



ICLG

The International Comparative Legal Guide to:

Franchise 2018

4th Edition

A practical cross-border insight into franchise law

Published by Global Legal Group, with contributions from:

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Suzie Levy, Rachel Williams

Chief Operating Officer

Dror Levy

Group Consulting Editor

Alan Falach

Publisher

Rory Smith

Published by

Global Legal Group Ltd.
59 Tanner Street
London SE1 3PL, UK
Tel: +44 20 7367 0720
Fax: +44 20 7407 5255
Email: info@glgroup.co.uk
URL: www.glgroup.co.uk

GLG Cover Design

F&F Studio Design

GLG Cover Image Source

iStockphoto

Printed by

Ashford Colour Press Ltd
September 2017

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ISBN 978-1-911367-73-4

ISSN 2055-8082

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Germany

Hoffmann Liebs Fritsch & Partner
Rechtsanwälte mbB

Christoph Schmitt



1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

There is no statutory legal definition of a franchise.

In practice, the most common franchise system is the so-called subordination franchising. The following definition of franchise is recognised in literature and legislation: a continuing obligation based on which the franchisor grants the franchisee against a fee (franchise fee) the right to distribute certain goods and/or services using the name, brand, equipment, etc., as well as the commercial and technical experience of the franchisor with due regard to the organisation and advertising concept developed by the franchisor, whereby the franchisor gives the franchisee assistance, advice and training in technical and sales terms and exercises control over the business activities of the franchisee.

1.2 What laws regulate the offer and sale of franchises?

There is no franchise-specific legislation in Germany. Therefore, the jurisdiction of the courts has to be considered, as well as the general provisions for contractual relationships. As franchise agreements are often standardised contracts, the law of General Terms and Conditions (§§ 305–310 of the German Civil Code) with its strict regulation applies.

1.3 If a franchisor is proposing to appoint only one franchisee/licensee in your jurisdiction, will this person be treated as a “franchisee” for the purposes of any franchise disclosure or registration laws?

Yes, in case the criteria of the above-mentioned definition are met. As there are no franchise-specific laws with regard to, e.g., disclosure or registration, it does not matter how many franchisees/licenseses the franchisor proposes to appoint.

1.4 Are there any registration requirements relating to the franchise system?

No, there are not any registration requirements relating to the franchise system as such. Nevertheless, there exist registration requirements relating to specific sectors (e.g. distribution of medical products) in Germany. Furthermore, the franchisee must usually submit an application for his business registration.

1.5 Are there mandatory pre-sale disclosure obligations?

Although there is no legislation or clear definition with regard to mandatory pre-sale disclosure obligations, the franchisor must reveal performance, mode of operation and prospect of success to the franchisee.

The franchisor – like any other economically independent entrepreneur – will carry the financial risks which come along with the conclusion of the franchise agreement. In order to assess its risks, the potential franchisee must be made aware of any conditions which are known by the franchisor and which might influence the decision of the franchisee with regard to the conclusion of the franchise agreement. In the German jurisdiction, the pre-sale disclosure obligation has been anchored due to the pre-contractual relationship of trust in §§ 311 Abs. 2, 241 Abs. 2 BGB (German Civil Code).

Lately, the courts have become stricter regarding pre-sale disclosure obligations. For example, the franchisor has to provide numerical data and give information about the profitability of the franchise system and the achievable turnover; if the franchisor only gives an estimation, he has to reveal this to the franchisor. Incorrect statements of the franchisor might lead to its liability.

Besides, the extent of pre-sale disclosure obligations depends on each individual case, especially with regard to the (economical) experience of the franchisee.

1.6 Do pre-sale disclosure obligations apply to sales to sub-franchisees? Who is required to make the necessary disclosures?

First of all, a sub-franchise is not usual in Germany. But in the case of a sub-franchise, the same pre-sale disclosure obligations (as mentioned in question 1.5) prevail in the relationship between the master-franchisee and the sub-franchisee. The master-franchisee will be obliged to reveal the relevant information to the sub-franchisee. Therefore, it is recommended to have the contractual relationships between the franchisor and the franchisee, as well as between the master-franchisee and the sub-franchisee, “synchronised”; in this context it is also important to note that the master-franchisee must be given the right by the franchisor to reveal the relevant information to a sub-franchisee.

1.7 Is the format of disclosures prescribed by law or other regulation, and how often must disclosures be updated? Is there an obligation to make continuing disclosure to existing franchisees?

The format of disclosures is not described by law or other regulation,

but by case law and varies from case to case. Nevertheless, it is recommended to have a document regarding the pre-sale disclosure signed by the franchisor and the franchisee.

There is an obligation to make continuing disclosure insofar as facts, essential to the franchise change, or new circumstances occur (e.g. discontinuation of a trade mark).

1.8 Are there any other requirements that must be met before a franchise may be offered or sold?

No; there are no other franchise-specific requirements to be met before a franchise may be offered or sold. However – according to jurisdiction – the franchisor usually has to have a tried-and-tested system in the sense that he has two businesses (franchise shops) which are ran successfully.

1.9 Is membership of any national franchise association mandatory or commercially advisable?

No, membership of a national franchise association is not mandatory, but commercially advisable. In Germany, the Deutsche Franchiseverband (German franchise association) represents franchisors as well as franchisees and is an institution which supports and promotes franchise systems and their images and quality in Germany, e.g. through getting in touch with members of parliament, federal ministries, etc. The Deutsche Franchiseverband also holds cooperation with various business partners.

1.10 Does membership of a national franchise association impose any additional obligations on franchisors?

As the members of the Deutsche Franchiseverband belong to a so-called community of quality, they are obliged to comply with a code of ethics, which is part of the constitution of the Deutsche Franchiseverband.

1.11 Is there a requirement for franchise documents or disclosure documents to be translated into the local language?

No, there is no legal requirement for documents to be translated into German language. Nevertheless, with regard to the requirement of transparency of standardised formulations (§ 307 section 1 sentence 2 of the German Civil Code), it is necessary that both parties understand the content of any documents. Therefore, an informative German translation of documents is recommended.

2 Business Organisations Through Which a Franchised Business can be Carried On

2.1 Are there any foreign investment laws that impose restrictions on non-nationals in respect of the ownership or control of a business in your jurisdiction?

No, unless the business operates in specific sectors (e.g. electricity, nuclear energy and armament).

2.2 What forms of business entity are typically used by franchisors?

There is a variety of business forms available to franchisors depending on initial capital, founding members, accountancy, tax, liability, obligation to publicly disclose, etc. Typically, an incorporated company such as a GmbH (limited liability company) or a GmbH & Co. KG (a limited commercial partnership where the general and individually liable partner is a limited liability company) is used by franchisors. For a large business entity, a stock company can also be used by the franchisor.

Regarding the type of business entities through which a franchisor might establish its franchise network, this is mostly subsidiary. Partnership franchises have become more common, however such franchises may cause trouble with regards to the anti-trust law.

2.3 Are there any registration requirements or other formalities applicable to a new business entity as a pre-condition to being able to trade in your jurisdiction?

Depending on the form of the business entity, an incorporated company must be registered in the commercial register as part of founding. Furthermore, each business entity has to have a valid VAT number and must register its business at the trade office, and depending on the type of business, a business licence will be required (e.g. restaurants, bars and hotels).

3 Competition Law

3.1 Provide an overview of the competition laws that apply to the offer and sale of franchises.

Since franchise agreements also regularly include a combination of different vertical regulations with regard to the products that are distributed (e.g. selective distribution, non-competition, exclusive distribution), as well as licence and know-how contractual use, Art. 101 of the Treaty on the Functioning of the European Union (TFEU) applies in principle, if this involves a perceptible restriction on trade. Regardless of the perceptible threshold, a prohibition of competition in respect of the goods or services acquired by the franchisee, for example, is not subject to the ban of cartels of Art. 101 TFEU if that obligation is necessary in order to preserve the uniformity and reputation of the franchise system (the criterion of indispensability). According to the Vertical Block Exemption Regulation (Vertical BER), based on Art. 101 TFEU, there is perhaps also an exemption from the ban on cartels if the market share of both parties does not amount to more than 30 per cent. If there is no cross-border external impact, the German Act against Restraints on Competition (ARC), which is substantially identical to Art. 101 TFEU in sections 1, 2, applies; the Vertical BER is also applicable. Furthermore, businesses in Germany must comply with the Act Against Unfair Competition, which serves the purpose of protecting competitors, consumers and other market participants against unfair commercial practice.

3.2 Is there a maximum permitted term for a franchise agreement?

No, but usually the term of a franchise agreement is five years. This is due to the regulation that a franchisee can only be prevented from selling competing products or providing competing services for five years.

3.3 Is there a maximum permitted term for any related product supply agreement?

No, because the franchisee is obliged to promote the products and/or services of the franchisor during the term of the franchise agreement. However, since product supply agreements are part of today's standard franchise systems in the sense that the franchisee is obliged to accept contract goods and services from the franchisor, a particular provider or supplier, only a maximum contract term of five years is permissible in the case of an exclusive purchase obligation. If, however, the product supply agreement contains no exclusive purchase obligation or other restriction of competition, a contract term of more than five years is possible.

3.4 Are there restrictions on the ability of the franchisor to impose minimum resale prices?

Yes. The franchisor must not restrict the franchisee's ability as a buyer to determine its (re)sale price. Nevertheless, the franchisor as a supplier may impose a maximum sale price or recommend a sale price, provided that it does not amount to a fixed minimum sale price as a result of pressure from or incentives offered by the franchisor.

3.5 Encroachment – are there any minimum obligations that a franchisor must observe when offering franchises in adjoining territories?

In most sectors, territorial protection is one of the functional conditions of a franchise. Therefore, franchise agreements contain so-called territorial protection clauses which are intended to protect the franchisee from the fact that another franchisee is taking advantage of other's acquisition efforts and is competing in the same territory. However, an absolute protection of the territory cannot be agreed, as franchisees are always entitled to carry out so-called passive sales at the request of a customer.

3.6 Are in-term and post-term non-compete and non-solicitation of customers covenants enforceable?

Yes. Whereas the in-term restraint on competition is inherent to the franchise system and does not need to be expressly stated in an agreement, the post-term restraint on competition has to be subject to an agreement of the franchisor and franchisee. Usually, the franchise agreement contains an in-term and a post-term restraint on competition, whereas the post-term restraint on competition must only last for one year. However, the requirements to be granted injunctions by court are high.

4 Protecting the Brand and other Intellectual Property

4.1 How are trade marks protected?

Trade marks can be registered at the Deutsche Patent- und Markenamt and, therefore, are protected by registration. The proprietor of the trade mark is entitled to injunction relief and claim damages in the case of infringement of the trade mark (§§ 14, 15 of the Act on the Protection of Trade Marks and other Symbols). Unregistered trade marks are only protected by the Act Against Unfair Competition or through contractual regulation.

4.2 Are know-how, trade secrets and other business-critical confidential information (e.g. the Operations Manual) protected by local law?

In general, no; unless it is a trade or industrial secret which has been entrusted to an employee who communicates it for the purpose of competition (criminal offence according to § 17 of the Act Against Unfair Competition). However, know-how, trade secrets and other business-critical confidential information can be protected by a non-disclosure agreement. Plagiarism by competitors is prevented by § 4 of the Act Against Unfair Competition. The proprietor of know-how, etc. is entitled to claim damages and injunction relief.

4.3 Is copyright (in the Operations Manual or in proprietary software developed by the franchisor and licensed to the franchisee under the franchise agreement) protected by local law?

Yes, protection is granted by the Act on Copyright and Related Rights to any intellectual creations of the franchisor within the meaning of this Act.

5 Liability

5.1 What are the remedies that can be enforced against a franchisor for failure to comply with mandatory disclosure obligations? Is a franchisee entitled to rescind the franchise agreement and/or claim damages?

In any case of a (culpable) breach of contractual duty by the franchisor, the franchisee will be entitled to claim damages (§ 280 of the German Civil Code) and – usually after expiration of an appropriate deadline – rescind from the contract.

5.2 In the case of sub-franchising, how is liability for disclosure non-compliance or for misrepresentation in terms of data disclosed being incomplete, inaccurate or misleading allocated between franchisor and master franchisee? If the franchisor takes an indemnity from the master franchisee in the Master Franchise Agreement, are there any limitations on such an indemnity being enforceable against the master franchisee?

Liability is defined by and on the basis of each contractual relationship. Therefore, the master franchisee is responsible for complying with disclosure obligations in a sublicensing context. As the relevant raw data has to be provided by the franchisor, it is recommended that the master franchise agreement contains a release from liability.

5.3 Can a franchisor successfully avoid liability for pre-contractual misrepresentation by including disclaimer clauses in the franchise agreement?

No, because such a disclaimer clause will be invalid as it leads to an unreasonable disadvantage for the franchisee.

5.4 Does the law permit class actions to be brought by a number of allegedly aggrieved claimants and, if so, are class action waiver clauses enforceable?

No, class actions are not permitted in the context of a franchise. Nevertheless, franchisees can claim against a franchisor as joint parties. A waiver clause will not be enforceable in the case of compulsory joinder.

6 Governing Law

6.1 Is there a requirement for franchise documents to be governed by local law? If not, is there any generally accepted norm relating to choice of governing law, if it is not local law?

There is neither such requirement nor a generally accepted norm. Moreover, the parties are free to choose the applicable law. However, with regard to standardised franchise documents, the choice of law must not be surprising to the other party (franchisee); therefore, the chosen law has to have a connection to the parties or the place of performance of the contract.

6.2 Do the local courts provide a remedy, or will they enforce orders granted by other countries' courts, for interlocutory relief (injunction) against a rogue franchisee to prevent damage to the brand or misuse of business-critical confidential information?

Yes, interlocutory relief can be granted by local courts; foreign court rulings are also enforceable in Germany under certain requirements (e.g. under a Regulation of the European Union, court rulings are usually enforceable in all Member States). However, before interlocutory relief is granted, a warning letter requiring the franchisee to cease and desist is usually necessary.

7 Real Estate

7.1 Generally speaking, is there a typical length of term for a commercial property lease?

The typical length of term for a commercial property lease is two to five years, although longer terms of 10 years or more are possible. The parties usually agree on one or two prolongation options.

7.2 Is the concept of an option/conditional lease assignment over the lease (under which a franchisor has the right to step into the franchisee/tenant's shoes under the lease, or direct that a third party (often a replacement franchisee) may do so upon the failure of the original tenant or the termination of the franchise agreement) understood and enforceable?

Yes, such an assignment is understood and will be enforceable if certain requirements with regard to the contractual regulations are met. Therefore, the franchisor's right has to be clearly stated not only in the franchise agreement but also in the lease agreement.

7.3 Are there any restrictions on non-national entities holding any interest in real estate, or being able to sub-lease property?

No, there are not.

7.4 Give a general overview of the commercial real estate market. Specifically, can a tenant reasonably expect to secure an initial rent free period when entering into a new lease (and if so, for how long, generally), or are landlords demanding "key money" (a premium for a lease of a particular location)?

The location is one of the essential criteria for the success of a franchise business. The real estate market depends on demand and need in a specific area. An initial rent free period can be expected up to six months. "Key money" is not usually demanded by landlords, but the cost of a lease can be a lot higher for particular favoured locations.

8 Online Trading

8.1 If an online order for products or request for services is received from a potential customer located outside the franchisee's exclusive territory, can the franchise agreement impose a binding requirement for the request to be re-directed to the franchisee for the territory from which the sales request originated?

No. With reference to Art. 101 of the Treaty on the Functioning of the European Union (AEUV) and the Vertical Agreement Block Exemption (GVO), absolute territorial protection cannot be granted. Any franchisor or franchisee may advertise its products and/or services in the media and via the internet, as long as distribution is not specifically addressed to customers in the area of another franchisee. The franchisor may only impose general binding requirements on the quality and design of advertisements.

8.2 Are there any limitations on a franchisor being able to require a former franchisee to assign local domain names to the franchisor on the termination or expiry of the franchise agreement?

The domain name is transferable under German law without limitations. However, as the franchisee and the franchisor have to expressly agree on the transfer, it must be clearly stated in the franchise agreement or any other document.

9 Termination

9.1 Are there any mandatory local laws that might override the termination rights that one might typically expect to see in a franchise agreement?

There are quite a few mandatory German regulations with regard to the termination of a franchise agreement. For example, termination with immediate effect is only effective if there is a good reason for it and usually only if the other party has previously been warned (§ 134 of the German Civil Code).

10 Joint Employer Risk and Vicarious Liability

10.1 Is there a risk that a franchisor may be regarded as a joint employer with the franchisee in respect of the franchisee's employees? If so, can anything be done to mitigate this risk?

In general, there is no such risk as long as the franchisee is not integrated into the operations of the franchisor, but autonomous to the greatest possible extent within the franchise system. It depends on the degree of control of the franchisor exercises over the franchisee's business. The franchisee will be treated as autonomous if he controls the organisation, personnel and pricing within its territory; this means that the franchisee has to act in accordance with the Operations Manual, but he is not bound by the instructions of the franchisor. The distinction between franchisor and franchisee as regards the employment of the franchisee's employees may start to become blurred, e.g., when the franchisor determines the time and place of work.

10.2 Is there a risk that a franchisor may be held to be vicariously liable for the acts or omissions of a franchisee's employees in the performance of the franchisee's franchised business? If so, can anything be done to mitigate this risk?

No, there is no such risk as long as the franchisor does not act as *de facto* manager of the franchisee's business. This again depends on the degree of control the franchisor exercises over the franchisee's day-to-day operations or, more specifically, where the franchisor exercises a considerable degree of control over the "instrumentality" at issue (i.e. the act causing the damage). In order to mitigate a risk, neither the franchisee nor its employees must personally depend on the franchisor.

11 Currency Controls and Taxation

11.1 Are there any restrictions (for example exchange control restrictions) on the payment of royalties to an overseas franchisor?

In Germany, there are no exchange control restrictions on the payment of royalties to an overseas franchisor.

11.2 Are there any mandatory withholding tax requirements applicable to the payment of royalties under a trade mark licence or in respect of the transfer of technology? Can any withholding tax be avoided by structuring payments due from the franchisee to the franchisor as a management services fee rather than a royalty for the use of a trade mark or technology?

For non-resident business entities or entrepreneurs, which do not have a permanent establishment in Germany, the income tax on domestic income from the assignment of rights or know how is levied at source in the absence of deviating rulings in double tax treaties. The tax rate is 15 per cent plus a solidarity surcharge of 5.5 per cent on the corporate income tax.

11.3 Are there any requirements for financial transactions, including the payment of franchise fees or royalties, to be conducted in local currency?

No, there are not.

12 Commercial Agency

12.1 Is there a risk that a franchisee might be treated as the franchisor's commercial agent? If so, is there anything that can be done to help mitigate this risk?

Yes, if the franchisor does not act independently but on behalf of the franchisor. Nonetheless, the legal prescriptions on commercial agents also prevail in the case of a franchise. In particular, the role of subordinate franchises has been a development in the law on commercial agents. Only those regulations which explicitly apply to the commercial agent acting on behalf of an entrepreneur do not apply to franchises. For example, unless the franchisee is obliged to transfer its customer base to the franchisor, the franchisor may have to pay compensation according to the law on commercial agents.

13 Good Faith and Fair Dealings

13.1 Is there any overriding requirement for a franchisor to deal with a franchisee in good faith and to act fairly in its dealings with franchisees according to some objective test of fairness and reasonableness?

Yes, as the franchisor and the franchisee are contractual parties, each is obliged to act in accordance with the general principle of good faith and take customary practice into consideration (§ 242 of the German Civil Code). Furthermore, as regulated by statute, the parties are obliged to take account of the rights, legal interests and other interests of each other (§ 241 section 2 of the German Civil Code; e.g. provide information, duty of care). As franchise agreements are usually standardised contracts, the strict regulations of the Law on General Terms and Conditions (§§ 305 ff. of the German Civil Code) applies, which enjoins the franchisor from any unreasonable disadvantage to the franchisee by contractual regulation.

14 Ongoing Relationship Issues

14.1 Are there any specific laws regulating the relationship between franchisor and franchisee once the franchise agreement has been entered into?

No, there are not.

15 Franchise Renewal

15.1 What disclosure obligations apply in relation to a renewal of an existing franchise at the end of the franchise agreement term?

There are no specific disclosure obligations with regard to a renewal of an existing franchise agreement.

15.2 Is there any overriding right for a franchisee to be automatically entitled to a renewal or extension of the franchise agreement at the end of the initial term irrespective of the wishes of the franchisor not to renew or extend?

In general no, unless such right for the franchisee is provided for in the franchise agreement. Based on contractual duty of care and loyalty, the franchisee may exceptionally and on a case-by-case basis be entitled to a renewal or extension of the franchise agreement if – due to an order from the franchisor – it has recently made substantial investments (e.g. redesign or expansion of location).

15.3 Is a franchisee that is refused a renewal or extension of its franchise agreement entitled to any compensation or damages as a result of the non-renewal or refusal to extend?

In general, no.

16 Franchise Migration

16.1 Is a franchisor entitled to impose restrictions on a franchisee's freedom to sell, transfer, assign or otherwise dispose of the franchised business?

Yes, because with the transfer of the franchise agreement comes all its rights and duties. Moreover, and as already stated in general contract law, the approval of the other party (franchisor) is required in order sell, transfer, etc. the franchised business.

16.2 If a franchisee is in breach and the franchise agreement is terminated by the franchisor, will a "step-in" right in the franchise agreement (whereby the franchisor may take over the ownership and management of the franchised business) be recognised by local law, and are there any registration requirements or other formalities that must be complied with to ensure that such a right will be enforceable?

Yes, the franchisor can take over the franchisee's business. Such a provision with regard to a "step-in" right will be enforceable if the reason, premises and circumstances are explicitly and transparently stated in the franchise agreement and the compensation is serious.

16.3 If the franchise agreement contains a power of attorney in favour of the franchisor under which it may complete all the necessary formalities required to complete a franchise migration under pre-emption or "step-in" rights, will such a power of attorney be recognised by the courts in the country and be treated as valid? Are there any registration or other formalities that must be complied with to ensure that such a power of attorney will be valid and effective?

A power of attorney in favour of the franchisor can only be validly agreed on in the franchise agreement if the franchisor is explicitly exempt from the prohibition of contracting with oneself (§ 181 of the German Civil Code). Usually, there are no formalities such as a written or notarised form of the power of the attorney, but this will depend on the specific type of franchised business. By all means, the premises and circumstances of the utilisation of the power of attorney must be explicitly and transparently stated in the franchise agreement in order to avoid misuse.

**Christoph Schmitt**

Hoffmann Liebs Fritsch & Partner
Rechtsanwälte mbB
Kaiserswerther Straße 119
40474 Düsseldorf
Germany

Tel: +49 211 518 82 123
Email: christoph.schmitt@hlfp.de
URL: www.hlfp.de

Christoph Schmitt has been advising national and international clients in the areas of commercial, corporate and employment law for more than two decades. He is a recognised expert for national and international business contract law, general terms and conditions and distribution law. He is specialised in corporate law and advises companies in the fields of corporate structuring, shareholder disputes and M&A.

Christoph Schmitt regularly gives seminars at renowned seminars in national and international contract law. Moreover, he is the author of various specialist books and publications and is highly recommended by *Chambers* as a commercial specialist.



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59 Tanner Street, London SE1 3PL, United Kingdom
Tel: +44 20 7367 0720 / Fax: +44 20 7407 5255
Email: info@glgroup.co.uk

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