

# Comparative Legal and Economic Analysis of Franchising

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*ABSTRACT Franchising is a business model that has been converting dozens of intangible assets into tangible in the history of mankind. Thus, nowadays it by itself covers a wide range of institutional aspects of law and economics.*

*Besides, a franchise runs according to Nash's Equilibrium theory. A player can achieve the desired outcome by not deviating from their initial strategy. For this purpose, the franchisor provides an amount of assistance to the franchisee in starting and managing the business activities.*

*De facto, principles of equality are slightly different for franchise contracts. This is because the results of the contract cannot be achieved without the strict supervision and advice of the license holder.*

*Therefore, this short comparative research has considered legal and business issues relating to franchise, including the main contract law requirements, the disclosure obligation, patent protection, vertical restraints, and the general economic outcome of franchising in some countries.*

**KEYWORDS** *Patent, Disclosure Act, Vertical Restraints.*

## **1. Background**

The franchise is not only an administrative process of licensing. Instead, it is an effective system for introducing intellectual property to the market. However, these concepts were co-existent in past times. Namely, the first franchise license in Australia under royal privilege was granted by Governor Macquarie in 1809. In the United States, trademark and product franchising developed when the 'Singer' sewing machine company was formed in 1851. Gradually, local municipalities started granting franchises to utility companies for water, gas, and electricity.<sup>1</sup>

The next stage in the renewing of franchising came around the turn of the 20th century when oil refinery companies and automobile manufacturers began to grant the right to sell their products. Moreover, international franchising such as chain restaurants, hotels, fast food, and consumer goods services had their beginnings in the 1960s.<sup>2</sup> The lack of legal arrangements for franchise agreements had led to disputes over licenses and compensation. Hence, the first

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<sup>1</sup> Kevin M. Shelley, and Susan H. Morton, "Control in Franchising and the Common Law," *Franchise Law Journal* 19 (2000): 119.

<sup>2</sup> OECD, "Competition Policy and Vertical Restraints," 1993, 117.

U.S. Federal Trade Commission Franchise Rule<sup>3</sup> was originally adopted in 1978.

After that, Australia, Canada, France, and Spain among other 30 countries, have enacted disclosure laws. For instance, France introduced franchise legislation, known as the ‘Doubin’ law<sup>4</sup> in 1989. The law is essentially a consumer protection act that requires a franchisor to provide certain information to a franchisee candidate. Similar legislation has been implemented in Belgium, Italy, Sweden, and Romania.<sup>5</sup>

Today, the franchise market is expanding in Asia, with China, Japan, and Singapore leading the way. Thus, Asian countries are intending to reform intellectual property and contract law to adapt it for this type of business.

China’s original regulation of franchising was enacted in 1997. The subsequent law of 2004 has been renewed in line with international practices. In Japan the first patent act of 1885 was enacted. Japan’s regulatory treatment of franchising dates back to 1983 when the Japan Fair Trade Commission issued guidelines. In Mongolia, the first detailed legal framework for franchise is enshrined in the 2002 Civil Code and franchising is legalized as a form of contract law.

## 2. Contract law overview, and disclosure requirements

As business models, franchise and distributorship have similarities. Because both of them directly distribute products or provide services. But a franchise is based on a more sophisticated policy and procedure. The provisions that are acceptable in franchise agreements differ from the provisions in exclusive or selective distribution contracts.<sup>6</sup> In particular, legal frames are applicable in either pre-contractual or contractual and post-contractual stages.<sup>7</sup> For instance, in Europe, franchisors must have had a successful business concept in the relevant market for at least one year before they may offer franchises and must provide full disclosure of all material facts to prospective franchisees.

The European Union has a flexible policy that respects the legal advantages of member states’ contract law. One example is that, pursuant to Article 6 of Regulation 593/2008 of the European Parliament and of the Council on the law applicable to contractual obligations, whenever a business directs its activities to consumers in another Member State, it has to comply with the contract law of that Member State.

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<sup>3</sup> “See also”, The Federal Automobile Dealer Franchise Act. Public Law 1026, U.S.C.A

<sup>4</sup> Raphaël Mellerio, “Franchise Law Review: France,” in *The Franchise Law Review*, ed. Mark Abell (London: Law Business Research Ltd, 2021), 254. <https://www.aramis-law.com/wp-content/uploads/2021/04/France-Franchise-Law-Review-2021.pdf>.

<sup>5</sup> John Goodhardt, “How to Franchise in France.” 2019, <https://www.global-franchise.com/news/how-to-franchise-in-france>.

<sup>6</sup> OECD, “Competition Policy and Vertical Restraints,” 1993, 20.

<sup>7</sup> European Franchise Federation, Code of Ethics, 2016. 5.6.

Disclosure of potential profit and actual risk is the main requirement of the agreement between the parties. Hence, these principles are specifically legislated by countries. If one of the parties misled the other before concluding the contract, the court will settle the dispute and compensate for the damage.

“The franchisor’s pre-contractual disclosure duty is the subject of extensive case law in France, in circumstances where the franchisee’s business is unsuccessful and the franchisee alleges that he or she has been misled by the franchisor on the financial prospects of the franchised business.”<sup>8</sup> Under the Civil Code and labor law, franchisors are required to inform the social dialogue committee of decisions likely to affect the volume or structure of the workforce, work duration, and conditions of hiring. Moreover, courts may “rebalance” the terms of franchise agreements or remove from contracts a term that creates an imbalance.<sup>9</sup>

In German and Austrian law there is a general duty of information in accordance with general principles of contract law.<sup>10</sup> “Pre-contractual disclosure obligations are imposed based on the principle of *culpa in contrahendo*, which is codified in Section 311(2) of the Civil Code. Franchise agreements that contain pre-emptive rights relating to the acquisition of real estate property or shares in a GmbH must be contained in a notarial deed executed in German before a German notary to be enforceable. A German notary will review and notarize those provisions only if they comply in all regards with German laws.”<sup>11</sup>

In Belgium, the country has implemented a new law (B2B). The aim of the new legislation is to balance the position of the contracting parties, with direct application to franchise agreements. This means it applies to all franchise agreements where the territory of responsibility is located in Belgium, irrespective of the franchisor’s or franchisee’s location or of any foreign governing law clause of the franchise agreement. In accordance with the law, the franchisor is obliged to provide the franchisee with a pre-contractual disclosure document at least one month before the conclusion of the franchise agreement.<sup>12</sup> For instance, a ‘pre-contractual information document’ and so on. “Under the law, the purpose of any pre-contractual disclosure is precisely to

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<sup>8</sup> Mellerio, “The Franchise Law Review: France,” 255, in <https://www.aramis-law.com/wp-content/uploads/2021/04/France-Franchise-Law-Review-2021.pdf>

<sup>9</sup> Carl Zwisler, *Global Franchise Regulation Update* (Washington, DC: Gray Plant Mooty firm 2019), 6. <https://www.franchise.org/sites/default/files/2019-05/%5BPUB%5D%20Global%20Franchise%20Regulation%20Update%204844-9080-8395%20v.25.pdf>.

<sup>10</sup> Reiner Schulze and Fryderyk Zoll (eds.), *The Law of Obligations in Europe* (Munich: Sellier European Law Publishers, 2013), 174.

<sup>11</sup> Ned Levitt, Kendal Tyre, and Penny Ward, *Controlling Your International Franchising System* (San Diego: American Bar Association, 2010), 21.

<sup>12</sup> Pieter Jan Aerts, Karolina Cotronei, and Babette Märzheuser-Wood, “New Franchise Law in Belgium – How Should Your Template Franchise Agreement Change?” May 19, 2021, [https://www.martindale.com/legal-news/article\\_dentons-sirote-pc\\_2547610.htm](https://www.martindale.com/legal-news/article_dentons-sirote-pc_2547610.htm).

establish a certain balance and transparency between the contracting parties. It ensures that the franchisee has access to all the relevant information about the franchise proposition, has an opportunity to assess the business model, make inquiries, and potentially walk away at this preliminary stage if they consider the proposed obligations to be too onerous.”<sup>13</sup>

“Belgium’s 2006 regulation of franchising has two parts: the first regards disclosure of significant contractual provisions, and the second addresses ‘facts contributing to the correct appreciation of the agreement.’ Within two years of executing the franchise, the franchisee can request nullification on the basis of asserted non-compliance with the disclosure requirements.”<sup>14</sup>

The Hungarian Civil Code has provisions such as the licensing of copyright, intellectual property rights, the franchisor’s obligation and supervisory rights, and rules on the termination of contracts. The franchisor shall, for the duration of the contract, ensure that the franchisee is able to exercise continuously and without disturbance the rights of exploitation and use necessary to operate the franchise.<sup>15</sup> There is no specific franchise law in Hungary, but the legal regulation of contracts is sufficient.

Under the Polish Civil Code, contract law focused on the questions of the liability of the parties and good faith requirements in the process of negotiations. There are some general rules that Polish law recognizes, such as the pre-contractual principle of good faith and certain other rules of contract law.<sup>16</sup>

As regards the pre-contractual stage, the statutory period for information disclosure is on average one month or more in the different countries. For instance, according to the Italian Franchise Act,<sup>17</sup> a franchisor is obliged to supply information to the franchisee at least 30 days before the established agreement. Although local courts will recognize a choice of foreign law in a franchise agreement for all aspects not regulated by the Franchise Law, apart from issues such as labor and consumers’ rights, the rules contained in the Italian Franchise Law apply in any case, on a merely territorial basis, consisting of the pursuit of business in Italy. Franchise law provides for a minimum three-year duration of the franchise contract.<sup>18</sup>

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<sup>13</sup> Ibid.

<sup>14</sup> Reinhard Zimmermann and Simon Whittaker, “Good faith in European contract law: surveying the legal landscape,” in *Good Faith in European Contract Law*, eds. Reinhard Zimmermann and Simon Whittaker (Cambridge: Cambridge University Press, 2000), 24.

<sup>15</sup> Péter Rippel-Szabó, Bettina Kövecses, and Péter Sziládi, “The Franchise Law Review: Hungary,” in *The Franchise Law Review*, <https://thelawreviews.co.uk/title/the-franchise-law-review/hungary>.

<sup>16</sup> Schulze and Zoll, *The Law of Obligations in Europe*, 104.

<sup>17</sup> IT, *Law N129*.

<sup>18</sup> Valerio Pandolfini, “How franchising is regulated in Italy,” 29 November, 2022, <https://franchisinginitaly.com/how-franchising-is-regulated-in-italy/>.

“Spanish law obliges franchisors to be transparent in their dealings with potential franchisees in two ways: by imposing upon them a duty to provide certain pre-contractual information and by requiring them to register in the franchisor registry. In Spain, sectoral laws offer a very broad definition that relates entirely to the rights granted by the franchisor and apparently contain the use of the words: ‘franchisor’ and ‘franchisee’.<sup>19</sup> It is not necessary to record the contract in writing, although the existence of documentary proof is usual. Apart from some specific aspects, such as pre-contractual disclosure, there is no statutory regulation for this type of contract, and the parties may insert such clauses into the contract as they deem necessary.”<sup>20</sup>

For countries with a common law system, court precedents and classical principles are proposed rather than detailed statute law. But de facto, the traditional and long-standing position under English law was that a good-faith clause was not ordinarily binding, or capable of being enforced. In England, the majority of laws that regulate business activities are part of Civil law. Accordingly, franchisors and franchisees have the right to enter into an agreement and terminate it as provided for in the franchise agreement itself or as governed by the common law.<sup>21</sup>

Therefore, the British Franchise Association (BFA) Code to some extent enshrines best and recommended practices in relation to pre-contractual disclosure requirements. Members of the BFA are required to disclose certain information in writing to prospective franchisees within a reasonable (not defined) period prior to the signature of the franchise agreement. As a minimum, the franchise agreement should include an appropriately worded grant of rights clause defining the extent and limits of the franchisee’s right to use the franchisor’s intellectual property rights.<sup>22</sup>

Franchising in the United States is regulated at both the federal and state levels. Therefore, it is imperative for a business considering expansion into the United States to determine whether its business arrangement constitutes a ‘franchise’ or ‘business’ opportunity and, if it is a franchise, to comply with all applicable federal and state laws. Located in the United States, the International Franchise Association has supported state laws that confirm franchisees and franchisors are independent contractors. As a result, 18 states have passed such laws.<sup>23</sup> All franchisors must abide by the rules and regulations contained in a

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<sup>19</sup> Mark Abell, “The Regulation of Franchising Around the World,” in *The Franchise Law Review*, <https://thelawreviews.co.uk/title/the-franchise-law-review/the-regulation-of-franchising-around-the-world>.

<sup>20</sup> Jaume Martí, “Spanish Legal System on Disclosure in Franchise Network,” *European Business Law Review* 25 (2014): 943.

<sup>21</sup> Aldo Frignani and John Pratt, “Termination and Non-renewal of Franchise Agreements in the European Union,” *Franchise Law Journal* 37 (2017): 16.

<sup>22</sup> Graeme Payne, “The Franchise Law Review: United Kingdom,” in *The Franchise Law Review*, <https://thelawreviews.co.uk/title/the-franchise-law-review/united-kingdom>.

<sup>23</sup> Robert Emmerson, “Franchising and the Collective Rights of Franchisees,” *Vanderbilt Law Review* 43 (1990): 1523.

federal law called the Franchise Rule. This is a long and detailed law, containing provisions on every aspect of franchising and judicial practice.

Federal law requires all franchisors to give prospective franchisees a disclosure document, also called a Uniform Franchise Offering Circular. This is an important component of franchising and gives prospective information such as fees to be paid, the obligations of parties, territory, dispute resolution methods, and financial statements. In addition to contractual or common law requirements limiting rights to terminate, franchisors must also satisfy any applicable statutes.<sup>24</sup>

In addition, the Federal Trade Commission (FTC) regulates franchising at the federal level under the Franchise Rule. The FTC rule governs franchise offerings in all US territories. Federal and state franchise laws impose pre-sale disclosure obligations and restrictions. First, the FTC Rule and most states require franchisors to provide prospective franchisees with the Franchise disclosure document upon reasonable request by the prospective franchisee, and no later than 14 calendar days before any agreement is signed or any money is paid.<sup>25</sup>

Canadian franchise laws contain various provisions addressed at preventing parties from contracting outside of the legislation. Waivers or releases of franchisees' statutory rights are void, as are contractual terms that purport to change the governing law of the franchise agreement or change the venue for disputes to that of a jurisdiction other than where the franchise is operated.<sup>26</sup> Canadian British Columbia Disclosure Law<sup>27</sup> is similar to franchise laws in the five other provinces. Some of the regulatory frameworks indicated under the provincial disclosure in Ontario and Alberta are aligned with those of the U.S. This regulation subjects the franchisor to certain conditions that must be met before any business contract is signed by the potential investors.<sup>28</sup>

In Australia, franchise legislation is found in the trade practices regulations 1998, 2015 and is known as the franchising code of conduct. The Code applies to a franchise agreement that concerns the distribution of goods or services in Australia. This agreement can take the form, in whole or in a part, of a written, oral, or implied agreement. The Australian Fair Work Act of 2009 Amendment makes franchisors jointly liable for workplace contraventions committed by franchisees when franchisors are aware of the infractions or should have been aware that they would occur, and fail to stop or prevent them.<sup>29</sup>

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<sup>24</sup> Deborah Coldwell, "Franchise law," *SMU Law Review* 65 (2016): 1066.

<sup>25</sup> U.S Federal Trade Commission, 16 CFR Parts 436 and 437.

<sup>26</sup> Evan Thomas, "Recent Developments in Canadian Franchise," *Franchise Law Journal* 35 (2020): 401.

<sup>27</sup> Carl Zwisler, *Global Franchise Regulation Update* (Washington, DC: Gray Plant Mooty firm 2019), 6, <https://www.franchise.org/sites/default/files/2019-05/5BPUB%5D%20Global%20Franchise%20Regulation%20Update%204844-9080-8395%20v.25.pdf>.

<sup>28</sup> Philip Zeidman, "Observations on the International Regulation of Franchising," *Stanford Journal of Law* 19 (2014): 250.

<sup>29</sup> The Fair Work Act, AUS, N28. 2009.

Under Chinese law, there are specific commercial franchising regulations that stipulate among other items, franchise-specific pre-contractual disclosure, and contract requirements. These regulations apply to both foreign-invested and local Chinese franchisors.<sup>30</sup> A franchisor should positively disclose in writing to the franchisee, at least 30 days before signing the franchising contract, certain information about itself.

Good faith in the contract and transparency of the franchise agreement has governed in accordance with articles 17, 42, and 60 of the Civil Code of the country. Chinese civil law jurisdiction and the requirements in the Franchise measures regarding disclosure are simply a clarification of the general principle regarding pre-contractual negotiations as set out in Article 42 of the Contract law. In this regard, it is very similar to modern civil code contractual principles in Western jurisdictions.<sup>31</sup>

In Japan, the 2002 replacement of concerned guidelines, together with the Medium and Small Retail Commerce Protection Act, addresses both disclosure and relationship aspects. There are unusually detailed aspects including business hours, business days, the structure of the business, and indemnification in the event the business is not profitable.<sup>32</sup> There is no mandatory clause required to be included in a franchise agreement. Parties are free to negotiate the terms of the deal.<sup>33</sup>

“Singapore’s legal framework has been modeled closely after the common law and statutory instruments of the United Kingdom. Contracting parties are prohibited from offering, selling, or promoting the sale of any franchise, product, or service by means of any explicit or implied representation that has a tendency to deceive or mislead prospective purchasers of such a franchise, product, or service. The franchisor is required under the Code of Ethics to disclose to the franchisee at least seven days prior to the execution of the franchise agreement its current operations, the investment required, performance records, and any other information reasonably required by the franchisee that is material to the franchise relationship.”<sup>34</sup>

Whereas under the Civil Code of Mongolia<sup>35</sup>, a franchisor shall undertake to transfer a license, obtained according to established procedures and allow the use of nonmaterial property, to a franchisee, and the latter shall undertake to conduct activities in accordance with structures and a cooperation program

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<sup>30</sup> Sven-Michael Werner, “The Franchise Law Review: China,” in *The Franchise Law Review*, <https://thelawreviews.co.uk/title/the-franchise-law-review/china>.

<sup>31</sup> Paul Jones, “The Regulation of Franchising in China and the Development of a Civil Law Legal System,” 2 *U. Pa. E. Asia L. Rev.* 78 (2006): 87.

<sup>32</sup> Zeidman, “Observations on the International Regulation of Franchising,” 252.

<sup>33</sup> Kentaro Tanaka, “The Franchise Law Review: Japan,” in *The Franchise Law Review*, <https://thelawreviews.co.uk/title/the-franchise-law-review/japan>.

<sup>34</sup> Steven Anderman, *The Interface Between Intellectual Property Rights and Competition Policy* (Cambridge: Cambridge University Press, 2007), 375.

<sup>35</sup> Civil Code, MGL, 335.

agreed with the franchisor, as well as pay proper fees<sup>36</sup> or a certain part of the revenues.

A franchisor shall have the obligation to protect a cooperation program from the involvement of third parties, regularly update the program, supply the necessary information to the franchisee, provide technical assistance to the franchisee, and offer training for employees. A franchisee shall have the obligations to use the rights and property received under the contract productively and in accordance with the purpose, pay fees and certain parts of the revenue on time, and ensure transferred rights and property to the franchisor if provided so by the contract.

Parties shall determine the duration of the franchising contract depending on the demand for a particular product or service and market share.<sup>37</sup> Upon the expiration of the franchising contract, the franchisor shall have the right to prohibit the franchisee's successor to compete in a specific territory for up to one year.

Also, parties shall exchange all necessary information only if a contract is concluded. In addition, the Civil Code does not provide for an obligation to exchange information in the pre-franchise agreement, nor does it set a time limit.

### 3. Vertical restraints and Patent protection

The core issue facing franchisors today is constituted by the legal aspect of the country to which the franchisee belongs. Local laws can affect the viability of a franchise system and the franchisor's ability to control the franchisee in a variety of ways. So due diligence<sup>38</sup> on legal issues should be carried out before a draft franchise agreement is provided to potential franchisees. At least, investors should check whether the trademarks have been registered and are valid, as well as figure out market restrictions applicable to the franchisor and leases or assets. These processes will reduce potential disputes further.

In EU countries, the cartel prohibition is laid down in Article 101 (1) of TEFU. Member states and courts shall apply both Union and national competition law.<sup>39</sup> Also, since Regulation No 19/65, the Commission has

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<sup>36</sup> The licensee may be required to make lump-sum payments, and in some situations the parties may agree upon a profit sharing scheme. "See also", Richard Whish, *Competition Law* (Oxford: Oxford University Press, 2012), 772.

<sup>37</sup> Valentine Korah, *In Introductory Guide to EC Competition Law and Practice*, (Oxford: Hart Publishing, 2007), 376.

<sup>38</sup> Ned Levitt, Kendal Tyre, and Penny Ward, *Controlling Your International Franchising System* (San Diego: American Bar Association, 2010), 3. <https://www.dickinson-wright.com/-/media/documents/documents-linked-to-attorney-bios/levitt-ned/20the-impossible-dream.pdf?la=en&hash=A14886008FC10EF3BFDB3AA13E380D8E52383E2C>.

<sup>39</sup> Derek French, Stephen Mayson, and Christopher Ryan, *Company Law* (Oxford: Oxford University Press, 2012), 21. Directives will have effect between a citizen and



adopted Regulation No 772/2004 conferring block exemption on technology transfer agreements pursuant to Article 101 (3) of the Treaty.<sup>40</sup>

“Franchise agreements are subject to a full review under EU competition law. A franchisor is not allowed to implement practices that are not permitted under competition law, such as vertical or horizontal price-fixing, sharing markets, prohibiting passive sales and imposing a direct or indirect ban on internet sales.”<sup>41</sup> Furthermore, Directive 2005/29/EC concerning unfair business-to-consumer commercial practices in the internal market removes a number of barriers to cross-border trade in the EU.<sup>42</sup> “Competition law mainly restricts the action which can be taken against parallel trade.”<sup>43</sup>

Specific contractual restrictions on the franchisee which are necessary to protect know-how and goodwill, and to maintain the common identity of the franchise network fall outside the European cartel prohibition.<sup>44</sup> A key element of a franchise agreement is the licensing of certain intellectual property rights. Hence, as mentioned in the abstract, the franchisor is not prohibited from having a priority right in the countries.<sup>45</sup> “Within the EU, the basic policy of free movement of goods dictates that intellectual property may not be used in this way to prevent a parallel importer from moving ‘legitimate’ goods between one member state and another.”<sup>46</sup> So the European single market is a strong factor in the process of globalization.<sup>47</sup>

However, the franchisee must trade and provide services only in the designated geographical location, population, and market. This is the main way to impose restrictions on the market without affecting the franchise party’s legal rights. Because market share and fair competitions are the fundamental rules of game theory. On the other hand, due to technological advances, strict market rules have begun to change. For instance, E-commerce is an unlimited virtual

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the state or its organs. “See also”, Andrew Burrows, *English Private Law* (Oxford: Oxford University Press, 2007), 6.

<sup>40</sup> Richard Whish, *Competition Law*, 781.

<sup>41</sup> Guy Tritton and Richard Davis, *Intellectual Property in Europe* (London: Sweet & Maxwell, 2008), 975.

<sup>42</sup> Stephen Weatherill and Ulf Bernitz, *The Regulation of Unfair Commercial Practices under EC Directive* (London: Hart Publishing, 2007), 31.

<sup>43</sup> Christopher Stothers, *Parallel Trade in Europe: Intellectual Property, Competition and Regulatory Law* (Oxford: Hart, 2007), 9.

<sup>44</sup> Lucy Jones, *Introduction to Business Law* (Oxford: Oxford University Press, 2017), 641. “See also”, Kennedy Van der Laan, “EU & Competition Law,” 2021, <https://www.lexology.com/library/detail.aspx?g=500ddb51-85e6-42c5-bdeb-0d0e221e24cd>.

<sup>45</sup> Annette Kur and Thomas Dreier, *European Intellectual Property Law* (Cheltenham: Edward Elgar Publishing, 2013), Chapter 3.

<sup>46</sup> Burrows, *English Private Law*, 503.

<sup>47</sup> Arthur Hartkamp and Martijn Hesselink, *Towards a European Civil Code* (Alphen aan den Rijn: Wolters Kluwer Law & Business, 2011), 110.

environment.<sup>48</sup> Therefore, recently the most pressing issue is the legal and market regulation related to the scope of conducting this type of business in digital form.<sup>49</sup>

Franchising is the vertical production process of supplying goods or services to customers. This type of business usually contains a combination of different vertical restraints with regard to the products being distributed, such as exclusivity, quality requirement, assortment, customer group, and certain internet sales restrictions. Hence, under EU competition law it is not allowed for a franchisor to impose on its franchisees an absolute ban on online sales and services.<sup>50</sup> It can be considered the second flexible regulation enshrined in the rules of the European Union.

EC Regulation No 330/2010 on vertical restrictions on competition and its subsequent guidelines makes a fundamental distinction, as far as online sales are concerned, between active and passive ones. Online sales are considered passive when the franchisee offers goods and/or services on the web, without “actively” soliciting consumers to come to his website.

However, franchisors can regulate, in the franchise agreement, the terms and conditions of use of the websites by the franchisees participating in the network, to protect their image and their distinctive signs. “These and other provisions, to be specifically included in the franchise agreement, are aimed at protecting the franchisor and his network, in order to ensure uniformity of image and the same quality standards of products and services, whether they are sold online or through traditional channels.”<sup>51</sup>

“In cases where another applicable law has been chosen by the parties and where the mandatory consumer protection provisions of the member state of the consumer provide a higher level of protection, these mandatory rules of the consumer’s law need to be respected. Traders, therefore, need to find out in advance whether the law of the member state of the consumer’s habitual residence provides a higher level of protection and ensure that their contract is in compliance with its requirements.”<sup>52</sup>

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<sup>48</sup> Efraim Turban, Judy Whiteside, David King, and Jon Outland, *Introduction to Electronic Commerce and Social Commerce* (USA: Springer International Publishing, 2017), 29. “See also”, Rozenn Perrigot and Thierry Pénard, “Determinants of E-commerce Strategy in Franchising,” *International Journal of Electronic Commerce* 17 (2013): 112.

<sup>49</sup> Robert W. Emerson, and Michala Meiselles, “U.S. Franchise Regulation as a Paradigm for the European Union,” *20 Washington University Global Studies Law Review* 20 (2021): 751.

<sup>50</sup> Rules Applicable to Antitrust Enforcement. EU Competition Law, Volume 1.

<sup>51</sup> Valerio Pandolfini, “Franchising and e-commerce: can franchisors (legally) limit online sales and social media by franchisees?,” 18 February, 2021, <https://franchisingitaly.com/franchising-and-e-commerce-can-franchisors-legally-limit-online-sales-and-social-media-by-franchisees/>.

<sup>52</sup> Martijn W. Hesselink, *The New European Legal Culture* (Deventer: Kluwer Law International, 2002.), 43. “See also”, Hesselink, *EU Contract law* (European University Institute, 2009.), 14.

In France, “the French courts have stressed the importance of know-how and continuing technical assistance as criteria distinguishing franchising from other distribution systems.<sup>53</sup> The French courts also attach great importance to a balanced contractual vertical relationship between franchisor and franchisee that shelters the franchisee from arbitrary impositions by the franchisor.”<sup>54</sup> Trademarks are regulated by the Intellectual Property Code, enacted by law no. 92-597 of 1992. A duly registered trademark confers exclusive rights on its holder for a period of 10 years, which is renewable indefinitely. Competition issues are governed by French and EC competition rules.<sup>55</sup>

In Germany, franchise agreements are subject to general German competition law.<sup>56</sup> “The objectives of the two German competition laws are the suppression of unfair business practices under the Act against Unfair Competition (Gesetz gegen unlauteren Wettbewerb), whose basic aim is the prevention of unethical, excessive, or otherwise abusive practices in competition, and the suppression of restrictive business practices under the Act against Restraints of Competition (Gesetz gegen Wettbewerbsbeschränkungen ARC), whose basic aim is to maintain competitive market structures. Franchise agreements are not specifically defined under the ARC. Generally speaking, however, franchise agreements are considered to be those by which a producer or trader (franchisor) grants to one or several independent enterprises (franchisees) the right to use his firm name and/or his trademark to distribute goods and services within the framework of a marketing concept developed by the franchisor.”<sup>57</sup>

The key intellectual property rights involved are trademarks, designs, domain names, and copyright, database, and know-how rights. Although copyright is not registrable in Germany, trademarks are, and franchisors can choose whether to register them as domestic German or European Union trademarks or international registrations.<sup>58</sup>

In Belgium, “Most franchise agreements expressly give the franchisee the right to use the franchisor’s trademarks or distinctive signs, or both, for the performance of the franchise agreement. Franchise agreements are subject to competition law, both at the EU and national levels. Economic law implements

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<sup>53</sup> Good faith in the performance of contracts is required by the French Civil Code. Zimmermann, and Whittaker, *Good Faith in European Contract Law*, 695.

<sup>54</sup> In France jurisprudence has distinguished franchising from other distribution systems for some purposes. OECD, “Competition Policy and Vertical Restraints,” 54.

<sup>55</sup> Emmanuel Schulte, “France,” in *Franchise 2011*, ed. Philip F. Zeidman (London: Law Business Research Ltd., 2011), 52.

<sup>56</sup> Antitrust law, based upon Article 101 of the Treaty on the Functioning of the European Union.

<sup>57</sup> OECD, “Competition Policy and Vertical Restraints,” 72.

<sup>58</sup> Stefan Münch, Alexander Duisberg, et al., “The Franchise Law Review: Germany,” in *The Franchise Law Review*, <https://thelawreviews.co.uk/title/the-franchise-law-review/germany>.

on the Belgian market a prohibition against anti-competitive agreements between undertakings and a prohibition against abuse of a dominant position.”<sup>59</sup>

In Hungary, “Franchise agreements must be in compliance with the Competition Act. In the absence of a special block exemption regulation on franchises, the general block exemption regulation sets out the criteria as to how franchise agreements may be exempted from the prohibitions relating to the restriction of competition. In relation to intellectual property rights and know-how, the provisions of the Trademark Act, Copyright Act, Patent Act, and Trade Secret Act may apply to franchise agreements.”<sup>60</sup> “Copyright rules, as well as industrial property standards, are of territorial effect and they can only be enforced in the territory of the country.”<sup>61</sup>

In Poland, “Franchisees must comply with Polish consumer laws if they offer products or services to consumers. A franchise agreement is a type of distribution relationship between independent entities. Under certain circumstances, such a relationship may affect trade by restricting or distorting competition in the relevant market, as it usually contains a combination of different vertical restraints. The confidentiality of trade secrets is protected under the Act on Combating Unfair Competition, even before entering into non-disclosure obligations.”<sup>62</sup>

In Italy, the domestic antitrust law, Act 287/1990, applies to the sole extent that the concerned vertical agreements, abuse of dominant position or concentrations do not fall within the scope of the EU rules.<sup>63</sup>

Under Spanish law, the franchisor must be in possession of the trademark that he is licensing to the franchisees. Furthermore, the license must not have been revoked.<sup>64</sup> Competition law is governed by EU Regulation No 330/2010, as well as Royal Decree 261 of, 2008 on antitrust regulation and Act 15/2007 on the competition.

U.S competition rules belong to a wide web of laws that are particularly worth noting, namely: the Sherman Act 1890, the Clayton Act 1914, and the Federal Trade Commission Act 1914.<sup>65</sup> The U.S and European experiences show that pre-emption norms can be used to limit the expansion of protection in intellectual property and unfair competition cases, but that the reverse effect of

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<sup>59</sup> *The Franchise Law Review: Belgium*, ed. Mark Abell (London: Law Business Research Ltd., 2016), 220–226.

<sup>60</sup> Rippel-Szabó, Kövecses, and Sziládi, “The Franchise Law Review: Hungary”. In <https://thelawreviews.co.uk/title/the-franchise-law-review/hungary>.

<sup>61</sup> Anikó Grad-Gyenge, “The Law of Intellectual Property,” in *Business Law in Hungary*, ed. Istvan Sandor (Budapest: Patrocinium, 2016), 441.

<sup>62</sup> Kuba Ruiz, “The Franchise Law Review: Poland,” in *The Franchise Law Review*, <https://thelawreviews.co.uk/title/the-franchise-law-review/poland>.

<sup>63</sup> Claudia Ricciardi, “The Franchise Law Review: Italy,” in *The Franchise Law Review*, <https://thelawreviews.co.uk/title/the-franchise-law-review/italy>.

<sup>64</sup> “See details”, <https://www.fieldfisher.com/en/locations/spain>.

<sup>65</sup> Maher Dabbah, *International and Comparative Competition Law*, (Cambridge: Cambridge University Press, 2010), 237.

pre-emption can be that harmonization efforts have to take into account the existing practice.<sup>66</sup>

At the federal level of U.S law, both intellectual property protection and antitrust policy share a common goal of encouraging innovation. This provides a second level of intellectual property protection besides each state protecting intellectual property through its own trade secret and trademark laws. “The Lanham act of 1946 supplements state trademark laws and the Economic espionage act of 1996 renders trade secret misappropriation a federal crime. The licensing guidelines address unilateral acquisitions of intellectual property when they take the form of exclusive licensing arrangements.”<sup>67</sup>

Under the U.S Federal Trade Commission Rule, a business or licensing arrangement will be regulated as a franchise if it has two elements: 1) the franchisor grants the franchisee a right to use the franchisor’s trademark; 2) the franchisor exerts or has the authority to exert a significant degree of control or assistance over the franchisee’s method of operation. Even if the parties to a contract call it a licensing agreement, a distribution agreement, or explicitly state that it is not a franchise arrangement, if the three elements are present, then US franchise law will apply.

Trademark rights in the United States are based on use under common law rather than arising from trademark registration. This means that from the moment that an owner begins to use a trademark on or in connection with some goods or service, the owner owns rights to the mark and it generates associated goodwill.

The Canadian Trade-Marks Act defines a trademark as a mark that is used by a person for the purpose of distinguishing or so as to distinguish wares or services manufactured, sold, leased, hired, or performed by him from those manufactured, sold, leased, hired or performed by others, a certification mark, a distinguishing guise or a proposed trade-mark. As such, distinctiveness is central to the definition and a trademark need not be registered to be valid, or even licensed, in Canada. The Competition Act sets forth penal and civil recourses with respect to various practices, including those identified as conspiracies and collusion, abuse of dominance, price maintenance, promotional allowances, and price discrimination, misleading advertising, deceptive marketing, pyramid selling, refusal to deal, exclusive dealing, tied selling, as well as certain other vertical market restrictions.<sup>68</sup>

The English competition legislation applicable to franchise agreements is comprised of four statutes: the Fair Trading Act 1973; the Restrictive Trade Practices Act 1976; the Resale Prices Act 1976 and the Competition Act 1980. The Fair Trading Act, which deals with monopoly situations, may apply to

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<sup>66</sup> Anselm Sanders, *Unfair Competition Law: The Protection of Intellectual and Industrial Creativity* (Oxford: Clarendon Press, 1997), 22.

<sup>67</sup> Anderman, *Intellectual Property Rights and Competition Policy*, 217.

<sup>68</sup> Bruno Floriani and Marvin Liebman, “Canada,” in *Franchise 2011*, ed. Philip F. Zeidman (London: Law Business Research Ltd., 2011), 26.

franchises if the franchised group falls within the definition of “complex monopoly”.

In Australia, the franchisor is required to provide disclosures about any patents or copyrights that are material to the franchise system. Such information must include a description of the intellectual property, and details of the franchisee’s rights and obligations in connection with the use of the intellectual property.<sup>69</sup> The Patents Act, the Copyright Act, and the Designs Act all make provisions for compulsory licensing. The patentee will be able to block parallel imports if they are put on the market in the foreign country by a licensee which does not have authority to sell in Australia.<sup>70</sup>

The Anti-Monopoly Law aims to safeguard China against anti-competitive activity. As such, it applies to conduct both within China, and conduct outside China which has the effect of eliminating or restricting competition in the Chinese market. It is permissible for a franchisor to exercise control over the franchisee’s business.<sup>71</sup> The Anti-Monopoly Law also allows private actions to be brought by parties who have suffered loss as a result of the contravention. The Law defines a dominant market position as the ability of one or several business operators to control the price, volume, or other trading terms in the relevant market, or to otherwise affect the conditions of a transaction.<sup>72</sup>

In Japan, intellectual property has always been interpreted in the wider context of competition policy and domestic development. This has often been regarded as discrimination against foreign rights owners. Compared with patents, know-how is characterized by an uncertain technological scope, weak exclusivity protection, and uncertainty as to the duration of protection. Therefore, in determining competition in market know-how licensing agreements, it is necessary to take into account these specific characteristics of know-how.<sup>73</sup> Under Antimonopoly laws, either franchise agreements as a whole, or specific provisions of franchise agreements, can be found to constitute unfair business practices. Under the decree guidelines, the franchise agreement as a whole must be so balanced as to avoid unreasonable restrictions on the franchisee.<sup>74</sup>

Singapore’s Patents Act 1994 sets out a legislative framework for grants. One of the central features of the internal interface between patent law and competition law is the way in which the patentee’s exclusive rights over the invention are circumscribed by the language he has used in his patent claims and specifications. “The Trademarks Act 1998 promulgates the legal framework

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<sup>69</sup> *International Franchise Sales Law*, ed. Andrew Loewinger and Michael Lindsey, (American Bar Association: Forum on Franchising 2006), 11.

<sup>70</sup> Anderman, *Intellectual Property Rights and Competition Policy*, 453.

<sup>71</sup> Werner, “The Franchise Law Review: China,” in *The Franchise Law Review*, <https://thelawreviews.co.uk/title/the-franchise-law-review/china>

<sup>72</sup> David Fleming, et al., “Antitrust and Competition in China,” 2008, <https://www.globalcompliance.com/antitrust-and-competition/antitrust-and-competition-in-china/>.

<sup>73</sup> Anderman, *Intellectual Property Rights and Competition Policy*, 276.

<sup>74</sup> OECD, “Competition Policy and Vertical Restraints,” 73.

which supports the registered trademark system in Singapore, setting out the legal standards for acquiring intellectual property rights in signs which are used in indicators of origin for goods and services.”<sup>75</sup>

There is no time limit for registering any trademark, therefore a trademark may be used by the owner without the need for registration. But, unless a trademark is registered, the trademark owner cannot bring an action for registered trademark infringement or seek relief under the Trade Marks Act.

The Competition Act came into force in 2005 and has a retrospective effect, applying equally to all agreements made before the effective date of the Act or the relevant provisions. In general, the Competition Act prohibits any agreement that has the object or effect of preventing, restricting, or distorting competition within Singapore. Therefore, a franchise agreement will be rendered void to the extent that the franchise agreement prevents, restricts, or distorts such competition. The Competition Act provides certain exemptions to and exclusions from the strict application of the provisions in the Competition Act. If a franchise agreement meets all the criteria required for any exemptions or falls within any exclusions, it can be exempted from compliance with the Competition Act requirements.

In Mongolia, entrepreneurs are prohibited from establishing contracts and agreements (cartels) aimed at restricting competition by negotiating and agreeing to fix the prices of goods and products<sup>76</sup>. Also, entities shall be prohibited from using trademarks, labels, names, and quality guarantees of others’ products without proper authorization, or copying brand names or packages.

Intellectual property rights<sup>77</sup> may be put into economic circulation through licenses<sup>78</sup>, franchises, merchandise, and other agreements, that allow full or partial use of the intellectual property<sup>79</sup> by others, transfer of ownership<sup>80</sup>, and investments made in legal entities in the form of intellectual property. Concerned laws focus predominantly on the appropriate design and application of antitrust rules to the accumulation and exercise of intellectual property rights. Most antitrust claims relating to intellectual property involve challenges to agreements, licensing practices, or affirmative conduct involving the use or

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<sup>75</sup> Anderman, *Intellectual Property Rights and Competition Policy*, 393.

<sup>76</sup> Garry Moore, Arthur Magaldi, and John Gary, “The legal environment of Business.” 1987. Vertical price fixing involves fixing the price at different levels of the manufacturing and distribution process.

<sup>77</sup> Law on Intellectual Property, MGL, 7. “See also”, Law on Competition, MGL, 1.5.

<sup>78</sup> Abdul Kadar, et al., *Business and Commercial law*, 1993. 91.

<sup>79</sup> Stothers, *Parallel Trade in Europe*, 27. Intellectual property rights give the owners the right to prohibit third parties from carrying out certain activities. “See also”, Burrows, *English Private Law*, 499.

<sup>80</sup> Marcus Smith and Nico Leslie, *The Law of Assignment*, 2013. 451. However, the mode of transfer of the intellectual property rights themselves does require separate consideration.

disposition of the intellectual property rights or the products they cover.<sup>81</sup> When two or more entities are using identical trademarks for similar goods or services, it shall protect the rights to ownership of the entity that has first applied for registration.<sup>82</sup>

A trademark registration shall be valid for a period of 10 years following the filing date and may be renewed by 10-year periods at the request of the owner.

Restricting market monopolies or promoting the franchise business is not a bipolar concept. This is because there is an economic and legal practice of granting monopolies to innovation in the market. The legal framework in the countries is generally based on the protection of the franchise's market share in certain territories and customers, and, on the special regulation of some monopoly franchises by investment and tax policies.

#### 4. Conditions for legal entities

The franchisor and the franchisee (master or sub) must be a legal entity and a contract shall be entered into between the company, the joint-stock partner, the corporation, and the business group. Most companies today are incorporated under the procedure laid down in the Company's act. Businesses use agents in various forms throughout their activities, particularly if they are companies, as all companies must have human agents or holding out a partner to act on their behalf.<sup>83</sup>

The scope of EU Company law covers the protection of the interests of shareholders and others. As companies are creatures of the law, and more specifically enterprises of persons and assets organized by rules, including the law, there is an unbreakable link between companies.<sup>84</sup> For instance, a Limited Liability Company (GmbH) is the most widespread form of corporation in Germany. The legal form of the stock corporation (*Aktiengesellschaft* or AG) was originally intended for large enterprises. Today, both large public companies and smaller companies are organized in the legal form of an AG and a group of AG. GmbH is a legal person and a corporation. The basic form of the corporation is the organization under civil law (*Verein*). Thus, the basic provisions of the organization under civil law apply analogously to the GmbH.<sup>85</sup>

The preferred choice of vehicle used for the expansion of a foreign franchise system into Canada is the incorporation of a Canadian subsidiary. By using a Canadian subsidiary, the franchisor has a direct physical presence and

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<sup>81</sup> *Antitrust, Patents and Copyright*, François Lévêque, Howard Shelanski (Edward Elgar Publishing, 2005), 12.

<sup>82</sup> Law on Trademarks and Geographical Indications, MGL, 4.

<sup>83</sup> Mueller, *Business Law*, 75. "See also", Ivamy Hardy, *Company Law*, 1985. 91.

<sup>84</sup> Nicola De Luca, *European Company Law*, 2017. 4.

<sup>85</sup> Gerhard Wirth and Michael Arnold, *Corporate Law in Germany* (München: Beck, 2004), 63. "See also", Joachim Rosengarten, Frank Burmeister, and Martin Klein, *The German Limited Liability Company* (München: Beck, 2015), 6.



indicates to the general public that it has made a commitment to Canada.<sup>86</sup> Each franchisee must operate as a truly independent and distinct entity from its franchisor so as to be considered a separate employer for labor union certification and collective bargaining purposes.<sup>87</sup>

If a foreign franchisor pursues economic activity in Hungary, it is required to set up a local company; setting up such a company follows the general rules of company formation. There is no general restriction on a foreign entity granting a master franchise or development rights to a local entity, although the parties to franchise agreements must comply with the provisions of competition law and sectoral rules.<sup>88</sup>

In Poland, non-EU companies are obliged to establish a branch or subsidiary company to operate a business. Ownership of real estate is restricted for non-European economic area franchisors and requires government approval.

In France, if a foreigner who is not a citizen of a country of the European Economic Area or of Switzerland is appointed as legal representative of a French company, some formalities like declarations to the prefectural authorities or obtaining a residence permit, depending on whether the person resides in France, must be fulfilled prior to the registration of the company.<sup>89</sup>

China requires a franchisor to establish and operate at least two company-owned units for at least one year before it grants franchises. The franchisor must be an enterprise. The earlier regulation specified that the pilot organizations should be in China, but the current law has removed that requirement. Since this increases the amount of capital that must be committed, as a practical matter, it bars all but well-capitalized companies. Indeed, it can bar even some very large companies whose business model calls for an entirely franchised network.<sup>90</sup>

A franchisor may choose its business structure when operating in Japan, such as establishing a corporation (subsidiary) or a branch in Japan.<sup>91</sup>

In Mongolia, a company (sole proprietorship, partnership, corporation, limited liability partnership) may have branches or representative offices in domestic or foreign countries. The establishing company shall be responsible for the consequences ensuing from the activities of its branches and representative offices. A founder of a company may be a citizen or legal person of Mongolia and, if provided by law, a foreign citizen or legal person, or a stateless person. Depending on the type of franchise agreement, the legal status of the parties to the agreement may be any.

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<sup>86</sup> Investment Canada Act, C 28. R.S.C.

<sup>87</sup> Bruno Floriani and Marvin Liebman, *Franchise Jurisdictions in Worldwide: Canada*, 2011. 26.

<sup>88</sup> Tamás Gödölle, "Hungary Franchise Laws and Regulations," 2022, <https://iclg.com/practice-areas/franchise-laws-and-regulations/hungary>

<sup>89</sup> Schulte, "France," 52.

<sup>90</sup> Zeidman, "Observations on the International Regulation of Franchising," 277.

<sup>91</sup> Tanaka, "The Franchise Law Review: Japan," in *The Franchise Law Review*, <https://thelawreviews.co.uk/title/the-franchise-law-review/japan>.

## 5. Economic outcome and tax policy

According to 2022 statistics, franchising produces two trillion US dollars in revenue every year worldwide. The sector, representing 2.5 percent of world GDP, has 2.4 million companies involved. Only in the United States, there are 773,603 franchise establishments registered and an estimated number of 8.43 million people were employed by franchise businesses, which contribute 477 billion US dollars to the GDP.<sup>92</sup>

In Europe, the franchise network has multiplied since the 1980s. It grew 2.7 times in Germany, 1.8 times in France and 2.1 times in the UK. The rules and regulations issued by the EU are directed at boosting member countries' exports, developing domestic manufacturers creating value-added products, and absorbing profits into Europe. Furthermore, the franchise business in the area is profitable, but the tax is slightly high (about 30 percent more than the Asian average). The rules and legal standards of playing in the market have elevated criteria including antitrust and consumer protection. Currently, around 10000 franchise networks operate in the EU, with nearly 405,000 outlets scattered across the EU, generating a turnover of almost 215 billion euros.<sup>93</sup>

It is the largest market for franchising in the Eurozone but also with more competition and high taxes and rents, and high standards for products and services. For instance, in France, if the franchisor is a company, it will be taxed at a 33.33 percent flat rate. If the franchisor is an individual, he or she will be subject to a progressive tax up to a maximum amount of 40 percent of his or her income. Value-added tax at a flat rate of 19.6 percent applies to all sales of goods or services in France. The fees paid to the franchisor are subject to value-added tax.

Franchisors that are tax residents in Germany are liable for corporation tax of 15 percent plus a solidarity surcharge that is added to the corporate income tax and set at a rate of 5.5 percent of the corporate income tax rate and trade tax. Trade tax is a municipal tax. As such, tax rates are individually determined by each municipality. A withholding tax of 25 percent is payable on dividends.<sup>94</sup>

Royalty (License fee) for the granting of rights under the German Copyright Act bears a reduced value-added tax rate of 7 percent, while all other fees paid to the franchisor by the franchisee are subject to value-added tax at 19 percent. The initial franchise fee is usually amortized over the duration of the franchise

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<sup>92</sup> Christina Niu, "Franchising Economic Outlook: Franchise Business Intelligence" (*International Franchise Association*, 2022), <https://www.franchise.org/sites/default/files/2022-02/2022%20Franchising%20Economic%20Outlook.pdf>.

<sup>93</sup> Emerson and Meiselles, "U.S. Franchise Regulation as a Paradigm for the European Union," 751.

<sup>94</sup> Münch, Duisberg, et al., "The Franchise Law Review: Germany." <https://thelawreviews.co.uk/title/the-franchise-law-review/germany>.

for income tax purposes. In addition to corporation tax and the solidarity surcharge, trade tax is also payable by franchisees.<sup>95</sup>

In Belgium, corporate tax exists at a rate of 33.99 percent on net profit. Belgium offers a broad range of double tax treaties and domestic exemptions allowing the setting of tax-efficient franchising structures. Reduced rates can apply to small and medium-sized enterprises.

Italian income tax rates for residents and non-residents range from 23 percent to 43 percent plus an additional regional tax of between 0.8 to 3.33 percent, furthermore, an additional municipal tax could be due; the tax rates range from 0 to 0.9 percent depending on the municipality.<sup>96</sup> In cases of cross-border franchising, according to domestic law, royalties due to a non-resident franchisor are relevant for tax purposes in Italy and a withholding tax of 30 percent is applied to the amount of royalties paid by the franchisee; however, a double-taxation treaty between Italy and a third country may entitle the franchisor to a lower withholding tax. When cross-border franchising, the reverse-charge mechanism for value-added tax should be applied by the franchisee both for entry fees and royalties.<sup>97</sup>

The rapid development of the franchise network in Eastern Europe is due to the flexibility of tax policy. For instance, in Hungary, the corporate rate tax is 9 percent of the positive tax base. Value-added tax rates are 27 percent. The specificity of Hungarian law is a flexible tax system with policies that support the franchise business environment, with franchise agreements detailed in civil and other legislation. Hence, its legal environment can be concluded as a decent environment for investment.

The standard Polish withholding tax rate due on franchise fees and dividends is 20 percent. If a double-taxation agreement applies, both franchise fees and dividends payable to foreign entities are subject to tax established thereunder. The Polish franchisee is a remitter of withholding tax in Poland and remains liable for payment of amounts due to the tax office.<sup>98</sup>

Franchisors will generally be responsible for US federal income tax on income earned in the United States and for withholding and payroll taxes for their US employees. Franchisors will also be responsible for state income taxes to the extent that they conduct business in the 40 or more US states that impose such taxes. The 2017 Tax Cuts and Jobs Act significantly reduced corporate tax rates, which went from graduated rates, ranging from 15 percent to 35 percent, to what is now a flat rate of 21 percent. State corporate income marginal taxes generally range from 3 to 12 percent. The franchisee pays the franchisor a fee of at least 615 dollars.<sup>99</sup>

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<sup>95</sup> Ibid.

<sup>96</sup> Italian Tax Code. Amendment.

<sup>97</sup> Ricciardi, "The Franchise Law Review: Italy".

<sup>98</sup> Ruiz, "The Franchise Law Review: Poland".

<sup>99</sup> Disclosure requirements and prohibitions concerning franchising. 15 U.S.C, 72FR 15444. Section 436.8.a.(1).

As far as the Canadian general corporate tax rate on business income is concerned, the net tax rate after the general tax reduction is 15 percent. For Canadian-controlled private corporations' eligible for small business deduction, the net tax rate is 9 percent. Franchising is responsible for 5 percent of Canada's GDP.

In the UK, the standard rate of value-added tax increased to 20 percent. As previously announced and enacted in the Finance Act 2021, the rate of the corporation tax will remain at 19 percent for 2022/23, but there will then be an increase to 25 percent from April 2023 applying to profits over £250,000.

Before starting or continuing to pay the business tax<sup>100</sup>, an initial capital investment fee, payment for goods or services, a fee based on a percentage of gross or net income; or a training fee or training school fee should be agreed upon. All companies are subject to a federal tax rate of 30 percent on their taxable income, except for 'small or medium business' companies, which are subject to a reduced tax rate of 25 percent. The standard value-added tax rate in Australia is a goods and services tax of 10 percent. Franchise royalties are often calculated as a function of sales, they are typically 5-6 percent but can be as high as 15 percent. Some franchisors charge a fixed fee irrespective of sales levels.

In China, the corporate income tax standard tax rate is 25 percent. The rate of value-added tax is 13 percent. In Japan, corporate and medium-sized enterprises' income tax is 21 to 29 percent. Value-added tax is 10 percent. In Singapore, the prevailing withholding tax rate is 10 percent and can be varied depending on the mutual deferred tax asset.

An investor shall have a right to seek tax and non-tax support in order to support investment. If investors fulfilled tax payment obligations, they shall have a right to transfer assets and revenues out of Mongolia, including license fees for use of their intellectual property rights and service charges.<sup>101</sup> The tax rate is 10-25 percent depending on the amount of income. In addition, there is a 5 percent tax for the sale of intellectual property rights. Value-added tax at the rate of 10 percent is imposed on the supply of goods, services, and works imported, exported, and sold in the country. The fees shall be imposed on income from royalties including the fee for the use and the right to the use of copyrighted works in accordance with the Law on copyright and related rights.

"Ensuring that franchise agreements can be legally enforced in the relevant jurisdictions is part of the solution, but establishing creative and practical methods of controlling international franchisees can be equally important. Franchising internationally can require more strategic and creative thinking and flexibility than franchising domestically. Franchisors cannot assume that they can simply transplant their domestic franchises overseas and manage them as they would at home. The tyranny of distance, time zones, cultural differences, market differences, unfamiliar business environments, and fewer opportunities to communicate combine to magnify the difficulty for the franchisor.

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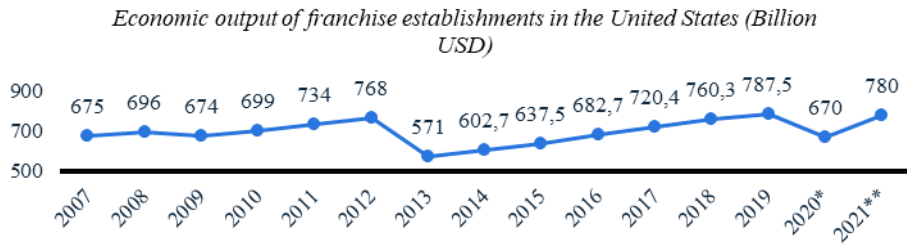
<sup>100</sup> Income Tax Assessment Act, N38. Franchise Fees Windfall Tax Act, N132.

<sup>101</sup> Law on Investment, MGL. 4.4.

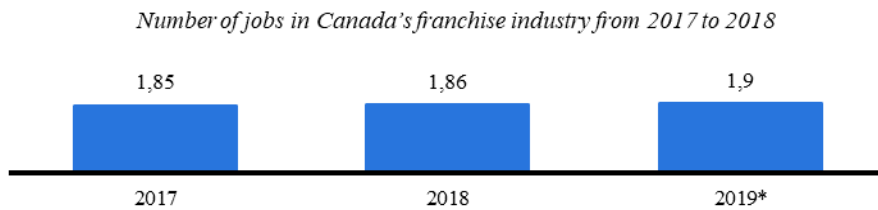
## Comparative Legal and Economic Analysis of Franchising

Franchisors should invest significant time and resources in investigating new markets, even if they locate a local master franchisee, area developer, or joint venture partner who will be primarily responsible for local compliance issues.”<sup>102</sup>

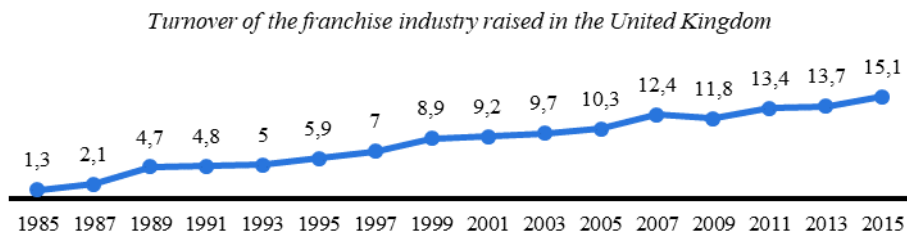
Investment, taxation, innovation, and long-term legal policies have a direct impact on franchise development. The positive impact or steady growth (sometimes U-turn) of franchise on the economic expansion of some countries can be seen in the following few charts.



(Source: <https://www.statista.com/statistics/190318/economic-output-of-the-us-franchise-sector>)



(Source: <https://www.statista.com/statistics/953160/franchise-related-employment-canada>)

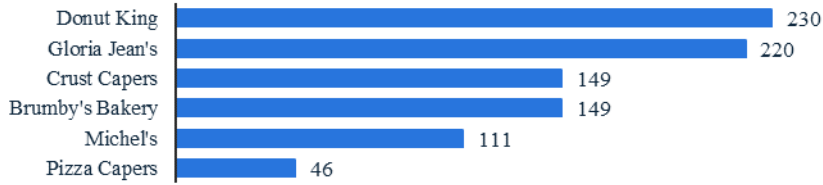


(Source: <https://www.statista.com/statistics/665673/franchise-industry-turnover-united-kingdom-uk>)

<sup>102</sup> Ned Levitt, Kendal Tyre, and Penny Ward, *Controlling Your International Franchising System* (San Diego: American Bar Association, 2010), 1, <https://www.dickinson-wright.com/-/media/documents/documents-linked-to-attorney-bios/levitt-ned/20the-impossible-dream.pdf?la=en&hash=A14886008FC10EF3BFDB3AA13E380D8E52383E2C>.

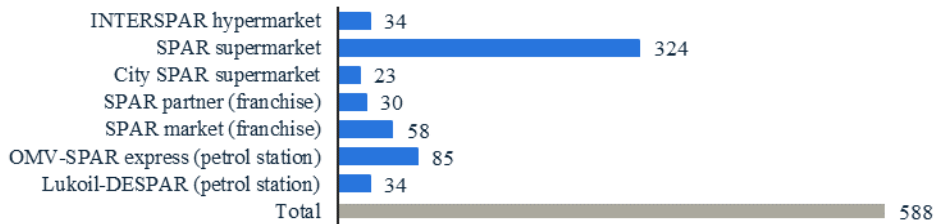
## NAMSRAI, BATTULGA

*Number of Retail Food Group franchises operating in Australia 2020*



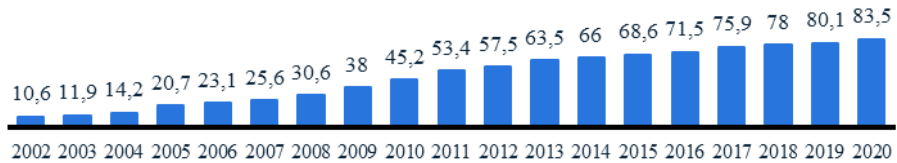
(Source: <https://www.statista.com/study/101203/restaurant-and-food-service-in-australia>)

*Number of 'Spar' stores in Hungary 2020*



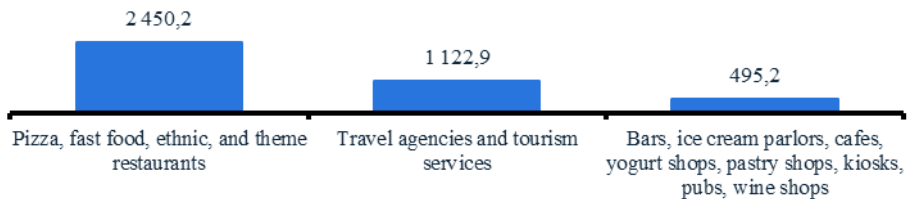
(Source: <https://www.statista.com/statistics/1224865/hungary-number-of-spar-stores-by-type>)

*Number of franchised points in thousands (Poland)*



(Source: <https://www.statista.com/statistics/1202390/poland-number-of-franchise-points-on-the-market>)

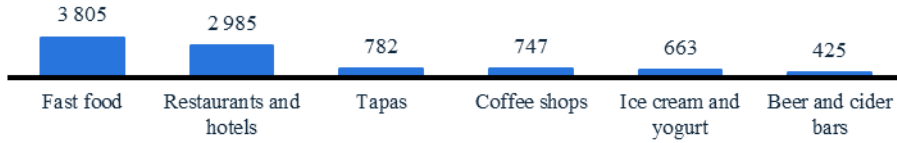
*Revenue of franchise chains in the tourism industry in Italy in 2020*



(Source: <https://www.statista.com/statistics/615224/franchised-stores-of-italian-fashioncompany-tods-by-brand>)

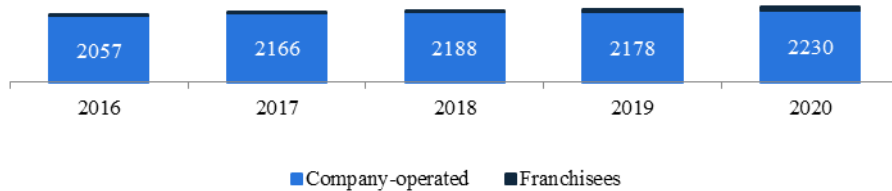
## Comparative Legal and Economic Analysis of Franchising

*A number of franchised hospitality industry in Spain in 2019*



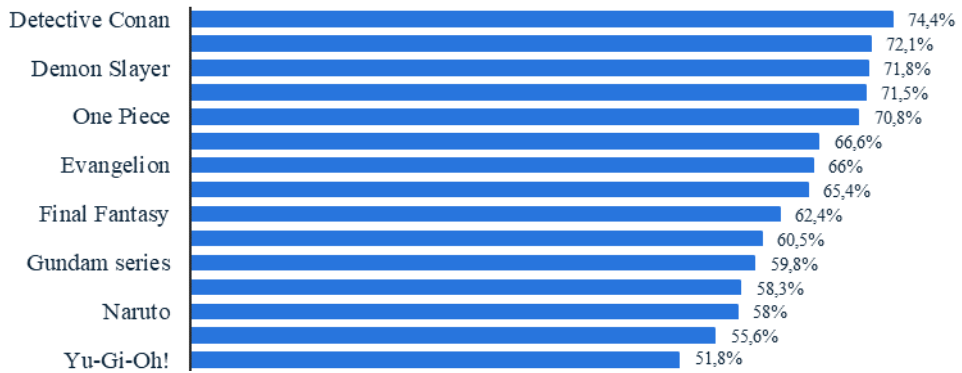
(Source: <https://www.statista.com/study/87689/food-service-spain>)

*Number of 'Pizza Hut' restaurants in China from 2016 to 2020, by mode of operation.*



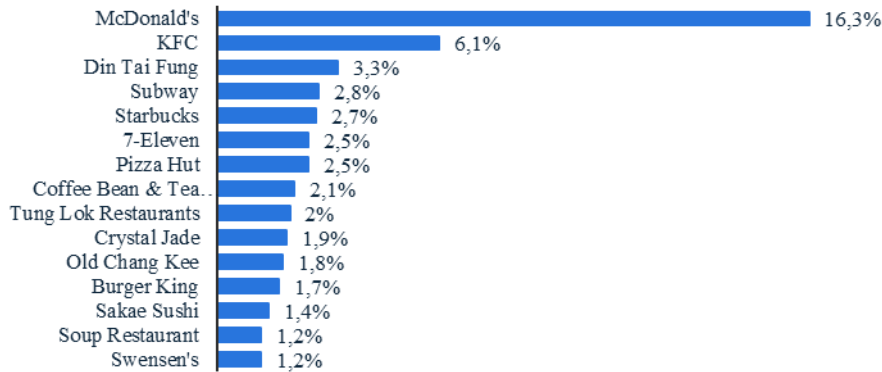
(Source: <https://www.statista.com/statistics/1005007/china-pizza-hut-restaurant-number-by-operation-mode>)

*Most recognized manga, anime, and video game franchises in Japan as of 2021*



(Source: <https://www.statista.com/statistics/1276143/japan-most-recognized-manga-anime-video-game-franchises>)

*Chained foodservice market share in Singapore in 2016*



(Source: <https://www.statista.com/statistics/724478/chained-foodservice-market-share-in-singapore-by-brand>)

## 6. Conclusion

Franchising is a business model and a legal object of contract that is important for re-selling intellectual property, industrial technology, and well-known products, and services, thus balancing supply and demand in the economy.

Contract law, intellectual property, tax, investment, competition, and consumer protection rules of countries are integrated through the exchange of experiences.

As intangible assets are an inexhaustible resource compared to tangible assets, this type of business environment will continue to expand at the national, regional, and international levels and will be a pillar of sustainable development. Statistical figures confirm this in the economic barometer. On the other hand, the legal challenges of running a franchise have not diminished. For instance, the number of cross-border litigations and franchise cases have doubled within the last 5 years in the world.

Legislative reforms in franchise are expected to continue in the broader areas of technology franchising, the regulation of large franchise networks in the region, unified intellectual property registration, inquiries, and monopoly regulation in economic blocs.