designs or the Patent Act) affect the franchise relations. As regards selling the contractual products or services of the franchise through the internet, specific rules may apply, including Regulation (EU) No. 2019/1150 on the promotion of fairness and transparency for commercial users of online intermediation services (P2B-Regulation). For details and checklists regarding which rules apply to different operators, see Rohrßen, *ZVertriebsR* 2019, 341 et seq.

## Policy affecting franchise relations

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

The most important franchise association in Germany is the German Franchise Association eV. Those who wish to become members must comply with its Code of Ethics, stipulating practical guidelines of best practice and fair dealings between franchisors and franchisees and regulating issues such as pilot projects, rights of use regarding the corporate identity and training for the franchisees.

## Termination by franchisor

### 32 | 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?

If the franchise agreement is entered into for an unlimited period, it can be terminated with cause or without cause, namely, ordinarily ('for convenience'), according to the terms stipulated in the agreement. In lack of such terms, the statutory provisions regarding commercial agents may apply by analogy (cf German Federal Court, 23 July 1997, Case No. VIII ZR 130/96, *Benetton*: likely, but not yet ruled out) as follows: one month's notice in the first year of contractual relationship, two months in the second year, three months in the third to fifth year and six months as of the sixth year. Fixed-term agreements, instead, can only be terminated for cause (ie, extraordinarily) with immediate effect, unless the parties specifically agreed on terms for ordinary termination. For the franchisor, such cause is typically, for example, the franchisee's non-payment of the franchise or advertisement fees, competitive practices, serious breaches of the franchise system directives or violation of the reporting and information obligations. Termination for cause, however, in principle requires sending the other party a warning first, since termination shall be the last resort (and hence default of payment alone does not necessarily suffice, cf Higher Regional Court of Berlin, 21 November 1997, Case No. 5 U 5398/97, *Burger King*). Finally, the parties can always agree on an amicable termination of the agreement. In very rare cases, the franchisor can also just let the franchisee's business run dry; however, to protect the franchisor's brand image and corporate identity, this option can be convenient only where the territory or the market are no longer relevant for the franchisor, for example, if the franchisor gives up the whole franchise.

## Termination by franchisee

### 33 | In what circumstances may a franchisee terminate a franchise relationship?

If the franchise agreement is entered into for an unlimited period, it can be terminated with cause or without cause ('ordinarily', or 'for

convenience'), according to the terms stipulated in the agreement. Without such terms, the statutory provisions on notice periods regarding the commercial agent may apply by analogy: one month in the first year of contractual relationship, two months in the second year, three months in the third to fifth year and six months as of the sixth year. Fixed-term agreements, instead, can only be terminated for cause (ie, extraordinarily), with immediate effect, unless the parties specifically agreed on terms for ordinary termination. For the franchisee, such cause is typically, among others, the franchisor's breach of territorial exclusivity, reduction of the assigned territory agreed upon or direct supply in said territory. The parties can, of course, always agree on an amicable termination of the agreement.

## Renewal

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

Renewals are usually effected in writing; typically, because this is required by the franchise agreement and because written agreements serve as proof of what the parties have stipulated. However, the parties may also renew the agreement tacitly, by simply continuing to perform it after its expiration date. To avoid undesired results (eg, if there are ongoing negotiations with a new franchisee), the parties should cease trading on the date of effective termination.

## Refusal to renew

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

Yes, in principle. The franchisor is free to either extend the franchise agreement or refuse to renew it, without requiring specific circumstances or reasons for its refusal. Nevertheless, further to the investment made in the franchise, the franchisee is entitled to a reasonable return and, at least, to recoup the resources invested: for this reason, if, shortly before the termination, the franchisor stated its intention to renew the franchise agreement, which led the franchisee to expend further resources in the franchise, the latter may be entitled to compensation for the damages suffered, in the event of a sudden refusal of the franchisor to renew the franchise agreement. Nevertheless, the franchisor's freedom to renew or not may be limited, especially where the franchisor has a dominant position on the market. Where the franchisor has created trust in the franchisee that the franchise agreement will be renewed, a decision to the contrary may result in the obligation to pay damages or frustrated expenses for investments not returned.

## Transfer restrictions

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

Yes. The transfer of the franchise and of the rights and obligations connected therewith to a third party requires the franchisor's consent by law (section 415 BGB), regardless if it occurs in form of sale, lease, pledging or others. In lack of it, there is cause for extraordinary termination (cf German Federal Court, 26 November 1984, Case No. VIII ZR 214/83). Further conditions for the transfer, including the franchisor's pre-emption right, are usually – and are best – stipulated in the franchise agreement. A transfer of the franchise can also be contractually excluded, to protect the franchisor's know-how and image, especially from competitors. Exceptions may apply to the transfer of single rights, which are not characterised by personal features of the franchisee.

## Fees

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

No. The nature, amount and payment modalities of the franchise fees are subject to the contractual freedom of the parties. Nevertheless, the franchise fees cannot violate the general principles of public policy (section 138 BGB).

## Usury

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

Interest rates must not be usurious, but comply with the general principles of public policy (section 138 BGB). As a rule of thumb, standard late payment interest rates amount to 5 per cent over the bank rate; nevertheless, the legal late payment interest rate in B2B transactions amounts to 9 per cent over the bank rate (section 288, paragraph 2 BGB). Regardless of the rate outcome, the creditor is also entitled to claim a lump sum of €40 as compensation for the payment delay (section 288, paragraph 5 BGB).

## Foreign exchange controls

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

No, there are no such restrictions. Nevertheless, any cross-border outgoing payment over €12,500 or the corresponding amount in the foreign currency must be reported to the German Central Bank (section 11 of the German Foreign Trade and Payments Act AWG) in connection with section 67 and following of the German Foreign Trade and Payments Ordinance (AWV).

## Confidentiality covenant enforceability

### 40 | Are confidentiality covenants in franchise agreements enforceable?

Yes. Confidentiality covenants are a fundamental means of protection of the franchisor's know-how. A contractual penalty is generally agreed upon to deter and simplify the calculation of damages in case of breach. Moreover, the breach of confidentiality can also amount to an infringement of competition law and be regulated by the German Act Against Unfair Competition. Finally, non-compliance with the confidentiality obligation can justify termination for cause.

## Good-faith obligation

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

Yes. The parties' obligation to live an agreement according to the requirements of good faith is expressly set forth by section 242 BGB and sections 86 and 86a HGB. The good faith obligation typically requires: franchisors to treat franchisees in an equal manner and to protect them, under very strict preconditions, from competition through other franchisees belonging to the very franchise system: Prerequisite for such an immanent obligation (and a corresponding contractual claim of the franchisee to injunctive relief) is that the economic existence of the franchisee is permanently endangered by the competing activity of the franchisor (Higher Regional Court of Düsseldorf, 10 February 2020, Case No. 16 W 62/11, juris, paragraph 39 *Kentucky Fried Chicken*; Higher Regional Court of Celle, decision of 28 August 2008, Case No. 13

U 178/08, juris, paragraph 15). If the franchise agreement qualifies as general terms and conditions (namely, if it was drafted unilaterally and offered to the counterparty on a take-it-or-leave-it basis), any provision contrary to the principle of good faith is void (section 307 BGB). Moreover, according to the case law, a breach of the obligation to act in good faith can be a cause for immediate termination of the franchise agreement (German Federal Court, 10 February 1993, Case No. VIII ZR 48/92, section IV.2(b) *Computer-Peripherie*).

## Franchisees as consumers

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

In principle, no – franchisees fall under the category of businesses (section 14 BGB) and, therefore, cannot claim consumer rights (German Federal Court, 24 February 2005, Case No. III ZB 36/04). Nevertheless, the franchisee may, if considered as a founder, be entitled to withdraw from the franchise agreement within the first 14 days regardless of any reason. To limit such term, the franchisor must instruct the franchisee accordingly (typically within the franchise agreement or its annexes).

## Language of the agreement

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

No, not by law. However, all documents should be in a language the franchisee understands, both for practical and legal reasons, as this avoids misunderstandings and disputes between the parties. It is also a requirement of the European Code of Ethics for Franchising. Moreover, the contractual language should ideally accord with the competent jurisdiction or arbitration's official language and with the law applicable to the franchise agreement. If the agreement is drafted in multiple languages, usually in a dual-column form, it is important to identify which language prevails in case of any discrepancy or dispute concerning meaning.

## Restrictions on franchisees

### 44 | Describe the types of restrictions placed on the franchisees in franchise contracts.

Franchisors may limit the franchisees' economic freedom in several ways, typically by restricting the following:

- Territories, by prohibiting active sales to exclusive territories (or customer groups), which the franchisor reserved for itself or allocated to another franchisee or other buyer. Limiting sales via the franchisee's website is, however, anticompetitive and such provision void and subject to fines by the competition authorities (cf on online sales bans and related internet resale restrictions, Rohrßen, *ZVertriebsR* 2019, 341 et seq with further references; example clauses of online resale restrictions in: Rohrßen, *GRUR-Prax* 2018, 39-41).
- Sourcing: franchisors may require the franchisees to source the contractual products or services from the franchisor. This is not a non-compete obligation in the narrow understanding of the Vertical Block Exemptions Regulation (VBER).
- Resale pricing: limited to imposing a maximum price or recommending a sale price, without any incentives or pressure.
- Poaching of the franchisor's or other franchisee's employees, to protect the franchisor's business secrets, especially where the franchisee after termination joins a competitor.
- Competition through non-compete obligations during and after the term of the franchise agreement.

## Competition law

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

Competition law (also known as antitrust law) consists both of EU and German laws. Basic principle: agreements or behaviour which have as their object or effect to appreciably restrict competition are prohibited (article 101 Treaty on the Functioning of the European Union; section 1 Act Against Restraints of Competition). Franchise agreements are privileged: 'Provisions which are strictly necessary in order to ensure that the know-how and assistance provided by the franchisor do not benefit competitors do not constitute restrictions of competition' (Court of Justice of the EU, 28 January 1986, Case No. 161/84, *Pronuptia*, paragraph 27). This typically includes post-contractual non-compete obligations. In practice, many franchise agreements simply adhere to the requirements of the Vertical Block Exemptions Regulation (the current one expiring on 31 May 2022) to be on the safe side.

## Courts and dispute resolution

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

Franchisors can turn to the German courts for mediation (cf section 278 paragraph 5 and section 278a German Code of Civil Procedure) and litigation. Litigation allows starting with interim injunctions to reach temporal results at an early stage. Also, an expedited payment procedure is available for cases where the franchisor does not expect the franchisee to reject a payment claim. Cases may also be dealt with in English, at the Chamber for International Commercial Disputes in Frankfurt am Main.

## Arbitration – advantages for franchisors

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

### Principal advantages over proceedings in court

Arbitration proceedings are as follows:

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

### Principal disadvantages over proceedings in court

Interim measures may not be as quick as before German courts. Therefore, franchise agreements should at least stipulate that the German courts have jurisdiction where the franchisor's industrial property rights are infringed, thus enabling the franchisor to act quickly.

Costs are, as a rule of thumb until an amount in dispute of €5 million, higher than in German courts. The costs of arbitration may, however, be lowered by reducing the number of arbitrators from three to one – the arbitration clause may therefore provide for such reduction especially with regard to smaller cases, where the amount in dispute is, for example, lower than €5 million (hence in the majority of disputes with single franchisees who do not also act as sub-franchisors).

# TaylorWessing

**Dr Benedikt Rohrßen**

b.rohrssen@taylorwessing.com

**Giorgia Carandente**

g.carandente@taylorwessing.com

Isartorplatz 8

80331 Munich

Germany

Tel: +49 89 210 38 176

www.taylorwessing.com/en

## National treatment

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

None – legally, they are to be treated the same. Practically, franchisees may prefer binding themselves to and cooperating with domestic franchisors – as this simply feels 'closer to home'. For the franchisor, in return, establishing a company in Germany brings the franchisor in closer contact to the market, the franchisees and helps to minimise the liability risk for the franchisor's principal company. Generally, domestic franchisors stipulate franchise agreements under German law – because even if a choice of a foreign law generally is permitted (article 3 Rome-I-Regulation), this choice would be overridden by a large amount of national mandatory provisions (including the quite strict rules on standard form contracts). For an overview on the various levels of protection of franchisees in various countries worldwide, see Rothermel, *Internationales Kauf-, Liefer- und Vertriebsrecht* (2016), Chapter H.

## UPDATE AND TRENDS

### New legislation and regulation

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

No, there are currently no concrete proposals for regulating the franchising business in Germany. Instead, the most recent discussions, which reached the German Parliament in 2011 via a petition, have petered out. This is also due to the results of a comparative study on franchise laws that concludes that the German courts have established a rather clear case law that reduced the typical information disparity between franchisor and franchisees. This, again, resulted in relatively few issues reaching the courts, compared to other countries where statutory rules (*Gesmann-Nuissl, Internationales Franchiserecht*, 2019, p18) – and also compared to distribution systems that rely on other intermediaries, eg, commercial agents or distributors.

In 2020, covid-19 has affected the German retail and franchise business. Franchisors are considering whether to permanently close down those shops where business is bad (especially those that were not doing well before). German law, however, adheres to the principle that agreements must be kept (*pacta sunt servanda*), and even the

specific covid-19-laws do not simply allow tenants to terminate their lease contracts due to the crisis nor to suspend the lease payments. Instead, the tenant can withhold the rents for April, May and June 2020 until 30 June 2022 without the risk of the landlord terminating the lease for this reason, with the tenant in the case of a dispute having to prove that his or her non-payment is due to the pandemic. As this crisis especially affected – among others – the food service sector, McDonald's announced in May 2020, that it would back up its franchisees to protect the franchise network and cope with the reduced turnover, by either suspending or even waiving their monthly franchise fees for March and April and also planning an advertising offensive as the restaurants (not only the drive-throughs) were allowed to reopen in May in Germany.

Market trends indicate that there are particularly high chances for growth in the home services sector, education or training, skilled trades, and healthcare offer – including especially tech-related franchises, for example, electronic device repair, business tech consulting and digital marketing services.

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