

TOWARD AN EGYPTIAN FRANCHISING LAW BASED ON A COMPARATIVE STUDY
OF THE LAWS OF THE UNITED STATES, CHINA, AND MALAYSIA

By

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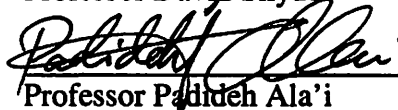
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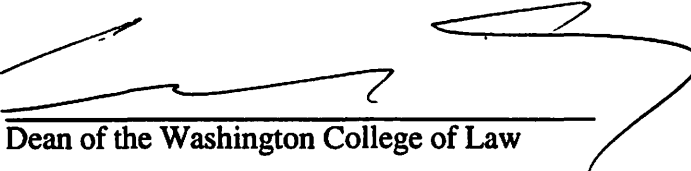
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DEDICATION

I dedicate this work to the memory of the blessed souls of the
Egyptian martyrs of the January Revolution...

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ABSTRACT

With the largest population in the Arab Middle East and serving as a midway point between Europe and East Asia at the center of the Middle East, Egypt offers one of the biggest sources of franchising markets in the world with new business opportunities. Egypt, however, does not have a specialized law regulating franchising which results in real challenges for investors seeking to franchise their businesses in Egypt, their legal advisors, and the courts deciding disputes arising from franchising transactions.

The result of this lack of franchising laws in Egypt is that other laws have a substantial impact on franchising. Examples include contract, commercial, and agency laws. The outcome is that various laws and regulations apply to franchise transactions that contradict the very specific nature of franchising and make it difficult to negotiate and decide various issues arising from franchise agreements. Also, the application of such a variety of laws imposes heavy burdens on franchising parties.

Time could not be better to discuss having a franchising law in Egypt. Legal reform is highly needed to recover from the economic impact of the January Revolution and to improve the chances for foreign investment.

This dissertation examines franchising laws in countries that work as guidance to Egypt in establishing a new franchising law. The American franchise law was chosen as a representative example of the common law system, the Chinese franchise law as an example of

the civil law system, and the Malaysian law as an example of the Islamic legal system. They will be compared and discussed in order to arrive at a proposed model for Egypt.

This dissertation concludes that a comprehensive Egyptian franchise law proposal should address various issues that are usually dealt with through franchise laws around the globe such as disclosure commitments, registration requirements, and substantive rights and obligations of the parties.

The model law recommended by the dissertation is a combination of the laws of the three examined legal systems. Being a civil law country should not prevent Egypt from following other franchising systems as long as those rules meet the Egyptian franchising legal market's requirements. Also, the fact that Islamic law is the main source of law in Egypt may not weigh so heavily when drafting a franchising law in Egypt as it turns out that Islamic law does not really affect franchise rules.

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OVERVIEW

Franchising is a dynamic tool that can be used to develop a country's investment opportunities as franchising encompasses almost all industrial sectors in both goods and services.¹ It can be found in automotive products and services, computer sales, construction and maintenance, legal services, fast food, and other industries.² At the outset, it may be appropriate to briefly introduce franchising as a business tool in which a business owner, called the franchisor, allows another person, the franchisee, to trade in his goods or services in conformity with the franchisor's business plan and using his trademark.³

Franchising helps a franchisor expand its business rapidly through a well-organized distribution system.⁴ Franchising can also be an alternative to traditional methods of raising capital such as bank loans.⁵ From the franchisee's perspective, franchising allows a franchisee to use a familiar or well-known trademark and to avoid having to spend large amounts of money on advertising and promotions.⁶ Similarly, it allows a franchisee to become part of a successful

¹ Michael G. Brennan, *Franchising and Licensing: Their Relevance to Corporate Counsel*, 2000 BUS. L. INT'L 222, 223 (2000).

² Francine Lafontaine & Roger D. Blair, *The Evolution of Franchising and Franchise Contracts: Evidence from the United States*, 3 ENTREPRENEURIAL BUS. L.J. 381, 387 (2009).

³ Brennan, *supra* note 1, at 223.

⁴ ANDREW C. SELDEN, ROBIN CANEFF GIPSON & AMANDA B. PARKER, AN INTRODUCTION TO FRANCHISING 48 (3d ed. 2008).

⁵ *Id.* at 3.

⁶ ROBERT T. JUSTIS & RICHARD J. JUDO, FRANCHISING 2-3 (Robert LaManna ed., 3d ed. 2003).

business chain already mastered by the franchisor⁷ and to receive the technical assistance necessary to efficiently operate the franchised business such as guidance on store layout, design, and site selection.⁸ Franchising, moreover, as a method of distribution, requires less capital investment than other methods like joint ventures.⁹ Franchising also allows franchisees to invest in additional retail outlets in various foreign markets using the goodwill and brand of the franchisor.¹⁰

This dissertation focuses on franchising in Egypt, a country rich with natural resources and competitively-priced labor that facilitates franchising.¹¹ Its position in the center of the Middle East makes Egypt a connection point to the Middle Eastern markets, enhancing its attractiveness to franchisors.¹² The Egyptian fast food chain Mo'men, for example, has three outlets in Libya, two in Sudan, two in Djibouti, and one in the United Arab Emirates.¹³ Similarly, Cookdoor has outlets in Libya, Algeria, and Syria.¹⁴ The large Egyptian population requires the convenient services that franchising can provide across all sectors.¹⁵ There currently exists a high demand for top brands in fashion, technology, and the like, all of which may be provided by

⁷ SELDEN, GIPSON & PARKER, *supra* note 4, at 50.

⁸ JUSTIS & JUDO, *supra* note 6, at 2-3.

⁹ *Id.* at 2-4.

¹⁰ SELDEN, GIPSON & PARKER, *supra* note 4, at 3.

¹¹ Hussein Aboul Fath, *Franchising Your Concept in Egypt*, INT'L FRANCHISE ASSOC. (Apr. 2007), <http://www.franchise.org/franchise-news-detail.aspx?id=33656>.

¹² *Id.*

¹³ *Id.*

¹⁴ J. Perry Maisonneuve, *Franchising in the Middle East: Business Perspective*, in *FRANCHISING IN THE MIDDLE EAST: NAVIGATING THE RISKS AND REWARDS OF THE WORLD'S MOST INTERESTED MARKET 10* (The American Bar Association ABA Forum on Franchising and the ABA Center for Continuing Legal Education ed., 2010).

¹⁵ Fath, *supra* note 11.

franchises.¹⁶ As a result, franchising in Egypt is an emerging market.¹⁷ Cairo, Egypt's capital and largest city, is the location of 65% of Egyptian franchised outlets.¹⁸ Another 8.6% are found in Alexandria, the second largest city.¹⁹

According to the most recently available statistics on franchising in Egypt, from the end of 2002 until 2004 the total number of franchised outlets within the country grew 14%.²⁰ In 2004 alone, the amount invested in the Egyptian franchise sector was estimated to be nearly twenty-two billion Egyptian Pounds.²¹ Approximately forty international franchisors have outlets in Egypt, twenty-five of them being in the food sector.²² Foreign franchisors include Chili's, Hard Rock Café, KFC, McDonald's, Pizza Hut, Baskin Robbins, Caravel Ice Cream, and Ruby Tuesday.²³ Other franchising sectors like home appliances and clothing are rapidly spreading in Egypt.²⁴ Riva, a French fashion company, has declared that it will expand in Egypt.²⁵ In 2006, SAS-Egypt, an Egyptian franchisor, bought the rights to the La Senza and Esprit brands in

¹⁶ *Id.*

¹⁷ *Maisonneuve, supra* note 14, at 16.

¹⁸ *Id.*

¹⁹ MARKETEERS-EGYPT, FRANCHISING CENSUS EGYPT 2004 (2004), <http://www.pdfking.net/Franchising-Census-Egypt-2004--PPT.html#> (powerpoint presentation summarizing report commissioned by SFD-SEDO, Franchise Department).

²⁰ *Id.*

²¹ *Id.*

²² Kendal Tyre, *Franchise Law Alert: Franchising Sector in Egypt Receives Financial Boost*, NIXON PEABODY (June 29, 2009), available at http://lexnoir.org/pdfs/forums/franchise/Franchise_Alert_06_29_09.pdf.

²³ U.S. COMMERCIAL SERVICE, U.S. DEPT. OF COMM., DOING BUSINESS IN EGYPT: 2010 COUNTRY COMMERCIAL GUIDE FOR U.S. COMPANIES (2010), http://www.franchise.org/uploadedFiles/Franchise_Industry/International_Development/Country_Profiles/Egypt_2010%20CCG.pdf [hereinafter DOING BUSINESS IN EGYPT].

²⁴ *Bright Franchising Future*, OXFORD BUS. GROUP (Feb. 23, 2007), http://www.oxfordbusinessgroup.com/economic_updates/bright-franchising-future.

²⁵ *Id.*

Egypt.²⁶ The Swedish company Ikea is an example of franchising in home furnishings in Egypt.²⁷

In summary, franchising in Egypt is an important investment methodology that significantly contributes to the Egyptian Gross Domestic Product (“GDP”). It helps to speed up Egyptian economic growth and trade, enables better planning, and promotes foreign investment in Egypt.

Significance of the Study

Generally speaking, a lack of laws specifically governing franchising in Egypt has left it to be regulated by a hodgepodge of other laws such as those governing intellectual property, tax, insurance, and labor.²⁸ The application of such a variety of laws and regulations contradicts the very specific nature of franchising transactions, which require strong protections for both parties, particularly with the fast growth of technology and the complexity of international licensing.

Franchising parties, furthermore, generally prefer their agreements to be governed by a simple and comprehensive law rather than different laws, the application of which makes it complicated to negotiate and decide various issues arising from an agreement. This is particularly relevant in a civil law country, like Egypt, where courts are more dependent on written statutes. A franchise law would work as a reference point for Egyptian courts in deciding

²⁶ *Id.*

²⁷ *Id.*

²⁸ Michael K. Lindsey, *Introduction to Franchising in the Middle East: Navigating the Risks and Rewards of the World's Most Interested Market*, in *FRANCHISING IN THE MIDDLE EAST: NAVIGATING THE RISKS AND REWARDS OF THE WORLD'S MOST INTERESTING MARKET* 15 (The American Bar Association ABA Forum on Franchising and the ABA Center for Continuing Legal Education ed., 2010).

disputes. It is not acceptable for a country like Egypt to lack a specialized law to regulate the growing business of franchising.

Though Egypt has witnessed remarkable economic growth in the last decade, most Egyptians have not felt the effects of this growth.²⁹ The public and private corruption of government officials and businessmen has resulted in the concentration of most investment tools in the hands of a tiny elite.³⁰ This unfair distribution of wealth contributed to the January Revolution in 2011 (“January Revolution”) which led to much economic and political chaos and rattled the national stock exchange, shaking investor confidence in the Egyptian market.³¹ After

²⁹ CREDIT AGRICOLE BANK, EMERGING MARKET FOCUS: THE POINT OF NO RETURN, EGYPT’S UNCERTAIN POLITICAL FUTURE, THE ECONOMY AND THE ARMY (Feb. 4, 2011), www.alfransi.com.sa/en/general/download/file/1027.

³⁰ *Id.*

³¹ The Egyptian Revolution that took place on January 25, 2011, called for changing the governing regime, democracy, justice, protecting human dignity, and applying the rule of law equally to all citizens. Many reasons stand behind the eruption of this Revolution, the most important was the decline of economic growth due to the corruption of public officials and businessmen, who were frequently motivated by politics and monopolized most investment tools. *See id.*

Another major reason was the denial of human rights and restrictions on public freedoms such as freedom of speech, and participation in public life. For instance, police abuses continued for more than two and a half decades, the ruling period of the past massive regime. *See* HUM. RTS. WATCH, WORK ON HIM UNTIL HE CONFESSES: IMPUNITY FOR TORTURE IN EGYPT (2011), <http://www.hrw.org/reports/2011/01/30/work-him-until-he-confesses-0>.

Police used to suppress social freedoms, practice torture, construct detention camps, commit security abuse, and destroy institutions in a clear violation of the basic human rights of Egyptian nationals. These harms also emphasize the state of emergency Egypt has been in for the past 30 years. Additionally, the economic corruption was the cause of wasting several development opportunities in Egypt during those years. In fact, both Egyptian and international human rights organizations have reported such police abuses occurring in Egypt, not to mention similar reports by foreign governments and the United Nations. Actually, one of the occasions that resulted in the Revolution was a famous accident about the murder of a young man by the police on June 7th, 2010, named Khalid Sa’id who was beaten to death by police forces in an internet café in Alexandria. This led some Egyptian youth to establish a Facebook group named “We are all Khalid Sa’id”, which soon gathered hundred thousand members. They formed discussion groups and moved from demanding justice for their friend to protesting emergency law, repression, corruption, and unemployment. In short, they decided to take their destiny in their own hands and to go for real change. Also, the fact that President Mubarak had been in power for thirty years to the extent that the Egyptian Constitution was amended in a way that gives him the ability to monopolize the country and to his son, Gamal Mubarak, to be groomed to follow him. The real challenge started when Dr. Mohammad El-Barad’ei a Nobel prize winner, went back to Egypt and challenged Mubarak’s leadership of the country and asked to amend the constitutional articles that were drafted in a way that give Mubarak the ability to monopolize the country. *See* JEREMY M. SHARP, CONG. RESEARCH SERV., RL 33003, EGYPT: THE JANUARY 25 REVOLUTION AND IMPLICATIONS FOR U.S. FOREIGN POLICY 1 (2011). For the entire story about the Heir Apparency of Gamal Mubarak *see* Jason Brownlee, *The Heir Apparency of Gamal Mubarak*, ARAB STUD. J., Fall 2007/Spring 2008, at 36; *see also* Daniel Sobelman, *Gamal Mubarak, President of Egypt?*, MIDDLE EAST Q., Spring 2001, at 31–40 (2001)

the January Revolution, Egypt suffered large losses in the production and services sectors;³² the loss is estimated to be between fifty-five million and one hundred million Egyptian pounds.³³ International companies working in Egypt were closed after sending their employees back to their home countries. Banks were closed for several days. As a result, the Egyptian National GDP is expected to decline from 5.1% in 2010 to 1.7% by the end of 2012.³⁴ Industrial production is expected to decline from 5.1% to 2% in the same time period.³⁵ The exchange rate between Egyptian pounds and American dollars is expected to go from 5.81 pounds to the dollar to 6.47.³⁶ Likewise, inflation is expected to go from an annual rate of 10.8% to 14.5%.³⁷

The challenge in Egypt is how best to provide economic and legal policies to help reverse the economic downturn. Aside from tackling social, governmental, and institutional policies, investment requires substantial attention. Also, legal reform is necessary to restore the private sector's confidence in the Egyptian market and particularly to lure back those foreign investors that fled. In the same context, reforming economic, commercial, and financial laws will help boost the Egyptian economy and shorten the economic recovery period. Accordingly, Egyptian laws in general, and franchising law in particular, need to be reconsidered to boost the recovery of the post-January Revolution economy and to offer greater security to foreign investors.³⁸

³² *Egyptian Economic Losses on the Rise*, ALBAWABA (Feb. 10, 2011, 10:50 GMT), <http://www1.albawaba.com/main-headlines/egypt-economic-losses-rise>.

³³ *Id.*

³⁴ GLOBAL INSIGHT, COUNTRY INTELLIGENCE REPORT: EGYPT (Feb. 20, 2011), *available at* <http://myinsight.ihsglobalinsight.com/servlet/cats?filterID=1147&serviceID=4078&typeID=15431&pageContent=report&pageType=ALL> (subscription required) (copy on file with author) [hereinafter GLOBAL INSIGHT EGYPT].

³⁵ *Id.*

³⁶ *Id.*

³⁷ *Id.*

³⁸ *Id.*

Rationale of the Study

This dissertation will analyze existing franchising legal systems in selected countries to arrive at a model franchising law, including a legislative drafting project that would work in Egypt. The American, Chinese, and Malaysian franchise laws will be compared and discussed to arrive at a proposed model for Egypt. The American franchise law was chosen as a representative example of the common law system in a highly developed market. Moreover, the Chinese franchise law represents an example of the civil law system in a robust but still emerging market. In addition, the Malaysian law is as an example for an Islamic legal system. Thus, while pursuing this study, the potential effect of Islamic law on the Egyptian legal system in general and franchising in particular should be considered. That is particularly relevant knowing that there is a possibility of incorporating Islamic law into the Egyptian legal system since the parliamentary elections in Egypt resulted in having Islamic groups dominating the Egyptian parliament.

Comprehensive franchising laws around the world usually regulate three areas: pre-sale disclosure, registration of franchise offers, and regulation of the relationship between the contracting parties.³⁹ Disclosure laws mandate that franchisors disclose to potential franchisees any information that can be expected to affect the franchisees' decision whether to enter into franchise transactions.⁴⁰ Disclosure laws are the most common among countries regulating

³⁹ See Pamela J. Mills, *Franchising Around the Globe, Relationship, Definition and Regulation*, in GOING INTERNATIONAL: FUNDAMENTALS OF INTERNATIONAL BUSINESS TRANSACTIONS (American Law Institute and the American Bar Association ABA Committee on Continuing Professional Education eds., 2005).

franchising. Approximately thirty countries have specialized franchising laws and of those, nineteen have only disclosure laws.⁴¹

Registration laws are not usually found independent from disclosure laws.⁴² Thus, registration rules usually require franchisors to file with a competent government registration authority, their disclosure documents as well as information on their intellectual property and sometimes documents related to their consultants and brokers, before making franchise sale offers.⁴³ Registration is usually required for authentication purposes.

Finally, few countries have franchisor-franchisee relationship laws. Relationship laws usually regulate the performance of the franchise relationship after a franchise agreement has been finalized.⁴⁴ Relationship laws elaborate on issues such as the rights and obligations of the franchising parties, renewal and transfer of a franchise agreement, good faith performance of the agreement, and the methods available for settling disputes arising out of the performance of a franchise agreement.⁴⁵ The focus of most relationship laws is termination.

To be complete and comprehensive, the proposed Egyptian franchise law must address all of these issues. It needs to clearly define what a franchise is and provide an inclusive explanation of franchise elements. It should also distinguish franchising from other forms of business with features similar to franchising, particularly because franchising transactions in Egypt are often confused with other forms of business such as agency, transfer of technology, and others. This is largely because these types of transactions have common features to

⁴¹ ELIZABETH CRAWFORD SPENCER, *THE REGULATION OF FRANCHISING IN THE NEW GLOBAL ECONOMY* 227 (2010).

⁴² *Id.*

⁴³ *Id.* at 248.

⁴⁴ *Id.* at 263.

⁴⁵ *Id.*

franchising but they are sufficiently different that each type of legal relationship would benefit from a purpose-made and appropriately tailored set of laws.

Having disclosure rules is necessary in order to give franchisees comprehensive information necessary to decide upon franchise opportunities.⁴⁶ Disclosure rules will also guarantee a minimum level of transparency, particularly in a country like Egypt with a large number of small investors as franchisees. Likewise, regulating all issues related to the relationship between the franchising parties, such as fulfillment of obligations arising out of franchise agreements, protection of intellectual property and confidential know-how, and termination of agreements will help protect both franchising parties. Significantly, improved regulations will reduce the number of disputes arising out of franchising agreements in countries like Egypt where deciding disputes can take a long time. A comprehensive franchising law will also protect small investors who may be subject higher levels of risk when entering into franchise agreements drafted with terms and conditions that may unfairly advantage franchisors.⁴⁷

Finally, the Egyptian law should adopt rules that will make franchising investments more attractive to foreign franchisors, such as removing procedural barriers for foreign franchisors. Attracting foreign investment to Egypt is greatly needed, particularly after the economic downfall following the January Revolution.

Part I of this dissertation will define and explore the main issues regarding franchising from not only a legal perspective but also from a practical perspective that emphasizes business dynamics. These issues include the key definitions and elements of a franchise and the most

⁴⁶ William L. Killion, *The Modern Myth of the Vulnerable Franchisee: The Case for a More Balanced View of the Franchisor-Franchisee Relationship*, 28 *FRANCHISE L.J.* 23, 29 (2008).

⁴⁷ Peter C. Lagarias & Robert S. Boulter, *The Modern Reality of the Controlling Franchisor: The Case for More not Less, Franchise Protections*, 29 *FRANCHISE L.J.* 139, 144 (2010).

important interests that a party may be concerned with, such as fees and duration of a franchise agreement.

Part II will then give a general overview of the economic, social, and cultural background necessary to understand Egyptian market dynamics and the main factors that commonly affect investment and which affect the franchising industry in particular. It will analyze and evaluate the current legal situation of franchising under Egyptian law and will examine how the Egyptian legal system treats issues similar to franchising, such as agency and technology transfers.

Part III follows with an examination of the comparative strengths and weaknesses of the American franchise law as an example of a common law system, the Chinese franchise law as an example of a civil law system, and the Malaysian law as an example of an Islamic law system.

Part IV will apply the preceding analysis in the Egyptian context. This will lead to a discussion of a model for legislation that would work in Egypt accompanied by a draft legislative text. Finally, the proposed model law will be attached as an appendix.

CHAPTER I

AN ANALYSIS OF THE BASIC CONCEPTS OF FRANCHISING

Introduction

To discuss franchising, an explanation of the underlying basic legal, commercial, and contextual issues is necessary. Section 1 of this Chapter discusses the definition and elements of, reasons for, subject matter of, and legal nature of franchising and distinguishes it from other business forms. Section 2 then explains some important factual and financial considerations for franchisors and franchisees, such as acquiring an understanding of the financial aspects of franchising, having a professional business plan, conducting proper market analysis, considering pilot operations before starting a franchise, and understanding what a franchise package entails and means. Finally, Section 3 elaborates on the legal aspects of franchising common in the franchising industries in different legal systems. This Section demonstrates that there are common features of laws governing franchising in different legal systems and common provisions that must be met in a franchise agreement such as those related to granted rights, intellectual property, confidentiality, know-how, and exclusivity.

1. Definition and Elements of Franchising

This Section explains franchising from a commercial perspective. It discusses what the subject matter of a franchise transaction can appropriately be and the features driving the rapid growth of franchising. It also considers whether the franchisor-franchisee relationship is a fiduciary relationship. Scholarly perspectives differ on the existence of a fiduciary relationship due to the complicated nature of franchising transactions that include a variety of granted rights such as intellectual property, manufacturing and distribution, and representation of franchisors'

from the perspective of franchisees is of special importance. That is because franchise agreements are on occasion accused of being concluded between large corporate franchisors and individual franchisees that lack bargaining power. The definition of good faith in a franchise relationship is of special importance to this discussion. An implied covenant of good faith may give rise to rights and obligations not explicitly provided by the franchise agreement. Finally, a distinction is made between franchising and other business forms like licensing, distribution, agency, employment, and sales representation.

1.1 Definition

Although business specialists and economists primarily consider franchising a method of doing business, most legal scholars who define franchising concentrate on the idea of contractual rights granted by one of the parties to the other.⁴⁸ From a commercial perspective, franchising is considered to be a business tool, rather than a branch of the business economy, through which one investor (the franchisor) allows another investor (the franchisee) to trade in his goods or services in conformity with the franchisor's business scheme, and using the franchisor's trademark.⁴⁹

To be more specific, according to the International Franchise Association ("IFA"),⁵⁰ franchising is a distribution methodology by which the franchisor grants the franchisee the right to deal under the franchisor's own trademark or trade name, and following his business plan, in

⁴⁸ Brennan, *supra* note 1, at 223.

⁴⁹ *Id.*

⁵⁰ The International Franchise Association was founded in 1960 to promote the franchising industry on an international basis with 95% of American companies as members. Bryan Schwartz & Leandro Zylberman, *International Franchise Regulation*, 8 ASPER REV. INT'L BUS. & TRADE L. 317, 329 (2008).

return for agreed fees.⁵¹ Similarly, the European Franchise Federation (“EFF”)⁵² considers franchising a marketing tool that allows the franchisee to use the franchisor’s business “know-how” in addition to the trade name, trademark, or service mark, business plan, procedural scheme, or commercial techniques.⁵³ In the same context, the European Commission (“EC”) regulation defines franchising as a combination of intellectual property rights, covering trademarks, designs, copyright, and other manufacturing rights such as trade secrets and patents.⁵⁴

The U.S. Federal Trade Commission (“FTC”) defines a franchise as an ongoing commercial relationship by which a franchisee is licensed to run a business under a franchisor’s trademark where the franchisee puts for sale goods or services that are offered under the franchisor’s trademark.⁵⁵ The franchisee runs such a business under the control and with the

⁵¹ *Frequently Asked Questions About Franchising: Answers to the 19 Most Commonly Asked Questions About Franchising*, INT’L FRANCHISE ASS’N, <http://www.franchise.org/franchiseessecondary.aspx?id=10008> (last visited Feb. 22, 2012).

⁵² The European Franchise Federation was founded in 1972 with the goal of introducing and supporting franchising, particularly ethical franchising, to different parties like European institutions and general public through its 1972 Code of Ethics to which all of its members are committed. Schwartz & Zylberman, *supra* note 50, at 318.

⁵³ EUR. FRANCHISE FED., EUROPEAN CODE OF ETHICS FOR FRANCHISING, *available at* <http://www.eff-franchise.com/spip.php?rubrique13> (last visited Feb. 22, 2012); *see* discussion *infra* Sec. (3.3) [hereinafter EUR. CODE OF ETHICS].

⁵⁴ MARTIN MENDELSON ET AL., FRANCHISING LAW 10 (Martin Mendelsohn, ed., Richmond Law & Tax, 2d ed. 2004) [hereinafter MENDELSON, FRANCHISING LAW] (citing the EC Commission Reg. No. 4087/88 on the application of Article 85(3) of the Treaty { which treaty? } that was superseded by a Block Exemption Regulation for Vertical Agreements that came into force on 1 June 2000). According to the U.S. Code of Federal Regulations, a

Franchise means any continuing commercial relationship or arrangement, whatever it may be called, in which the terms of the offer or contract specify, or the franchise seller promises or represents, orally or in writing, that:

(1) The franchisee will obtain the right to operate a business that is identified or associated with the franchisor’s trademark, or to offer, sell, or distribute goods, services, or commodities that are identified or associated with the franchisor’s trademark.

16 C.F.R. § 436.1 (h)(1). Furthermore, the Code of Federal Regulations defines franchisee as follows:

(i) Franchisee means any person who is granted a franchise.

(j) Franchise seller means a person that offers for sale, sells, or arranges for the sale of a franchise. It includes the franchisor and the franchisor’s employees, representatives, agents, sub-franchisors, and third-party brokers who are involved in franchise sales activities. It does not include existing

assistance of the franchisor and in return, the franchisee pays the franchisor an agreed upon amount of fees.⁵⁶ A court may well hold that an agreement is not a franchise if it does not involve the exchange of a fee for a right to sell goods or services under the franchisor's mark.⁵⁷

With regard to the assistance and control element, it includes any help, guidance or instructions given by the franchisor to the franchisee related to the management, operation and promotion of the franchised business which must relate to the franchisee's technique of operation of the franchise, rather than to the sale of goods or services.⁵⁸ Finally, the entire process of operating the franchised business should take place per the franchisor's instructions and according to the franchisor's business plan.⁵⁹

1.2 Subjects of Franchising

Franchising encompasses different industrial sectors dealing in both goods and services,⁶⁰ which include automotive products and services, computer sales, business aids and services,

franchisees who sell only their own outlet and who are otherwise not engaged in franchise sales on behalf of the franchisor.

(k) Franchisor means any person who grants a franchise and participates in the franchise relationship. Unless otherwise stated, it includes sub franchisors. For purposes of this definition, a "sub franchisor" means a person who functions as a franchisor by engaging in both pre-sale activities and post-sale performance.

§ 436.1(k).

⁵⁶ § 436.1(h)(2) ("The franchisor will exert or has authority to exert a significant degree of control over the franchisee's method of operation, or provide significant assistance in the franchisee's method of operation.").

⁵⁷ Jason J. Stover, C. Griffith Towle & David M. Byers, *Franchising (& Distribution) Currents*, 30 *FRANCHISE L.J.* 43, 51 (2010) (citing *BJB Electric, L.P., v. N. Cont. Enter., Inc.*, 14 F. Supp. 317 (N.D. Ill. 2010)).

⁵⁸ See Anthony J. Marks, *An Overview of U.S. Franchise Laws*, in *REPRESENTING THE GROWING BUSINESS, TAX, CORPORATE, SECURITIES, AND ACCOUNTING ISSUES* (American Law Institute and the American Bar Association ABA Committee on Continuing Professional Education eds., 2008); see also *infra* Section 3.8.3 (explaining further the importance of assistance and support).

⁵⁹ See Marks, *supra* note 58; see also *infra* Section 2.4 (providing a more in-depth analysis of the importance of business plans).

⁶⁰ Brennan, *supra* note 1, at 222.

construction and maintenance, fast food, and cars.⁶¹ According to the latest reports from the IFA and PricewaterhouseCoopers (“PwC”), the top ten lines of business in franchising are: automotive, commercial and residential servicers, quick service restaurants, full service restaurants, retail food, lodging, real estate, retail products and services, business services, and personal services.⁶² Indeed, franchising is the most successful method of expanding fast food restaurants, hotels, automobile dealerships, and gasoline service stations.⁶³

1.3 Types of Franchises

Franchises may be divided into three main categories with regard to their subject matter: business format franchises; product franchises; and business opportunities. The business format franchise, in which the franchisee adopts the entire business system of the franchisor, is the most

⁶¹ Lafontaine & Blair, *supra* note 2, at 387.

⁶² See generally PRICEWATERHOUSECOOPERS, 2010 FRANCHISE BUSINESS ECONOMIC OUTLOOK (Dec. 21, 2009), http://www.franchise.org/uploadedFiles/IFA_NEWS/EconOutlook%20FactSheet2010.pdf.

⁶³ Robert W. Emerson, *Franchise Encroachment*, 47 AM. BUS. L.J. 191, 200 (2010).

Goods franchising may take one of three forms: when the franchisee distributes the goods produced by the franchisor in the trademark or name of the franchisor; when the franchisee manufactures the goods himself according to a license agreement concluded with the franchisor; and when the franchisee deals in the goods that have the franchisor's trademark but do so in the franchisee's own trade name or trade dress. Examples include the situation where franchisee sells the franchisor's goods under the franchisor's trademark but using carry away bags with his own trademark or trade name. JOHN N. ADAMS ET AL., *FRANCHISING: PRACTICE AND PRECEDENTS IN BUSINESS FORMAT FRANCHISING* 19 (5th ed. 2006).

Genuine use guarantees the identity of the goods origin to the consumer or end user by enabling him without any possibility of confusion to distinguish the product from others that have a different origin. Dual-branding takes place by associating links between two or more products or services with famous trademarks or trade dress which allows a product to feed off the other's goodwill and public acceptance. Examples include lining snack chips by pairing it with Coca-Cola through tie-in sales or coupons. It also includes fast-food franchisors, such as Miami Subs Grill and Baskin Robbins, who operate together in the same facility to further receive the benefits of dual-branding. Dual-branding is criticized, however, because it may confuse consumers about the source of the product or service, particularly when the owner of a weak mark tries to make use of the goodwill of a famous one. It also damages the owner of a famous mark when its marks are associated with a negatively viewed product. To avoid such negative effects, the franchisee should make it clear to consumers that there is a difference between the trademark he uses for his own goods or the trade name he uses to sell the franchisor's products, and the franchisor's products sold under the franchisor's trademark. See also Donald R. Kirk, *Franchise Dual-Branding: The Irony of Association*, 10 DEPAUL BUS. L.J. 1, 11-15 (1997) (“In this case, allowing franchisees to use their own trademarks or trade names does not contradict the fact that the goods will be sold in the trademark of the franchisor as long as this complies with the idea of ‘genuine use.’”).

common form of franchising. Examples include McDonald's and KFC (formerly known as Kentucky Fried Chicken).⁶⁴

In a product distribution franchise the franchisee sells the franchisor's products with more freedom to choose business styles and distribution techniques and the franchisor exercises less control than in a business format franchise.⁶⁵ The primary example of a product distribution franchise is an automobile dealership.⁶⁶

Business opportunity laws regulate agreements in which a buyer purchases a business opportunity from a seller who provides products, services, or other supplies to enable the buyer to start a new business in return for certain fees.⁶⁷ Examples of business opportunity franchises include vending machines and arcade games.⁶⁸ In these arrangements, the seller makes representations to the buyer that the buyer will achieve a minimum level of income that will exceed the costs the buyer paid for the business opportunity⁶⁹ and the seller is required to provide the buyer with a scheme or plan to help him achieve the promised results.⁷⁰ Thus, the seller provides a refund or repurchase provision in the agreement that assures the seller will buy the business back if the buyer does not achieve the promised profits.⁷¹

⁶⁴ Manitoba Law Reform Comm'n, *Consultation Paper on Franchise Legislation*, 8 ASPER REV. INT'L BUS. & TRADE L. 181, 188-89 (2008).

⁶⁵ *Id.*

⁶⁶ *Id.*

⁶⁷ See generally James A. Ullman, *Not a Franchise? Do Business Opportunity Statutes Apply?*, GT ALERT (Mar. 2002), http://www2.gtlaw.com/pub/alerts/2002/ullmanj_03.pdf.

⁶⁸ Manitoba Law Reform Comm'n, *supra* note 64, at 189-190.

⁶⁹ *Id.*

⁷⁰ *Id.*

⁷¹ *Id.*

Technically speaking, business opportunity transactions are more like distributorship agreements than franchising agreements. The main concern of franchising is the use of the franchisor's trademarks, but in a business opportunity transaction sellers usually present deals allowing franchisees to start a new business with the seller's products but without the trademark.⁷² Many business opportunity laws, nevertheless, are intertwined with franchising laws as they are so broadly drafted to regulate deals to participate in business enterprises including franchising.⁷³ Thus, if a franchisor wishes to offer a franchise in a country that has business opportunity laws, he must find an exemption or exclusion from the business opportunity law or he will have to comply with that law as well as franchising laws.⁷⁴

Another category of franchise is based on the type of legal agreement concluded. These include unit franchises, area development franchises, master franchises, and joint venture franchises.⁷⁵ The unit franchise is the simplest and most popular form of franchise.⁷⁶ A unit franchise is an individual simple franchise transaction where the franchisor allows the franchisee to operate certain franchised outlets in a specific region.⁷⁷ A unit franchise is common with businesses requiring an operator such as restaurants and automotive services.⁷⁸ An extended form of the unit franchise is the area development franchise agreement where the franchisor

⁷² *Id.*

⁷³ Mark H. Miller, *Unintentional Franchising*, 36 ST. MARY'S L.J. 301, 343 (2005). In the United States, for example, both the FTC Rules and state laws regulate business opportunities. *Id.*

⁷⁴ *Id.*

⁷⁵ *See supra* Ch. I. 3.2 (discussing Franchising Methodologies).

⁷⁶ Manitoba Law Reform Comm'n, *supra* note 64, at 189.

⁷⁷ Stuart Hershman & Andrew A. Caffey, *Structuring a Unit Franchise Relationship*, in FUNDAMENTALS OF FRANCHISING 52-53 (Rupert M. Barkoff & Andrew C. Selden eds., 3d ed. 2008).

⁷⁸ *Id.*

licenses the franchisee to operate multiple outlets within a specific territory.⁷⁹ The area development agreement usually regulates the terms of the franchise expansion and the number of outlets to be established, while the details of the individual outlets are usually dealt with in a unit franchise agreement.⁸⁰

In master franchise agreements, the franchisor grants the franchisee the right to sub-franchise within a specific geographical area.⁸¹ In this case, two agreements exist: the master franchise agreement between the franchisor and the sub-franchisor, and the sub-franchise agreement between the sub-franchisor and each of the sub-franchisees.⁸² Finally, in a joint venture franchise, a franchisor and a franchisee enter into a joint venture agreement where the franchisor gives the franchisee a unit, area development, or master franchise.⁸³

1.4 Reasons for Franchising

There are several reasons for the integration of franchising in a variety of industrial markets. From a business perspective, franchising is attractive to business owners who seek to expand their business rapidly through a well-organized distribution system that suits the products or services they intend to market.⁸⁴ Franchising also allows franchisees to receive the technical assistance necessary to operate the franchised business, including store layouts and designs,

⁷⁹ Manitoba Law Reform Comm'n, *supra* note 64, at 189.

⁸⁰ *Id.*

⁸¹ *Id.*

⁸² INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW [UNIDROIT], GUIDE TO INTERNATIONAL MASTER FRANCHISE ARRANGEMENTS 3 (2007).

⁸³ Manitoba Law Reform Comm'n, *supra* note 64, at 189.

⁸⁴ SELDEN, GIPSON & PARKER, *supra* note 4, at 48.

instructions on getting and operating suitable equipment, and site selection.⁸⁵ In addition, franchisees receive assistance with the process of managing the franchised unit on a daily basis and instructions on dealing with any problems that might arise.⁸⁶ At the same time, franchisees receive training on appropriate methods for conducting the franchised business and on other matters such as those related to advertising and marketing.⁸⁷ The most important advantage is that franchising allows a franchisee to become part of the operations of a successful chain of business mastered by the franchisor.⁸⁸ Franchising also provides the unique advantage that no competition from other franchisees will take place within a determined geographic area⁸⁹ because franchisees usually enter into an exclusive territorial franchise agreement that provides security against direct competition for their business.⁹⁰

From a financial perspective, investors use franchising as a parallel method to raise growth capital alongside the classic methods such as lending capital and placing securities through capital markets.⁹¹ From a management perspective, franchising provides an appropriate level of management by the franchisee who has a personal interest in the success of the franchise.⁹² Franchisees, therefore, will be more incentivized to provide a high degree of professional management rather than simply hiring managers with little personal stake.⁹³

⁸⁵ JUSTIS & JUDO, *supra* note 6, at 2-3.

⁸⁶ *Id.*

⁸⁷ SELDEN, GIPSON & PARKER, *supra* note 4, at 48; *see also* MENDELSON, FRANCHISING LAW, *supra* note 54, at 33.

⁸⁸ SELDEN, GIPSON & PARKER, *supra* note 4, at 50.

⁸⁹ JUSTIS & JUDO, *supra* note 6, at 2-4.

⁹⁰ *Id.*

⁹¹ SELDEN, GIPSON & PARKER, *supra* note 4, at 3.

⁹² *Id.* at 49.

⁹³ MENDELSON, FRANCHISING LAW, *supra* note 54, at 3-4.

1.5 Nature of Franchising

1.5.1 Is the Franchisor-Franchisee Relationship a Fiduciary Relationship?

It is not common to say that the entire franchise relationship is a fiduciary one; it is, rather, more appropriate to find fiduciary obligations related to particular provisions of franchise agreements such as non-competition or confidentiality provisions.⁹⁴ Accordingly, franchisees cannot annul the whole franchise relationship on the basis of a breach of fiduciary duty.⁹⁵

In the United States, for example, it was unsettled whether a franchise relationship is a fiduciary relationship until *Broussard v. Meineke Discount Muffler Shops, Inc.*, where the Fourth Circuit Court of Appeals found that there is a low probability for fiduciary duties to exist in franchise relationships.⁹⁶ Franchising is a business relationship where the parties aim to maximize their profits, an arrangement which argues against the creation of fiduciary duties.⁹⁷ Essentially, there is neither a strict rule negating the existence of fiduciary duties in franchisor-franchisee relationships, nor a rule that a fiduciary relationship definitely exists.⁹⁸ Each case is different according to whether there is “something about the franchise that transforms it from arm’s length to fiduciary.”⁹⁹

⁹⁴ *Id.* at 62.

⁹⁵ *Id.*

⁹⁶ *Broussard v. Meineke Discount Muffler Shops, Inc.*, 155 F.3d 331 (4th Cir. 1998).

⁹⁷ *Id.* (citing *Eaton, Yale and Towne, Inc., v. Sherman Industrial Equipment Co.*, 316 F. Supp. 435 (E.D. Mo. 1970)).

⁹⁸ William L. Killion, Diane Green-Kelly & Jeffery S. Haff, *Franchising Currents from A to Z*, 23 FRANCHISE L.J. 49, 56 (2004).

⁹⁹ *Id.*

1.5.2 Are Franchisor-Franchisee Agreements Adhesionary?

Some argue that franchise agreements are contracts of adhesion based on the principle that a franchisee must essentially take it or leave it, particularly because franchisees usually enjoys considerably less bargaining power than franchisors.¹⁰⁰ Further, others argue that franchisors include terms and conditions in franchise agreements that mostly benefit themselves.¹⁰¹ Franchisees' obligations arising out of franchise agreements are also large and numerous while franchisors' obligations are usually limited to specific terms such as grants of trademark licenses, training, some ongoing assistance, and similar provisions.¹⁰²

On the other hand though, some scholars conclude that franchisees today have similar bargaining power to franchisors for various reasons. Legislative disclosure requirements, for example, provide franchisees with comprehensive information to assist deciding upon franchise opportunities.¹⁰³ Many franchised units are multi-unit franchises that are owned by large companies with strong bargaining power against franchisors.¹⁰⁴ In the same vein, some scholars argue that franchise negotiations depend on various factors such as the franchise agreement, the parties' economic statuses and legal interests, and the negotiability of a franchise agreement where relative bargaining power is largely dependent on supply and demand.¹⁰⁵

An intermediate view urges that a distinction should be drawn between legal provisions imposed by franchisors trying to control franchisees and the day-to-day operational control

¹⁰⁰ Killion, *supra* note 46, at 29.

¹⁰⁰ *Id.* at 30.

¹⁰¹ *Id.*

¹⁰³ Killion, *supra* note 46, at 29.

¹⁰⁴ *Id.* at 30.

¹⁰⁵ Andrew C. Selden & Rupert M. Barkoff, *Counseling Franchises*, in *FUNDAMENTAL OF FRANCHISING 300-01* (Rupert M. Barkoff & Andrew C. Selden, eds., 2008).

imposed by the technical nature of franchise businesses where franchisors must intervene to guarantee standardization.¹⁰⁶

Most single unit franchise transactions are adhesion contracts where franchisors usually resort to standard agreements.¹⁰⁷ Master franchise agreements are, however, exposed to more negotiation possibilities as there are usually cultural, legal, economic, language, and social differences between the franchisor's and franchisee's regions which make it difficult to use a standard franchise agreement.¹⁰⁸

1.6 Distinguishing Franchising From Similar Business Forms

Because many elements of franchising overlap with other forms of legal business transactions, this may cause confusion as to the nature of the transaction. A product franchise, for instance, is a distribution methodology that may cause confusion between franchising and distributorship agreements.¹⁰⁹ In distributorship agreements, distributors undertake to distribute goods in the name of the principal and in a product franchises franchisees do the same. In the same context, since franchisors exercise a degree of control over franchisees' process of operating the business, franchising may be confused with employment agreements. Franchising may also be confused with agency, partnership, and sales representation.

1.6.1 Franchising v. Licensing

¹⁰⁶ MENDELSON, FRANCHISING LAW, *supra* note 54, at 348-349.

¹⁰⁷ UNIDROIT, *supra* note 82, at 24.

¹⁰⁸ *Id.*

¹⁰⁹ MENDELSON, FRANCHISING LAW, *supra* note 54, at 45-46.

Franchising transactions are often confused with licensing agreements because both kinds of transactions include the grant of a license for the use of a trademark, a name, or other forms of intellectual property rights.¹¹⁰ Although, the core of the franchisor–franchisee relationship is licensing the use of a trademark and the grant of know-how,¹¹¹ marketing and manufacturing are ancillary but crucial tasks as well.¹¹² This is contrasted with licensing where the main purpose is the manufacture of licensed goods.¹¹³ As a result, franchising does not require the same level of prior experience in manufacturing that licensing needs.¹¹⁴ In particular, franchisors have more control over the franchised business because franchisees need to follow the business systems or plans of franchisors, unlike licensors whose rights are only to supervise the use of the license in order to protect it and to collect royalties.¹¹⁵

Franchising should also be distinguished from technology transfer agreements. A technology transfer agreement is a form of licensing agreement by which a license is given by the transferor to the transferee to establish a manufacturing unit to manufacture a product using the transferor’s technology without having control over the way the licensee operates its business.¹¹⁶ Nevertheless, a franchise agreement is only a limited license that allows the franchisor to authorize the franchisee to use the franchisor’s trade name or mark to produce or

¹¹⁰ *Id.* at 47.

¹¹¹ *Id.*

¹¹² *Id.*

¹¹³ *Id.*

¹¹⁴ *Id.*

¹¹⁵ *Id.*

¹¹⁶ UNIDROIT, *supra* note 82, at 11.

distribute the franchisor's products or services where the franchisor has day-to-day control over the franchisee's operation of the business.¹¹⁷

1.6.2 Franchising v. Distribution

Though the fact that franchising is a complicated process that includes both licensing and distribution rights, there are vital differences between franchising and distribution relationships.¹¹⁸ A distributor buys the goods from the manufacturer and the title is transferred to the distributor once payment is made.¹¹⁹ A distributor is supposed to have a location or showroom to display the goods in addition to a place for storage.¹²⁰ While franchisees are not allowed to sell any competing products to the franchised products, distributors may sell competing or complementary products to the products they are charged to distribute.¹²¹

Distribution contracts are common for relatively low cost products requiring little pre- and post-sale services, or for products that consumers are used to buying in retail outlets that carry multiple brands of the same product, such as appliances.¹²² Furthermore, franchisees distribute franchised products under the trade name or trademark of the franchisor, whereas distributors sell products under their own name, even if the distributor may have signs on display bearing the product's trademarks or trade names.¹²³ In addition, franchisees work according to

¹¹⁷ *Id.*

¹¹⁸ MENDELSON, *FRANCHISING LAW*, *supra* note 54, at 46; *see also* ANDREW J. SHERMAN, *FRANCHISING AND LICENSING* 350 (3d ed. 2003); UNIDROIT, *supra* note 82, at 10.

¹¹⁹ SHERMAN, *supra* note 118, at 350.

¹²⁰ *Id.*

¹²¹ MENDELSON, *FRANCHISING LAW*, *supra* note 54, at 46; *see also* SHERMAN, *supra* note 118, at 349.

¹²² Brennan, *supra* note 1, at 225.

¹²³ MENDELSON, *FRANCHISING LAW*, *supra* note 54, at 46; *see also* SHERMAN, *supra* note 118, at 349.

the business system or plan of franchisors, following their instructions, whereas distributors sell the products in their own way, using their own business systems and methods.¹²⁴ Lastly, franchisees usually need special kinds of training programs run by franchisors, whereas distributors do not need such technical training.¹²⁵

1.6.3 Franchising v. Agency

A commercial agent is an intermediary who is authorized to negotiate and conclude a commercial transaction on behalf of or in the name of the principal, while a franchisee is completely independent of the franchisor.¹²⁶ The franchisor and the franchisee are not liable for each other's behavior and the franchisee does not have the power to bind the franchisor. In other words, an agent is a legal representative who deals on behalf of, and for the benefit of, the principal while a franchisee operates the franchised business on his own behalf and for his own benefit with no authority to work on behalf of the franchisor.¹²⁷

Another distinction between franchising and agency is that the independence of the franchisor and the franchisee is usually confirmed in the franchise agreement.¹²⁸ In agency relationships, though, agents negotiate the conclusion of a transaction on behalf of, or in the name of, the principal. Conversely, franchisees conclude transactions on their own account and not on behalf of franchisors and they cannot bind, nor are they liable to, franchisors.¹²⁹

¹²⁴ MENDELSON, *FRANCHISING LAW*, *supra* note 54, at 46; *see also* SHERMAN, *supra* note 118, at 349.

¹²⁵ MENDELSON, *FRANCHISING LAW*, *supra* note 54, at 46; *see also* SHERMAN, *supra* note 118, at 349.

¹²⁶ UNIDROIT, *supra* note 82, at 9.

¹²⁷ SHERMAN, *supra* note 118, at 349.

¹²⁸ UNIDROIT, *supra* note 82, at 9.

¹²⁹ *Id.*

Sometimes, a sign is placed in the franchised unit to educate customers that the business is a franchise and not an agency or some other kind of commercial or legal relationship.¹³⁰

1.6.4 Franchising v. Employment

The FTC Disclosure Requirements and Prohibitions Concerning Franchising¹³¹ emphasize the distinction between franchise and employment arrangements by expressly excluding “the relationship between an employer and an employee.”¹³² The reason franchise and employment relationships may get confused is that both contain a certain degree of control. Franchisors, for instance, like employers, determine franchisees’ working hours, appearance, and types and levels of services provided.¹³³

There are many differences between employment and franchise relationships though.¹³⁴ Most important, the degree of control exercised in each relationship is different.¹³⁵ While employers maintain complete control over employees, franchisees are considered independent and subject only to a limited degree of control that includes the business and technical systems necessary to achieve expected outcomes.¹³⁶ The amount and method of payment, moreover, is one of the elements that distinguish franchising and employment relationships.¹³⁷ Employees do

¹³⁰ *Id.*

¹³¹ 16 C.F.R. §§ 436-37.

¹³² 16 C.F.R. § 437.2(4)(i).

¹³³ SHERMAN, *supra* note 118, at 349.

¹³⁴ *Id.* at 349-50.

¹³⁵ Lagarias & Boulter, *supra* note 47, at 145.

¹³⁶ *Id.*

¹³⁷ SHERMAN, *supra* note 118, at 349-50.

not make payment to their employers in order to begin or maintain a business relationship.¹³⁸ Some scholars recommend that franchisors consider certain factors to avoid creating employment relationships with franchisees such as requiring franchisees to prepare and equip the premises.¹³⁹ Also, franchisors should make it clear that franchisees are investing at their own risk and that they have their own management responsibilities. Finally, it should be clear that franchisees are in control of the business to a certain extent, such as having the capacity to employ personnel and be responsible for them.¹⁴⁰

1.6.5 Franchising v. Partnership

A franchise agreement is totally different from a partnership agreement.¹⁴¹ Though the franchisor is paid fees as a percentage of the franchisee's net profits, these fees are paid in return for the services that the franchisor provides and not in return for the carrying on of a commonly owned business.¹⁴² The franchisor is paid as a supplier, producer, or manufacturer of the franchised goods or services.¹⁴³ Moreover, the franchisee sells the franchised goods or services for his benefit and not for the benefit of a partnership.¹⁴⁴ To further distinguish the two, in a franchise it is the responsibility of the franchisee to finance the capital expenses needed to build the franchised business. The franchisee also retains ownership of the franchise's assets, unlike in

¹³⁸ *Id.*

¹³⁹ MENDELSON, *FRANCHISING LAW*, *supra* note 54, at 55.

¹⁴⁰ *Id.*

¹⁴¹ *Id.*

¹⁴² *Id.* at 55-56.

¹⁴³ *Id.*

¹⁴⁴ *Id.*

a partnership where the partners typically share the capital expenses necessary to build a common business.¹⁴⁵

Some franchising laws exclude “any continuing commercial relationship created solely . . . among general business partners.”¹⁴⁶

2. Understanding the Practical and Financial Aspects of Franchising

Potential parties to a franchise agreement need to understand the mechanisms of how costs and revenues of a franchised business work. It is also very important to search the larger industry and conduct market analysis before establishing a franchise business. In addition, having a qualified business plan to be adopted by the franchisee is one of the most important factors that lead to the success of a franchise. Conducting thorough due diligence before starting a franchise is very important for the success of such a business. Other important considerations for franchise players are pilot operations and franchise packages. Each of these elements will be addressed below.

2.1 Financial Issues

2.1.1 Costs and Revenues From a Franchisor’s Perspective

The typical fees collected from a franchisee include initial fees, continuing fees, and advertisement fees. Initial fees are the primary fees paid by the franchisee to the franchisor in return for the services and advice provided by the franchisor to help the franchisee establish and

¹⁴⁵ *Id.*

¹⁴⁶ 16 C.F.R. § 437.2 (4)-(i).

operate the franchised unit.¹⁴⁷ This is a one-time fee usually paid at the beginning of a franchise agreement.¹⁴⁸ Franchisees pay initial fees in exchange for joining the franchise network, for services such as training, assistance with site choice, preparation of premises, and for designs prepared by the franchisor or a third party.¹⁴⁹ In some instances the agreement will require that the franchisor buy the premises and prepare it for the franchisee to start the business and in return, that the franchisee pay the associated fees in stages while work is under progress.¹⁵⁰ This is called turnkey operation.¹⁵¹ Alternatively, the franchisee may provide the premises on his own and request that the franchisor equip it in return for a mark-up that covers the costs incurred by the franchisor for buying the equipment from a specific supplier.¹⁵² Or instead, the franchise parties may agree that the franchisee rent the equipment from the franchisor to decrease the initial fees due to the franchisor.¹⁵³ It may be concluded that if the franchisee buys or rents the equipment from another supplier in accordance with the franchisor's specifications, no fees for the equipment will be required to be paid to the franchisor.

¹⁴⁷ MENDELSON, *FRANCHISING LAW*, *supra* note 54, at 92; *see also* ODAVIA BUENO DIAZ, *FRANCHISING IN EUROPEAN CONTRACT LAW* 181, 191 (2008) (discussing different aspects of franchising in both France and Spain including franchise fees).

¹⁴⁸ Lafontaine & Blair, *supra* note 2, at 399.

¹⁴⁹ MENDELSON, *FRANCHISING LAW*, *supra* note 54, at 91-92; *see also* DIAZ, *supra* note 147, at 191.

¹⁵⁰ MARTIN MENDELSON, *THE GUIDE TO FRANCHISING* 93 (6th ed. 1999) [hereinafter MENDELSON, *GUIDE TO FRANCHISING*].

¹⁵¹ *Id.*

¹⁵² *Id.* at 94. The same would apply to the sale of specific goods or products, particularly if the franchisor is a manufacturer who asks the franchisee to buy certain goods from him or from a specific supplier in return for specific price and mark-up fees. *Id.* at 99.

¹⁵³ MENDELSON, *GUIDE TO FRANCHISING*, *supra* note 150, at 94-95.

Many factors are taken into account in the estimation of initial franchise fees. A primary factor is the actual cost of the training and assistance provided by the franchisor.¹⁵⁴ Additional factors such as the value of the territory where the franchising unit will be located, including the range of customers and the network established by the franchisor therein, are considered when estimating the initial fees.¹⁵⁵ Similarly, the effectiveness, success, and value of the business system developed by the franchisor are important factors in estimating initial fees.¹⁵⁶ There are no precise guidelines for the exact initial fees that should be paid by franchisees and they must be calculated on a case-by-case basis.¹⁵⁷ In the United States, for example, the IFA and the FRAN Data Corporation found that most franchisors charge initial fees between \$5,000 and \$35,000.¹⁵⁸ Average fees range from \$20,000 to \$25,000.¹⁵⁹ A small number of franchisors, less than 1%, charge no initial fees at all. Rarely do franchisors charge fees in excess of \$80,000.¹⁶⁰

Continuing fees are ongoing royalty payments made for services provided by the franchisor during the agreement term such as assistance and ongoing use of intellectual property.¹⁶¹ Continuing fees represent the principal source of income for franchisors from franchise transactions.¹⁶² There are generally three methods for collecting continuing

¹⁵⁴ UNIDROIT, *supra* note 82, at 52.

¹⁵⁵ *Id.*

¹⁵⁶ *Id.*

¹⁵⁷ *Id.*

¹⁵⁸ Lafontaine & Blair, *supra* note 2, at 403.

¹⁵⁹ *Id.*

¹⁶⁰ *Id.*

¹⁶¹ *Id.* at 399; *see also* DIAZ, *supra* note 147, at 182.

¹⁶² MENDELSON, FRANCHISING LAW, *supra* note 54, at 93.

fees: royalties based upon gross revenue,¹⁶³ agreed upon flat annual fees, and pre-determined percentages of the profit achieved by the franchisee.¹⁶⁴ The rules for calculating and collecting continuing fees, however, differ among cases and legal systems.¹⁶⁵

Some franchisors charge a mark-up on the franchised goods and supplies in addition to the franchise fees.¹⁶⁶ Sometimes, the goods are delivered at cost, or at cost plus some logistical charges in addition to the franchise fees.¹⁶⁷ In the United States 82% of franchisors ask for royalties, while 5% collect a “flat amount” each period, 2% collect fees for each selling action by the franchisee, and 5% do not ask for royalties at all.¹⁶⁸

Finally, advertisement fees should be considered when talking about costs and revenues. The calculation and collection of advertisement fees varies among legal systems and depends on the nature of each transaction and the agreement of the parties.¹⁶⁹ Some manufacturer franchisors handle the advertisement process themselves and do not require franchisees to pay any

¹⁶³ Some scholars argue that continuing fees should be calculated depending upon gross sales as they are not as easy to distort as net profits. *See, e.g.*, MENDELSON, *FRANCHISING LAW*, *supra* note 54, at 93.

¹⁶⁴ ADAMS ET AL., *supra* note 63, at 246.

¹⁶⁵ For example, in Poland the average collection of royalties is 5% of the franchisee’s net income and sometimes royalties are incorporated into the price of goods sold by the manufacturer franchisor to its franchisee. *See* Andrzej Krawczyk, *Franchising In Poland*, 5 INT’L J. FRANCHISING L. 19, 21 (2007). While, in the Czech Republic, the royalties, called recurrent fees, are 6% - 9% of the monthly turnover. *See* INTERNATIONAL FRANCHISING (Dennis Campbell & Antonida Netzer eds., 2008) 118; *see also* UNIDROIT, *supra* note 82, at 54-55.

¹⁶⁶ MENDELSON, *FRANCHISING LAW*, *supra* note 54, at 93; UNIDROIT, *supra* note 82, at 57.

¹⁶⁷ *Id.*

¹⁶⁸ Lafontaine & Blair, *supra* note 2, at 403.

¹⁶⁹ For example, in most French franchise agreements, the costs of local advertisements are usually paid by the franchisee, but the costs of national and international advertisements are usually divided between the franchisor and the franchisee. While in Spain, a franchisee may be required to pay for advertising costs as part of the royalty fees paid to a franchisor. *See* DIAZ, *supra* note 147, at 182-91.

associated fees.¹⁷⁰ Other franchisors, however, collect advertising fees from franchisees as part of the continuing franchisee fees.¹⁷¹ Still other franchisors charge fixed advertising fees on a monthly or weekly basis.¹⁷² 52% of American franchisors ask their franchisees to pay advertising fees, 28% do not ask for advertisement fees, 12% ask for fees only for local advertisements, 5% collect flat fees, and 1% collect advertisement fees per transaction.¹⁷³

2.1.2 Costs and Revenues From a Franchisee's Perspective

On one hand, the expected revenues of a franchisee, earned through operation of the individual franchise unit include profits from the investment and rewards for his efforts.¹⁷⁴ On the other hand, the costs that need to be fulfilled by a franchisee include franchise fees, as discussed above, such as advertising fees, continuing fees or royalties, package fees, equipment fees, premises preparation (unless a turnkey agreement exists) and others.¹⁷⁵ Additionally, franchisees need to consider the costs of insuring against damages to the premises and business property, and liability insurance for customers and employees.¹⁷⁶ Labor expenses and professional fees such as legal and accounting advice are also cost factors.¹⁷⁷

¹⁷⁰ MENDELSON, FRANCHISING LAW, *supra* note 54, at 94.

¹⁷¹ *Id.*

¹⁷² Lafontaine & Blair, *supra* note 2, at 410.

¹⁷³ *Id.*

¹⁷⁴ *Id.* at 87.

¹⁷⁵ *See infra* Ch. III. 2.2.4 (discussing Fees).

¹⁷⁶ THE FRANCHISE HANDBOOK: A COMPLETE GUIDE TO ALL ASPECTS OF BUYING, SELLING, OR INVESTING IN A FRANCHISE 61 (2006) [hereinafter FRANCHISE HANDBOOK].

¹⁷⁷ *Id.* at 61-62.

2.2 Due Diligence

Due diligence refers to the collection of industry, corporate, and commercial information and market research before the conclusion of a franchise transaction.¹⁷⁸ Due diligence assists in assessing the profits and risks surrounding the transaction and in considering the price that should be paid in return.¹⁷⁹ Due diligence also helps estimate legal risks, particularly with regard to potential litigation responsibilities that may arise after the conclusion of the franchise transaction.¹⁸⁰

2.3 Market Analysis

Since a franchised business is part of a larger industry, comprehensive research into both the industry and the business market will help franchisors and franchisees identify potential risks.¹⁸¹ These risks may include political, economic, legal, or cultural risks. Examples of political risks are expropriation policy, nationalization, currency devaluations, foreign exchange, strikes, boycotts, and armed conflicts.¹⁸² Economic risks may include capital flight, debt default, liquidity crises, currency fluctuations, and taxation issues.¹⁸³ Legal risks may take the form of ownership restrictions, profit repatriation, lack of organizing laws and regulations, or

¹⁷⁸ Amy Cheng & Fredric A. Cohen, *A Road Map to Due Diligence in the Acquisition of Franchise Companies*, 28 FRANCHISE L.J. 3, 5 (2008).

¹⁷⁹ *Id.*

¹⁸⁰ *Id.*

¹⁸¹ E. Hachemi Aliouche & Udo A. Schlenrich, *International Franchise Assessment Model: Entry and Expansion in the European Union*, 3 ENTREPREN. BUS. L.J. 517, 523-24 (2009).

¹⁸² *Id.*; see also UNIDROIT, *supra* note 82, at 16.

¹⁸³ Aliouche & Schlenrich, *supra* note 181, at 524.

meaningfully different legal regimes with respect to different aspects of franchising.¹⁸⁴ Moreover, cultural differences, and the different languages of the franchisors' and franchisees' markets may lead franchisors to invest in countries that have cultural and linguistic similarities to their own.¹⁸⁵ Some other factors that need to be considered include the size of the market and the population of potential customers.¹⁸⁶ The size of the market, for instance, is an important factor in attracting investors.¹⁸⁷

Conducting a market analysis before initiating a transaction in a potential market will help figure out likely competitors, possible methods of advertisement, and any other factors that may be relevant to determining whether the business will be profitable from a cost-revenue perspective.¹⁸⁸ Such market analysis will help estimate the required costs of a transaction.¹⁸⁹ Searching the broad industry and analyzing the market may be done through independent marketing research firms, specialized university marketing professors or other specialists, or by the franchisee himself and his assistants.¹⁹⁰ Researching the industry within the particular potential market requires contacting potential customers, employees, suppliers and distributors, competitors and other franchisees in the same industry.¹⁹¹

¹⁸⁴ *Id.* at 526; *see also* Franklin C. Jesse, Jr., *How to Take a U.S. Franchise System into a Foreign Market*, 38 PRAC. LAW. 59, 61 (1992).

¹⁸⁵ Jesse, *supra* note 184, at 61.

¹⁸⁶ Aliouche & Schlenrich, *supra* note 181, at 526.

¹⁸⁷ *Id.* at 525.

¹⁸⁸ FRANCHISE HANDBOOK, *supra* note 176, at 90; *see also* SELDEN, GIPSON & PARKER, *supra* note 4, at 64.

¹⁸⁹ SELDEN, GIPSON & PARKER, *supra* note 4, at 65.

¹⁹⁰ FRANCHISE HANDBOOK, *supra* note 176, at 91.

¹⁹¹ *Id.* at 94-95.

2.4 Business Estimation

Business estimations made by the franchising parties, before concluding the transaction, will give a clear idea of the situation from the beginning and will focus attention on the goals of the business.¹⁹² A business plan works as a road-map to establish the path of creation of the business from start to finish.¹⁹³

From the franchisee's perspective, a business plan should refer to the market research made by the franchisee which would list competitors, the size of the industry, customer base, chances of business success, and various factors that may affect the potential business.¹⁹⁴ Day-to-day operations, management, and particularly different issues related to employees, their wages, and employment terms, are usually mentioned in detail in franchisees' estimation of the potential transaction.¹⁹⁵ The costs, required capital, an examination of cash flow, and estimation of predicted profit and loss should also be incorporated.¹⁹⁶

If the business plan is prepared by the franchisor, an executive summary will refer to the history of the company, the advantages of investing in the company, the main characteristics of the products, and an overview of the management team.¹⁹⁷ An independent section will include sales techniques, expected competitors, pricing strategies, advertising methodologies and costs,

¹⁹² *Id.* at 65.

¹⁹³ LEONARD D. DUBOFF, *THE LAW (IN PLAIN ENGLISH) FOR RESTAURANTS AND OTHERS IN THE FOOD INDUSTRY* 27 (2006). A business plan should start with a mission statement that introduces the franchise, followed by an executive summary that describes the business, any potential risks, the concerned market, an overview on competitors, a description of the financial situation, and the advantages and disadvantages vis-à-vis the competitors. *FRANCHISE HANDBOOK*, *supra* note 176, at 65-66. A comprehensive section in the business plan should refer to corporate structure such as officers, directors and shareholders. *SHERMAN*, *supra* note 118, at 235.

¹⁹⁴ *FRANCHISE HANDBOOK*, *supra* note 176, at 67; *see also* DUBOFF, *supra* note 193, at 29.

¹⁹⁵ *FRANCHISE HANDBOOK*, *supra* note 176, at 67; *see also* DUBOFF, *supra* note 193, at 31.

¹⁹⁶ *FRANCHISE HANDBOOK*, *supra* note 176, at 68.

¹⁹⁷ *SHERMAN*, *supra* note 118, at 233; *see also* DUBOFF, *supra* note 193, at 27.

and usual consumers and franchisees.¹⁹⁸ The business plan will also include an identification of all details related to the management team members.¹⁹⁹

2.5 Franchise Packages

A franchise package may require a franchisor to supply all, or part of, the equipment and goods, and to acquire and prepare the premises.²⁰⁰ The contents of the franchise package are determined by the contracting parties and depend on the nature and circumstances of each transaction.²⁰¹

The type of franchise where the franchisor is responsible for finding or constructing, preparing, and equipping the franchised premises before handing it over to the franchisee is called a turnkey operation.²⁰² In these transactions, the franchisee need not do anything to begin operating the business.²⁰³ Turnkey transactions may be suitable for franchisees entering the franchise market for the first time because the experienced franchisor has the requisite knowledge to find a suitable location, get permits, supervise contractors, and other responsibilities.²⁰⁴ Turnkey transactions, however, require large financial investment and start-up effort which is why they may not be welcomed by franchisees except in the case of large and

¹⁹⁸ SHERMAN, *supra* note 118, at 235.

¹⁹⁹ *Id.* at 236.

²⁰⁰ Lewis G. Rudnick, *Structuring a Franchise Relationship*, 1 J. COMM. FRANCHISING 5, 6 (1981).

²⁰¹ *Id.*

²⁰² *Id.*

²⁰³ Schwartz & Zylberman, *supra* note 50, at 278.

²⁰⁴ Paul Steinberg & Gerald Lescatre, *Beguiling Heresy: Regulating the Franchise Relationship*, 109 PENN ST. L. REV. 105, 230 (2004).

well-financed franchisors.²⁰⁵ Payment in turnkey transactions is usually made in installments during the period of construction and preparation.²⁰⁶ The turnkey price usually includes a mark-up on the costs paid by the franchisor and sometimes also includes initial fees to be paid by the franchisee.²⁰⁷

Another form of a franchise package is the unequipped premises package.²⁰⁸ In this form, the franchisor will supply the premises and the franchisee will be required to equip them.²⁰⁹ The franchisor may offer to sell or lease the franchisee an equipment package containing all of the equipment needed to operate the franchised business.²¹⁰

Finally, in specific kinds of transactions, mainly when the franchisor is a manufacturer, the franchisor may require that the franchisee buy goods or supplies from the franchisor himself or from a certain supplier determined by the franchisor.²¹¹

Sometimes, a franchise package may refer to the provision of future supplies, equipment, goods, or other facilities to be provided by the franchisor.²¹² Such an agreement will be contained in the franchise package if there is one, but its performance will be postponed to a specific date or future point when its subject matter is needed by the franchisee.²¹³ This ensures that a franchisee will not be forced to accept the future package unless or until he runs out of

²⁰⁵ Rudnick, *supra* note 200, at 5.

²⁰⁶ MENDELSON, GUIDE TO FRANCHISING, *supra* note 150, at 95.

²⁰⁷ *Id.*

²⁰⁸ *Id.* at 94.

²⁰⁹ *Id.*

²¹⁰ *Id.*

²¹¹ *Id.* at 98-99.

²¹² *Id.*

²¹³ *Id.*

goods or supplies that need replenishment or when the equipment in question is not working properly and requires servicing or replacement.²¹⁴ The franchisee also needs to make sure in the agreement that no additional mark-up will be charged other than an adjustment based on the market price of the goods, supplies, or equipment.²¹⁵

The contents of the franchise package, called the “inventory or schedule of equipment” or “equipment list,” are usually listed in a document provided at the negotiation stage recording all matters that the franchisee was informed to expect.²¹⁶ This document may be treated as confidential according to the nature of the transaction and the degree of protection required by the franchisor.²¹⁷ In such a case, the franchisee will be required to return this document to the franchisor if the transaction is not concluded.²¹⁸

2.6 Pilot Operations

Due to the fact that the franchisor will be offering technical know-how and transferring technical experience to franchisees, the franchisor needs to test the functionality of each new franchise market first using his own financial resources, conducting experiments in various areas.²¹⁹ Allowing otherwise would mean that the franchisor could offer a trial package to franchisees and put them at risk of undertaking uncertain transactions.²²⁰

²¹⁴ *Id.*

²¹⁵ *Id.*

²¹⁶ *Id.* at 184.

²¹⁷ *Id.*

²¹⁸ *Id.*

²¹⁹ MENDELSON, GUIDE TO FRANCHISING, *supra* note 150, at 56-59.

²²⁰ *Id.*

Herein lies the role of pilot operations. Pilot operations work as practical tests of the effectiveness and expected success of the business.²²¹ They also clarify anticipated problems with the business.²²² Pilot operations show the degree of marketability of the offered goods and/or services.²²³ Moreover, they help to figure out the suitable premises, equipment, and any required training programs, services, and other assistance that may be required.²²⁴ Additionally, they aid in developing detailed operational manuals that will be used by future franchisees.²²⁵ Pilot operations should typically be open for at least one year, particularly where seasonal aspects are a consideration.²²⁶ It may be concluded that pilot operations help support franchisor's representations that they are offering a business to franchisees that has been proven successful.²²⁷

3. Understanding Legal Aspects of Franchising

Understanding the legal aspects of franchising requires elaborating on the different types of laws that regulate franchising and the ways they function. It is important to recognize the different forms of franchising methodologies in order to choose the one most suitable to achieving the franchise's goals. Finally, different key issues need to be considered while drafting a franchise agreement such as confidentiality, licensing the use of intellectual property, transfer and termination of the agreement, settlement of disputes, and exclusivity.

²²¹ MENDELSON, FRANCHISING LAW, *supra* note 54, at 38.

²²² *Id.*

²²³ *Id.*

²²⁴ *Id.*

²²⁵ *Id.*

²²⁶ MENDELSON, GUIDE TO FRANCHISING, *supra* note 150, at 56.

²²⁷ MARTIN MENDELSON & LEWIS G. RUDNICK, NEGOTIATING AN INTERNATIONAL MASTER FRANCHISE AGREEMENT 11 (1999).

3.1 Laws Governing Franchising

Many laws and regulations, though they are not directed at franchise agreements, strongly affect franchising. Competition laws, for example, try to preserve a competitive free market.²²⁸ Similarly, intellectual property law is closely connected to franchising, as use of trademarks or trade names is one of the most important elements of franchising.²²⁹ In the same context, corporate and tax laws play a vital role in deciding whether to expand franchising through a branch or a subsidiary and the corporate form that best fits each franchise relationship.²³⁰

The franchising relationship is a contractual one and, as a result, contract law governs the general framework of a franchise relationship.²³¹ The rules and regulations governing such a contractual relationship differ from one jurisdiction to another and sometimes vary even in the same jurisdiction.²³²

Generally speaking, three types of rules regulate franchising relationships: (1) pre-sale disclosure laws that require disclosure of relevant information; (2) registration laws, requiring the registration of franchising agreements, disclosure documents, and any other related documents; and (3) relationship laws, organizing the franchise parties' rights and obligations.²³³

²²⁸ MENDELSON, *FRANCHISING LAW*, *supra* note 54, at 382.

²²⁹ *Id.* at 383.

²³⁰ *Id.* at 384.

²³¹ *Id.* at 382.

²³² *Id.* For instance, the FTC does not require that franchising agreements be in writing. *See* 16 C.F.R. § 436.1(h) (“Franchise means any continuing commercial relationship or arrangement, whatever it may be called, in which the terms of the offer or contract specify, or the franchise seller promises or represents, orally or in writing {seems like something is missing here}.”). However, some states like Idaho, Mississippi and Nebraska, require that a franchise agreement be in writing. *See* Nicole S. Zellweger, *Enforceability of Oral Franchise Agreements*, 28 *FRANCHISE L.J.* 136, 136 (2009).

²³³ *See* Mills, *Franchising Around the Globe, Relationship, Definition and Regulation*, in *GOING INTERNATIONAL, FUNDAMENTALS OF INTERNATIONAL BUSINESS TRANSACTIONS*, *supra* note 39.

Disclosure formats, language, period and document requirements differ from one jurisdiction to another.²³⁴ Unlike disclosure laws, registration laws are less common around the world.²³⁵ In the United States, franchisors are required under the California Franchise Investment Law, for example, to register their franchise offers with the state before making any offers for sale of a franchise in the state.²³⁶ Similarly, in China, the Chinese New Regulations obligate various governmental agencies to supervise and administer the application of franchise rules.²³⁷ Franchisors are asked to register within fifteen days of executing a franchise agreement.²³⁸

Few countries have franchisor-franchisee relationship laws. In the United States, franchisor-franchisee relationship laws have evolved at the state level, where most of the laws focus on termination.²³⁹ The Chinese New Regulations also organize the franchisor-franchisee relationship with very specific rules.²⁴⁰ For instance, a franchisor must operate two company-owned units in China for more than one year before offering franchises for sale, more commonly known as the “Two-Plus-One Requirement.”²⁴¹

3.2 Franchising Methodologies

²³⁴ *See id.*

²³⁵ *See id.*

²³⁶ CAL. CORP. CODE § 31110 (2012).

²³⁷ Regulations on Administration of Commercial Franchises (promulgated by the State Council of China, art. 5, Jan. 31, 2007, effective May 1, 2007) (Lawinfochina) (China) [hereinafter Chinese New Regulations].

²³⁸ *Id.* at art. 8.

²³⁹ *See Mills, supra* note 39.

²⁴⁰ *See generally* Chinese New Regulations, *supra* note 237.

²⁴¹ *Id.* at art. 7(4).

There are different methods by which a franchise may be structured, such as direct franchising, master franchise agreements, and joint venture franchise agreements. The choice of franchising method depends on a number of factors that affect the franchising parties' decision.

3.2.1 Direct Franchising

Direct franchising creates a straightforward relationship between the franchisor and the franchisee, whereby the franchisor enters into a direct franchise agreement with each individual franchisee.²⁴² Direct franchising allows for broad protection of a franchise system, as it is easier for franchisors to bring direct claims against franchisees for breaches of the franchise agreement without interference by third parties like customers or suppliers.²⁴³ In addition, it allows franchisors to maintain all the fees paid by franchisees as there are no intermediaries or sub-franchisors who have intermediary rights over these fees.²⁴⁴ On the other hand, direct franchisees usually require more training and assistance from the franchisor because they usually have less experience than franchisees in other types of franchising.²⁴⁵ Also, franchisors need to be aware of local laws and regulations, languages, and culture in the region where the franchised unit is located as it is the responsibility of franchisors to ensure that the franchisees comply with these considerations.²⁴⁶ Having the legal responsibility to assure that business operations comply with national laws and regulations that govern the transaction, franchisors need to search during their

²⁴² WORLD INTELLECTUAL PROPERTY ORGANIZATION [WIPO], FRANCHISING GUIDE 21 (1994) [hereinafter WIPO FRANCHISING GUIDE].

²⁴³ ALEXANDER S. KONIGSBERG, INTERNATIONAL FRANCHISING 89 (3d ed. 2008).

²⁴⁴ *Id.*

²⁴⁵ Catherine A. Riesterer, *Structuring the Contractual Relationship*, in FUNDAMENTALS OF INTERNATIONAL FRANCHISING 41 (Richard M. Asbill & Steven M. Goldman eds., 2001); *see also* KONIGSBERG, *supra* note 243, at 90.

²⁴⁶ Riesterer, *supra* note 245, at 42; *see also* KONIGSBERG, *supra* note 243, at 90.

due diligence for the relevant national laws and regulations of the targeted market and judge whether their business can comply with those requirements.²⁴⁷

Direct franchising is frequent in domestic franchising because it allows the franchisor to extend his business without setting up any new structures such as joint ventures.²⁴⁸ It is also common when the target market is not that far from the franchisor's country and communication between the two countries is not costly or when franchisors want to explore the waters of a target market.²⁴⁹ Moreover, direct franchising is suitable in cases where there are limited numbers of franchise outlets.²⁵⁰ Conversely, direct franchising is less common in international franchising transactions because of cultural, commercial, legal, economic and political differences between the regions in which the franchisor and the franchisee are located, which at times requires an intermediate sub-franchisor who is more aware of these differences.²⁵¹

Direct franchising may take the form of individual unit franchising where the franchisor agrees with the franchisee to operate a certain franchised outlet in a specific region.²⁵² The other form of direct franchising is the development agreement. A development agreement is an "umbrella agreement" or "multiple unit development rights agreement." In other words, the franchisor, under the development agreement, sells a bundle of franchised units in a specific territory to a franchisee developer, who will be responsible for operating and developing the group of franchises himself according to an agreed upon development plan, and who will issue

²⁴⁷ Riesterer, *supra* note 245, at 42.

²⁴⁸ WIPO FRANCHISING GUIDE, *supra* note 242, at 22.

²⁴⁹ Riesterer, *supra* note 245, at 43.

²⁵⁰ KONIGSBERG, *supra* note 243, at 88.

²⁵¹ WIPO FRANCHISING GUIDE, *supra* note 242, at 22.

²⁵² Hershman & Caffey, *supra* note 77, at 52-53.

separate franchise agreements for each unit independently with sub-franchisees.²⁵³ Franchisors usually resort to development agreements when they want to reduce the number of franchisees in a foreign territory by having one developer who operates and develops a number of franchise outlets, while the franchisor remains the controller of the whole system.²⁵⁴

The key issues in structuring a development agreement usually relate to having multiple developers, having a bundle of sold franchised units spanning an entire geographic region, maintaining a specific development quota, and setting a time frame for development.²⁵⁵ The franchisor and the developer usually conclude two contractual relationships: a framework agreement, with a pre-scheduled development plan, for all the franchised units, and a separate franchise agreement for each unit the developer operates under the framework agreement, through which he has the same rights and commitments of any individual franchisee.²⁵⁶ According to the World Intellectual Property Organization (“WIPO”), these individual outlets do not have a separate legal status, rather they are divisions of one overall franchised structure.²⁵⁷ It is worth mentioning that the developer usually pays an “umbrella development fee” for the specified territory in addition to the individual fees payable for each unit separately.²⁵⁸ The development agreement usually includes sanctions for the developer if he does not fulfill the obligations included in the development agreement or if he does not meet the time

²⁵³ *Id.* at 53.

²⁵⁴ KONIGSBERG, *supra* note 243, at 94.

²⁵⁵ Hershman & Caffey, *supra* note 77, at 53.

²⁵⁶ UNIDROIT, *supra* note 82, at 13.

²⁵⁷ WIPO FRANCHISING GUIDE, *supra* note 242, at 24.

²⁵⁸ SHERMAN, *supra* note 118, at 123.

frame provided in the development schedule.²⁵⁹ Development agreements usually require extensive financial resources²⁶⁰ and usually determine whether the developer is licensed to use the franchisor's trademark for the purpose of the collective target of the agreement, for example on regional headquarters and flyers, or whether use of the trademark is limited to individual units.²⁶¹

3.2.2 Master Franchise Agreements

In master franchising, the franchisor, called the master franchisor, grants the franchisee, called a sub-franchisor, the right to license third parties, called sub-franchisees, to operate franchised outlets through the creation of sub-franchise agreements with each sub-franchisee operating in a specific territory.²⁶² The sub-franchisor usually pays the master franchisor initial fees and a certain percentage of the profits achieved from the sub-franchised outlets representing continuing fees, in return for the grant of the licensing right.²⁶³ Thus, two agreements are concluded: the international master franchise agreement between the franchisor and the sub-franchisor, and the domestic sub-franchise agreements between the sub-franchisor and each of the sub-franchisees. No direct relation usually appears between the franchisor and the sub-franchisee.²⁶⁴ The master franchisor generally retains the right to determine the features of the

²⁵⁹ MENDELSON, GUIDE TO FRANCHISING, *supra* note 150, at 66.

²⁶⁰ UNIDROIT, *supra* note 82, at 14.

²⁶¹ Riesterer, *supra* note 245, at 45.

²⁶² Hershman & Caffey, *supra* note 77, at 54-55; *see also* WIPO FRANCHISING GUIDE, *supra* note 242, at 24.

²⁶³ UNIDROIT, *supra* note 82, at 3.

²⁶⁴ *Id.* at 3. A question may arise as to whether a master franchisor is helpless to take action against a misbehaving sub-franchisee if the sub-franchisor is deficient. The answer may not be in favor of franchisors, as franchisors have no other options except to rely on sub-franchisors to enforce sub-franchise agreements and to protect the master franchisor's rights, including protection of his intellectual property rights. To avoid this risky situation, franchisors

relationship between the sub-franchisor and each sub-franchisee.²⁶⁵ For instance, master franchisors would have final say on site approvals and on fees paid by sub-franchisees to sub-franchisors through the sub-franchise agreements.²⁶⁶

Sub-franchisors remain responsible to master franchisors if a sub-franchisee does not fulfill its obligations arising from the sub-franchise agreements.²⁶⁷ If master franchisors cannot intervene when sub-franchisees breach sub-franchise agreements due to the lack of a contractual relationship between master franchisors and sub-franchisees, master franchisors can still sue sub-franchisors instead.²⁶⁸ Hence, sub-franchisors play a dual role; for the sub-franchisees they act as franchisors, and for franchisors, they act as franchisees and as intermediary.²⁶⁹ On the one hand, both master franchisors and sub-franchisors can provide sub-franchisees with required services, training, advice, and support.²⁷⁰ On the other hand, both master franchisors and sub-franchisors share the profits achieved by the sub-franchisees according to the terms provided in the master franchise agreement.²⁷¹ It is also agreed, most of the time, that the master franchisor should provide assistance directly to sub-franchisees whether in general, or in case an emergency arises.²⁷²

can conclude contractual relationships with the sub-franchisees where franchisors are parties to the sub-franchise agreement to be able to take action when the sub-franchisor fails. Being a party to the sub-franchise agreement defeats the entire goal of having a sub-franchise agreement. *See id.* at 5-6.

²⁶⁵ Hershman & Caffey, *supra* note 77, at 54-55.

²⁶⁶ *Id.*

²⁶⁷ *Id.*

²⁶⁸ *Id.*

²⁶⁹ *Id.* at 54-55.

²⁷⁰ *Id.*

²⁷¹ *Id.*

²⁷² UNIDROIT, *supra* note 82, at 74.

Master franchisors usually resort to master franchise agreements to achieve instant results because master franchising allows for rapid growth and fast development of the business in the franchised industry.²⁷³ Moreover, master franchise agreements work well for franchisors who know about franchising in certain territory, and would like to minimize risk when expanding into new territories by getting help from experienced sub-franchisors.²⁷⁴ The key issue behind master franchising is making use of the sub-franchisor's experience, training knowledge, and knowledge of the cultural and language background of the foreign territory.²⁷⁵ Master franchising, furthermore, is a good method of investment for sub-franchisees with few financial resources because sub-franchisors pay for training, employees, premises, supplies, and other costs.²⁷⁶

Master franchisors usually enjoy less control over the actions of sub-franchisees because no direct relationship exists between them.²⁷⁷ Master franchisors will not be concerned with the daily operational issues of the sub-franchisees.²⁷⁸ They will deal only with the sub-franchisor as their main contractor.²⁷⁹ That is why master franchisors are usually advised to incorporate into the master franchise agreement all requirements and expectations from the franchise process and the sub-franchise agreements.²⁸⁰ Furthermore, any change that takes place with regard to the master franchise agreement would affect the relationship between the sub-franchisor and the sub-

²⁷³ *Id.*; see also *id.* at 4.

²⁷⁴ WIPO FRANCHISING GUIDE, *supra* note 242, at 24; see also UNIDROIT, *supra* note 82, at 4.

²⁷⁵ Riesterer, *supra* note 245, at 51.

²⁷⁶ KONIGSBERG, *supra* note 243, at 98.

²⁷⁷ WIPO FRANCHISING GUIDE, *supra* note 242, at 5.

²⁷⁸ MENDELSON, GUIDE TO FRANCHISING, *supra* note 150, at 88.

²⁷⁹ *Id.*

²⁸⁰ Riesterer, *supra* note 245, at 52.

franchisee.²⁸¹ That is why most sub-franchise agreements provide for an automatic transfer of the sub-franchisor rights in the sub-franchise agreement to the master franchisor in case the sub-franchise agreement is terminated.²⁸²

3.2.3 Joint Venture Franchise Agreements

In a joint venture, two or more companies join their efforts without merging or entering into a long-term business relationship.²⁸³ As contrasted with a standard franchise agreement, a joint venture requires a community of interests, an obligation to share both the profits and losses of the business, and a right to share in the business management and operations.²⁸⁴ A joint venture is not a specific form of business so much as a general concept that may include, for example, partnerships and corporations.²⁸⁵ An example is where a company inventing products and another company manufacturing products enter into a joint agreement to complement each other's business and at the same time avoid any repetition of services provided to consumers.²⁸⁶ Some legal systems do not exclude a joint venture in franchising transactions if the franchise elements are met.²⁸⁷ The joint venture parties establish a company under the laws and regulations of the foreign territory to carry out the franchised business tasks.²⁸⁸

²⁸¹ Hershman & Caffey, *supra* note 77, at 54-55; *see also* KONIGSBERG, *supra* note 243, at 101-03.

²⁸² Hershman & Caffey *supra* note 77, at 54-55.

²⁸³ JAMES E. BURK & RICHARD P. LEHMANN, FINANCING YOUR SMALL BUSINESS 14 (2006).

²⁸⁴ Andrew L. McIntosh & Kimberley A. Agster, *Walking Like A Duck: Joint Ventures and Franchises*, 26 FRANCHISE L.J. 85, 88 (2006).

²⁸⁵ *Id.*

²⁸⁶ BURK & LEHMANN, *supra* note 283, at 14.

²⁸⁷ McIntosh & Agster, *supra* note 284, at 88.

²⁸⁸ KONIGSBERG, *supra* note 243, at 237.

In a joint venture franchise, there will be two agreements: a joint venture agreement and a franchise agreement, which may be a master franchise agreement, an individual unit franchise agreement, or an area development franchise agreement.²⁸⁹ A franchisor will be in a controlling position in a joint venture vehicle as the franchisor will have significant power over the joint venture through the franchising agreement in addition to the regular rights conferred by the joint venture agreement.²⁹⁰

Franchisors often choose the joint venture franchising option when they fail to locate a sub-franchisor when a master franchise agreement might be preferable, or a developer in cases where a development agreement with the needed financial resources, experience, or a foreign partner who is familiar with the laws, language, culture, and commercial practices of the foreign country might be desirable.²⁹¹ Also, a joint venture franchising option is available to franchisors not wanting to expose themselves to the direct risks arising out of the franchising business and they therefore choose to maintain equity in the franchised business.²⁹²

3.3 Drafting a Franchise Agreement

The considerations surrounding the drafting of a franchise agreement vary from one legal system to another and from one case to the next. For instance, agreements in common law countries are usually longer and contain more details than civil law agreements that usually include references to statutes or other legislative instruments as complementary documents.²⁹³

²⁸⁹ MENDELSON, GUIDE TO FRANCHISING, *supra* note 150, at 423.

²⁹⁰ *Id.*

²⁹¹ *Id.* at 238.

²⁹² *Id.* at 105-06.

²⁹³ UNIDROIT, *supra* note 82, at 30.

Similarly, the parties may prefer to include a lot of details that reflect their exact will to avoid future disputes.²⁹⁴ Nevertheless, in nearly all cases there are common provisions found in well-drafted franchise agreements.

3.3.1 Granted Rights

Rights granted by franchise agreements are usually organized under titles such as “Rights Granted” or “System” that describe the nature of the business, operation, quality assurance methods, product design, goodwill, and the exact public image that the franchisees need to uphold.²⁹⁵

3.3.2 Ownership of the System

The franchisee has to make sure that the franchisor is the actual owner of the know-how, intellectual property, and the franchised system in general, and that the franchisor is explicitly granting those rights to the franchisee.²⁹⁶ If no information is available on the franchisor’s ownership, the franchisor needs to warrant in the franchise agreement that it has the authority to grant the franchisee a license to use them.²⁹⁷

3.3.3 Confidentiality Clauses

The purpose of a confidentiality clause is to protect the franchisor’s know-how, trade secrets, and any other information dealt with by the franchisor as confidential that is disclosed to

²⁹⁴ *Id.* at 31.

²⁹⁵ *Id.* at 133.

²⁹⁶ *Id.* at 137.

²⁹⁷ *Id.*

the franchisee in the course of the negotiations or business.²⁹⁸ Know-how, according to the EFF, is defined as a collection of “identified,” “secret,” and “substantial” data gathered through the franchisor’s practices and experiences.²⁹⁹ “Identified” means that the know-how is defined in an inclusive way that suits its confidential nature.³⁰⁰ “Secret” means that the know-how is confidential and undisclosed to the public.³⁰¹ “Substantial” means that the know-how is material to the franchisee’s use in connection with the franchised business whether in the field of manufacturing, contacting consumers, or managing the franchised business.³⁰²

The grant of know-how is usually accompanied by the disclosure of marketing methodologies, product information, methods of delivery, quality standards and control, and training programs.³⁰³ The granted know-how is protected only when it is confidential.³⁰⁴ Confidential information, however, is not usually limited to know-how, it includes trade secrets and other undisclosed information as well.³⁰⁵

Trade secrets are defined by the Uniform Trade Secrets Act as:

²⁹⁸ *Id.* at 141.

²⁹⁹ EUR. CODE OF ETHICS, *supra* note 53.

³⁰⁰ *Id.*

³⁰¹ *Id.*

³⁰² *Id.*

³⁰³ UNIDROIT, *supra* note 82, at 36; *see also* Mark S. Vanderbroek & Christian B. Turner, *Protecting And Enforcing Franchise Trade Secrets*, 25 FRANCHISE L.J. 191, 196 (2006).

³⁰⁴ UNIDROIT, *supra* note 82, at 36. According to Article 39(2) of the TRIPS Agreement, confidentiality or secrecy means that the information “is not, as a body or in the precise configuration and assembly of its components, generally known among or readily accessible to persons within the circles that normally deal with the kind of information in question...” Agreement on Trade-Related Aspects of Intellectual Property Rights art. 39(2), Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1C, 1869 U.N.T.S. 299 (1994). Article 39(2) also provides that for an undisclosed information to be protected, it must have a “commercial value because it is secret.” *Id.*

³⁰⁵ UNIDROIT, *supra* note 82, at 134.

Information, including a formula, pattern, compilation, program, device, method, technique, or process, that: (i) derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use, and (ii) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.³⁰⁶

The Restatement of Unfair Competition defines trade secrets as:

[A]ny information that can be used in the operation of a business or other enterprise and that is sufficiently valuable and secret to afford an actual or potential economic advantage over others.³⁰⁷

Franchisors usually determine in the franchise agreement any other confidential information that franchisees are prohibited from disclosing whether during the execution of the franchise agreement or after its termination.³⁰⁸ Franchisors also determine the exact communication methods that include this confidential information such as operations manuals, business and development plans, recipes, and formulas, to avoid the risk of losing this confidential information by delivering such documents to potential or previous franchisees.³⁰⁹

Finally, the benefit of claiming trade secret protection, in addition to contractual confidentiality obligations, is the protection conferred by law. This added legal protection promotes the enforcement of non-competition agreements.³¹⁰

3.3.4 Grant-Back Clauses

³⁰⁶ UNIF. TRADE SECRET ACT § 1(4), 14 U.L.A. 437 (1985); *see also* Clay A. Tillack & Mark E. Ashton, *Who Takes What: The Parties' Rights to Franchise Materials at the Relationship's End*, 28 FRANCHISE L.J. 88, 124 (2008).

³⁰⁷ Restatement (Third) of The Law Unfair Competition § 39 (1995).

³⁰⁸ Tillack & Ashton, *supra* note 306, at 123.

³⁰⁹ *Id.* at 124.

³¹⁰ *Id.* at 125.

Grant-back clauses are common in franchise agreements. The grant-back clause requires the franchisee to transfer to the franchisor any experience or information obtained while operating the franchised business and to license the franchisor to use this information.³¹¹

3.3.5 Field of Use Restrictions Clauses

The Field of Use Restrictions clause limits use of know-how, or any other information or experience transferred by the franchisor to the franchisee, to operating and developing the franchised business.³¹² It guarantees that the franchisee will not use the transferred information in another venture without the express authorization of the franchisor or without compensating the franchisor.

3.3.6 Non-Compete Clauses

The non-compete clause prevents the franchisee from engaging in any business similar to the franchise whether through trade with specific customers, with specific products, or in a territory where his activities compete with the franchisor.³¹³ The purpose of this clause is to prevent direct competition, through use of the know-how, unless the franchisor expressly agrees.³¹⁴

Non-competition clauses apply both during the term of the franchise agreement and after the termination of the franchise agreement.³¹⁵ The restriction on competition after the

³¹¹ UNIDROIT, *supra* note 82, at 143.

³¹² *Id.* at 144.

³¹³ MENDELSON, GUIDE TO FRANCHISING, *supra* note 150, at 325.

³¹⁴ *Id.*

³¹⁵ Hershman & Caffey, *supra* note 77, at 81.

termination of the agreement is usually extended for a reasonable period of time that is determined by law in some jurisdictions and left to the negotiation of the parties in others.³¹⁶ Courts accept non-compete clauses only when they are reasonable in a way that does not unduly affect the interests of the concerned parties or the public.³¹⁷ Non-compete clauses are usually reasonable when they are limited, whether in duration, extent of restricted activities, geography, or when they are needed to protect the franchisor's legitimate interests.³¹⁸

3.3.7 Intellectual Property

Intellectual property protection is typically the most important part of the franchise agreement; the core of franchising is the grant of a license to use the trademark or trade name owned by a business. For instance, a trademark of well-established reputation is usually a valuable business asset constituting goodwill that attracts franchisees, investors, and customers.³¹⁹ Coca-Cola is a prime example of a valuable trademark based on its goodwill and consumer recognition, making it one of the world's top ten brands.³²⁰ Franchising allows for use of intellectual property during the agreement and the right of use ceases at termination of the agreement.³²¹ During the term of the franchise agreement, use of the intellectual property is restricted by the conditions set by the franchisor in the franchise agreement.³²²

³¹⁶ UNIDROIT, *supra* note 82, at 145.

³¹⁷ MENDELSON, GUIDE TO FRANCHISING, *supra* note 150, at 325.

³¹⁸ Hershman & Caffey, *supra* note 77, at 81.

³¹⁹ William A. Finkelstein, *Protecting Trademarks and Related Intellectual Property Rights*, in FUNDAMENTALS OF INTERNATIONAL FRANCHISING 62 (Richard M. Asbill & Steven M. Goldman, eds., 2001).

³²⁰ *Id.*

³²¹ Tillack & Ashton, *supra* note 306, at 88.

³²² *Id.* at 91.

There are different types of intellectual property rights protected under each legal system. For franchising purpose, some of these rights are more important than others. Ordinarily trademarks, confidentiality of undisclosed information, and copyright are paramount.

3.3.7.1 Trademarks

Trademarks help consumers ensure that products and services bearing the same identifying marks are of the same quality.³²³ Trademarks are one part of a bundle of elements, including trade dress and trade name, that together form a brand.³²⁴ The brand represents the identity of the franchised business and refers to the business' image in the concerned market.³²⁵ While trademarks are used in connection with products, service marks are used in connection with services.³²⁶ Service marks are generally considered a type of trademark and are usually protected and organized under the laws and regulations governing trademarks in different legal systems.³²⁷ Trademarks should be distinguished from trade dress; trade dress is a general term that refers to the overall appearance of a business entity or product.³²⁸ It includes the features of buildings, the designs and decorations, employees' uniform, product packaging, and any other similar designs used to form the specific image of the business for consumers.³²⁹ Additionally,

³²³ SHERMAN, *supra* note 118, at 135. A trademark is a word, symbol, name, numerical, picture, slogan, colors, sounds, figure, or any other (check this) indicate that is used to identify a product, distinguish it from other products, specify its origin, and indicate its ownership. *Id.*

³²⁴ Finkelstein, *supra* note 319, at 63.

³²⁵ *Id.*

³²⁶ SHERMAN, *supra* note 118, at 135.

³²⁷ Finkelstein, *supra* note 319, at 63.

³²⁸ SHERMAN, *supra* note 118, at 145.

³²⁹ *Id.*

trademarks are different from trade names. Trade names are the names by which business entities are known to others in the relevant market.³³⁰

The way trademarks are selected and the conditions for a protectable trademark go beyond the scope of this project. Franchisors are, however, advised to conduct research before filing to register their trademarks or starting to use them internationally.³³¹ It may not be convenient to use the same trademark in different countries because the meaning of a trademark in the local language of a foreign country may be offensive to consumers.³³² Similarly, some legal systems do not allow registration of combinations of numbers or specific letters as trademarks.³³³

Franchise agreements should address different issues that guarantee the protection of the trademark. For instance, the trademark licensed through the franchise agreement should be defined in a clear way.³³⁴ Also, the trademark terms should confirm that the franchisor is the sole and proper owner of the licensed trademark.³³⁵ Use of the trademark by the franchisee takes place in accordance with the conditions listed in the operating manuals, and franchisees are usually prohibited from including the trademark as part of their business entities' trade names unless they are licensed by franchisors to utilize the whole brand.³³⁶ Franchisors usually require

³³⁰ William A. Finkelstein & Christopher P. Bussert, *Trademark Law Fundamentals and Related Franchising Issues*, in *FUNDAMENTALS OF FRANCHISING 3* (Rupert M. Barkoff & Andrew C. Selden eds., 3d ed. 2008).

³³¹ KONIGSBERG, *supra* note 243, at 298.

³³² *Id.* at 301.

³³³ *Id.*

³³⁴ SHERMAN, *supra* note 118, at 141.

³³⁵ *Id.* at 142.

³³⁶ UNIDROIT, *supra* note 82, at 11.

that franchisees introduce themselves as licensees and not as owners of the trademark.³³⁷ Similarly, the franchise agreement usually confirms that the use of the trademark by the franchisee according to the franchise agreement does not give the franchisee any property rights over the trademark.³³⁸

Franchisors need to ensure they maintain the right to develop the trademark or any other trademarks to be used for the franchised business.³³⁹ At the same time, franchisees should be responsible for supervision of the ways in which the trademark is used and are usually required to notify the franchisor immediately in case of infringement or improper use by any third party of which they are aware.³⁴⁰ Meanwhile, the franchise agreement should make clear the procedures to be taken in case of trademark infringement.³⁴¹ Attention should also be given to whether the franchisee is authorized to sub-license the trademark and the exact conditions thereof.³⁴²

Besides having comprehensive trademark terms in their franchise agreements, franchisors usually try to develop a training program to teach franchisees the proper method of displaying and using the trademark.³⁴³ Finally, the franchise agreement may explicitly provide that any use of the trademark after expiration or termination of the franchise agreement is trademark infringement.³⁴⁴

³³⁷ SHERMAN, *supra* note 118, at 141.

³³⁸ *Id.*

³³⁹ *Id.*

³⁴⁰ *Id.* at 141.

³⁴¹ UNIDROIT, *supra* note 82, at 121.

³⁴² *Id.* at 123.

³⁴³ SHERMAN, *supra* note 118, at 143.

³⁴⁴ Finkelstein & Bussert, *supra* note 330, at 43.

3.3.8 Common Franchisor Obligations

Beside the franchisor's obligation to transfer know-how and to license use of intellectual property to the franchisee, other common commitments of franchisors are found in many franchise agreements.

3.3.8.1 Opening

The franchisor is responsible for the preparation of the premises or the opening of the franchised unit; this needs to be clearly stated in the franchise agreement with a schedule and exact dates for when the franchised unit will be ready for operation.³⁴⁵

3.3.8.2 Operation Manuals

Operation manuals are the most important method of communication provided by the franchisor to the franchisee. They include the required information needed to carry out the franchised business: information related to know-how, intellectual property, operational guidance, and other information provided during the franchise agreement.³⁴⁶ Manuals also include such information as administrative instructions, rules for hiring employees, supply orders details, services introduced to consumers, maintenance work, opening and closing hours, bookkeeping, advertising, and safety issues.³⁴⁷

Accordingly, operations manuals help franchisors maintain uniformity and consistency across various franchised outlets and reduce the franchisee's need to contact the franchisor about

³⁴⁵ WIPO FRANCHISING GUIDE, *supra* note 242, at 30.

³⁴⁶ UNIDROIT, *supra* note 82, at 69; *see also* Hershman & Caffey, *supra* note 77, at 75.

³⁴⁷ Hershman & Caffey, *supra* note 77, at 75.

routine issues.³⁴⁸ Manuals need to be effectively and comprehensively drafted, otherwise serious problems may arise with regard to operating the franchised units, know-how, or licensed intellectual property.³⁴⁹

Manuals may take different forms such as written documents, videotapes, computer software programs, emails, or any other method of communication.³⁵⁰ Manuals are usually incorporated in the franchise agreement itself or at least referred to as an integral part of the agreement.³⁵¹ Particularly because manuals usually include undisclosed information and proprietary material, they remain the sole property of the franchisor and the franchisee will be required to return them to the franchisor at the termination of the agreement.³⁵² As a result of the proprietary nature of the manuals, they usually fall under the confidentiality provision included in the franchise agreement.³⁵³ Manuals may need to be translated into the local language of the franchisee. In cases where translation is necessary, the franchise agreement determines who shall bear the cost and responsibility for the translation.³⁵⁴ Manuals may also need to be adapted to conform with the laws, habits, culture, or tastes of consumers in the franchisee's country.³⁵⁵

3.3.8.3 Assistance And Support

³⁴⁸ *Id.*

³⁴⁹ Cheng & Cohen, *supra* note 178, at 6.

³⁵⁰ Hershman & Caffey, *supra* note 77, at 75.

³⁵¹ UNIDROIT, *supra* note 82, at 68.

³⁵² ADAMS ET AL., *supra* note 63, at 230.

³⁵³ *Id.*

³⁵⁴ UNIDROIT, *supra* note 82, at 70.

³⁵⁵ *Id.* at 71.

During the course of the franchise agreement, the franchisor provides assistance to the franchisee when required, answering questions that may arise regarding execution of the agreement, or introducing relevant advice concerning technical issues or management problems.³⁵⁶

3.3.8.4 Providing Information

In addition to the obligation of disclosure provided by many legal systems, the franchise agreement usually provides for the franchisor's obligation to provide the franchisee with relevant information required for running the franchised business.³⁵⁷ Such information is usually listed in the franchise agreement, and includes technical information and legal or economic information that may affect the performance of the agreement.³⁵⁸

3.3.8.5 Training

Franchisors need to transfer their experience, knowledge, and skills to franchisees and their employees by providing suitable and efficient training programs.³⁵⁹ The form of the training depends on the nature of the franchised business. In general, the franchisor may teach franchisees marketing skills connected with the franchised business,³⁶⁰ and may also provide training on the technical issues of manufacturing and preparing the franchised products.³⁶¹ Moreover,

³⁵⁶ WIPO FRANCHISING GUIDE, *supra* note 242, at 31.

³⁵⁷ UNIDROIT, *supra* note 82, at 65.

³⁵⁸ *Id.*

³⁵⁹ Hershman & Caffey, *supra* note 77, at 74.

³⁶⁰ WIPO FRANCHISING GUIDE, *supra* note 242, at 29.

³⁶¹ *Id.*

franchisors may teach franchisees certain maintenance and repair skills required for the specific type of franchised goods.³⁶² In addition, franchisees may need general training with regard to a variety of issues such as recordkeeping, technical assistance related to computer software, and the like.³⁶³

The franchise agreement should identify whether training costs will be included in the initial fees paid by the franchisee and the method and currency of payment.³⁶⁴ A franchise agreement should also stipulate the franchisee's obligations to abide by the training programs and to ensure that their employees meet the standards required by the franchisor.³⁶⁵

3.3.8.6 Supply of Goods

Franchisors want to make sure that products provided to consumers by franchisees meet all required standards.³⁶⁶ In addition, franchisors sometimes make profits by providing franchisees with goods and equipment.³⁶⁷ Requiring franchisees to buy equipment and goods from franchisors can help protect the know-how and confidential information provided by franchisors.³⁶⁸ In these situations, franchisors may require franchisees to buy the goods, supplies, equipment and other items from franchisors themselves or from specific suppliers in return for a mark-up on the price of the provided goods or supplies.³⁶⁹ A supply of goods clause, however, is

³⁶² *Id.* at 30.

³⁶³ *Id.*

³⁶⁴ Hershman & Caffey, *supra* note 77, at 74.

³⁶⁵ MENDELSON, GUIDE TO FRANCHISING, *supra* note 150, at 374.

³⁶⁶ UNIDROIT, *supra* note 82, at 75.

³⁶⁷ Hershman & Caffey, *supra* note 77, at 77.

³⁶⁸ *Id.*

³⁶⁹ MENDELSON, GUIDE TO FRANCHISING, *supra* note 150, at 98-99.

more important in product-based franchise relationships than service-based franchise relationships.³⁷⁰

3.3.9 Franchisee Obligations

In addition to the franchisee's main obligation to conduct the franchised business according to the standards and instructions of the franchisor, franchisees have other obligations that need to be clearly organized in the franchise agreement.³⁷¹ The most common obligations of franchisees include:

- Payment of franchise fees
- Observing opening and closing hours
- Respecting franchisors' rights of inspection
- Following franchisors' business plans
- Cleaning and maintaining premises and equipment.³⁷²

3.3.10 Development and Subsequent Changes

The franchised business should be updated to meet future developments and changes.³⁷³ Examples include demographic modifications; technological, competition environment, and legal changes; and changes in the strategy of obtaining supplies, goods, and equipment.³⁷⁴ This should be negotiated by the parties and clearly provided for in the franchise agreement.

3.3.11 Liability

³⁷⁰ SHERMAN, *supra* note 118, at 100.

³⁷¹ MENDELSON, GUIDE TO FRANCHISING, *supra* note 150, at 372.

³⁷² *Id.* at 373.

³⁷³ *Id.* at 370.

³⁷⁴ UNIDROIT, *supra* note 82, at 150.

Various issues may be discussed regarding liability related to franchise agreements. Examples include pre-contractual liability, vicarious liability, and insurance requirements. Most pre-contractual misrepresentations arise through advertisements made by franchisors to attract franchisees, particularly those with information promising profits.³⁷⁵ A distinction has to be made between fraudulent, negligent, and innocent misrepresentations. Situations that allow recovery for losses arising out of misrepresentations, with the exception of fraudulent misrepresentations, if proven, are not common.³⁷⁶ For example, in *Hoffman v. Red Owl Stores*, the Supreme Court of Wisconsin decided that actions for fraud cannot be based on unfulfilled promises unless the promisor shows an intention not to perform. In that case there was no evidence that the agent made any promises in bad faith with the intent that they would not be fulfilled.³⁷⁷ The putative franchisor was found liable for the potential franchisee's expenses, but not for lost profits or similar damages. In these circumstances even liability for expenses is doubtful under current law.³⁷⁸ It seems that most franchise laws do not regulate liability arising out of pre-contractual negotiations, but rather leave it to be regulated by the general rules of liability for contracts and torts.

Additionally, franchisors usually try to secure themselves against any claim from a third party arising out of misconduct or negligence committed by franchisees while operating the franchised business. To avoid vicarious liability, franchisors may provide in the franchise

³⁷⁵ MENDELSON, *FRANCHISING LAW*, *supra* note 54, at 112-14.

³⁷⁶ *Id.* at 114.

³⁷⁷ The issue before the Court was whether there was promissory estoppel as per Restatement (First) Restatement of Contracts sec. 90. The Restatement provides that any promise made by the promisor that is expected to induce the promisee to take an action relying on it should be binding. *See Hoffman v. Red Owl Stores, Inc.*, 133 N.W.2d 267 (Wis. 1965).

³⁷⁸ Robert E. Scott, Symposium: Commercial Calamities: *Hoffman v. Red Owl Stores* and the Myth of Pre-contractual Reliance, 68 Ohio St. L.J. 71, 90 (2007).

agreement for franchisees' obligation to indemnify the franchisor for any loss due to a third party claim arising out of the operation of the franchised business by the franchisee. Adding such a provision will make the franchisee more careful and will protect the franchisor against vicarious liability risks.³⁷⁹ In such a case, the liability will pass to the franchisee as it is particularly his own duty to operate the franchised business in a careful way.³⁸⁰

As far as insurance is concerned, franchise agreements usually require franchisees to take insurance in light of their operation of the franchised business.³⁸¹ Additionally, franchisors may require that their names be added to insurance policies as an insured party in addition to the franchisee.³⁸² Parties to franchise agreements are usually careful to search out the probable risks that may arise in the franchised business country.³⁸³ Examples of these liabilities and risks are fire, employers' liabilities, product liability, property used, and interruption of business.³⁸⁴

Furthermore, franchisors usually state in both the franchise agreement and the premises lease agreement, if there is one, that the franchisor and the franchisee are independent from each other and that the franchisee's role is to operate the business.³⁸⁵ Most of the time, franchise agreements use very clear language that negates any agency, employment, partnership, representation, or any other similar relationships.³⁸⁶ In addition, franchisors are counseled to

³⁷⁹ Jay Hewitt, *Franchisor Direct Liability*, 30 FRANCHISE L.J. 35, 37 (2010); see also Heather Carson Perkins, Sarah J. Yatchak & Gordon M. Hadfield, *Franchisor Liability For Acts of The Franchisee*, 29 FRANCHISE L.J. 174, 181 (2010).

³⁸⁰ Hewitt, *supra* note 379, at 36; see also Perkins, Yatchak & Hadfield, *supra* note 379, at 181.

³⁸¹ SHERMAN, *supra* note 118, at 110.

³⁸² UNIDROIT, *supra* note 82, at 175.

³⁸³ UNIDROIT, *supra* note 82, at 175.

³⁸⁴ ADAMS ET AL., *supra* note 63, at 433.

³⁸⁵ Perkins, Yatchak & Hadfield, *supra* note 379, at 181.

³⁸⁶ *Id.*

provide in the franchise agreement that they are not responsible for the franchisees' employees, to avoid any responsibility arising out of employees' misbehavior.³⁸⁷

Franchise agreements may also provide for the franchisee's liability to announce to consumers that they are not the owners of the business and that they are just operating the business in different ways. Examples include putting a conspicuous notice on the premises that refers to the fact that the franchisee just operates the business and is independent from the franchisor who owns the business.³⁸⁸

3.3.12 Premises

Franchise agreements usually determine whether site selection is to be done by the franchisor or the franchisee. Franchisors, however, usually give consideration to the franchisees' opinion in evaluating the site when the franchisee is more aware of the local conditions of his own country.³⁸⁹

Ownership of the franchised business premises varies from one franchise agreement to another. Some franchisors like to control the franchised business unit premises to be able to maintain the premises in future if the franchisee withdraws from the franchise relationship. In such a case, the franchisor prefers to keep the ownership or leasehold of the premises in his own name and lease it or sublease it to the franchisee.³⁹⁰ Alternatively, if the premises are owned by the franchisee, the franchisor can conclude an assignment with the franchisee so that at the end

³⁸⁷ *Id.* at 182.

³⁸⁸ *Id.*

³⁸⁹ *Id.* at 235.

³⁹⁰ Hershman & Caffey, *supra* note 77, at 67-68.

of the franchise agreement, the franchisee's ownership of the premises vests in the franchisor.³⁹¹ Even when the franchisee is simply a lessee, the same can be accomplished through an assignment, executed at the time of the franchise, of the franchisee's leasehold rights.³⁹² In all cases, the franchisee will deserve compensation for any improvements made to the premises by the end of the franchise agreement.³⁹³

3.3.13 Advertisements

Franchisors usually prefer to control advertising for various reasons. For example, it is more appropriate to have an international standard of advertisement, particularly for global franchisors, that keeps the same image of the franchised business and maintains the same impression in consumers' minds.³⁹⁴ Franchisors' control of the advertisement system will also help them to enhance their trademarks and the goodwill of the franchised business.³⁹⁵ Moreover, franchisors guarantee the elimination of misleading or unsuitable advertisements that do not fit well with the nature of the franchised business.³⁹⁶

Accordingly, franchisors shall determine in the franchise agreement the exact methodologies of advertisement. Franchisors may prefer to provide all the advertisement materials, contact advertising agencies, select the media used, and the other methodologies of

³⁹¹ *Id.*

³⁹² *Id.*

³⁹³ ADAMS ET AL., *supra* note 63, at 240.

³⁹⁴ MENDELSON, *GUIDE TO FRANCHISING*, *supra* note 150, at 98.

³⁹⁵ *Id.*

³⁹⁶ *Id.*

advertisement themselves.³⁹⁷ Alternatively franchisors may only keep the right to approve franchisees' decisions on advertising.³⁹⁸ Advertisement costs should be organized in the franchise agreement as outlined earlier.³⁹⁹

Franchise agreements usually provide for franchisees' obligation to refrain from advertising without the prior consent of the franchisor.⁴⁰⁰ Also, franchise agreements usually provide for the franchisee's obligation to follow advertisement standards as set by the franchisor or provided by the franchisee himself and approved by the franchisor.⁴⁰¹

3.3.14 Exclusivity

Exclusivity issues arise in respect to territory, granted rights, and time. As far as territory is concerned, franchisors may decide to limit the franchise agreement to a specific geographical area, like a country, county, or city. In such cases, the franchisor will undertake to protect the franchisee from competition by refraining from granting other franchises in the same territory.⁴⁰² The franchisor may also limit the exclusivity of territory or specific rights to a specific period of time depending on the nature of each franchise relationship and the surrounding circumstances.⁴⁰³

³⁹⁷ *Id.* at 99.

³⁹⁸ *Id.* at 100.

³⁹⁹ *See supra* Ch. III. 2.11 (discussing Advertisements).

⁴⁰⁰ MENDELSON, GUIDE TO FRANCHISING, *supra* note 150, at 373.

⁴⁰¹ *Id.*

⁴⁰² WIPO FRANCHISING GUIDE, *supra* note 242, at 38.

⁴⁰³ *Id.* at 39.

With respect to granted rights, the franchisor may license the franchisee to sell franchised products or services to specific consumers such as individual consumers and not companies.⁴⁰⁴ Similarly, the franchisor may allow the franchisee to use only specific methods of sale such as home delivery of the franchised products.⁴⁰⁵

3.3.15 Regulatory and Procedural Issues

Since running a business requires more than just consideration of substantive issues, procedural issues such as obtaining permissions should also be addressed. These regulatory issues should be organized in detail in the franchise agreement to avoid future disputes.⁴⁰⁶ Examples of regulatory and procedural issues include any required governmental approvals, procedures governing employment of foreign employees, and import and export licenses.⁴⁰⁷

3.3.16 Taxes

How taxes are calculated, reported and collected varies from one tax system to another.⁴⁰⁸ On a local level, property taxes, sales taxes, and business profit taxes are collected, and a distinction should be drawn between the assets regarded as capital and those regarded as revenue for tax purposes.⁴⁰⁹ On an international level, it is important to be aware of any bilateral or other tax treaties between the franchisor's country and the target country; avoidance of double taxation

⁴⁰⁴ *Id.*

⁴⁰⁵ *Id.*

⁴⁰⁶ MENDELSON, GUIDE TO FRANCHISING, *supra* note 150, at 241-47.

⁴⁰⁷ *Id.*

⁴⁰⁸ MENDELSON & RUDNICK, *supra* note 227, at 11.

⁴⁰⁹ UNIDROIT, *supra* note 82, at 62.

may be a significant factor in business planning.⁴¹⁰ In addition, some countries impose a withholding tax on advertising fees.⁴¹¹ Hence, the franchise agreement should consider tax issues whether by considering tax payments in the franchisor's country or the franchisee's country or both when required.⁴¹²

3.3.17 Term

The length of the franchise agreement usually depends on the franchisor's intentions, the potential life of the premises, and other factors that vary from one franchise agreement to another.⁴¹³ Still, it is common for franchise agreements to be long enough in duration to allow both parties to achieve the expected profits from the franchise relationship.⁴¹⁴ A long-term franchise agreement allows the franchisor to achieve acceptable profits on his business model and it gives the franchisee the time to develop the franchised business in a way satisfactory to the franchisor.⁴¹⁵

3.3.18 Renewal

Franchisors usually make renewal of the agreement conditional on a number of factors. For instance, fulfillment of the franchisee's obligations, a written notice given by the franchisee of his desire to renew and another notice made by the franchisor accepting or declining renewal,

⁴¹⁰ MENDELSON & RUDNICK, *supra* note 227, at 11.

⁴¹¹ UNIDROIT, *supra* note 82, at 62.

⁴¹² UNIDROIT, *supra* note 82, at 62.

⁴¹³ Hershman & Caffey, *supra* note 77, at 60.

⁴¹⁴ ADAMS ET AL., *supra* note 63, at 275.

⁴¹⁵ UNIDROIT, *supra* note 82, at 48.

and other conditions that depend on the nature of each transaction.⁴¹⁶ Renewal, though, does not necessarily take place according to the same provisions of the old franchise agreement.⁴¹⁷ For example, franchisors may use a different fee structure and franchisees may not need training that took place during the first franchise agreement.⁴¹⁸

Most of the time, renewal is conditional on the franchisee's compliance with the terms of the first franchise agreement.⁴¹⁹ Sometimes, franchisors allow renewal on condition that the franchisee refurbish the franchised unit and make specific improvements to make it appear in a new form.⁴²⁰ The latter case is called a "revamp clause" and is not well-embraced by franchisees who, in many cases, must raise money in an amount that equals or sometimes exceeds that which they invested in the first agreement.⁴²¹ In the same context, franchisors may allow renewal of the agreement only on the condition that the franchisee move the site of the franchised business to another location that the franchisor considers more suitable or that fits the franchised business in a better way. This is called a "relocation clause."⁴²²

3.3.19 Death

In order to avoid any interruption in the operation of the franchised unit and to maintain the public image of the unit, franchisors may provide in the franchise agreement that in case of

⁴¹⁶ SHERMAN, *supra* note 118, at 337.

⁴¹⁷ WIPO FRANCHISING GUIDE, *supra* note 242, at 46.

⁴¹⁸ *Id.*

⁴¹⁹ Hershman & Caffey, *supra* note 77, at 62.

⁴²⁰ MENDELSON, GUIDE TO FRANCHISING, *supra* note 150, at 368.

⁴²¹ *Id.*

⁴²² *Id.* at 369.

death or if the franchisee is unable to operate the franchised unit for other reasons,⁴²³ that the right to operate the unit is transferred to the franchisee's heirs and if they are unable to operate it, that the franchisor has the right to manage or repurchase it.⁴²⁴

3.3.20 Transfer

Because franchise relationships are usually based on personal considerations, transfer provisions can be hard to negotiate. Though franchisors usually maintain the right to transfer the franchise agreement, they try to protect themselves against transfer taking place by franchisees.⁴²⁵

Franchisors usually try to make sure that all the franchisee's monetary obligations arising out of the agreement are completely fulfilled before the transfer process takes place.⁴²⁶ Similarly, franchisors try to make sure that transfer does not take place unless franchisees comply with all duties and obligations arising from the franchise agreement.⁴²⁷ In the same context, the franchisee usually releases the franchisor from any claims brought against the franchisee or any of his employees before the transfer takes place.⁴²⁸ Franchisors also try to confirm that transferees accept assignment of all the pending obligations and debts of the franchisee and that transferees are willing to meet all conditions required by franchisors and provided in the

⁴²³ ADAMS ET AL., *supra* note 63, at 259.

⁴²⁴ MENDELSON, *GUIDE TO FRANCHISING*, *supra* note 150, at 375.

⁴²⁵ Hershman & Caffey, *supra* note 77, at 86.

⁴²⁶ SHERMAN, *supra* note 118, at 339.

⁴²⁷ *Id.*

⁴²⁸ *Id.*

franchise agreement.⁴²⁹ Moreover, franchisors usually require franchisees to remain liable for any commitments that have arisen before the signing of the transfer agreement.⁴³⁰

Finally, it is common for franchise agreements to provide for the franchisee's obligation not to assign the franchised business or the franchise agreement without the prior approval of the franchisor.⁴³¹ It is important for franchisors to incorporate into the franchise agreement a right of first refusal clause.⁴³² If the franchisor refuses to have the unit transferred to himself, transfer usually takes place to new transferees on conditions and limitations accepted by the franchisor.⁴³³

3.3.21 Termination

Franchise agreements are terminated once their agreed upon period ends, unless there is a provision for its extension or renewal, or when the agreement provides for renewal or extension but the parties decide not to renew or extend.⁴³⁴ The franchise agreement may provide the franchisor with a right to terminate the agreement for many reasons. For instance, the franchisee's failure to comply with the development schedule, opening times, training standards, or any other requirements determined by the franchise agreement.⁴³⁵ Similarly, the franchisor may have the right to terminate the franchise agreement in case of bankruptcy or insolvency of the franchisee.⁴³⁶ The franchisor also has the right to terminate the franchise agreement in

⁴²⁹ *Id.* at 342-43.

⁴³⁰ *Id.* at 343.

⁴³¹ Bruce S. Schaeffer, *Succession Planning For Franchisees*, 21 *FRANCHISE L.J.* 90, 92 (2001).

⁴³² UNIDROIT, *supra* note 82, at 169.

⁴³³ *Id.*

⁴³⁴ UNIDROIT, *supra* note 82, at 188-189.

⁴³⁵ Hershman & Caffey, *supra* note 77, at 87.

⁴³⁶ *Id.* at 88.

various other cases such as where there is an unapproved assignment by the franchisee, where a franchisee refuses to allow inspection by the franchisor, where there is a failure to pay any of the monetary obligations arising out of the franchise agreement, unauthorized use of the intellectual property licensed by the franchise agreement, and death of the franchisee.⁴³⁷ Situations where a franchisee may terminate the franchise agreement by its own will are rarely provided in franchise agreements,⁴³⁸ while situations where the franchisor may terminate a franchise agreement are usually organized in a clear and definite way to avoid future disputes.⁴³⁹

Consequences arising out of the termination of the agreement include, among others, the franchisee's obligation to stop operating the franchised unit, using the franchisor's intellectual property, or making use of the know-how and confidential information, to return manuals and similar materials, and to delete any communications or advertising.⁴⁴⁰

Some franchise laws and regulations provide for what is called the "good cause" termination clause, which allows a party to the franchise agreement to terminate the agreement upon a showing of good cause.⁴⁴¹ The grounds constituting good cause for termination differ from one legal system to another.⁴⁴² Examples of good cause include harm to the franchisor's reputation done by the franchisee, selling competing goods and services, and the franchisee's failure to meet specific requirements of the franchise agreement.⁴⁴³ The parties may list what

⁴³⁷ *Id.*

⁴³⁸ UNIDROIT, *supra* note 82, at 191.

⁴³⁹ Hershman & Caffey, *supra* note 77, at 88.

⁴⁴⁰ UNIDROIT, *supra* note 82, at 191-93.

⁴⁴¹ Thomas M. Pitegoff & W. Michael Garner, *Franchise Relationship Laws*, in *FUNDAMENTALS OF FRANCHISING LAW* 194 (Rupert M. Barkoff & Andrew C. Selden eds., 3d 2008).

⁴⁴² *Id.*

⁴⁴³ *Id.* at 195-99.

constitutes good cause for termination in their franchise agreement. The procedures required for termination, such as sending a termination notice within a specific period of time, should be organized in the franchise agreement.⁴⁴⁴

Some post-termination restrictions and obligations survive termination of franchise agreements.⁴⁴⁵ The most important examples of these restrictions include provisions prohibiting use of the franchisor's know-how.⁴⁴⁶ Others include provisions prohibiting use of confidential or undisclosed information, or competition with the franchisor for a certain period or within a specific area.⁴⁴⁷ In the same context, the restriction prohibiting the franchisee from contacting former customers of the franchisor is one of the important obligations surviving termination of the franchise agreement.⁴⁴⁸

3.3.22 Breach

Franchise agreements usually define situations where material breach will allow the non-breaching party to terminate the agreement.⁴⁴⁹ A material breach is a breach that touches the root of the franchise agreement or that affects the main goal of the agreement.⁴⁵⁰ Examples of material breach by franchisees include non-payment of fees, breach of the competition clause,

⁴⁴⁴ SHERMAN, *supra* note 118, at 111.

⁴⁴⁵ WIPO FRANCHISING GUIDE, *supra* note 242, at 42.

⁴⁴⁶ *Id.*

⁴⁴⁷ *Id.* at 43.

⁴⁴⁸ MENDELSON, GUIDE TO FRANCHISING, *supra* note 150, at 329.

⁴⁴⁹ WIPO FRANCHISING GUIDE, *supra* note 242, at 41.

⁴⁵⁰ W. Michael Garner & Sarah A. Johnston, *Utilizing the Doctrine of Prior Material Breach to End a Franchise Relationship*, 24 FRANCHISE L.J. 23, 24 (2004).

and non-payment for supplied goods.⁴⁵¹ Examples of material breach committed by franchisors include unilateral and fundamental changes made to the relationship, and breach of the principle of good faith in performing the franchise agreement.⁴⁵²

The parties, however, may postpone termination of the agreement and may give the breaching party a chance to correct the consequences of his breach.⁴⁵³

3.3.23 Disputes

To avoid confusion, franchising parties may decide whether they will resort to compulsory methods of alternative dispute resolution or litigation in case of future disputes. It is beyond the scope of this paper to analyze the respective merits of dispute resolution mechanisms. Nevertheless, if the parties agree to resort to arbitration it is important to decide on the applicable law, the procedural rules governing the arbitration, the language, number of arbitrators, place of arbitration, and any other issues related to the nature of the franchise agreement.⁴⁵⁴

3.3.24 Choice of Law

In general, franchising parties exercise a freedom of choice over the law that governs the franchise agreement. In all cases, however, the franchising parties must comply with any mandatory legislation such as that protecting intellectual property rights, pursuing public policy

⁴⁵¹ *Id.* at 25.

⁴⁵² *Id.*

⁴⁵³ WIPO FRANCHISING GUIDE, *supra* note 242, at 41.

⁴⁵⁴ KONIGSBERG, *supra* note 243, at 266.

goals, regulating registration procedures with governmental entities, and tax obligations.⁴⁵⁵

These mandatory laws usually have provisions that cannot be superseded by contractual terms.⁴⁵⁶

If the franchise agreement does not determine the exact law governing the franchise relationship, the applicable law will be determined through a conflict of law analysis.⁴⁵⁷ The conflict of law rules could lead to application of the law of the place where the agreement was made, the law of the place where the agreement is performed, or the law of any other place agreed upon by the parties that bears some relation to the agreement.⁴⁵⁸

3.3.25 Severability

Severability is relevant with regard to long-term agreements. It is important that performance of the franchise relationship continues until the parties achieve the expected returns on their investments.⁴⁵⁹ It is logical to provide in the franchise agreement that if a specific provision becomes invalid or unenforceable, that the rest of the agreement will remain valid and is not affected by the invalid provision.⁴⁶⁰ In such a case, the invalid clause is severed, amended, or replaced with another valid one.⁴⁶¹

3.3.26 Integration Clauses

⁴⁵⁵ UNIDROIT, *supra* note 82, at 197.

⁴⁵⁶ *Id.*

⁴⁵⁷ UNIDROIT, *supra* note 82, at 196.

⁴⁵⁸ *Id.*

⁴⁵⁹ UNIDROIT, *supra* note 82, at 218.

⁴⁶⁰ Garner & Johnston, *supra* note 450, at 28.

⁴⁶¹ *Id.*

It is often appropriate for the parties to a franchise agreement to provide that their agreement is the entire agreement concluded by the parties and that any other documents that are not referred to in the agreement are invalid.⁴⁶² One can conclude that franchising parties usually insert this clause to avoid future disputes. The entire agreement may include many other documents signed by the parties and intended to be part of the franchise agreement through incorporation, such as operations manuals, representations, warranties, and equipment lists.⁴⁶³ These additional documents are incorporated into the franchise agreement by reference and integration.

3.3.27 Notices

The notice clause should specify what constitutes notices, appropriate forms, whether notices need to be in writing, their duration, the method of their delivery, and when exactly they are considered delivered.⁴⁶⁴

3.3.28 Language

Franchise agreements include, to a certain extent, technical information related to confidential know-how which makes determining the language of the agreement important.⁴⁶⁵ The importance of language seems clear when it comes to vital documents such as operating manuals that are delivered to the franchisee. It is necessary to translate documents into the franchisee's language if it differs from the franchisor's. In such cases, the question of who bears

⁴⁶² UNIDROIT, *supra* note 82, at 218-19 .

⁴⁶³ *Id.*

⁴⁶⁴ *Id.* at 224.

⁴⁶⁵ KONIGSBERG, *supra* note 243, at 260.

the burden of the fees for the translation should be settled in advance in the franchise agreement.⁴⁶⁶ Additionally, local laws and regulations of the franchisee's country sometimes require that the franchise agreement be in the local language; translation, additionally, may be needed for registration and other procedural issues.⁴⁶⁷

3.3.29 Force-Majeure and Hardship

Both force-majeure and hardship result from external unavoidable events that were unforeseeable or that otherwise were not taken into account in the agreement.⁴⁶⁸ Hardship usually affects the equilibrium of the agreement and requires a sort of renegotiation of the agreement to restore a working equilibrium whereas force-majeure usually prevents the performance of the agreement and works as a reason for termination or delay.⁴⁶⁹ Examples of force majeure include fire, government acts, acts of God, explosions, war, and epidemics, whereas examples of hardship include change in the exchange rate of the payment currency or a sudden increase in the price of a raw material.⁴⁷⁰ Either way, the franchise agreement should define both events and perhaps give examples of both, and it should provide for the remedies or solutions available in case of force-majeure or hardship.⁴⁷¹

3.4 Ancillary or Complementary Agreements

⁴⁶⁶ *Id.* at 261.

⁴⁶⁷ UNIDROIT, *supra* note 82, at 27.

⁴⁶⁸ KONIGSBERG, *supra* note 243, at 277.

⁴⁶⁹ *Id.*

⁴⁷⁰ UNIDROIT, *supra* note 82, at 215-217.

⁴⁷¹ KONIGSBERG, *supra* note 243, at 277.

Complementary agreements include, among others, “preliminary agreements, side agreements, and . . . addenda.”⁴⁷² The reason behind concluding an independent additional agreement, different from the franchise agreement itself, is that some commitments may precede the franchise agreement, like pilot agreements.⁴⁷³ Other commitments follow the franchise agreement such as termination and transfer agreements.⁴⁷⁴ Also, some commitments need extensive explanation or concentration such as those related to non-competition and confidentiality.⁴⁷⁵ The most important thing to note about ancillary agreement is that their provisions should be consistent with the franchise agreement itself.⁴⁷⁶

Ancillary or complementary agreements and their contents differ from one legal system to another and from one franchise transaction to another.⁴⁷⁷ The most common ancillary or complementary agreements include letters of intent, pilot agreements, premises selection agreements, confidentiality agreements, and non-competition agreements.⁴⁷⁸ They also include a guarantee agreement that allows franchisors to ask guarantors for compensation in case of the franchisee’s failure to fulfill any of his obligations arising out of the franchise agreement.⁴⁷⁹ Additionally, supply agreements, equipment purchase or lease agreements, software license agreements, and trademark license agreements may be included.⁴⁸⁰ Services and consultation

⁴⁷² UNIDROIT, *supra* note 82, at 222.

⁴⁷³ *Id.* at 223.

⁴⁷⁴ *Id.*

⁴⁷⁵ *Id.*

⁴⁷⁶ MENDELSON, *FRANCHISING LAW*, *supra* note 54, at 397.

⁴⁷⁷ *Id.*

⁴⁷⁸ MENDELSON, *GUIDE TO FRANCHISING*, *supra* note 150, at 378.

⁴⁷⁹ UNIDROIT, *supra* note 82, at 227.

⁴⁸⁰ *Id.* at 234.

agreements, release agreements,⁴⁸¹ transfer agreements, and termination agreements are sometimes independent from the franchise agreement itself.

Conclusion

This chapter elaborated on the most important considerations in understanding how a franchise transaction works. This includes the definition, elements, and legal nature of franchise transactions that distinguish them from other forms of business. Moreover, it elaborated on other financial and factual issues that are important to better understand the franchising process, such as financial considerations and market analysis. The most important aspect from a legal perspective is the franchise agreement itself, starting with the negotiation process and the liability of the negotiating parties. The chapter also examined the most common provisions in franchise agreements such as rights and obligations of the parties, confidentiality, non-competition, settlement of disputes, and termination.

Establishing a comprehensive background is important for conducting a comparative analysis of the franchising laws of the American, Chinese and Malaysian legal systems chosen for this study with the goal of reaching a working model law on franchising for Egypt. A brief background will be given on the state of Egyptian law in the following chapter to examine the features of a franchising law that would work best for that country.

⁴⁸¹ See *supra* Ch. I. 3.4 (discussing Ancillary and Complementary Agreements).

CHAPTER II

FRANCHISING IN EGYPT: CURRENT SITUATION

Introduction

Despite the relatively small size of the Egyptian franchising market as compared to the American and Chinese markets, the Egyptian population and its unique geographical location make Egypt a desirable destination for international franchisors.⁴⁸² The franchising industry in Egypt began in the 1970s when the Egyptian market was first opened for foreign investment by President Sadat.⁴⁸³ Egypt, however, does not have a specific law on franchising, which creates confusion and conflict between franchising parties.⁴⁸⁴ In the absence of such a law, it is important to analyze the general legal environment in Egypt. Doing so will clarify how franchising is legally addressed at the present, the precise legislative gaps that need to be filled, and the importance of having a comprehensive franchising law in Egypt. This Chapter will also discuss the economic situation of the Egyptian market and briefly examine the extent to which Islamic law (*Shari'a*) affects Egyptian laws and trade.

After providing an overview of the legal, economic, and religious situation in Egypt, this Chapter will discuss the current situation on franchising in Egypt, the historical background of franchising in Egypt, and the present legal situation regarding franchising and the problems arising therefrom.

⁴⁸² Egypt is located in the center of the Middle East with Libya to the west, Sudan to the South, Israel to the northeast, the Mediterranean Sea to the north, and the Red Sea. Egypt is the only land bridge connecting Africa and Asia. Egypt also has the sixteenth highest population in the world. See Mohamed S. E. Abdel Wahab, *An Overview of the Egyptian Legal System and Legal Research*, GLOBALEX (Nov./Dec. 2008), <http://www.nyulawglobal.org/Globalex/Egypt1.htm> (Section 9, Enforcements of Judgments and Appeal).

⁴⁸³ MARAT TERTEROV, *DOING BUSINESS WITH EGYPT* 4 (2001).

⁴⁸⁴ Lindsey, *supra* note 28, at 15.

1. Background: Economic, Legal, and Religious Contexts

1.1 Economic Context

The Arab Republic of Egypt stands as a gateway to the Arab Middle East and Africa with a population of 82,054,000 in 2011.⁴⁸⁵

President Gamal Abdel-Nasser, 1952-70, adopted nationalization as an economic policy and promoted the role of the public sector in developing the economy.⁴⁸⁶ Economic laws in this era concentrated on developing agriculture, governing and organizing public companies, controlling prices, and nationalizing laws.⁴⁸⁷

President Al-Sadat, 1970-81, transformed economic policy from a public sector-based economy to a private sector-based economy, adopting the so-called “Open Door Policy.” This policy aimed at attracting private capital to the Egyptian local market by liberalizing trade and promoting a free economy.⁴⁸⁸ Hence, economic regulation in this era concentrated on privatization laws, investment laws, and budgetary laws.⁴⁸⁹

President Mubarak, 1981-2011, made use of Egypt’s geopolitical position in the Middle East for Egypt’s benefit. During the Mubarak era, the Egyptian government received subsidies in return for enhancing the American role in the Middle East and committing to the peace treaty with Israel.⁴⁹⁰ Economic laws during this time concentrated on foreign direct investment,

⁴⁸⁵ GLOBAL INSIGHT EGYPT, *supra* note 34.

⁴⁸⁶ TERTEROV, *supra* note 483, at 9.

⁴⁸⁷ Lama Abu-Odeh, *On Law And The Transition To Market: The Case of Egypt*, 23 EMORY INT’L L. REV. 351, 366 (2009).

⁴⁸⁸ TERTEROV, *supra* note 483, at 9.

⁴⁸⁹ Abu-Odeh, *supra* note 487, at 366.

⁴⁹⁰ *Id.* at 362.

corporate governance, telecommunications, imports and exports, competition, and free tariffs zones.⁴⁹¹ Nevertheless, most investment tools during the Mubarak era were concentrated in the hands of the elite.⁴⁹² This elite monopoly led to an unfair distribution of wealth which eventually caused the January Revolution in 2011.⁴⁹³ Forty four percent of Egyptians used to be categorized as extremely poor to near poor, more than 10% are unemployed and almost 90% of the unemployed are between 15 and 24 years old.⁴⁹⁴

In essence, the main sources of the Egyptian economy are Suez Canal dues, tourism, the oil and gas industry, and remittances from expatriates working abroad.⁴⁹⁵ Trade is a principal element of the Egyptian economy.⁴⁹⁶ Egypt's main imports are agricultural products, food components, medicines, and metal industrial components; its primary exports are oil and cotton.⁴⁹⁷ Egypt's main trade partners include the United States, China, the United Kingdom, Spain, Germany, Syria, and Saudi Arabia.⁴⁹⁸

⁴⁹¹ *Id.* at 366.

⁴⁹² CREDIT AGRICOLE BANK, *supra* note 29.

⁴⁹³ . See generally Radwa S. Elsaman & Ahmed Elshorbagy, *Doing Business in Egypt after the January Revolution: Capital Market and Investment Laws*, 11 RICHMOND J. GLOBAL L. & BUS. 3 (2011). See also discussion *supra* note 31.

⁴⁹⁴ Ben W. Heineman Jr., *Why Egypt's Economy Matters*, THE ATLANTIC (Dec. 12, 2011, 7:25 AM), <http://www.theatlantic.com/international/archive/2011/12/why-egypts-economy-matters/249718/>.

⁴⁹⁵ GIL FEILER, THE MIDDLE EAST IN THE NEW MILLENNIUM ECONOMIC DEVELOPMENT & BUSINESS LAW 46-49 (2000). The latest report issued by the Central Bank of Egypt on the GDP factor by sector provides that the total Egyptian GDP for the year 2009/2010 amounted to 837,770.3 million Egyptian pounds. The oil share of the GDP amounts to 47,055.0 million Egyptian pounds, where the natural gas share is 3,437.0 million Egyptian pounds. Also, manufacturing industries share is 134,764.0 million Egyptian pounds. Moreover, Suez Canal share is 25,328.5 million Egyptian pounds. Finally, tourism share is 35,648.8 million Egyptian pounds. See CENTRAL BANK OF EGYPT, ANNUAL REPORT 2009/2010 115 (2010), http://www.cbe.org.eg/public/annualreport2009_2010E.pdf.

⁴⁹⁶ See FEILER, *supra* note 495, at 47-49 (noting that the main exports of Egypt include crude petroleum, raw cotton, and rice and the main imports include transportation equipments, chemicals, metal products, and foodstuff).

⁴⁹⁷ *Id.* at 46-49.

⁴⁹⁸ *Country Fact Sheet: Egypt*, INT'L FRANCHISE ASS'N, <http://franchise.org/IndustrySecondary.aspx?id=45590> (last visited Jan. 14, 2012). For instance, the Egyptian market is the fourth largest importer of American products in the Middle East and one of the most important importers of specific American products such as agricultural equipments

1.2 Legal Context

The Egyptian legal system is a combination of Islamic law (“*Shari’a*”) and an adaptation of the Napoleonic Code.⁴⁹⁹ Egypt is the first Arab Middle Eastern country that voluntarily adopted Western style laws in the late nineteenth century.⁵⁰⁰ It is important to understand that Egypt is a civil law country whose legal system is based on codified law.⁵⁰¹ Understanding the Egyptian legal system requires a brief exposition of the most relevant law, and a brief overview of how the Egyptian judicial system works. This is necessary especially, to understand the role the judiciary plays in applying and interpreting different laws.

1.2.1 Laws

Among the most important Egyptian laws is the Civil Law laying down general rules governing contracts and property. Also, the Commercial Law provides general rules on the conclusion of commercial transactions. Moreover, Egypt has different laws regulating specific legal areas such as the Intellectual Property Law, Competition Law, Tax Law, Companies Law, and Investment Law.

1.2.1.1 Civil Law

and products. Also the United States is the second biggest foreign investor in the Egyptian market. *DOING BUSINESS IN EGYPT*, *supra* note 23.

⁴⁹⁹ Wahab, *supra* note 482.

⁵⁰⁰ SAMIR SALEH, *COMMERCIAL ARBITRATION IN THE ARAB MIDDLE EAST, SHARI’A, LEBANON, SYRIA, AND EGYPT* 335 (2006).

⁵⁰¹ Wahab, *supra* note 482.

The Egyptian Civil Law, which is heavily influenced by European models, particularly the French Civil Code,⁵⁰² is the general law that governs private relationships in areas such as property, contracts, personal guarantees, and evidence.⁵⁰³ The Egyptian Civil Law also serves as a gap filler for other areas of private law, including commercial law.

1.2.1.2 Commercial Law

The Egyptian Commercial Law is the general law regulating trade and commerce in Egypt.⁵⁰⁴ It regulates various matters related to commerce such as banking operations, commercial sales, bankruptcy, and commercial paper.⁵⁰⁵ There are two criteria for applying the Egyptian Commercial Law: conducting commercial transactions or acting in the capacity of a merchant whether by natural or juridical persons.⁵⁰⁶ Commercial transactions include buying goods with the intent to sell or rent them, the formation of businesses, supply of goods and services, insurance, banking operations, construction transactions, and any other transactions of a similar nature.⁵⁰⁷ Additionally, the word merchant means any person carrying out commercial activities as long as he enjoys the legal capacity to trade. Merchants include companies, according to rules provided by the Egyptian company law explained below.⁵⁰⁸

⁵⁰² May El Batouti et al., *Egypt, in* ARBITRATION AND MEDIATION IN THE SOUTHERN MEDITERRANEAN COUNTRIES 18 (Giuseppe De Palo & Mary B. Trevor eds., 2007).

⁵⁰³ Law No. 131 of 1948 (Civil Law), *Al-Jarida Al-Rasmiyya*, 29 July 1948 (Egypt) [hereinafter Egyptian Civil Law]

⁵⁰⁴ Law No. 17 of 1999 (Commercial Law), *Al-Jarida Al-Rasmiyya*, 17 May 1999 (Egypt) [hereinafter Egyptian Commercial Law]. The Commercial Law replaced the old Law of Commerce that was promulgated in 1883 and inspired by the Napoleonic Law. *See* EGYPT AND ITS LAWS 49 (Nathalie Bernard-Maugiron et al. eds., 2002).

⁵⁰⁵ *See generally* Egyptian Commercial Law, *supra* note 504.

⁵⁰⁶ *Id.* at art. 1.

⁵⁰⁷ *Id.* at arts. 4-7.

⁵⁰⁸ *Id.* at art. 10.

1.2.1.3 Agency Laws

Agency is mainly regulated by Egyptian Commercial Law No. 17 of 1999.⁵⁰⁹ The Civil Law also includes various rules that apply primarily to agency such as general definitions, elements, and effects of agency.⁵¹⁰ Both the Egyptian Commercial Law and the Egyptian Civil Law regulate the substantive issues of licensing and operation of commercial agents. In addition, some other specialized laws regulate specific procedural conditions necessary to be registered as an agent, such as the Commercial Register Law No. 34 of 1976⁵¹¹ that requires that commercial agents be allowed to register in Egypt and conduct business.⁵¹² It also provides that for corporations and partnerships to work as agents, the majority of their capital must be owned by Egyptians.⁵¹³

1.2.1.4 Law on Protection of Intellectual Property No. 82 of 2002

The Egyptian Intellectual Property Law addresses patents, copyrights, trademarks, integrated circuit designs, trade secrets, geographical indications, and industrial designs.⁵¹⁴ Although the Egyptian Intellectual Property Law gives a flexible definition of trademark as any distinctive sign distinguishing products or services, it restricted trademarks to visible signs.⁵¹⁵

⁵⁰⁹ *Id.* at art. 148-91.

⁵¹⁰ Egyptian Civil Law, *supra* note 503, at arts. 699-717.

⁵¹¹ Law No. 34 of 1976 (Commercial Registrar), *Al-Jarida Al-Rasmiyya*, 6 May 1976 (Egypt).

⁵¹² *See generally id.*

⁵¹³ *See generally id.*

⁵¹⁴ Law No. 82 of 2002 (Intellectual Property Law), *Al-Jarida Al-Rasmiyya*, 2 June 2002 (Egypt) [hereinafter Egyptian Intellectual Property Law].

⁵¹⁵ *Id.* at art. 63.

The Egyptian Intellectual Property Law allows transfer of the ownership of the mark independently from the commercial enterprise or business association.⁵¹⁶ According to the Egyptian Intellectual Property Law, trademark registration is valid for ten years from the date of filing the trademark application.⁵¹⁷ The Egyptian Intellectual Property Law also allows an owner to license a trademark while simultaneously retaining ownership rights and to use the trademark unless the license agreement provides otherwise.⁵¹⁸

1.2.1.5 Taxation Law

The Egyptian taxation system has two main categories of taxes: income taxes on individuals and corporations and an indirect value-added tax on goods and services.⁵¹⁹ The law organizing taxation in Egypt is Income Tax Law No. 91 of 2005.⁵²⁰ Egypt is party to treaties with various countries seeking to avoid double taxation.⁵²¹

1.2.1.6 Competition Law No. 3 of 2005

The law protecting and ensuring a competitive market in Egypt is the Protection of Competition and Prohibition of Monopolistic Practices Law No. 3 of 2005, which is implemented by the Egyptian Competition Authority. This law provides that a company

⁵¹⁶ *Id.* at arts. 87-89.

⁵¹⁷ *Id.* at art. 90.

⁵¹⁸ *Id.* at art. 95.

⁵¹⁹ FEILER, *supra* note 495, at 69.

⁵²⁰ Law No. 91 of 2005 (Income Tax Law), *Al-jarida Al-Rasmiyya*, 9 June 2005 (Egypt).

⁵²¹ FEILER, *supra* note 495, at 73. An example of a double treaty is the American-Egyptian treaty that reduces royalty taxes to 15% of the gross royalty. *See id.*

controlling 25% or more of a specific industrial sector in the Egyptian market can be accused of unfair practices and would be liable under the competition law.

1.2.1.7 Company Law No. 159 of 1981

Business associations in Egypt are governed by Company Law No. 159 of 1981,⁵²² in addition to remnants of the old Egyptian Commercial Law of 1883 that are still in force.⁵²³ The Egyptian Company Law recognizes different forms of business associations such as partnerships, limited partnerships, partnerships limited by shares, limited liability companies, and corporations.⁵²⁴

1.2.1.8 Investment Incentives Law No. 8 of 1997

The Egyptian Investment Law provides, in case of investing in specific fields, incentives, guarantees, and benefits such as tax exemptions, and a prohibition on nationalization or confiscation. Examples of these fields include reclaiming and cultivating desert lands, manufacturing, mining, hotels, maritime transport, petroleum services, and others.⁵²⁵ The list of fields embodied in the Egyptian Investment Law is not exclusive and other fields and activities can be added by the Cabinet, by virtue of its the executive authority.⁵²⁶ Incentives and guarantees

⁵²² Law No. 159 of 1981 (Company Law), *Al-Jarida Al-Rasmiyya*, 1 Oct. 1981 (Egypt)

⁵²³ Some other parts of other laws apply to companies such as the Investment Incentives Law, the laws dealing with public sector companies, the law dealing with companies working in receiving and investing funds, and the Stock Exchange Law. See EGYPT AND ITS LAWS, *supra* note 504, at 63.

⁵²⁴ Tarek F Riad, *The Legal Environment for Investment in Egypt in the New Millennium*, 15 ARAB L. Q. 117, 122 (2000).

⁵²⁵ Law No. 8 of 1997 (Investment Incentives Law), art. 1, *Al-Jarida Al-Rasmiyya*, 11 May 1997 (Egypt) [hereinafter the Egyptian Investment Law].

⁵²⁶ *Id.* Examples of included fields are reclamation and cultivation of desert, animals and fish production, mining works, hotels and motels, tourists' transportation, transportation and storage of goods, air and maritime

provided by the Egyptian Investment Law apply to both foreign and local investors.⁵²⁷ The authority designated to enforce and supervise the application of the Egyptian Investment Law is the General Authority for Investment (“GAFI”), which was established by the Egyptian Investment Law and is headed by the Minister of Investment.⁵²⁸

1.2.2 Judicial System

Understanding the main features of the Egyptian court system helps to understand the importance of having independent laws in particular legal areas like franchising. That is particularly relevant knowing that the judicial power in a civil law country like Egypt is more limited than in common law countries where judges sometimes make law. The Egyptian court system is comprised of two different court structures; civil and commercial courts, and administrative courts, and within each are different levels. The civil courts consist of first degree courts, second degree courts and the Egyptian Court of Cassation (the Supreme Court).⁵²⁹ First degree court decisions are appealed to the second degree courts, the decisions of which are

transportation, housing furnishing, roads and communication industry electricity services, medical sets, financial leases, securities, and software production. *Id.*

⁵²⁷ *Id.* art 12. Examples of guarantees include protection against confiscation, nationalization, administrative sequestration, seizure, price control, cancellation of licenses, and the like. One examples of an incentive is the exemption of taxes for a specific period of time. In addition, the Egyptian Investment Law specifies geographical areas, called free zones, which are determined by a decision of the Cabinet. Free zones are areas where investors in specific activities can receive high incentives such as removing customs, wide exemption from taxes, and fewer requirements for importation and exportation. Though the Law of Importation and Exportation No. 118 of 1975 prevent foreigners from engaging in importation into Egypt and require Egyptians to be registered in the Registrar of Imports to import into Egypt, the Egyptian Investment Law provides an exception to this rule. It allows investors investing in the activities provided by the Egyptian Investment Law, Egyptians or foreigners, to import the raw materials without being registered in the Registrar of Imports.

⁵²⁸ Decree No. 284 of 1997 (Establishing the General Authority For Investment), *Al-Jarida Al-Rasmiyya*, 9 Aug. 1997 (Egypt).

⁵²⁹ EGYPT AND ITS LAWS, *supra* note 504, at xxviii-xxix.

appealed to the Court of Cassation.⁵³⁰ Administrative disputes are heard by the State Council (“*Conseil d’Etat*”), which decides upon the validity of the administrative decrees issued by government officials and ministers. The Supreme Constitutional Court decides the constitutionality of laws and disputes between the different courts and judicial bodies.⁵³¹

Recognition of foreign judgments by Egyptian courts requires the satisfaction of certain conditions. For example, Egyptian courts must not have had competence to decide the dispute.⁵³² Furthermore, an enforceable foreign judgment has to be final and should not contradict any previous decision made by an Egyptian court.⁵³³

Methods of alternative dispute resolution are also common in Egypt to solve commercial disputes. The Cairo Regional Center for International Commercial Arbitration serves as the regional institution to oversee both domestic and international commercial disputes submitted by the parties in accordance with their arbitration clauses.⁵³⁴ Egypt is also party to the New York Convention, which facilitates the enforcement of foreign arbitral awards in Egypt through adoption of Article V.⁵³⁵

⁵³⁰ *Id.*

⁵³¹ *Id.*

⁵³² Wahab, *supra* note 482.

⁵³³ *Id.*

⁵³⁴ For more information about the Cairo Regional Center for International Commercial Arbitration, *see generally Fact Sheet*, CAIRO REG’L CTR. FOR INT’L COM. ARB., <http://www.crcica.org.eg/factsheet.html> (last visited Jan. 14, 2012).

⁵³⁵ Rob Lauer, *Franchising in the Middle East: Legal Perspective*, in *FRANCHISING IN THE MIDDLE EAST: NAVIGATING THE RISKS AND REWARDS OF THE WORLD’S MOST INTERESTING MARKET* 16 (The American Bar Association ABA Forum on Franchising and the ABA Center for Continuing Legal Education ed., 2010). Some conditions, however, exist for the enforcement of foreign arbitral awards in Egypt such as the requirement that no previous arbitral award issued by an Egyptian arbitration tribunal is there, the condition that the foreign arbitral award does not contradict with the Egyptian public policy, and the condition that notifications of the issuance of the arbitral award and the requesting its enforcement takes place. *See* Wahab, *supra* note 482.

1.3 Religious Context

Some scholars divide Muslim countries according to their understanding of *Shari'a* as a source of law into three main categories: (i) countries that do not provide for *Shari'a* as the main source of law (ii) countries that provide for *Shari'a* as the main source of law, but not with a deep conviction of applying it to the various aspects of their legal systems; and (iii) countries that recognize *Shari'a* as the main source of their national laws to the extent that they consider the *Qur'an* the constitution of their countries.⁵³⁶

It may be argued here that Egypt is an example of the second category, as one that does not deeply recognize the application of *Shari'a* with regard to the detailed aspects of the Egyptian legal system. This is demonstrated by the fact that the Egyptian Civil and Commercial Laws are based on the French “Code Civil” and “Code de Commerce.”⁵³⁷

As a general rule, Egyptian laws and regulations must be consistent with *Shari'a*.⁵³⁸ The second provision of the previous Egyptian constitution provides that “Islam is the Religion of the State.⁵³⁹ Arabic is its official language, and the principal source of legislation is Islamic Jurisprudence (*Sharia*).”⁵⁴⁰ Additionally, the Temporary Constitutional Declaration, that replaced the Constitution after the January Revolution, preserved article two, providing that

⁵³⁶ NISRINE ABIAD, SHARIA, MUSLIM STATES AND INTERNATIONAL HUMAN RIGHTS TREATY OBLIGATIONS: A COMPARATIVE STUDY 47-51 (2008).

⁵³⁷ El Batouti et al., *supra* note 502, at 18.

⁵³⁸ The word *Shari'a* literally means “the path or the way”, and, in a legal sense, *Shari'a* refers to Islamic law or the entire system of jurisprudence associated with Islam. Muslim States do not only include Arab Middle Eastern states rather than some other states that are not part of the Arab region but most of their populations are Muslims and where the state is a member of the Organization of the Islamic Conference (OIC). ABIAD, *supra* note 536, at 19. The word Islam, formally, *Al-Islam*, refers to the religion of Muslims whose rules and principles are derived from the Muslims’ holy book, *Qur'an*. *Qur'an* is the Islamic holy book revealed to Prophet Muhammad. See *Glossary of Islamic Legal Terms*, 1 J. ISLAMIC L. 89 (1996).

⁵³⁹ Constitution of the Arab Republic of Egypt art. 2, 11 Sept. 1971, *as amended*, May 22, 1980, May 25, 2005, March 26, 2007 (Egypt) (repealed 2011).

⁵⁴⁰ *Id.*

“Islam is the religion of the state, and the Arabic language is its official language, the principles of Islamic law are the chief source of legislation.”⁵⁴¹

Also, the Egyptian Supreme Constitutional Court held,

The principles of the Islamic *Shari'a* are the major source of legislation. This imposes a limitation curtailing both the legislative and executive power, through which they are obliged that whatever laws or decrees they enact, no provision contained in them may contradict the provisions of Islamic law which are definite in terms of their immutability and their meaning . . . whatever legislative enactment contravenes them must be declared null and void.⁵⁴²

Furthermore, the Egyptian Civil Law provides that “in case the applicable law does not regulate certain issues, courts shall decide according to customs. In case of absence of custom, courts shall decide in accordance with the principles of the Islamic Law.”⁵⁴³ The situation after the January Revolution has changed and may lead to a changing political and economic attitude in Egypt in future.

Accordingly, before deciding to franchise in Egypt, *Shari'a* rules should be taken into consideration particularly since the application of *Shari'a* may affect the Egyptian legal system in general since it is considered to be the source of national laws. Examples of *Shari'a*'s effect on franchising are found in the fast food sector where trade in pork and alcohol products, for instance, are strongly prohibited by the religious attitudes of Muslims.⁵⁴⁴ Another example is that

⁵⁴¹ Temporary Constitutional Declaration of the Arab Republic of Egypt, *Al-Jarida Al-Rasmiyya*, 30 March 2011 (Egypt).

⁵⁴² Case No. 5257/43/ Dec. 28, 1997 /Constitutional Court (Egypt).

⁵⁴³ Egyptian Civil Law, *supra* note 503, at art. 1. Also, the political situation in Egypt has changed after the January Revolution. Thus, Islamists dominate the parliament within the last parliamentary elections took place in 2012. This creates the possibility of Egypt moving towards the strict application of *Shari'a* in different legal sectors. See discussion *infra* notes 645-46 and accompanying text. See also *supra* note 500 and accompanying text.

⁵⁴⁴ See QUR'AN 2:173, 5:90; THE HOLY QUR-AN ENGLISH TRANSLATION OF THE MEANINGS AND COMMENTARY 69, 315 (Presidency of Islamic Researchers, Ifta, & Call and Guidance eds., 1994) [hereinafter HOLY QURAN ENGLISH COMMENTARY].

restaurants and beverage shops are sometimes required to close during the entirety of fasting days during the entire month of Ramadan.⁵⁴⁵ Also, Muslims have very specific techniques required for the slaughter of animals, and consumers will not accept meat products that do employ those techniques.⁵⁴⁶ In addition, franchise agreement provisions on the transfer or sale of the franchise in case of death of the franchisee should take into account mandatory *Shari'a* rules on inheritance. Heirs, for instance, are likely to be involved in the franchise agreement even though they are not parties to it.⁵⁴⁷

2. Analysis of the Franchise Sector in Egypt

Egypt is the franchising center of the Middle East with up to \$14 billion invested in the franchising sector.⁵⁴⁸ Though Egypt has a specialized franchise association, the Egypt Franchise Development Association (“EFDA”), there is little awareness about what franchising entails.⁵⁴⁹ In addition to the lack of awareness, the lack of franchising laws, changes in political conditions, and the economic risks associated with franchising represent the most important constraints standing against the development of Egyptian franchising.⁵⁵⁰

2.1 Development of a Franchising Industry in Egypt

⁵⁴⁵ QUR’AN 2:173, 5:90; HOLY QURAN ENGLISH *supra* note 544, at 69, 315.

⁵⁴⁶ INTERNATIONAL FRANCHISING IN EMERGING MARKETS, CHINA, INDIA, AND OTHER ASIAN COUNTRIES 224 (Ilan Alon & Dianne H.B. Welsh eds., 2001).

⁵⁴⁷ Lindsey, *supra* note 28, at 14

⁵⁴⁸ *Bright Franchising Future*, OXFORD BUS. GROUP (Feb. 23, 2007), http://www.oxfordbusinessgroup.com/economic_updates/bright-franchising-future.

⁵⁴⁹ Maisonneuve, *supra* note 14, at 16.

⁵⁵⁰ *Id.*

As mentioned earlier, franchising entered the Egyptian market with the implementation of the Open Door Policy in 1973.⁵⁵¹ Wimpy, an English fast food chain, was the first to establish a franchise in Egypt.⁵⁵² Within a few years, the franchising sector began to see rapid growth and hundreds of international brands established a presence in Egypt.⁵⁵³

The Egyptian franchise market is a growing market.⁵⁵⁴ In fact, from the end of 2002 until 2004, the number of franchised outlets increased by 14%.⁵⁵⁵ While 49.53% of franchisees are 35 to 49 years old, 43.87% of them are above 50 years old, and 6.6% are younger than 34 years old.⁵⁵⁶ Eighty eight percent of Egyptian franchisees are males while only 12% are females.⁵⁵⁷

Approximately forty international franchisors are now investing in Egypt. Twenty-five of them are in the food sector.⁵⁵⁸ Approximately \$300 million are invested in the Egyptian food franchise market by both foreign and domestic investors.⁵⁵⁹ Examples of famous foreign brands in Egypt include Chili's, Hard Rock Café, KFC, McDonald's, Pizza Hut, Baskin Robbins, Carvel Ice Cream and Ruby Tuesday.⁵⁶⁰ Other franchising sectors are expanding fast in Egypt including lifestyle brands, home appliances, and clothing.⁵⁶¹ In 2006, SAS-Egypt, an Egyptian franchisor

⁵⁵¹ See *supra* Ch. II. 2.1 (discussing Analysis of the Franchising Sector in Egypt).

⁵⁵² Fath, *supra* note 11.

⁵⁵³ *Id.*

⁵⁵⁴ Maisonneuve, *supra* note 14, at 16.

⁵⁵⁵ MARKETEERS-EGYPT, *supra* note 19.

⁵⁵⁶ *Id.*

⁵⁵⁷ *Id.*

⁵⁵⁸ Tyre, *supra* note 22.

⁵⁵⁹ DOING BUSINESS IN EGYPT, *supra* note 23.

⁵⁶⁰ *Id.*

⁵⁶¹ *Bright Franchising Future*, *supra* note 548.

bought La Senza and Esprit brands to distribute in Egypt⁵⁶² and the Swedish company, Ikea, has established a home furnishings franchise presence.⁵⁶³

In 2001-2002, the African Development Bank (“AfDB”) initiated a program to increase awareness of franchising in a number of countries including Egypt.⁵⁶⁴ As a result, the AfDB approved a \$40 million subsidy to finance the Egyptian franchising sector.⁵⁶⁵ The program’s main goal is to promote the franchising sector in Egypt as one of most important business tools that help to develop investment.⁵⁶⁶ To achieve the program’s goal, the AfDB gave the Egyptian government the \$40 million loan.⁵⁶⁷ The AfDB tried to help increase awareness and promote the role of franchise players such as the EFDA, franchise consultants, franchise lawyers, and the like.⁵⁶⁸ The program is expected to provide 375 franchise outlets, and create 7,000 jobs.⁵⁶⁹

2.2 Legal Perspective

2.2.1 Applicable Laws

Because there is no specific, comprehensive law regulating franchising in Egypt, franchising transactions are governed by a myriad of different laws rather than by a singular, specialized statute. The most frequently applied laws are related to the regulation of contracts,

⁵⁶² *Id.*

⁵⁶³ *Id.*

⁵⁶⁴ *AfDB Supports Franchising in Egypt – US \$40 Million for Franchising Sector Support Program*, AFRICAN DEV. BANK GROUP (Feb. 25, 2009), <http://www.afdb.org/en/news-events/article/afdb-supports-franchising-in-egypt-us-40-million-for-franchising-sector-support-program-4340/>.

⁵⁶⁵ *Id.*

⁵⁶⁶ *Id.*

⁵⁶⁷ *Id.*

⁵⁶⁸ *Id.*

⁵⁶⁹ *Id.*

commerce, intellectual property, taxation, insurance, and labor.⁵⁷⁰ The applicable law is usually the law that bears the closest relationship to the provisions of the franchise agreement.⁵⁷¹

2.2.1.1 Agency Rules⁵⁷²

Some Egyptian practitioners and legal writers believe that franchise agreements would be subject to the provisions of the Egyptian Commercial Law governing agency and the Commercial Agency Laws.⁵⁷³ According to the Egyptian Commercial Law, agency is the contract by which a commercial agent undertakes to perform a specific legal service in favor of the principal whether in the name of the principal or the name of the agent himself, in case of undisclosed agency.⁵⁷⁴ An example is when the agent, on behalf of the principal, enters certain contracts. In return, the franchisee concludes, in his own name, sales transactions of the franchisor's products or services using the franchisor's trademark or trade name. Comparing both relationships,⁵⁷⁵ it seems this is a legal representation where the agent is liable to the principal, unlike franchising where the franchisee is totally independent and does not have any power to bind the franchisor.⁵⁷⁶ By contrast, under franchise agreements the franchisee works for his own benefit.⁵⁷⁷ The agent, according to the Egyptian agency laws, is responsible for any

⁵⁷⁰ Lindsey, *supra* note 28, at 15.

⁵⁷¹ *Id.*

⁵⁷² See Egyptian Commercial Law, *supra* note 504, at arts. 148-191.

⁵⁷³ Lindsey, *supra* note 28, at 15.

⁵⁷⁴ Egyptian Commercial Law, *supra* note 504, at arts. 148, 166, 177.

⁵⁷⁵ See *supra* Ch. I. 1 (discussing the Definition and Elements of Franchising).

⁵⁷⁶ See *supra* Ch. I. 1.6.3 (discussing Franchising v. Agency).

⁵⁷⁷ See *id.*

damage of the goods in his authority unless the damage arises due to force majeure or due to an inherent defect in the goods themselves.⁵⁷⁸

Beside the general rules on agency, which regulate any transaction concluded by and in the name of the agent where the effects go to the principal, the Egyptian agency rules regulate two extra, special types of agency: commission agency and contracts agency. Commission agency is when transactions are concluded in the name of the agent but for the benefit of the principal which means the principal's personality is not disclosed.⁵⁷⁹ Contracts agency refers to the situation where the agent undertakes the activities of marketing, negotiating, and concluding transactions, in a specific area, in the name and for the benefit of the principal.⁵⁸⁰ Contracts agency is the form of agency that is usually confused with franchising in Egypt due to its special nature where the agent acts like a franchisee to a certain extent by marketing, negotiating and then concluding the transaction for the principal.

Agency laws also provide rules on termination that are specific to the nature of the agency relationship rather than to the franchise relationship. In case of termination of a defined term agency contract, renewal is compulsory under the Egyptian Commercial Law and requires the principal, if he decides not to renew the contract, to pay compensation to the agent even if the contract provides otherwise.⁵⁸¹ If the term of an agency agreement is not fixed, the principal cannot terminate it unless the agent commits a mistake, otherwise the principal has to pay a proper compensation to the agent.⁵⁸²

⁵⁷⁸ Egyptian Commercial Law, *supra* note 504, at art. 155.

⁵⁷⁹ *Id.* at art. 166.

⁵⁸⁰ *Id.* at art. 177.

⁵⁸¹ *Id.* at art. 189.

⁵⁸² *Id.* at art. 188(1).

2.2.1.2 Transfer of Technology Rules

Most Egyptian practitioners and legal writers believe that franchise agreements are essentially transfer of technology agreements and accordingly are subject to the relevant Egyptian Commercial Law provisions.⁵⁸³ Having a look into the rules regulating transfer of technology agreements would lead to the conclusion that franchise agreements are different from technology transfer agreements.⁵⁸⁴ Transfer of technology agreements are those in which the licensor undertakes to transfer technical information to the licensee to use in a special, technical way to produce specific commodities or to install or operate specific equipment.⁵⁸⁵ The mere sale of technical products is not a transfer of technology.⁵⁸⁶ Hence, licensing the use of a trademark is not, in itself, a transfer of technology unless it is connected to a transfer of technology contract.⁵⁸⁷ The subject matter of a technology transfer is different from franchising in that it is not only restricted to technical information related to the production of specific goods but also includes services. In the same context, the Egyptian Commercial Law excludes agreements licensing the use of trademarks unless such license includes a transfer of technical information.⁵⁸⁸

⁵⁸³ *Maisonneuve*, *supra* note 14, at 16.

⁵⁸⁴ *See supra* Ch. I. 1.6.1 (discussing Franchising v.Licensing).

⁵⁸⁵ Egyptian Commercial Law, *supra* note 504, at art. 73.

⁵⁸⁶ *Id.*

⁵⁸⁷ *Id.*

⁵⁸⁸ Egyptian Commercial Law, *supra* note 504, at art. 73.

Unlike with franchises, the technology transfer rules on licensing are very protective of licensees and limit the control of licensors over the transferred technology.⁵⁸⁹ For instance, Article 75 of the Egyptian Commercial Law provides that any provision in the transfer of technology agreement that restricts the freedom of the licensee to use, develop, or advertise the transferred technology may be invalidated. Examples include provisions requiring licensees to accept any improvements introduced by licensors, provisions prohibiting licensees from developing the transferred technology, and prohibiting licensees from using specific trademarks that distinguish the transferred technology from other technology.⁵⁹⁰ Examples also include provisions allowing licensors to participate in running the licensee's establishment or choosing the licensee's employees, and provisions requiring the licensee to purchase raw materials, equipment, machines and others necessities from the licensor.⁵⁹¹ These provisions are accepted because licensors, particularly in high technology sectors, are usually protective of their technical assets and generally are not ready to grant rights, except limited rights to their licensees. Licensors are usually monopolistic, which eliminates competitive activities and puts the markets at risk, therefore causing the legislature to intervene to protect the weaker parties and to protect competition. This does not fit the nature of franchise transactions where the franchisee runs the franchised business under the control of and with the assistance of the franchisor.⁵⁹²

⁵⁸⁹ See *supra* Ch. I.1.1(discussing the Definition and Elements of Franchising).

⁵⁹⁰ Egyptian Commercial Law, *supra* note 504, at art. 75.

⁵⁹¹ *Id.*

⁵⁹² See *supra* Ch. I. 1 (discussing the Definition and Elements of Franchising).

In addition, applying the rules of transfer of technology to franchise agreements would make franchise agreements subject to obligatory choice of law and forum requirements.⁵⁹³ That is because the Egyptian Commercial Law provides that Egyptian courts shall have jurisdiction to decide on disputes arising from technology transfer agreements.⁵⁹⁴ It also provides for the application of the Egyptian law even if the agreement provides otherwise.⁵⁹⁵ Furthermore, it provides that if transfer agreement parties choose arbitration as a method of solving disputes arising out of a transfer of technology agreement, arbitration shall be held in Egypt according to the Egyptian law.⁵⁹⁶

2.2.2 The Egypt Franchise Development Association

The EFDA is a non-governmental organization founded in 2001 to promote the Egyptian franchising industry.⁵⁹⁷ With the establishment of the EFDA, Egypt became the first Middle Eastern country to be a member of the World Franchise Council.⁵⁹⁸ The EFDA has a Law of Ethics that is binding on all members, but is not binding on parties to franchise agreements until

⁵⁹³ The Egyptian Commercial Law provides that “if the technology transfer agreement parties agree to choose arbitration, arbitration shall take place according to the Egyptian substantive and procedural law and any agreement between the parties to submit their disputes to any law other than the Egyptian law shall be null and void.” Egyptian Commercial Law, *supra* note 504, at art. 87. It also provides that “if the technology transfer agreement parties agree to choose arbitration, arbitration shall take place inside Egypt.” *Id.* Moreover, the Egyptian Commercial Law provides that “no distinction between the national or international arbitration as long as it is concerned with arbitrating a technology licensing agreement.” *Id.* at art. 72.

⁵⁹⁴ *Id.* at art. 87.

⁵⁹⁵ *Id.*

⁵⁹⁶ *Id.*

⁵⁹⁷ *What is Franchising?*, EGYPTIAN FRANCHISE DEV. ASS’N, <http://www.efda.org.eg/Default.aspx?Id=128> (last visited March 15, 2011).

⁵⁹⁸ *Bright Franchising Future*, *supra* note 548.

they explicitly adopt it as part of their franchise agreement.⁵⁹⁹ The most important feature of the Law of Ethics is that it requires the franchisor to have at least one pilot operation before starting a franchised business.⁶⁰⁰ It also requires the franchisor to be the legal holder of the licensed trademark.⁶⁰¹ Moreover, it obliges the franchisor to provide franchisees with necessary training.⁶⁰² The Law of Ethics provides for franchisors' obligations of disclosure of information, such as any existing franchise, and capital invested.⁶⁰³ It also provides an appendix containing the required disclosure document requirements.⁶⁰⁴ Furthermore, the Law of Ethics provides for the confidentiality of all information disclosed during negotiations and the performance of the franchise agreement.⁶⁰⁵

3. The Need for Legal and Economic Reform

Since the January Revolution⁶⁰⁶ the Egyptian economy has declined due to political instability.⁶⁰⁷ Foreign investors fled, taking their capital with them and more than 300 Egyptian businessmen are on a government watch list.⁶⁰⁸ Over the following year, Egyptian GDP declined

⁵⁹⁹ *What is Franchising?*, *supra* note 597.

⁶⁰⁰ *Id.*

⁶⁰¹ *Id.*

⁶⁰² *Id.*

⁶⁰³ *Id.*

⁶⁰⁴ *Id.*

⁶⁰⁵ *Id.*

⁶⁰⁶ *See supra* note 500.

⁶⁰⁷ The continuing unrest due to the contradictions between different demands – majority interests v. minority rights, secular vs. religious, military vs. civilian, Christians vs. Muslims, Muslim Brotherhood vs. Salafists, poor and unemployed vs. elites, old vs. young. *See* Heineman, *supra* note 494.

⁶⁰⁸ David Schenker, *Egypt and the Arab Fall*, L.A. TIMES (June 1, 2011), <http://articles.latimes.com/2011/jun/01/opinion/la-oe-schenker-egypt-20110601>.

four times. The reserves dropped from \$36 billion at the beginning of 2011 to \$22 billion in October 2011, and further dropped to \$15 billion in January 2012.⁶⁰⁹ Tourism decreased by 35% and the stock market saw a decline of more than 40%.⁶¹⁰ This implies that the Egyptian transitional government failed to rescue the Egyptian economy during the transition period.⁶¹¹ This indicates that the new government will be facing a horrible scenario of economic decline. The coming economic era requires careful attention to both applied economic and legal policies.

In light of this, Egyptian laws need to be considered.⁶¹² This will help to boost the recovery of the Egyptian economy and improve the financial situation in Egypt after the January Revolution.⁶¹³ Pursuing such a legal reform will help improve the Egyptian economy.⁶¹⁴ In the same context, establishing franchising law should be considered soon.

Conclusion

Having a specialized franchising law would work to overcome legislative gaps, practical disputes, and inefficient transactions. It would also help to avoid the application of a variety of Egyptian laws on franchising transactions that are too general to meet the specific needs of franchise parties. In addition, franchisors and franchisees usually prefer to have a very clear and comprehensive law instead of applying a variety of laws which may sometimes be confusing. Furthermore, because Egypt is a civil law country where courts depend on written statutes,

⁶⁰⁹ Heineman, *supra* note 494.

⁶¹⁰ *Id.*

⁶¹¹ IBRAHIM SAIF, CHALLENGES OF EGYPT'S ECONOMIC TRANSITION 2 (Nov. 2011), http://carnegieendowment.org/files/egypt_econ_transition.pdf.

⁶¹² *Id.*

⁶¹³ *Id.*

⁶¹⁴ GLOBAL INSIGHT EGYPT, *supra* note 34.

providing a franchise law would work as a reference source for Egyptian courts to decide disputes. The next Chapter will move a step forward to compare, analyze, and evaluate examples of different franchising laws as a necessary study to help achieve the best features of franchising in Egypt. The next Chapter will examine the laws of the U.S., China, and Malaysia.

CHAPTER III

COMPARISON OF THE U.S., CHINESE, AND MALAYSIAN FRANCHISE LAWS AND THEIR IMPLICATIONS FOR EGYPT

Introduction

Comparing franchising laws of countries belonging to different legal systems is an essential tool for a law reform initiative intended to help structure and design the essential features of a new Egyptian franchising law. Many reasons support the choice of the U.S., Chinese, and Malaysian franchising laws in this respect.

As far as the United States is concerned, the United States is one of four common law countries that have franchise legislation and one of six countries that has revised its legislation since 2000.⁶¹⁵ According to the Central Intelligence Agency (“CIA”) World Fact Book, in 2012, the U.S. economy was the world’s second largest, after the European Union, with a GDP of almost fifteen trillion dollars,⁶¹⁶ approximately \$2.5 trillion coming from franchising.⁶¹⁷ Moreover, the U.S. plays a very active role in promoting the franchising industry worldwide to the extent that 95% of the International Franchise Association’s (“IFA”) members are American companies.⁶¹⁸ Current statistics show that franchising now spans across almost all American economic sectors. Franchising in the United States dominates, for example, in the hotel, fast

⁶¹⁵ SPENCER, *supra* note 41, at 215-16. According to Spencer, the six countries that reviewed their franchise legislations since 2000 are Mexico, Spain, China, Taiwan, Japan, and the United States of America. *See id.* at 215. Also, the four common law countries that have franchise legislations are Canada, Australia, Barbados, and the United States. *See id.* at 216.

⁶¹⁶ *United States*, in THE WORLD FACT BOOK (last updated Feb. 8, 2012), <https://www.cia.gov/library/publications/the-world-factbook/geos/us.html> (last visited Feb. 22, 2012).

⁶¹⁷ *See* Susan A. Grueneberg & Jonathan C. Solish, *Franchising 101 Key Issues in the Law of Franchising*, BUS. L. TODAY, Mar.-Apr. 2010, at 1.

⁶¹⁸ Schwartz & Zylberman, *supra* note 50, at 317.

food, gas, transportation, insurance, and construction industries.⁶¹⁹ Franchising provides about 21,000,000 jobs and contributes nearly \$2.5 trillion dollars to the American economy each year. Franchised business units provide consumer goods and services that amount to nearly \$881 billion every year and comprise \$2.31 trillion of the annual output of the private sector.⁶²⁰ Finally, the economic relationship between Egypt and the United States is very strong; the United States is one of Egypt's primary trading partners.⁶²¹

China, a civil law country, also has a very promising economy, the world's third largest, with a GDP of almost \$10 trillion in 2010.⁶²² China is the largest franchise market in the world with 2,600 brands and 200,000 retail stores across nearly eighty industrial sectors.⁶²³ Two of the main franchising sectors in China are retail stores and catering.⁶²⁴ According to the IFA, Chinese

⁶¹⁹ Susan Grueneberg, *Food Trucks and Franchising: A Recipe for Success?*, DAILY J., Nov. 18, 2010, reproduced at http://www.swlaw.com/assets/pdf/news/2010/10/01/FoodTrucksandFranchisingARecipeforSuccess_WEB.pdf.

⁶²⁰ SPENCER, *supra* note 41, at 145.

⁶²¹ *Country Fact Sheet: Egypt*, *supra* note 498. For instance, the Egyptian market is the fourth exporter of American products in the Middle East and one of the most important importers of specific American products such as agricultural equipments and products. Also the United States is the second biggest foreign investor in the Egyptian market. DOING BUSINESS IN EGYPT, *supra* note 23.

⁶²² *China*, in THE WORLD FACT BOOK (last updated Feb. 8, 2012), <https://www.cia.gov/library/publications/the-world-factbook/geos/ch.html> (last visited Feb. 22, 2012).

⁶²³ JIJ GROUP, CHINA: FRANCHISING INDUSTRY OVERVIEW OF EMERGING MARKETS, http://www.jijgroup.com/uploads/Executive_Summaries/USCS-JIJ%20China%20Franchising%20Market%20-executive%20summary.pdf (last visited Feb. 24, 2012). At least fifty American franchisors have entered the Chinese market. Examples include 7-Eleven, Accor, Athlete's Foot, Budget, Burger King, California Pizza Kitchen, Carl's Jr., Century 21, Dairy Queen, Days Inn, Dunkin' Donuts, Econo Lodge, Gloria Jean's Coffee, Haagen Dazs, Hilton, Holiday Inn, Hooters. Other examples include Hyatt, KFC, Marriott, McDonald's, Papa John's, Pizza Hut, Sign-A-Rama, Starbucks, Starwood, Subway, Super 8, T.G.I. Friday's, Taco Bell, TCBY, and Wyndham. See Philip F. Zeidman, *China: 2010 and Beyond*, INT'L FRANCHISE ASS'N (Jan. 2010), <http://www.franchise.org/Franchise-Industry-News-Detail.aspx?id=49348>.

⁶²⁴ *Research and Markets: China Franchise Market Report, 2010*, BUSINESS WIRE (Feb. 4, 2011), available at <http://search.proquest.com/docview/849231047?accountid=8285>.

retail sales increased by 16.2% in 2009.⁶²⁵ The number of consumers shopping at franchises is expected to reach 600,000,000 by 2015 from middle tier consumers alone.⁶²⁶

In addition to the United States and China, Malaysia was chosen for this study because of the combination of legal and societal customs represented in its primarily Islamic law.⁶²⁷ The basis of Malaysian law is a combination of the English common law and Islamic law.⁶²⁸ Studying a country with an Islamic context is helpful in considering proposals for the Egyptian legal system. After the January Revolution, parliamentary elections in Egypt resulted in Islamists winning⁶²⁹ almost 90% of seats, bringing them closer to dominating the first elected body since

⁶²⁵ Zeidman, *supra* note 623. Franchising is expected to increase yet more within the coming ten years in different industries. In the fast food industry, CKE Restaurants may open an extra 100 units in the next eight years, Carl's Jr. stores are expected to open 480 units in the coming ten years, and Dairy Queen expects 500 units in the coming five years. In the hotel sector, Holiday Inn currently has approximately 60 hotels and Hilton plans to establish 33 new hotels. *Id.* Coca-Cola sales also increased 15% at the end of 2009. *Id.*

⁶²⁶ *Id.*

⁶²⁷ SPENCER, *supra* note 41, at 200: *see also* Malaysia, FOREIGN LAW GUIDE, <http://foreignlawguide.com/ip/flg/Malaysia.htm> (last visited Feb. 22, 2012).

⁶²⁸ *Id.*

⁶²⁹ The most common Muslim groups in Egypt are the Muslim Brotherhood (“pronounced *Al-Ikhwan Al-Muslimeen*”) and the *Salafi's* group. Currently, the Muslim Brotherhood is the most powerful political force in Egypt. It was established in 1928. The Brotherhood, a group that virtually invented the Islamist movement eight decades ago, is at its core a middle-class missionary institution, led not by religious scholars but by doctors, lawyers and professionals. It has long sought to move Egypt toward a more orthodox Islamic society from the bottom up, one person and family at a time. Its vast following and the disciplined organization it built during its decades in opposition have given it preeminence among civilian groups since the revolution that toppled the regime of former President Mubarak in February 2011, even though the uprising was set off primarily by young people and liberal activists. The Brotherhood's Freedom and Justice Party was the clear winner in the parliamentary voting held in late November, 2011 and appeared poised to create a dominant coalition with a more conservative Islamicist party. *Muslim Brotherhood (Egypt)*, N.Y. TIMES (last updated Feb. 1, 2012), http://topics.nytimes.com/top/reference/timestopics/organizations/m/muslim_brotherhood_egypt/index.html?inline=nyt-org (last visited Feb. 23, 2012).

In contrast, the *Salafis* are political newcomers, directed by religious leaders. Ten months after a broad popular uprising overthrew President Hosni Mubarak, the *Salafis'* new brand of religious populism has propelled Al Nour and its allies to claim more than a quarter of the vote in the first round of parliamentary elections, surprising even the most seasoned Egyptian analysts and Western diplomats. David D. Kirkpatrick, *In Egypt, a Conservative Appeal Transcends Religion*, N.Y. TIMES (Dec. 12, 2011), <http://www.nytimes.com/2011/12/11/world/middleeast/salafis-in-egypt-have-more-than-just-religious-appeal.html?pagewanted=all>. Recently, the Brotherhood's party denied that there was any “alleged alliance” to form “an Islamist government” with Al Nour, a party formed by ultraconservative Islamists known as *Salafis*. *Muslim Brotherhood (Egypt)*.

President Mubarak's fall from power.⁶³⁰ This creates the possibility of Egypt having an Islamic government in the near future.

Malaysia also has a thriving franchise sector that increases by at least 10% each year and contributes around \$5 billion dollars to the Malaysian GDP.⁶³¹ This represents almost 12% of the total Malaysian GDP⁶³² which is estimated to be \$414.4 billion dollars.⁶³³ In 2009, Malaysia had sixty-four franchisors, mainly in the food industry.⁶³⁴ The food industry represents 31% of the Malaysian franchise market, with apparel comprising 15%, services 11%, health and cosmetic products 8%, and retail sales 4%.⁶³⁵

Thus, surveying the common, civil, and Islamic legal systems of the United States, China, and Malaysia respectively, allows for a comparison that identifies different features of laws regulating franchising relationships as the rules differ significantly among the systems.⁶³⁶ This Chapter is divided into three Sections. Section 1 gives a general overview of the laws governing

⁶³⁰ *Muslim Brotherhood (Egypt)*.

⁶³¹ *Id.*

⁶³² *Id.*

⁶³³ *United States, in THE WORLD FACT BOOK, supra note 616.*

⁶³⁴ TRACY YEOH, U.S. DEP'T OF COMM., U.S. COMMERCIAL SERVICE, MALAYSIA: FRANCHISE INDUSTRY (2009), http://www.franchise.org/uploadedFiles/Franchise_Industry/International_Development/MalaysiaFranchise.pdf.

⁶³⁵ *Id.* Examples of Malaysian franchises in the fast food industry include Secret Recipe Cakes and Cafe, Marybrown Restaurant, D'Tandoor, and Nelson. Other franchises include Smart Reader Childcare Center, which has more than 300 outlets. *Id.*

⁶³⁶ For instance, the principle of caveat emptor, which means that the buyer cannot recover from the seller for defects on the subject matter of the contract unless the seller hides defects or makes intentional misrepresentations, applies more strongly in common law systems during contractual negotiations. Applying this principle to franchising contracts, in a common law system franchisees will be largely responsible for conducting their own due diligence. By contrast, in civil law systems, which rely more heavily on the principle of good faith, franchisors must disclose specific information to franchisees during negotiations. See generally Paul Jones, *The Regulation of Franchising in China and the Development of a Civil Law Legislation*, 2 CHINESE L. & POL'Y REV. 78 (2006) (an article based upon a "Country Update" written for the International Franchising Committee of the International Bar Association by the author). Similarly, Islam requires the fulfilment of contracts and promises as the Qur'an says "O you who believe! Fulfil [your] obligations." QUR-AN 5:1; HOLY QURAN ENGLISH TRANSLATION, *supra* note 544, at 276. In the same context, though *Shari'a*, which forms the basis of Islamic law, does not explicitly provide for caveat emptor or good faith, it sharply prohibits deception in business transactions and contracts in general.

franchising in each of the three countries. Section 2 then discusses some basic substantive concepts on the rules regulating the franchise relationship between parties in the three countries. Finally, Section 3 addresses disclosure and registration issues.

1. Laws Governing Franchising

1.1 The United States

Franchising laws in the United States are generally divided into three categories: federal and state franchise disclosure and registration rules, state franchise relationship laws, and business opportunity laws.⁶³⁷ Additionally, there are specialized laws regulating specific franchising industries.⁶³⁸

On December 21, 1978, the FTC promulgated its first set of disclosure and registration rules on franchising, called the “Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures” or the “Old Rule.”⁶³⁹ The Old Rule required the disclosure of specific information before a sale was concluded unless the transaction was exempted.⁶⁴⁰ The FTC recently amended the Old Rule by adopting “The Disclosure Requirements and Prohibitions Concerning Franchising” or, the “New Rule.”⁶⁴¹ The New Rule took seventeen months to be fully implemented from the time of its adoption by the FTC.

⁶³⁷ See Marks, *supra* note 58.

⁶³⁸ See generally 15 U.S.C. §§ 1221-1225 (detailing the Petroleum Marketing Practices Act and the Automobile Dealer Franchise Act).

⁶³⁹ 43 Fed. Reg. 59,614 (Dec. 21, 1987).

⁶⁴⁰ 43 Fed. Reg. 59,625; see also Marks, *supra* note 58.

⁶⁴¹ 16 C.F.R. § 436.1.

Franchisors were permitted to begin using the New Rule's disclosure format and procedures on July 1, 2007 and were officially obliged to comply on July 1, 2008.⁶⁴²

Additionally, the Uniform Franchise Offering Circular ("UFOC") was introduced in 1986 to provide franchisors with an alternative means of disclosure.⁶⁴³ Until 2007, the Commission permitted franchisors to comply with disclosure requirements by following either the provisions of the Old Rule or the UFOC guidelines, as they maintain similar requirements.⁶⁴⁴ The Federal Disclosure Documents ("FDD"), however, replaced the UFOC and has been the new disclosure standard since July 1, 2007.⁶⁴⁵ Beyond the federal requirements, many states have pre-sale disclosure and registration laws.⁶⁴⁶ Fifteen states have laws requiring franchisors to disclose specific information material to franchisees when making franchise decisions.⁶⁴⁷ State laws work as gap fillers for the federal disclosure and registration laws⁶⁴⁸ and generally follow federal law with some differences regarding the definition and elements of a franchise, disclosure requirements, and exemptions.⁶⁴⁹

⁶⁴² THE FTC FRANCHISE RULE 85 (Susan Grueneberg & Ann Hurwitz eds., 2008).

⁶⁴³ Marks, *supra* note 58.

⁶⁴⁴ *Id.*

⁶⁴⁵ Rochelle B. Spandorf & Mark B. Forseth, *Franchise Registration*, in FUNDAMENTALS OF FRANCHISING 140 (Rupert M. Barkoff & Andrew C. Selden eds., 3d ed., 2008).

⁶⁴⁶ Brian B. Schnell & Sarh J. Yatchak, *Let's Make a Deal: Developing a Successful Franchise Resale Program*, 27 FRANCHISE L.J. 215, 217 (2008).

⁶⁴⁷ States with disclosure laws include California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Oregon, Rhode Island, South Dakota, Virginia, Washington and Wisconsin. *See generally* Marks, *supra* note 58.

⁶⁴⁸ Rupert M. Barkoff, *Franchise Sales Regulation Reform: Taking the Noose off the Golden Goose*, 3 ENTREPREN. BUS. L.J. 233, 246 (2009).

⁶⁴⁹ *Id.* at 249-50.

Fifteen states regulate franchisor-franchisee relationships, albeit with substantive variations.⁶⁵⁰ Conflicts of law do not arise in the interaction between the federal rules and state franchise relationship laws because federal franchise rules regulate only disclosure and registration. Conflict may arise, however, between federal franchise rules and state disclosure and registration laws. The New Rule addressed this issue by clarifying that it does not prevent application of any state franchise law unless the state law contradicts the New Rule.⁶⁵¹ The states must accept the federal rules as the baseline protections that must be conferred, but are free to promulgate more restrictive rules. Conflicts will not occur, therefore, so long as the state laws confer equal or better protection than that provided by the New Rule.⁶⁵²

As noted above, there are specialized laws regulating specific franchising industries such as the 1987 Petroleum Marketing Practices Act (“PMPA”)⁶⁵³ and the 1956 Automobile Dealer Franchise Act (“ADFA”).⁶⁵⁴ The PMPA addresses the arbitrary termination and non-renewal of franchise relationships.⁶⁵⁵ The ADFA tries to create equilibrium between automobile producers and dealers by addressing the issue of good faith and providing for a cause of action in case of bad faith performance.⁶⁵⁶

⁶⁵⁰ Marks, *supra* note 58.

⁶⁵¹ Gerald C. Wells & Dennis E. Wiczorek, *A Road Map to the New FTC Franchise Rule*, 27 FRANCHISE L.J. 105 (2007); *see also* Karen B. Satterlee & Leslie D. Curran, *Exemption Based Franchising: Are You Playing in a Minefield?*, 28 FRANCHISE L.J. 191, 195 (2009).

⁶⁵² Wells & Wiczorek, *supra* note 651; *see also* David W. Oppenheim, *Changes in State Franchising Registration and Disclosure Laws as a Result of the Federal Trade Commission’s Revised Franchise Rule*, 6 INT’L J. FRANCHISING L. 37 (2008).

⁶⁵³ 15 U.S.C. §§ 2801-2806 (2012).

⁶⁵⁴ §§ 1221-1225.

⁶⁵⁵ Mark J. Burzych & Emily L. Matthews, *Vive la Difference? Selective Enforcement of Franchise Agreement Terms and System Standards*, 23 FRANCHISE L.J. 110 (2003).

⁶⁵⁶ *Id.*

1.2 China

In China, as in other civil law countries, the hierarchy of legal rules begins with laws or codes that set forth the general rules applicable to different aspects of legal transactions, followed by guiding and explanatory regulations, decrees, orders, and ordinances.⁶⁵⁷ The first Chinese law to address franchising specifically was the Measures for the Administration of Commercial Franchise Operations.⁶⁵⁸ These Measures were replaced with the Measures for the Administration of Commercial Franchises referred to as the “Old Measures.”⁶⁵⁹ The Regulations on Administration of Commercial Franchise or the “Chinese New Regulations” then replaced the Old Measures in 2007.⁶⁶⁰ The Chinese Ministry of Commerce (“MOFCOM”)⁶⁶¹ issued two sets of rules implementing and interpreting the Chinese New Regulations: the Administrative Measures for Archiving Commercial Franchises (“Archiving Measures”)⁶⁶² and the Measures for the Administration of Information Disclosure of Commercial Franchises (“Chinese Disclosure

⁶⁵⁷ Paul Jones & Erik Wulff, *Franchise Regulation in China: Law, Regulations, and Guidelines*, 27 *FRANCHISE L.J.* 57, 57 (2007).

⁶⁵⁸ The Measures for the Administration of Commercial Franchise Operations were issued by the Ministry of Internal Trade in 1997. See *INTERNATIONAL FRANCHISING IN EMERGING MARKETS, CHINA, INDIA, AND OTHER ASIAN COUNTRIES* 85 (Ilan Alon & Dianne H.B. Welsh eds., 2001); see also Bryan W. Blades, *Franchising in China: A Current Perspective*, 14 *CURRENTS INT’L TRADE L.J.* 20, 22-27 (2005); SPENCER, *supra* note 41, at 181.

⁶⁵⁹ Chinese New Regulations, *supra* note 237; see Zeidman, *supra* note 623; see also Blades, *supra* note 658, at 22-28; SPENCER, *supra* note 41, at 181.

⁶⁶⁰ Chinese New Regulations, *supra* note 237; see also Zeidman, *supra* note 623; Blades, *supra* note 658, at 22-28; SPENCER, *supra* note 41, at 181.

⁶⁶¹ *Ministry of Commerce*, PEOPLE’S REPUB. OF CHINA, <http://english.mofcom.gov.cn/> (last visited Feb. 22, 2012).

⁶⁶² Administrative Measures for Archiving Commercial Franchises (promulgated by the Ministry of Commerce, Apr. 6, 2007, effective May 1, 2007) (Lawinfochina) (China) [hereinafter Chinese Archiving Measures]; SPENCER, *supra* note 41, at 181.

Measures”).⁶⁶³ Other measures and notices related to the Chinese New Regulations and their implementing rules have been issued by administrative agencies.⁶⁶⁴

In addition to the franchise regulations and measures already mentioned, franchise agreements in China are usually subject to the general rules of certain bodies of law, like Contract Law.⁶⁶⁵ Consideration should also be given to the Company Law⁶⁶⁶ and the Arbitration Law.⁶⁶⁷ Moreover, the Chinese intellectual property laws are closely connected to franchising and consist of the Copyright Law,⁶⁶⁸ the Law on Unfair Competition,⁶⁶⁹ the Patent Law,⁶⁷⁰ the Trademark Law,⁶⁷¹ and the Anti-Monopoly Law.⁶⁷²

⁶⁶³ Measures for the Administration of Information Disclosure of Commercial Franchises (promulgated the Ministry of Commerce, Apr. 6, 2007, effective May 1, 2007) (Lawinfochina) (China) [hereinafter Chinese Measures for the Administration of Information Disclosure]; *see also* SPENCER, *supra* note 41, at 181.

⁶⁶⁴ Notice of the State Administration of Foreign Exchange on the Pilot Work of Franchise Individual Foreign Exchange Business (promulgated by the State Admin. of Foreign Exchange, Aug. 19, 2008) (Lawinfochina) (China); *see also* Measures for the Pilot Work of Franchised Individual Foreign Exchange Business (promulgated in by the State Admin. of Foreign Exchange, Sept. 11, 2009) (Lawinfochina) (China); Notice of the Higher People’s Court of Beijing Municipality on Issuing the Guiding Opinions of the Higher People’s Court of Beijing Municipality on Several Issues Concerning the Application of Law in the Trial of Disputes over Commercial Franchise Contracts (promulgated by the Beijing Municipality, Feb. 24, 2011) (Lawinfochina) (China).

⁶⁶⁵ Contract Law (promulgated by the Nat’l People’s Cong. Mar. 15, 1999, effective Oct. 1, 1999) (Lawinfochina) (China) [hereinafter Chinese Contract Law].

⁶⁶⁶ Company Law (promulgated by the Standing Comm. of the Nat’l People’s Cong., Dec. 29, 1993, effective Jan. 1, 2006) (Lawinfochina) (China).

⁶⁶⁷ Arbitration Law (promulgated by the Standing Comm. of the Nat’l People’s Cong., Aug. 31, 1994, effective Sept. 1, 1995) (Lawinfochina) (China).

⁶⁶⁸ Copyright Law (promulgated by the Standing Comm. of the Nat’l People’s Cong., Sept. 7, 1990, effective Oct. 1, 1999) (Lawinfochina) (China).

⁶⁶⁹ Law for Countering Unfair Competition (promulgated by the Standing Comm. of the Nat’l People’s Cong., Sept. 2, 1993, effective Dec. 1, 1993) (Lawinfochina) (China) [hereinafter Chinese Unfair Competition Law].

⁶⁷⁰ Patent Law (as amended 2008) (promulgated by the Standing Comm. of the Nat’l People’s Cong., Mar. 12, 1984, effective Oct. 1, 2009) (Lawinfochina) (China).

⁶⁷¹ Trademark Law (promulgated by the Standing Comm. of the Nat’l People’s Cong., Aug. 23, 1982, amendments effective Dec. 1, 2001) (Lawinfochina) (China) [hereinafter Chinese Trademark Law].

⁶⁷² Anti-Monopoly Law (promulgated by the Standing Comm. of the Nat’l People’s Cong., Aug. 30, 2007) (Lawinfochina) (China) [hereinafter Chinese Anti-Monopoly Law].

1.3 Malaysia

The Malaysian law governing franchising is the Franchise Act of 1998 (“Malaysian Franchise Act”).⁶⁷³ Malaysia also has Ministerial Regulations on related issues, such as forms and fees through the Franchise Forms and Fees Regulations,⁶⁷⁴ qualifications of a franchise brokers as set forth in the Franchise Broker Regulations,⁶⁷⁵ and the compounding of offences via the Compounding of Offences Regulations.⁶⁷⁶

2. The Main Features of Franchising Relationship Rules in the US, China, and Malaysia

2.1 Definition

A good definition of franchising is one that satisfies the legal elements of such a relationship - a distribution methodology in which the franchisor grants the franchisee the right to deal under the franchisor’s trademark or trade name and following his business plan in return for an agreed amount of fees.⁶⁷⁷ The elements of franchising are fees, assistance and control, general use of intellectual property such as trademarks, and a business or marketing plan. The inclusion of these elements helps to distinguish franchising from other legal forms with common

⁶⁷³ Franchise Act 1998, *Warta Kerajaan seri Paduka Baginda Gazette*, 31 December 1998, available at http://www.commonlii.org/my/legis/consol_act/fa199895/ (Malaysia) [hereinafter Malaysian Franchise Act].

⁶⁷⁴ Franchise (Forms and Fees) Regulations 1999, *Warta Kerajaan seri Paduka Baginda Gazette*, 8 Oct. 1999, (Malaysia) [hereinafter Franchise Forms and Fees Regulations 1999].

⁶⁷⁵ Franchise Qualifications of a Franchise Broker Regulations 1999, *Warta Kerajaan seri Paduka Baginda Gazette*, 8 Oct. 1999, (Malaysia).

⁶⁷⁶ Franchise Compounding of Offences Regulations 1999. *Warta Kerajaan seri Paduka Baginda Gazette*, 8 Oct. 1999, (Malaysia).

⁶⁷⁷ See *supra* Ch. I.1.1 (discussing the Definition and Elements of Franchising).

features but that do not include all the franchising elements such as agency and transfer of technology.

In the United States, state law franchise definitions generally resemble the New Rule's definition in that most states recognize the elements of franchising to be use of trademarks, payment of fees, existence of a community of interests between franchisor and franchisee, and the existence of a marketing plan.⁶⁷⁸ In *Beilowitz v. General Motors Corp.*, for example, the court decided that the contractual relationship between Beilowitz and General Motors was a franchise under the New Jersey Franchise Practices Act for various reasons, significantly that Beilowitz used the General Motors trademark for twenty-three years.⁶⁷⁹ The court also accorded weight to the fact that the public associated Beilowitz's business with the General Motors trademark.⁶⁸⁰

As exemplified in *Beilowitz*, a business transaction is deemed to be a franchise relationship according to the New Rule if it satisfies the elements mentioned above regardless of how the parties describe the relationship themselves and whether they perform the duties arising under this relationship.⁶⁸¹ Similarly, the relationship is not considered a franchise relationship, even if the parties call it a franchise, if it does not satisfy the elements of a franchise according to the New Rule.⁶⁸² Furthermore, a franchise agreement is not considered concluded until the

⁶⁷⁸ BYRON E. FOX & BRUCE S. SCHAEFFER, *FRANCHISE REGULATION AND DAMAGES* (2011).

⁶⁷⁹ *Beilowitz v. General Motors Corp.*, 233 F. Supp. 2d 631, 639-40 (D.N.J. 2002) (citing N.J. STAT. ANN. §§ 56:10-3, 10-4).

⁶⁸⁰ *Id.* at 642.

⁶⁸¹ 16 C.F.R. § 436.1(h).

⁶⁸² *Id.*

franchise agreement is signed, even if the franchisee pays the fees before signing the agreement.⁶⁸³

The New Rule explicitly excludes from its scope employer-employee relationships, partnerships, cooperative associations, certification or testing services, and single trademark licenses.⁶⁸⁴ According to the Franchise Rule Compliance Guide, such relationships have some similarities to franchises, but do not satisfy one or more of the franchise elements.⁶⁸⁵ For instance, many factors should be considered in deciding whether a relationship is an employment relationship. For instance, the degree of control exercised by the master, whether the employee is paid a salary or a lump sum payment, whether the employee may be discharged without any liability of the employer, and whether the employee is required to invest money in the relationship.⁶⁸⁶ Also, the Compliance Guide defines cooperative associations to include “agricultural cooperatives authorized by the Capper-Volstead Act, 7 U.S.C. § 291” and “retailer owned cooperative chains.”⁶⁸⁷ The Compliance Guide provides the example of “Underwriters Laboratories” as a testing service⁶⁸⁸ and defines single trademark licenses as those that require the licensee to manufacture goods according to the licensor’s instructions and where use of the mark is the principal purpose of the agreement.⁶⁸⁹

⁶⁸³ 16 C.F.R. § 436.1(i); *see also* THE FTC FRANCHISE RULE, *supra* note 642, at 17-18.

⁶⁸⁴ 16 C.F.R. § 437.2(4)(i)-(iii).

⁶⁸⁵ *See generally* FED. TRADE COMM., FRANCHISE RULE COMPLIANCE GUIDE (2008), <http://business.ftc.gov/sites/default/files/pdf/bus70-franchise-rule-compliance-guide.pdf> [hereinafter FRANCHISE RULE COMPLIANCE GUIDE].

⁶⁸⁶ *Id.*

⁶⁸⁷ *Id.*

⁶⁸⁸ *Id.*

⁶⁸⁹ *Id.*

Somewhat similar to the United States, the Chinese New Regulations address the basic elements of franchising, such as intellectual property, business plans, and fees.⁶⁹⁰ The Regulations' definition of franchising, however, is sometimes criticized for being neither precise nor accurate, as it may extend to include other types of businesses that are only similar to franchising.⁶⁹¹ Additionally, the Regulations restrict franchising to enterprises.⁶⁹² An enterprise is any business, including a company, partnership, joint-stock cooperative, state-owned business, collectively-owned business, joint venture, wholly foreign-owned enterprise, or foreign-invested joint stock limited company.⁶⁹³ Limiting franchising to enterprises means that individual projects are not allowed to be franchisors in China.⁶⁹⁴ If the enterprise requirement is violated, Article 24 of the Chinese New Regulations provides for a penalty fine of between 100,000 RMB and 500,000 RMB.⁶⁹⁵

In contrast, the Malaysian Franchise Act defines franchising as an agreement in which a franchisor grants a franchisee a license to operate a business under the franchisor's trademark and to use the franchisor's trade secrets or other intellectual property, while holding administrative rights and control over the business in return for fees paid by the franchisee.⁶⁹⁶ The Act's definition of franchising clearly distinguishes franchising from other business forms

⁶⁹⁰ See Chinese New Regulations, *supra* note 237, at art. 3.

⁶⁹¹ Jones & Wulff, *supra* note 657, at 58.

⁶⁹² INTERNATIONAL FRANCHISING, *supra* note 165, at 96.

⁶⁹³ Yanling Ren, *China*, in GETTING THE DEAL THROUGH FRANCHISE 28 (Philip F. Zeidman ed., 2011), available at http://www.franchise.org/uploadedFiles/Franchise_Industry/F2011Chinachapter.pdf.

⁶⁹⁴ *Id.*

⁶⁹⁵ Chinese New Regulations, *supra* note 237, at art. 24.

⁶⁹⁶ INTERNATIONAL FRANCHISING, *supra* note 165, at 286; Malaysian Franchise Act, *supra* note 673, at art. 4.

such as partnerships, services agreements, and agency relationships.⁶⁹⁷ Unlike the Chinese New Regulations, the Malaysian Franchise Act provides that a franchise agreement may be concluded between two or more individuals and is not restricted to enterprises.⁶⁹⁸

The best model for the Egyptian law to consider when defining franchising appears to be the New Rule as its definition encompasses a comprehensive description of each one of the franchising elements. Moreover, the proposed Egyptian franchising law should avoid the ambiguity of the Chinese New Regulations which are silent on distinguishing franchising from other forms of business transactions. Thus, the Egyptian legislation should also follow the Malaysian Franchise Act in its explicit exclusion of other forms of licensing transactions that have similar features to franchising.⁶⁹⁹ Finally, Egypt should avoid the Chinese New Regulations' provision that makes franchising exclusive to enterprises.

2.2 Elements of a Franchise

As mentioned above, the elements of franchising include the control exercised by the franchisor over the franchised business, the existence of a marketing plan, the existence of a community of interests between the franchisor and the franchisee, payment of fees by the franchisee, and a license to use the franchisor's intellectual property.⁷⁰⁰ Each of these elements is examined in more detail below.

2.2.1 Control and Assistance

⁶⁹⁷ Malaysian Franchise Act, *supra* note 673, at art. 4.

⁶⁹⁸ Malaysian Franchise Act, *supra* note 673, at art. 5.

⁶⁹⁹ Examples include agency and transfer of technology agreements.

⁷⁰⁰ See *supra* Ch. I.1.1 (discussing the Definition and Elements of Franchising).

The element of control and assistance is the extent to which franchisors manage and direct different aspects of the franchised business.⁷⁰¹ In essence, control takes place through various activities such as assisting franchisees in choosing a location, preparing the premises, and fulfilling the requirements for design and appearance.⁷⁰² Control also includes assisting to a certain extent with business operations, providing technical training for the franchisee's employees, and providing help with establishing accounting systems and marketing.⁷⁰³ The importance of control and assistance is that it ensures that franchisors maintain the goodwill of their businesses and protect use of their franchised trademarks.⁷⁰⁴

The New Rule in the United States provides that franchisors must exercise *significant* control and assistance in the operation of the franchised business.⁷⁰⁵ Though the word significant is generally subjective, it requires a strong connection with the operation of the franchised business and is more than minor advice provided to the franchisee.⁷⁰⁶ Similarly, the Chinese New Regulations require a franchisor to have a business model and to provide his franchisees with any required guidance, training, technical help, or other similar assistance.⁷⁰⁷

The Malaysian Franchise Act appears to be the clearest and most comprehensive when it comes to control and assistance. The Act explicitly requires franchisors to continuously exercise

⁷⁰¹ Miller, *supra* note 73, at 315.

⁷⁰² *Id.*

⁷⁰³ *Id.*

⁷⁰⁴ *Id.*

⁷⁰⁵ 16 C.F.R. § 436.1(h)(2).

⁷⁰⁶ Miller, *supra* note 73, at 320 (citing the Final Guides to the Franchising and Business Opportunity Ventures Trade Regulation Rule, 44 Fed. Reg. 49,967).

⁷⁰⁷ Chinese New Regulations, *supra* note 237, at art. 7.

control over the franchised business during the entire term of the franchise agreement⁷⁰⁸ and clearly makes franchisors responsible for providing general assistance and specific assistance as to the supply of raw materials and necessary services, training, marketing, and business or technical assistance.⁷⁰⁹

The proposed Egyptian franchising law should combine the aspects of assistance and control from the New Rule and the Malaysian Franchise Act. Requiring significant assistance and control similar to the New Rule will help to avoid disputes about the type of assistance to be provided by franchisors if it's not clearly stated in the franchise agreement. Also, requiring continuous assistance and control, like under the Malaysian Franchise Act, will help to avoid disputes about when the assistance and control obligations begin and when they should end.

2.2.2 Marketing Plan

A marketing plan outlines a method for operating the business according to the system determined by the franchisor.⁷¹⁰ It usually requires use of the franchisor's trademarks, business standards, product and service specifications, training systems, operation manuals, specific advertising systems, and other requirements determined by the franchisor to establish a consistent look across all the franchised outlets.⁷¹¹

In the United States, the California Franchise Relations Act considers a marketing plan the core of a franchise by explicitly incorporating it into the definition of a franchise. Under the

⁷⁰⁸ Malaysian Franchise Act, *supra* note 673, at art. 4(C)

⁷⁰⁹ *Id.* at art. 4(D)

⁷¹⁰ Pitegoff & Garner, *supra* note 441, at 189. *See, e.g.*, CAL. CORP. CODE § 31005 (2012); CONN. GEN. STAT. § 42-133e (2012).

⁷¹¹ Rochelle B. Spandorf, *Franchise Player*, 29 LOS ANGELES LAW. 34 (2006).

California law, a franchise is an agreement in which a franchisor grants a franchisee the right to offer, sell, or distribute the franchisor's goods or services under a marketing plan that is associated with the use of a trademark, service mark, or trade name.⁷¹² A marketing plan exists not only when the franchisee is required to use the franchisor's business plan, but also when the franchisor makes use of the plan optional.⁷¹³

The Chinese New Regulations also connect franchise transactions with marketing plans by requiring franchisees to conduct the franchised business in accordance with the business model determined by the franchisor.⁷¹⁴ The Malaysian Franchise Act similarly provides that franchisees shall operate the franchised business according to the system determined by franchisors.⁷¹⁵

The proposed Egyptian franchising law should follow the definition of marketing plan given by the California Franchise Relations Act as it provides more details on what a marketing plan entails and clearly ties the marketing plan to the use of a trademark and other forms of intellectual property to avoid any confusion about the definition or application of marketing plans.⁷¹⁶ Further, the idea that a marketing plan is optional should be avoided because doing so contradicts the core of franchising, which is operating the franchised business in accordance with the franchisors assistance, training, recommendations, and standards. It also reduces the franchisor's ability to supervise franchisees' operations, which may in turn affect the franchisor's goodwill. Therefore, an obligatory marketing plan provision is recommended.

⁷¹² CAL. BUS. & PROF. CODE § 20001 (2012).

⁷¹³ See *To-Am Equip. Co. v. Mitsubishi Caterpillar Forklift Am., Inc.*, 953 F. Supp. 987, 994 (N.D. Ill. 1997).

⁷¹⁴ Chinese New Regulations, *supra* note 237, at art. 3.

⁷¹⁵ Malaysian Franchise Act, *supra* note 673, at art. (4)(a).

⁷¹⁶ CAL. BUS. & PROF. CODE § 20001.

2.2.3 Community of Interests

A community of interests exists where there shared financial interests in the success of the business, particularly when each of the parties is dependent on the other to some extent.⁷¹⁷ One can conclude that requiring a mutual financial interest guarantees a certain degree of seriousness of the contracting parties.

In the United States, some states require a community of interests rather than a marketing plan.⁷¹⁸ In *Ziegler Co. v. Rexnord, Inc.*, the Wisconsin Supreme Court articulated ten factors used to determine whether a community of interests exists: the relationship's duration; the scope and nature of the obligations of the parties; the time spent by the dealer to distribute the products in question; the revenue gained by the distributor; territorial exclusivity; the extent to which the distributor uses the other party's mark; whether the distributor invests his own money; the number of employees the distributor uses to perform his obligations under the relationship; the amount of money spent by the distributor on advertising; and any other services the distributor provides to the other party's clients in performing his obligations.⁷¹⁹

Conversely, neither the Chinese New Regulations nor the Malaysian Franchise Act regulate community of interests but rather reference the rest of the franchise elements, particularly emphasizing the marketing plan and assistance and control. The proposed Egyptian franchising law may not need to require having a community of interests for a franchise

⁷¹⁷ Pitegoff & Garner, *supra* note 441, at 189.

⁷¹⁸ See, e.g., S.D. CODIFIED LAWS § 37-5A-1 (2011); HAW. REV. STAT. § 482E-2 (2011); MINN. STAT § 80C.01(4) (2012).

⁷¹⁹ *Ziegler Co., Inc. v. Rexnord, Inc.*, 407 N.W.2d 873, 879 (Wis. 1987). For other cases on community of interests, see Finkelstein & Bussert, *supra* note 330, at 17-18; see also generally Jonathan Solish & Bruce Napell, *What is a Franchise?* 26 FRANCHISE L.J. 3 (2006).

relationship to exist. That is because the general rules of contract law in Egypt require a motivation for the conclusion of any contract, the form of that motivation depending on the nature of each contract. In the context of franchising, it will ordinarily be expected that the motivation will be financial in nature.

2.2.4 Fees

In the United States, both federal and state laws emphasize fees as one of the basic elements when defining a franchise.⁷²⁰ Additionally, the New Rule not only refers to fees while defining franchising, but also defines required payments to include any consideration the franchisee pays to the franchisor to obtain the franchise.⁷²¹ Thus, the New Rule covers all payments, whether direct or indirect, made by the franchisee or any third party acting on his behalf, to the franchisor or its affiliates, paid in a lump sum or installments, in any form, and provided in the franchise agreement or required by the practical nature of the business.⁷²² Fees may include different forms of payments such as initial franchise fees, payments for advertising assistance, payments for rent, payments for required equipment and supplies, security deposits, escrow deposits, and royalties on sales.⁷²³

In *Adees v. Avis Rent-a-Car System, Inc.*, Avis, a car agency operator, owned rental car locations and entered into an agreement with Adees titled an “Agency Operator Agreement” that

⁷²⁰ 16 C.F.R. § 436.1(j).

⁷²¹ The New Rule provides that “Required payment means all consideration that the franchisee must pay to the franchisor or an affiliate, either by contract or by practical necessity, as a condition of obtaining or commencing operation of the franchise. A required payment does not include payments for the purchase of reasonable amounts of inventory at bona fide wholesale prices for resale or lease.” *Id.* at § 436.1(s).

⁷²² Miller, *supra* note 73, at 322-23; *see* Final Guides to the Franchising and Business Opportunity Ventures Trade Regulations Rule, 44 Fed. Reg. 49,967 (Aug. 24, 1979) (discussing the FTC's intent to capture all hidden franchise fees).

⁷²³ Miller, *supra* note 73, at 322.

required Adees to act as an operator for Avis without any commitment to pay initial fees.⁷²⁴ According to the agreement, Adees was required to deposit money from the car rentals into Avis' bank account on a daily basis and Avis paid Adees a 15% commission of the revenue from rentals and 65% of the revenue from refueling services and gasoline charges.⁷²⁵ Adees' commission, however, was supposed to be reduced by a \$0.20 fleet surcharge per vehicle for each day the vehicle was assigned to the facility.⁷²⁶ When Avis terminated the agreement, Adees claimed that Avis breached the franchising covenant of good faith because the agreement was a franchise agreement as, in Adees's opinion, it paid Avis two kinds of franchise fees: indirect fees represented by the \$0.20 per car per day fleet surcharge that Avis deducted from Adees's commission and the fuel surcharge percentage split.⁷²⁷

The court decided that none of the claimed payments were actually franchise fees and therefore, that the agreement was not a franchise agreement.⁷²⁸ Regarding the fleet surcharge, the court explained that a variety of factors regulate when a fee is considered a franchise fee including whether the franchisor receives something of value in return for the fee, whether the party making the payment received something of value in exchange for the fee, if the fees paid are an irrevocable cost of doing the business, and whether the franchisee puts its own money at risk.⁷²⁹ Applying these factors to Adees's claim, the fleet surcharge cannot be considered a franchise fee because Adees received something of value in return for the fleet surcharge: the use

⁷²⁴ Adees Corp. v. Avis Rent a Car Sys., No. 03-57227 2003 U.S. Dist. LEXIS 26293, at *2 (C.D. Cal., Nov. 19, 2003).

⁷²⁵ *Id.*

⁷²⁶ *Id.*

⁷²⁷ *Id.*

⁷²⁸ *Id.* at *2-3.

⁷²⁹ *Id.*

of the cars that formed the basis for the commission.⁷³⁰ The court also found that Adees had the choice to return any extra cars to AVIS and to stop paying the fleet surcharge for these extra cars.⁷³¹ Moreover, the court explained that Adees did not invest any capital or buy any material from Avis.⁷³² Concerning, the refueling surcharge commission split, the court found that it was not a cost that Adees had to pay as a license for operating Avis's business but rather an income gained from the activity of renting cars.⁷³³

In China, the New Regulations provide that the payment of franchising fees is an element of a franchise.⁷³⁴ The New Regulations require inclusion in the franchise agreement information of the type, amount, and payment method of franchising fees.⁷³⁵ The Malaysian Franchise Act also explicitly provides for payment that fees or other forms of consideration are one of the franchise elements.⁷³⁶ The Malaysian Franchise Act, like the U.S. New Rule, provides examples of different types of fees including set fees, royalties, promotion fees, or any other payment provided for in the franchise agreement.⁷³⁷ Moreover, the Act requires that any fees be included in the written franchising agreement.⁷³⁸ Franchisors must also mention in writing any request for franchisees to make payments before signing a franchise agreement and illustrate the purpose of

⁷³⁰ *Id.*

⁷³¹ *Id.*

⁷³² *Id.*

⁷³³ *Id.* at *4.

⁷³⁴ Chinese New Regulations, *supra* note 237, at art. 3.

⁷³⁵ *Id.* at art. 11.

⁷³⁶ Malaysian Franchise Act, *supra* note 673, at art. 4(e).

⁷³⁷ *Id.* at art. 30.

⁷³⁸ *Id.* at art. 18.

the payment and the conditions for the use and refund of the money paid.⁷³⁹ Furthermore, the Act requires that fees be consistent with those set forth in the disclosure documents.⁷⁴⁰ Finally, the Act prohibits the unreasonable reassessment of fees.⁷⁴¹

The proposed Egyptian franchising law should follow the U.S. approach, rather than that of the Malaysian Franchise Act or the Chinese New Regulations when defining fees as an essential element of a franchise. That is because the U.S. laws have broader rules that cover different types of fees paid, payment methods, whether paid by franchisee or its representatives and so on. Additionally, the Egyptian law should include a provision such as that of the Malaysian and Chinese laws, requiring explicit written documentation describing the fees required, appropriate payment methods, and any other details related to fees, and that the fees described must be in accordance with disclosure documents to avoid disputes arising over fees. Finally, the Egyptian law should provide a rule similar to the Chinese New Regulations that imposes a penalty if the writing requirement is breached. The penalty would serve as a deterrent for deviation from the requirements of the law.

2.2.5 Licensing the Use of Intellectual Property

Licensing the use of intellectual property is the cornerstone of franchising transactions.⁷⁴² For franchising purposes, the most important intellectual property licensed to the franchisee is the franchisor's trademarks or trade name and trade secrets or other proprietary information. Unfair competitive practices also bear a close relationship with the use of intellectual property.

⁷³⁹ *Id.* at art. 19.

⁷⁴⁰ *Id.* at art. 21.

⁷⁴¹ *Id.* at art. 29.

⁷⁴² *See supra* Ch. I.1.1 (discussing the Definition and Elements of Franchising).

More details on trademark, undisclosed information, and unfair competition are given in the following sections.

2.2.5.1 Trademark

In the United States both federal and state law regulate trademarks. Federal law provides protection for distinctive marks used in business,⁷⁴³ regulates false designation of origin and false advertising disputes,⁷⁴⁴ and provides registration as a method of protecting ownership and use of the mark⁷⁴⁵ that results in incontestability.⁷⁴⁶ The United States Patent and Trademark Office (“U.S. PTO”) reviews applications for registration.⁷⁴⁷ State law provides the primary legal principles governing trademarks under unfair competition laws, model trademark laws, the Uniform Deceptive Trade Practices Act, state trademark protection statutes, and state dilution statutes.⁷⁴⁸ The law regulating trademarks in China is the Trademark Law of the People’s Republic of China (“Chinese Trademark Law”).⁷⁴⁹ In Malaysia, the governing trademark laws

⁷⁴³ Lanham Act, 15 U.S.C. § 1051; *see also* SHELDON W. HALPERN, CRAIG ALLEN NARD, & KENNETH L. PORT, FUNDAMENTALS OF UNITED STATES INTELLECTUAL PROPERTY LAW: COPYRIGHT, PATENT, TRADEMARK 289-305 (3d ed. 2011).

⁷⁴⁴ 15 U.S.C. § 1125(a).

⁷⁴⁵ 15 U.S.C. § 1072.

⁷⁴⁶ 15 U.S.C. § 1065.

⁷⁴⁷ *See generally* UNITED STATES PATENTS AND TRADEMARK OFFICE, <http://www.uspto.gov/> (last visited Feb. 23, 2011).

⁷⁴⁸ *See generally* Steven John Olsen, *Mixed Signals in Trademark’s “Likelihood of Confusion Law”*: Does Quality Matter?, 44 VAL. U.L. REV. 659, 662-63 (2010).

⁷⁴⁹ *See generally* Chinese Trademark Law, *supra* note 671.

are the Trademark Act of 1976 (“Malaysian Trademark Act”)⁷⁵⁰ and the Trademark Regulations of 1997.⁷⁵¹

Though registration of a trademark is not mandatory in the United States to protect the trademark owner’s rights, federal trademark registration with the U.S. PTO affords many benefits such as validity, ownership, and exclusive rights to use the mark.⁷⁵² Federal registration on the basis of a good faith intention to use the mark is not usually obtained until the applicant shows that the mark submitted for registration is in use in his business.⁷⁵³

The counterpart to federal registration in the U.S. is state registration.⁷⁵⁴ State registration does not have the same advantages as federal registration as it rarely grants additional rights and covers only the state where registration takes place.⁷⁵⁵ State registration is proof of the validity of the mark in the state where the mark is registered.⁷⁵⁶ State registration also serves as an information system to those who search “the state register of the registrant’s ownership interest.”⁷⁵⁷ After five years of state registration, the registration becomes incontestable.⁷⁵⁸ Incontestability means that the owner of the mark can offensively claim the strength of the mark

⁷⁵⁰ Trademark Act 1967, *Warta Kerajaan seri Paduka Baginda Gazette*, 24 June 1976, available at http://www.commonlii.org/my/legis/consol_act/tma1976121/ [hereinafter Malaysian Trademark Act].

⁷⁵¹ Trademark Regulations 1997, *Warta Kerajaan seri Paduka Baginda Gazette*, 16 Nov. 1997, available at http://www.commonlii.org/my/legis/consol_reg/tmr1997230/ [hereinafter Malaysian Trademark Regulations].

⁷⁵² Finkelstein & Bussert, *supra* note 330, at 5.

⁷⁵³ Francis J. Duffin & Bryan S. Watson, *Best Practices in Protecting and Enforcing Trademarks, Copyrights, and Other Intellectual Property Rights*, 28 *FRANCHISE L.J.* 132, 132 (2008).

⁷⁵⁴ *Id.* at 133.

⁷⁵⁵ Finkelstein & Bussert, *supra* note 330, at 289-305; *see also* Duffin, & Watson, *supra* note 753, at 133.

⁷⁵⁶ *Id.*

⁷⁵⁷ *Id.*

⁷⁵⁸ 15 U.S.C. § 1115(b).

and defensively claim that it is beyond specific kinds of attack.⁷⁵⁹ Aside from incontestability, registration works as a constructive notice by the mark's owner against any subsequent applications to register the same mark and such applications should be denied by the U.S. PTO if they cause confusion or deception.⁷⁶⁰ It is also worth mentioning that in the U.S. use of the mark is the key element to obtaining ownership rights as priority of rights is determined according to the "first in time" principle with regard to use of the mark.⁷⁶¹ Judicial practice has provided that specific requirements be considered for granting rights over the trademark through use including requirements that the use be sufficient⁷⁶² and take place in good faith.⁷⁶³

The duration of a registered trademark, under U.S. trademark laws, is ten years, but is renewable.⁷⁶⁴ There is no limit on the number of times a trademark can be renewed, each time for an additional ten years. The owner must simply continue using the mark and submit a Declaration of Continued Use application to the U.S. PTO, otherwise the registration will be cancelled.⁷⁶⁵

U.S. law does not provide a specific list of signs that cannot be registered as trademarks, rather it establishes specifications and requirements of what can be registered as a trademark. For example, names cannot be registered as trademarks except in specific cases where the name has a

⁷⁵⁹ HALPERN, NARD & PORT, *supra* note 743, at 352.

⁷⁶⁰ 15 U.S.C. § 1072.

⁷⁶¹ 15 U.S.C. § 1051(a).

⁷⁶² Florida v. Real Juices, Inc., 330 F. Supp. 428 (M.D. Fla. 1971).

⁷⁶³ HALPERN, NARD & PORT, *supra* note 743, at 338.

⁷⁶⁴ Chinese Trademark Law, *supra* note 671, at arts. 37-38; Malaysian Trademark Act, *supra* note 750, at arts. 32, 41-42.

⁷⁶⁵ Duffin & Watson, *supra* note 753, 134.

secondary meaning.⁷⁶⁶ A good example of secondary meaning is found in *Emra Corp. v. Superclips, Ltd.* In that case, Emra Corporation, a company with operation in California, brought a claim against Superclips Ltd., a company with operations in Canada and its franchisees in Canada and the United States. Emra operated hair cutting shops and sold related products under the name “SUPERCUTS.”⁷⁶⁷ The defendant, James Tucker contacted Emra, inquired about a franchise and was told that Emra was not seeking expansion.⁷⁶⁸ The defendant and some partners then opened their own hair cutting shops under the name “SUPERCLIPS, Ltd.,” and registered a trademark, “SUPERCLIPS.”⁷⁶⁹ Emra brought an action against SUPERCLIPS alleging that the defendant’s trademark would cause confusion.⁷⁷⁰ The defendants cross-claimed that the plaintiff’s trademark was a weak mark, that it had not acquired secondary meaning outside of California, and that accordingly, it was not eligible for trademark protection since it was simply descriptive.⁷⁷¹ The federal District Court for the Eastern District of Michigan held that:

Emra is entitled . . . to injunctive . . . and other relief . . . against any unauthorized use in commerce of any reproduction, copy or colorable imitation of a registered mark in connection with the sale, offering for sale, distribution or advertising of any goods or services on or in connection with which such use is likely to cause confusion, or to cause mistake, or to deceive. The legal standard governing the grant of injunctive relief under § 43(a) of the Lanham Act, is a showing of “likelihood of confusion.”⁷⁷²

⁷⁶⁶ HALPERN, NARD & PORT, *supra* note 743, at 319.

⁷⁶⁷ *Id.*, at 709

⁷⁶⁸ *Id.*

⁷⁶⁹ *Id.*, at 710

⁷⁷⁰ *Id.*

⁷⁷¹ *Id.*

⁷⁷² *Emra Corp. v. Superclips, Ltd.*, 559 F. Supp. 705 (E.D. Mich. 1983).

The court applied an eight-factor test to determine likelihood of confusion, examining: 1) the strength of the plaintiff's mark; 2) the relatedness of the goods; 3) the similarity of the marks; 4) evidence of actual confusion; 5) marketing channels used; 6) the likely degree of purchaser care; 7) the defendant's intent in selecting the mark; and 8) the likelihood of expansion of product lines.⁷⁷³ Concerning the first element, the court explained that trademarks fall into one of four categories: generic, descriptive, suggestive, or arbitrary or fanciful.⁷⁷⁴ Specifically, a mark is descriptive when it communicates to consumers the characteristics, functions, qualities, ingredients, properties, or uses of a product or service.⁷⁷⁵ A descriptive mark is a weak mark and is not protected unless it has a secondary meaning, for example, denoting goods or services provided only by a particular business.⁷⁷⁶ The concept of secondary meaning was originally designed to limit the extent to which a manufacturer could monopolize through trademarks words and symbols that are useful in describing products.⁷⁷⁷ The doctrine holds that a descriptive or geographical mark receives protection against copying only when consumers have come to associate it with a particular manufacturer or source.⁷⁷⁸ When a mark has acquired a secondary meaning, a second-comer is barred from using it because such use is virtually certain to create confusion in the public mind as to the source of the product.⁷⁷⁹ The court concluded that the Plaintiff's mark established a secondary meaning in this area of the industry.⁷⁸⁰

⁷⁷³ *Id.* at 713.

⁷⁷⁴ *Id.*

⁷⁷⁵ *Id.*

⁷⁷⁶ *Id.*

⁷⁷⁷ *Id.* at 714

⁷⁷⁸ *Id.*

⁷⁷⁹ *Id.*

⁷⁸⁰ *Id.*

Examples of descriptive trademarks that have established secondary meanings in their industry include “Giant Hamburger” for burgers, “Pestway” for pest control services, “Beef & Brew” for restaurants, “Platinum” for home loan mortgage services, “Jewelry Repair Center” for jewelry repair.⁷⁸¹ In the same context, the Lanham Act specifies that using a reproduced, counterfeited, copied, or imitated mark that is likely to cause confusion or mistake, or to deceive others shall result in liability in a civil action brought by the registrant of the mark.⁷⁸² Remedies include damages, injunctive relief, court costs, and attorney fees.⁷⁸³ For example, in *Howard Johnson Co. v. Khimani*, the court found that the termination compensation should cover all lost royalties.⁷⁸⁴

Another important issue when talking about trademarks is the assignment of a trademark. Assignment of a trademark is invalid until an application of the statement of use of the trademark is submitted by the assignor to the U.S. PTO.⁷⁸⁵ Nevertheless, assignment of a trademark without goodwill is generally invalid in the United States.⁷⁸⁶

⁷⁸¹ Finkelstein & Bussert, *supra* note 330, at 9-10.

⁷⁸² 15 U.S.C. § 1114(1).

⁷⁸³ § 1114(2).

⁷⁸⁴ See generally *Howard Johnson Co. v. Khimani*, 892 F.2d 1512 (11th Cir. 1990).

⁷⁸⁵ 15 U.S.C. § 1060 provides that:

(a)

(1) A registered mark or a mark for which an application to register has been filed shall be assignable with the good will of the business in which the mark is used, or with that part of the good will of the business connected with the use of and symbolized by the mark. Notwithstanding the preceding sentence, no application to register a mark under section 1(b) shall be assignable prior to the filing of an amendment under section 1(c) to bring the application into conformity with section 1(a) or the filing of the verified statement of use under section 1(d), except for an assignment to a successor to the business of the applicant, or portion thereof, to which the mark pertains, if that business is ongoing and existing.

(2) In any assignment authorized by this section, it shall not be necessary to include the good will of the business connected with the use of and symbolized by any other mark used in the business or by the name or style under which the business is conducted.

Finally, U.S. law allows a licensor to maintain the right to control the quality of the products produced by the licensee.⁷⁸⁷ The “quality control” provision inserted in licensing agreements allows the franchisor to control the quality of the products.⁷⁸⁸ Hence, if a licensor gives up quality control rights, this may result in a naked license. A naked license may be inferred if a trademark owner does not police the use of its mark and allows others to use it without providing oversight.⁷⁸⁹ In either case, abandonment of the trademark will result and the trademark owner will lose all trademark rights.⁷⁹⁰

(3) Assignments shall be by instruments in writing duly executed. Acknowledgment shall be prima facie evidence of the execution of an assignment, and when the prescribed information reporting the assignment is recorded in the United States Patent and Trademark Office, the record shall be prima facie evidence of execution.

(4) An assignment shall be void against any subsequent purchaser for valuable consideration without notice, unless the prescribed information reporting the assignment is recorded in the United States Patent and Trademark Office within 3 months after the date of the assignment or prior to the subsequent purchase.

(5) The United States Patent and Trademark Office shall maintain a record of information on assignments, in such form as may be prescribed by the Director.

(b) An assignee not domiciled in the United States may designate by a document filed in the United States Patent and Trademark Office the name and address of a person resident in the United States on whom may be served notices or process in proceedings affecting the mark. Such notices or process may be served upon the person so designated by leaving with that person or mailing to that person a copy thereof at the address specified in the last designation so filed. If the person so designated cannot be found at the address given in the last designation, or if the assignee does not designate by a document filed in the United States Patent and Trademark Office the name and address of a person resident in the United States on whom may be served notices or process in proceedings affecting the mark, such notices or process may be served upon the Director.

⁷⁸⁶ HALPERN, NARD & PORT, *supra* note 743, at 350.

⁷⁸⁷ *Id.*

⁷⁸⁸ *Id.*

⁷⁸⁹ *Yokum v. Covington*, 216 U.S.P.Q. (BNA) 210 (T.T.A.B. 1982).

⁷⁹⁰ HALPERN, NARD & PORT, *supra* note 743, at 350.

A case exemplifying the issue of quality control under the Lanham Act is *Dawn Donut Co. v. Hart's Food Stores*.⁷⁹¹ In that case, the Second Circuit Court of Appeals discussed the issue of cancellation of a trademark registration when the owner fails to exercise the quality control required by the Lanham Act over the nature and quality of the goods sold.⁷⁹² The court explained that the Lanham Act requires “the licensor of a registered trademark to take reasonable measures to detect and prevent misleading uses of his mark by his licensees or suffer cancellation of his federal registration.”⁷⁹³ The Lanham Act takes the position that, unlike naked licensing, controlled licensing helps to avoid abandonment of registration.⁷⁹⁴ In other words, if control is not required, the trademark owner’s right to license the mark away from the business associated to it may result in differences in the quality of products bearing the same trademark.⁷⁹⁵ The Act considers that the licensor’s control of his licensee’s actions reduces the risk that the public may be unwittingly deceived.⁷⁹⁶

In China, unlike in the United States, registration of a trademark is mandatory under Article 4 of the Chinese Trademark Law which requires trademarks to be registered with the

⁷⁹¹ *Dawn Donut Co. v. Harts Food Stores, Inc.*, 267 F.2d 358, 420 (2d Cir. 1959).

⁷⁹² *See generally id.* at 430.

⁷⁹³ 15 U.S.C. § 1064; *see also Dawn Donut Co.*, 267 F.3d at 366.

⁷⁹⁴ 15 U.S.C. § 1055 provides that:

Where a registered mark or a mark sought to be registered is or may be used legitimately by related companies, such use shall inure to the benefit of the registrant or applicant for registration, and such use shall not affect the validity of such mark or of its registration, provided such mark is not used in such manner as to deceive the public.

15 U.S.C.A. § 1127 defines ‘related company’ to mean “any person who legitimately controls or is controlled by the registrant or applicant for registration in respect to the nature and quality of the goods or services in connection with which the mark is used.”

⁷⁹⁵ *Dawn Donut Co.*, 267 F.3d at 367.

⁷⁹⁶ *Id.*

State Trademark Office (“STO”).⁷⁹⁷ The Chinese Trademark Law further provides a list of signs that cannot be registered as trademarks.⁷⁹⁸ The duration of a registered trademark, under the Chinese trademark laws is ten years, but, just like in the U.S., is renewable.⁷⁹⁹

Concerning the assignment of a trademark in China, if the trademark owner decides to assign ownership of the trademark, both the assignor and assignee must conclude an assignment agreement and submit a joint application to the STO. The assignee may then enjoy the exclusive right to use the trademark from the date of publication.⁸⁰⁰ The Chinese Trademark Law also provides licensors more rights than licensees. For instance, the Law explicitly provides for the licensor’s right to supervise the quality of the goods for which the licensee uses the trademark and requires the licensee to guarantee the quality of the goods.⁸⁰¹

Moreover, the Chinese Trademark Law defines the actions that are considered to be infringement to include use of a registered mark on counterfeit products or using marks identical to registered ones.⁸⁰² It provides a unique system to deal with infringement. First, it requires the disputing parties to try to resolve the problem through communication before making recourse to courts or asking the Administrative Authority for Industry and Commerce (“AAIC”) to take action with regard to the infringement. If consultations fail to produce an amenable result, then recourse can be sought from the AAIC. If the disputing party is not satisfied with the decision of

⁷⁹⁷ See Chinese Trademark Law, *supra* note 671, at art. 4.

⁷⁹⁸ *Id.* at arts. 10-11; Malaysian Trademark Act, *supra* note 750, at arts. 14-20.

⁷⁹⁹ Chinese Trademark Law, *supra* note 671, at arts. 37-38; Malaysian Trademark Act, *supra* note 750, at arts. 32, 41, 42.

⁸⁰⁰ Chinese Trademark Law, *supra* note 671, at art. 39.

⁸⁰¹ *Id.* at art. 40.

⁸⁰² *Id.* at art. 52.

the AAIC, it can file a claim in court.⁸⁰³ The Chinese Trademark Law grants the AAIC the power to investigate, inspect, and handle infringement cases unless the infringement action constitutes a crime.⁸⁰⁴ The Law also allows prompt precautionary measures by courts in the case of an infringement requiring immediate action.⁸⁰⁵ The courts also handle cases of criminal infringement and those alleging an abuse of power by administrative agencies concerned with trademark issues.⁸⁰⁶

The Malaysian Trademark Act, though not mandating trademark registration,⁸⁰⁷ provides that registration confers many benefits, the most important of which is guaranteeing the protection of exclusive rights granted by the Act.⁸⁰⁸ The duration of a registered trademark, under the Malaysian trademark laws is ten years, but is renewable.⁸⁰⁹ The Malaysian Trademark Act also provides a list of signs that cannot be registered as trademarks.⁸¹⁰

Concerning assignments, the Malaysian Trademark Act does not require a joint application by the assignor and assignee, but rather an application submitted only by the assignee and proof of title to the mark.⁸¹¹ The Malaysian Trademark Act invalidates any assignment of a

⁸⁰³ *Id.* at art. 53.

⁸⁰⁴ *Id.* at arts. 54-55.

⁸⁰⁵ *Id.* at art. 58.

⁸⁰⁶ *Id.* at arts. 60-62.

⁸⁰⁷ MOHD BUSTAMAN HJ ABDULLAH, GUIDE ON FRANCHISING IN MALAYSIA 62 (1997); *see also* Malaysian Franchise Act, *supra* note 673, at art. 25(1).

⁸⁰⁸ ABDULLAH, *supra* note 807, at 62; *see also* Malaysian Franchise Act, *supra* note 673, at art. 25(1).

⁸⁰⁹ Chinese Trademark Law, *supra* note 671, at arts. 37-38; *see also* Malaysian Trademark Act, *supra* note 750, at arts. 32, 41, 42.

⁸¹⁰ Chinese Trademark Law, *supra* note 671, at arts. 10-11; Malaysian Trademark Act, *supra* note 750, at arts. 14-20.

⁸¹¹ Malaysian Trademark Act, *supra* note 750, at art. 47.

mark that was not at any time before the assignment used in good faith in Malaysia by the assignor or his predecessor,⁸¹² except in very specific cases as provided by the Act.⁸¹³

Unlike the Chinese and U.S. trademark laws, the Malaysian Trademark Act creates equality between licensors and licensees. The licensor maintains control over the licensed trademark including the way the mark is used and the quality of the goods or services connected to it, but the Malaysian Act also goes a step further to designate the licensee a “registered user.” This requires the trademark owner to submit an application to the Registrar to designate the licensee as a registered user of the mark.⁸¹⁴ Moreover, the Act provides for the right of the registered user to use the trademark to the same extent and with the same limitations as the owner.⁸¹⁵ The Act goes so far as to allow the registered user to request that the owner take any required measures to stop any infringement of the mark, and if the owner fails to respond to the request within two months of notification, the registered user has the right to institute proceedings for infringement on his own provided the owner is a co-plaintiff in the action.⁸¹⁶

The Malaysian Trademark Act also provides a detailed section on trademark infringement. It defines an infringer as not being the registered proprietor of the trademark or a

⁸¹² *Id.* at art. 55(2).

⁸¹³ *See Id.* at art. 55(2) (providing that where “(a) the trade mark was registered with the intention that it shall be assignable to a body corporate yet to be formed and the trade mark has been assigned; or (b) the trade mark was registered with the intention that a person shall be permitted to use it as a registered user and such registered user has been registered in respect of the trade mark within six months after the registration of the trade mark and has used that trade mark within that period”).

⁸¹⁴ *Id.* at art. 48(2)-(4) (providing that “[s]uch application shall be accompanied by the prescribed fee and the following information: (a) the representation of the registered trade mark; (b) the names, addresses, and addresses for service of the parties; (c) the goods or services in respect of which the registration is proposed; (d) any conditions or restrictions proposed with respect to the characteristics of the goods or services, to the mode or place of permitted use or to any other matter; and (e) whether the permitted use is to be for a period or without limit of period, and if for a period, the duration of that period”).

⁸¹⁵ *Id.* at art. 48(5)-(6); *see also id.* at art. 49 (relating to the registration process and cancellation of registration by the registrar when related to registered users).

⁸¹⁶ *Id.* at art. 51.

registered user who uses the mark, an identical mark, or a mark that resembles the protected mark to the extent that it causes confusion among the public about the identity of the original mark.⁸¹⁷ It also lists specific acts that do not constitute infringement.⁸¹⁸ The Act gives the Registrar general powers to apply the rules of the Act. For instance, the Registrar can call witnesses, accept oaths as evidence, and request any necessary documents or information.⁸¹⁹ The Act also gives the Registrar the power to extend the time periods specified within the Act or its executive regulations, unless otherwise expressly provided by the Court.⁸²⁰

The law governing trademarks in Egypt is the Intellectual Property Law,⁸²¹ which provides that, similar to the Chinese Trademark Law, registration of a trademark is mandatory as registration confers title to the owner.⁸²² The duration of protection of a registered trademark in Egypt is ten years, the same as in the U.S., Chinese, and Malaysian laws, and is renewable.⁸²³ Egypt differs, however, in that the Egyptian Intellectual Property Law requires distinctiveness as one of the conditions necessary to register a trademark.⁸²⁴ Unlike the U.S. law, and similar to

⁸¹⁷ *Id.* at art. 38.

⁸¹⁸ *Id.* at art. 40. Examples include a person using his own name or the name of his place of business or the name of the place of business of any of his predecessors in business in good faith, using description of the character or quality of person's goods or services, using a trademark in relation to goods or services in respect of which a person has by himself or his predecessors in business, and using a trade mark by a person in relation to goods or services adapted to form part of, or to be accessory to, other goods or services in relation to which the trade mark has been used without infringement of the right given or might for the time being be so used, if the use of the trade mark is reasonably necessary in order to indicate that the goods or services are so adapted and neither the purpose nor the effect of the use of trade mark is to indicate otherwise than in accordance with the facts a connection in the course of trade between any person and the goods or services. *Id.*

⁸¹⁹ *Id.* at art. 75(1).

⁸²⁰ *Id.* at 77(1).

⁸²¹ *See supra* Ch. II. Sec. 1.2.1.4 (discussing the Law on Protection of Intellectual Property No. 82 of 2002).

⁸²² Egyptian Intellectual Property Law, *supra* note 514, at art. 65.

⁸²³ *Id.* at art. 90.

⁸²⁴ *Id.* at art. 67.

both the Chinese and Malaysian trademark laws, the Egyptian Intellectual Property Law provides a list of signs that cannot be registered as trademarks.⁸²⁵

Concerning assignment, the Egyptian Intellectual Property Law is similar to the Malaysian Franchise Act as it does not require a joint application prepared by the assignor and the assignee, as the Chinese Trademark Law does, but rather an application submitted by the assignee alone.⁸²⁶ With regard to trademark licensing, unlike both the Chinese and U.S. attitudes, the Egyptian Intellectual Property Law adopts reasonable rules that favor neither the licensor nor the licensee and restricts each to guarantee a degree of equilibrium between both parties' rights. For instance, the Egyptian Intellectual Property Law does not confer the same degree of protection on the licensee as the Malaysian Franchise Act and does not recognize the licensee as a registered user. The Egyptian Intellectual Property Law does not, however, allow a trademark owner to terminate a license agreement without good cause⁸²⁷ and prohibits unreasonable restrictions on licensees.⁸²⁸

Finally, the Egyptian Intellectual Property Law provides a reasonable system for dealing with trademark infringement. It has many features common to the U.S., Chinese, and Malaysian trademark laws. For example, it provides a list of infringing acts such as counterfeiting a trademark, fraudulent use of an imitated mark, and fraudulent attachment of a trademark to products belonging to a third party.⁸²⁹ The law also provides for precautionary measures to be taken by courts, such as confiscation of the infringing products, disgorgement of profits, and the

⁸²⁵ *Id.*

⁸²⁶ *Id.* at arts. 87-89.

⁸²⁷ *Id.* at art. 97.

⁸²⁸ *Id.* at art. 98.

⁸²⁹ *Id.* at art. 113.

return of products and implements used in the infringement to the trademark owner.⁸³⁰ Penalties for infringement include imprisonment for a period of not less than two months or a fine of between 5,000 and 20,000 Egyptian pounds, or both. Penalties may also include closure of the infringing enterprise for a period not exceeding six months.⁸³¹

In summary, no specific recommendations may be made to the proposed Egyptian franchising law with respect to trademarks except incorporating the Egyptian Intellectual Property Law into the proposed law by reference to the regulations governing licensing and use of trademarks in relation to franchise operations. The Malaysian Franchise Act may be used as guidance in this respect because it refers to the application of the intellectual property laws in the context of franchising transactions.⁸³²

2.2.5.2 Trade Secrets

In the United States, most states have adopted the Uniform Trade Secrets Act (“UTSA”).⁸³³ More information is given below on the definition of trade secrets, the information protected as trade secrets, and the remedies available in case of disclosure of protected trade secrets in the United States.

The definitions of trade secrets in the Restatement Third of Unfair Competition, the Restatement of Torts, and the UTSA basically require that for information to be considered a trade secret it must be valuable, provide an advantage over competitors, be non-public, and be

⁸³⁰ *Id.*

⁸³¹ *Id.*

⁸³² See Chinese New Regulations, *supra* note 237, at art. 31; Malaysian Trademark Act, *supra* note 750, at art. 24.

⁸³³ Duffin & Watson, *supra* note 753, at 136; see also Vanderbroek & Turner, *supra* note 303.

capable of being kept secret through reasonable efforts.⁸³⁴ In *I Can't Believe It's Yogurt v. Gunn*, the franchisor terminated the franchise agreement when the franchisee failed to pay the agreed upon royalties, but the franchisee continued to sell the franchised products using the franchisor's layout after the termination.⁸³⁵ As a result, the franchisor sued the franchisee for misappropriation of trade secrets, alleging that the operation manual included his business system, layouts, design, accounting procedures, know-how, and management information.⁸³⁶ The U.S. District Court for the District of Colorado applied the following factors to determine whether information constitutes a trade secret:

1. The extent to which the information is known outside the business;
2. The extent to which it is known to those inside the business, *i.e.*, by the employees;
3. The precautions taken by the holder of the trade secret to guard the secrecy of the information;
4. The savings effected and the value to the holder in having the information as against competitors;
5. The amount of effort or money expended in obtaining and developing the information; and
6. The amount of time and expense it would take for others to acquire and duplicate the information.⁸³⁷

Based on the above-mentioned factors, the court concluded that the plaintiff failed to prove that the information in dispute should be treated as trade secrets since this information was

⁸³⁴ UNIF. TRADE SECRETS ACT § 1(4), 14 U.L.A. 437 (1985); Restatement (Third) of Unfair Competition § 39 (1995).

⁸³⁵ *I Can't Believe It's Yogurt v. Gunn*, No. 94-OK-2109-TL, 1997 U.S. Dist. LEXIS 14480 at *29 (D. Colo. Apr. 15, 1997)

⁸³⁶ *Id.* at *56.

⁸³⁷ *Id.* at *57-58 (citing *Network Telecommunications, Inc. v. Boor-Crepeau*, 790 P.2d 901, 903 (Colo. App. 1990); *Colorado Supply Company, Inc. v. Stewart*, 797 P.2d 1303, 1306 (Colo. App. 1990).

disclosed to all people in Yogurt University and to the managers and employees who were required to sign neither the franchise agreement nor the confidentiality agreement.⁸³⁸

Furthermore, the court explained that for information to be protected as trade secrets, appropriate measures should be taken to prevent the secret from becoming available to people other than those who are allowed by the trade secret owner to have access to the information for the purpose of operating the business.⁸³⁹ The court added that the fact that the franchisor disclosed the information to employees and managers who did not sign confidentiality agreements meant that the franchisor did not take proper measures to protect the confidentiality of the information as trade secrets.⁸⁴⁰

The Third Restatement of Unfair Competition considers the duty of confidentiality a duty of confidence that exists when there is an express commitment of confidentiality or the person is supposed to know that disclosure is made in confidence while the disclosing party reasonably assumes an obligation of confidentiality.⁸⁴¹ The Restatement also establishes liability for misappropriation of a trade secret by any employee who discloses a trade secret in breach of a duty of confidence.⁸⁴²

Various types of business information can benefit from protection as trade secrets including business systems, business formats, processing, customer and supplier information, business plans, marketing information, recipes, product information, formulas, financial plans,

⁸³⁸ *I Can't Believe It's Yogurt v. Gunn*, No. 94-OK-2109-TL, 1997 U.S. Dist. LEXIS 14480 at *58 (D. Colo. Apr. 15, 1997).

⁸³⁹ *Id.* At 57.

⁸⁴⁰ *Id.*

⁸⁴¹ Restatement (Third) of Unfair Competition § 41 (1995).

⁸⁴² § 42.

inventories, and software.⁸⁴³ In *Tan-Line Studios, Inc. v. Bradley*, Tan-Line claimed that Bradley misappropriated its trade secrets, including tanning studio operation methodologies, training programs, layouts, advertising and marketing methodologies, and accounting information that Bradley learned while working as a consultant to Tan-Line and subsequently used to operate a competing business.⁸⁴⁴ Bradley alleged in his counterclaim that the information he obtained from Tan-Line did not constitute trade secrets.⁸⁴⁵ The law applied by the District Court for the Eastern District of Pennsylvania mirrored the definition of trade secrets contained in the Restatement of Torts.⁸⁴⁶ The court declined Bradley's argument and decided that Bradley had misappropriated Tan-Line's trade secrets and found him liable for damages to Tan-Line.⁸⁴⁷

It is noteworthy that franchisees can also sue franchisors for misappropriation of the franchisees' trade secrets. In *Camp Creek Hospitality Inns, Inc. v. Sheraton Franchise Corp.*,⁸⁴⁸ Camp Creek operated a Sheraton Inn franchise when the franchisor granted another Sheraton Inn franchise in the same area and made the new business appear to be operated by Camp Creek.⁸⁴⁹ Camp Creek sued the franchisor asserting that the franchisor had hired a former manager of the franchisee, who had had access to the franchisee's confidential information.⁸⁵⁰ The District Court for the Eastern District of Kentucky decided that there was no misappropriation of trade secrets

⁸⁴³ See generally Duffin & Watson, *supra* note 753, at 179 n.25.

⁸⁴⁴ *Tan-Line Studios, Inc. v. Bradley*, No. 84-5925, 1986 U.S. Dist. Lexis 27754, at *2-13 (E.D. Pa. Mar. 25, 1986).

⁸⁴⁵ *Id.*

⁸⁴⁶ Restatement (Third) of Unfair Competition § 39 comment d (1995). ("A trade secret may consist of a formula, pattern, compilation of data, computer program, device, method, technique, process or other form or embodiment of economically valuable information.").

⁸⁴⁷ *Tan-Line Studios*, 1986 U.S. Dist. Lexis 27754, at *30.

⁸⁴⁸ *Camp Creek Hospitality Inns, Inc. v. Sheraton Franchise Corp.*, 139 F.3d 1396 (11th Cir. 1998)

⁸⁴⁹ *Id.* at 1401.

⁸⁵⁰ *Id.*

but was subsequently reversed by the Eleventh Circuit.⁸⁵¹ The Court of Appeals held that the franchisee provided sufficient proof that the information used by the manager constituted trade secrets through expert testimony that the information used by the franchisor was specific in nature and used only in the hotel industry.⁸⁵² The court found that although the franchisee had disclosed this information voluntarily, Camp Creek had not disclosed this information except with the understanding that the franchisor would keep it confidential, which was supported by a note of confidentiality.⁸⁵³ The court granted Camp Creek an injunction preventing its competitor from misusing the confidential information.⁸⁵⁴

Liability for breach of confidentiality usually attaches when an actor acquires or uses information he knows or should know is a trade secret in an “improper” way.⁸⁵⁵ “Improper”

⁸⁵¹ *Id.*

⁸⁵² *Id.* at 1413.

⁸⁵³ *Id.*

⁸⁵⁴ *Id.*

⁸⁵⁵ Restatement (Third) of Unfair Competition § 40 (1995) provides that:

One is subject to liability for the appropriation of another’s trade secret if:

(a) the actor acquires by means that are improper under the rule stated in § 43 information that the actor knows or has reason to know is the other’s trade secret; or

(b) the actor uses or discloses the other’s trade secret without the other’s consent and, at the time of the use or disclosure,

(1) the actor knows or has reason to know that the information is a trade secret that the actor acquired under circumstances creating a duty of confidence owed by the actor to the other under the rule stated in § 41; or

(2) the actor knows or has reason to know that the information is a trade secret that the actor acquired by means that are improper under the rule stated in § 43; or

(3) the actor knows or has reason to know that the information is a trade secret that the actor acquired from or through a person who acquired it by means that are improper under the rule stated in § 43 or whose disclosure of the trade secret constituted a breach of a duty of confidence owed to the other under the rule stated in § 41; or

means of acquiring another's trade secret under the Third Restatement of Unfair Competition § 43 include "theft, fraud, unauthorized interception of communications, inducement of or knowing participation in a breach of confidence, and other means either wrongful in themselves or wrongful under the circumstances of the case. Independent discovery and analysis of publicly available products or information are not improper means of acquisition."⁸⁵⁶ When the misappropriation of trade secrets causes injury to the franchisor, the franchisor is usually entitled to injunctive relief.⁸⁵⁷

In China, the domestic contract, tort, labor contract, and criminal laws provide for the protection of trade secrets.⁸⁵⁸ China also has an independent law that regulates trade secrets: the Law of the People's Republic of China for Countering Unfair Competition⁸⁵⁹ and its supplementary Provisions on Prohibiting Infringements upon Trade Secrets.⁸⁶⁰ Generally speaking, the criminal law penalizes with three years imprisonment and a fine, any encroachment upon commercial trade, such as: acquiring a rightful owner's commercial secrets via theft, lure by promise of gain, threat, or other improper means; disclosing, using, or allowing others to use a

(4) the actor knows or has reason to know that the information is a trade secret that the actor acquired through an accident or mistake, unless the acquisition was the result of the other's failure to take reasonable precautions to maintain the secrecy of the information.

⁸⁵⁶ Restatement (Third) of Unfair Competition § 43.

⁸⁵⁷ *Deutsche Inv. v. Riverpoint Capital*, 2002 U.S. Dist. LEXIS 16147 (S.D. Ohio Aug. 22, 2002); *see also*, *Nelson v. Nat'l Fund Raising Consultants, Inc.*, 823 P.2d 1165 (Wash. Ct. App. 1992).

⁸⁵⁸ *See* JAMES M. ZIMMERMAN, CHINA LAW DESK BOOK 568 (3d ed., 2010); Chinese Contract Law, *supra* note 665, at arts. 117-22.

⁸⁵⁹ *See generally* Chinese Unfair Competition Law, *supra* note 669.

⁸⁶⁰ Several Provisions on Prohibiting Infringements Upon Trade Secrets (promulgated by the State Admin. for Indust. and Comm., Nov. 23, 1995, amended Dec. 3, 1998) (Lawinfochina) (China) [hereinafter Chinese Regulations on Trade Secrets].

rightful owner's commercial secrets which are acquired through the aforementioned means.⁸⁶¹ The criminal law also defines a trade secret to include any technical and operating information that is unknown to the public, can bring economic profits, is functional, and is kept as a secret by its rightful owner.⁸⁶² According to the criminal law, users of trade secrets who have permission of the owner are deemed to be rightful owners of the secrets.⁸⁶³ It is also worth mentioning that the prohibition on the illegal use of trade secrets is not restricted to direct infringers, but is applied to third parties who come across trade secrets indirectly in any way.⁸⁶⁴

Moreover, the Labor Contracts Law, supplementing and updating the Chinese Labor Law of 1995,⁸⁶⁵ is the latest Chinese law to deal with protection of trade secrets and has promulgated rules on trade secrets and confidentiality issues.⁸⁶⁶ The Labor Contract Law provides for the employer's right to include a confidentiality of trade secrets and intellectual property clause in the employment contract⁸⁶⁷ and if the employee breaches the covenant, that he is responsible for compensating the employer through liquidated damages as per the contract.⁸⁶⁸

Furthermore, under the Chinese Unfair Competition Law, trade secrets are defined as "technical information and operational information which is not known to the public, which is

⁸⁶¹ See Criminal Law, art. 220, (promulgated by the Nat'l People's Cong., July 1, 1979, amended Mar. 14, 1997) (Lawinfochina) (China)

⁸⁶² See *id.* at art. 219(3).

⁸⁶³ See *id.* at art. 219.

⁸⁶⁴ Robert Bejesky, *Investing in the Dragon: Managing The Patent Versus Trade Secret Protection Decision For The Multinational Corporation in China*, 11 TULSA J. COMP. & INT'L L. 437, 458 (2004).

⁸⁶⁵ Labor Law (promulgated by the Standing Comm. of the Nat'l Peoples' Cong., July 5, 1994, effective Jan. 1, 1995) (Lawinfochina) (China) [hereinafter Chinese Labor Law].

⁸⁶⁶ Marisa Anne Pagnattaro, *Protecting Trade Secrets in China: Update on Employee Disclosures and the Limitations of the Law*, 45 AM. BUS. L.J. 399, 405 (2008).

⁸⁶⁷ Chinese Labor Law, *supra* note 865, at art. 22.

⁸⁶⁸ *Id.*

capable of bringing economic benefits to the owners of the rights, which has practical applicability and which the owners of the rights have taken measures to keep secret.”⁸⁶⁹ The Supreme People's Court also issued the “Interpretation of Several Issues Relating to Trial of Civil Cases of Unfair Competition,”⁸⁷⁰ according to which, the disclosure of trade secrets acquired through one’s own research or study is not considered a breach of the Unfair Competition Law.⁸⁷¹ Hence, infringement is deemed to take place when trade secrets have been obtained in an illegal way or when they are obtained through a bad faith breach of a confidentiality obligation.⁸⁷²

Nevertheless, specific conditions must be met for trade secrets to be protected in China. For instance, employers have to take serious measures to guarantee protection of their trade secrets, such as adopting a written policy to protect trade secrets that should be signed by employees and keeping records of all employees who go to any meeting where confidential information is disclosed.⁸⁷³ Also, the plaintiff has to prove that the information is of “economic value and practical applicability.”⁸⁷⁴ The Chinese Supreme Court requires that the economic loss be at least CNY 500,000 if the infringement is committed by an individual and CNY 1,500,000 if infringement is committed by an entity. One commentator argues that proving this amount of loss is not easy, particularly as political considerations affect the judicial process.⁸⁷⁵

⁸⁶⁹ Chinese Unfair Competition Law, *supra* note 669, at art. 10.

⁸⁷⁰ ZIMMERMAN, *supra* note 858, at 568 n.90; *see generally*, Pagnattaro, *supra* note 866, at 403-08.

⁸⁷¹ ZIMMERMAN, *supra* note 858, at 568 n.90.

⁸⁷² MAARTEN ROOS, CHINESE COMMERCIAL LAW A PRACTICAL GUIDE 285 (2010).

⁸⁷³ *Id.* at 82-83.

⁸⁷⁴ *Id.*

⁸⁷⁵ *Id.* at 285.

The Supreme People's Court confirmed that the burden of proof for breach of confidentiality rests on the person alleging violation. This requires showing

(1) That it complied with the statutory requirements (e.g., detailed content and commercial value of the trade secret as well as specific confidentiality measures taken), (2) that the information used by the opposing party is identical or materially identical to its trade secret, and (3) that the opposing party obtained the information by improper means.⁸⁷⁶

Similarly, the Supreme People's Court provides guidelines for the courts to follow when deciding whether trade secret owners have followed sufficient confidentiality measures: “(1) restricting disclosure to relevant people, (2) "locking" or encrypting confidential information, (3) marking the information "confidential," (4) using passwords or codes on the confidential information, (5) entering into confidentiality agreements, (6) restricting access/visits to machines or sites with confidential information, and (7) other reasonable measures.”⁸⁷⁷

The remedies provided under Article 25 of China's Competition Law are injunctions and fines ranging from CNY 10,000 to CNY 200,000.⁸⁷⁸ Chinese enforcement agencies may impose administrative sanctions on infringers directly without recourse to the courts.⁸⁷⁹ Also, the Chinese Public Security Authority may impose administrative sanctions against minor infringements under the Regulations for the Administration and Punishment of Security Violations.⁸⁸⁰ If an injured party is not satisfied with the remedies provided by the administrative process, it may appeal within fifteen days to “the competent authority at the next higher levels

⁸⁷⁶ Pagnattaro, *supra* note 866, at 406.

⁸⁷⁷ *Id.*

⁸⁷⁸ Chinese Unfair Competition Law, *supra* note 669, at art. 25.

⁸⁷⁹ Nathan Greene, *Enforceability of The People's Republic of China's Trade Secret Law: Impact on Technology Transfer in The PRC and Preparing for Successful Licensing*, 44 IDEA 437 (2004).

⁸⁸⁰ *Id.*

for reconsideration” within the control and inspection authority.⁸⁸¹ If the claimant is still not satisfied with the administrative remedies, another appeal may be had to the competent People's Court.⁸⁸²

Because the protection of trade secrets in China is generally poor, particularly in terms of enforcement, trade secret owners must take practical steps to protect their information. Examples include conducting proper due diligence before concluding deals, utilizing confidentiality agreements, incorporating non-competition provisions, and providing for remedies in the case of breach.⁸⁸³

The U.S. and Chinese franchise laws do not have specific rules on trade secrets but the Malaysian franchise act does. The Malaysian Franchise Act provides a detailed section on confidentiality. Article 26 of the Act requires franchisees to execute written assurances to franchisors that neither they nor their employees will disclose any information they come to know during the operation of the franchised business or from training programs and operation manuals.⁸⁸⁴ This obligation runs for two years from the termination of the franchise agreement and any breach of this obligation is considered an offense that is penalized with the general penalty provided by the Act.⁸⁸⁵ The general penalty is a fine of 5,000 to 50,000 ringgit for the first offense and 10,000 ringgit, up to five years imprisonment, or both, for subsequent offenses.⁸⁸⁶

⁸⁸¹ Bejesky, *supra* note 864, at 458.

⁸⁸² *Id.*

⁸⁸³ Greene, *supra* note 879, at 466-67.

⁸⁸⁴ Malaysian Franchise Act, *supra* note 673, at art. 26; *see also* INTERNATIONAL FRANCHISING, *supra* note 165, at 291.

⁸⁸⁵ Malaysian Franchise Act, *supra* note 673, at art. 39-1.

⁸⁸⁶ *Id.*

The High Court of Malaysia recognized the importance of providing protection to trade secrets and confidential information in *Schmidt Scientific Sdn Bhd v. Ong Han Suan*. The Plaintiff claimed the Defendants, who were ex-employees of the Plaintiff, violated their duties of good faith and confidentiality when they kept copies of confidential information that was disclosed to them in the course of their work. The Plaintiff also claimed the Defendant's used this information to run a competing business. The High Court decided that the defendant employees were obliged not only to refrain from misusing trade secrets, but that it is also one of the implied good faith requirements not to use any trade secret without the prior agreement of the employer.⁸⁸⁷

In Egypt, the law protecting undisclosed information is the Egyptian Intellectual Property Law. The Egyptian Intellectual Property Law confers protection on information as long as: 1) it is confidential, in the sense that it is not generally known or common among those involved in the same technical sector where the information falls; 2) has commercial value in relation to its confidentiality; and 3) measures are taken by the person lawfully in control of it to keep it confidential.⁸⁸⁸ The Egyptian Intellectual Property Law requires the person lawfully in control of undisclosed information to take all appropriate measures to preserve the confidentiality of such information and prevent its circulation amongst unauthorized persons.⁸⁸⁹ Examples of acts constituting a breach of the Egyptian Intellectual Property Law include bribing employees to acquire confidential information, encouraging employees to disclose confidential information, and acquisition of confidential information through fraudulent means.⁸⁹⁰ The Egyptian

⁸⁸⁷ *Schmidt Scientific Sdn Bhd v. Ong Han Suan* [1997] 5 M.L.J 632.

⁸⁸⁸ Egyptian Intellectual Property Law, *supra* note 514, at art. 55.

⁸⁸⁹ *Id.* at art. 57

⁸⁹⁰ *Id.* at art. 58.

Intellectual Property Law provides for civil remedies, fines, and imprisonment for breaching the obligation to protect undisclosed information.⁸⁹¹

Although the Egyptian Intellectual Property Law protects undisclosed information, the proposed Egyptian franchising law should include an obligation for franchisees to protect confidential information provided by franchisors in the context of the operation of the franchised business. This obligation should run for a reasonable period of time after the termination of the franchise agreement. The law should also provide for penalties and fair compensation for breach of the confidentiality obligation. The Malaysian law may serve as the best model in this respect because it has a comprehensive rule requiring franchisees to provide written guarantees that neither they nor their employees will disclose to any person any information contained in the operation manual or obtained while operating the franchised business, and penalizes any breach of that obligation.⁸⁹²

2.2.5.3 Unfair Competition

In the United States, unfair competition is regulated at both the federal and state levels. At the federal level, the Lanham Act “was intended to make actionable the deceptive and misleading use of marks, and to protect persons engaged in . . . commerce against unfair competition.”⁸⁹³ It basically prohibits commercial practices that cause confusion between the provider of goods or services and another, false advertisements pertaining to the origins of goods or services, and trademark infringement.⁸⁹⁴

⁸⁹¹ *Id.* at art. 61.

⁸⁹² Malaysian Franchise Act, *supra* note 673, at art. 26.

⁸⁹³ 15 U.S.C. § 1127.

⁸⁹⁴ Section 43(a) of the Lanham Act provides that:

Although the Lanham Act primarily concentrates on trademark and service mark infringement, Section 43(a) deals with unfair competition.⁸⁹⁵ The Supreme Court, however, noted that Section 43(a) of the Lanham Act “does not have boundless application as a remedy for unfair completion” but rather “because of its inherently limited wording, section 43(a) can never be a federal codification of the overall law of unfair competition.”⁸⁹⁶ The FTC also has specific regulations concerning unfair competition.⁸⁹⁷ The FTC acts in the interest of the public by issuing complaints, conducting hearings before administrative judges, and providing reviews and decisions that may be reviewed by federal courts.⁸⁹⁸

A. Civil Action:

(1) Any person who, on or in connection with any goods or services, or any container for goods, uses in commerce any word, term, name, symbol, or device, or any combination thereof, or any false designation of origin, false or misleading description of fact, or false or misleading representation of fact, which—

(A) is likely to cause confusion, or to cause mistake, or to deceive as to the affiliation, connection, or association of such person with another person, or as to the origin, sponsorship, or approval of his or her goods, services, or commercial activities by another person, or

(B) in commercial advertising or promotion, misrepresents the nature, characteristics, qualities, or geographic origin of his or her or another person’s goods, services, or commercial activities, shall be liable in a civil action by any person who believes that he or she is or is likely to be damaged by such act.

(2) As used in this subsection, the term “any person” includes any State, instrumentality of a State or employee of a State or instrumentality of a State acting in his or her official capacity. Any State, and any such instrumentality, officer, or employee, shall be subject to the provisions of this chapter in the same manner and to the same extent as any nongovernmental entity.

(3) In a civil action for trade dress infringement under this chapter for trade dress not registered on the principal register, the person who asserts trade dress protection has the burden of proving that the matter sought to be protected is not functional.

15 U.S.C. § 1125(a).

⁸⁹⁵ BUSINESS TORTS AND UNFAIR COMPETITION HANDBOOK 49 (ABA Section of Antitrust Law ed., 2d ed. 2006)

⁸⁹⁶ *Dastar Corp. v. Twentieth Century Fox Film Corp.*, 539 U.S. 23, 32 (2003) (quoting *Alfred Dunhill, Ltd. v. Interstate Cigar Co.*, 499 F.2d 232, 237 (2d Cir. 1974)).

⁸⁹⁷ 15 U.S.C. § 45.

⁸⁹⁸ BUSINESS TORTS AND UNFAIR COMPETITION HANDBOOK, *supra* note 895, at 79.

Additionally, the Restatement (Third) of Unfair Competition emphasizes freedom of competition unless harm arises from deceptive marketing, infringement of trademarks, or appropriations of intangible trade values such as trade secrets.⁸⁹⁹ Prohibitions against unfair competition include actions that interfere significantly with others' abilities to compete or that contradict public policy as recognized by statutory or common law.⁹⁰⁰

At the state level, legislation has been enacted dealing with various aspects of unfair competition. Alabama, for example, prohibits contracts restraining trade, such as agreements seeking to prevent someone from exercising a lawful trade or business, and expressly allows sellers to agree with their agents and employers to refrain from having a similar business to theirs through non-competition clauses.⁹⁰¹ California provides for a similar rule in its Business and Professions Code⁹⁰² and the Minnesota Franchise Act and South Dakota Franchise Act explicitly prohibit engagement in any unfair or inequitable practices.⁹⁰³

Likewise, court decisions have clearly dealt with unfair competition. For instance, in *Re/Max International, Inc. v. Trendsetter Realty, LLC*,⁹⁰⁴ the Defendant, a former employee of a Re/Max franchise, claimed that the post-termination covenant not to compete was unreasonable as the provision was unlimited in scope, duration, and geographical area, and was unclear under the Texas Business and Commerce Code.⁹⁰⁵ The District Court for the Southern District of Texas

⁸⁹⁹ Cf. Restatement (Third) of Unfair Competition § 38 (1995).

⁹⁰⁰ BUSINESS TORTS AND UNFAIR COMPETITION HANDBOOK, *supra* note 895, at 48.

⁹⁰¹ ALA. CODE § 8-1-1 (2011).

⁹⁰² CAL. BUS. & PROF. CODE § 16600 (2012).

⁹⁰³ MINN. STAT. § 80 C.14 (2012); S.D. CODIFIED LAWS § 37-5A-51 (2011).

⁹⁰⁴ *Re/Max Int'l, Inc. v. Trendsetter Realty, LLC*, 655 F. Supp. 2d 679, 718 (S.D. Tex. 2009).

⁹⁰⁵ *Id.* at 718.

explained that a non-competition clause does not need to explicitly prohibit competition, as long as the practical and economic reality of the provision prohibits competition.⁹⁰⁶ The court also held that the clause was not a covenant not to compete, as it did not prevent the Defendant from competing with Re/Max clients, but rather aimed to protect Re/Max's goodwill by prohibiting previous employees from using its trademark to make consumers think that they were still employed by Re/Max.⁹⁰⁷

Moreover, in *Atlanta Bread Co. Int'l v. Lupton-Smith*, the franchisor, Atlanta Bread, concluded franchise agreements with the franchisee, Lupton-Smith, by which the franchisee was granted the right to operate five bakery stores in Atlanta. All the agreements included a clause preventing the franchisee, without written permission from the franchisor, from engaging in any bakery business with similar operation methods to the franchisor's.⁹⁰⁸ The franchisee started a P.J.'s Coffee & Lounge in Atlanta that caused the franchisor to terminate the franchise agreement, claiming that the franchisee's activity breached the covenant not to compete.⁹⁰⁹ The Supreme Court of Georgia concluded that non-competition clauses included in franchise agreements need to be reasonable as to time, territory and scope.⁹¹⁰ Accordingly, the court decided that the restraint in this case was unreasonable because the territorial limitations were overly broad.⁹¹¹

⁹⁰⁶ *Id.* at 718-19.

⁹⁰⁷ *Id.*

⁹⁰⁸ *Atlanta Bread Co. Int'l v. Lupton-Smith*, 679 S.E.2d 722, 723-24 (Ga. 2009).

⁹⁰⁹ *Id.*

⁹¹⁰ *Id.* at 725 (citing *Gandolfo's Deli Boys, LLC v. Holman*, 490 F. Supp. 2d 1353, 1357-58 (N.D. Ga. 2007)).

⁹¹¹ *Id.*

Other related state statutes also regulate unfair trade practices.⁹¹² Colorado, Delaware, Hawaii, and Kansas, for example, have enacted legislation to deal with different aspects of unfair competition.⁹¹³ The Uniform Deceptive Trade Practices Act was drafted in 1964 and adopted by a number of states in 1966. It provides eleven deceptive trade practices among which are trademark infringement, passing off goods, bait and switch, disparagement, misrepresentation of standards, origins or quality of goods, and misleading price comparisons.⁹¹⁴ In addition, almost all states have adopted “Little FTC Acts” that are deemed to be essentially private versions of the Unfair Trade Practices Act and Consumer Protection Act.⁹¹⁵ These Acts basically provide exhaustive lists of unfair practices and allow consumers and sometimes other private parties to sue on grounds similar to those on which the FTC can sue.

In China, the applicable law to unfair competition practices is the Unfair Competition Law, which should be distinguished from the Anti-Monopoly Law that deals with antitrust and monopolistic actions.⁹¹⁶ The Chinese Unfair Competition Law provides for the promotion of fair competition and the interests of market players by requiring equality, fairness, honesty, credibility, and consideration of business ethics in trade by requiring the government to support and protect fair competition.⁹¹⁷ The Law prohibits many actions considered harmful to fair

⁹¹² See CAL. BUS & PROF. CODE §§ 16700 et seq. (2012) (covering combinations on restraint of trade); *but see* CAL. FOOD & AGR. CODE §§ 54038-39 (2012) (stating contracts between nonprofit cooperative marketing associations and their members are not a restraint on trade).

⁹¹³ See Mary W. Craig, *A Horse of a Different Color: A Study of Color Bias, Anti-trust, and Restraint of Trade Violations in the Equine Industry*, 22 ST. THOMAS L. REV. 433, 441 (2010).

⁹¹⁴ Marilyn B. Cane & Peter Ferola, *Back to the Future the States' Struggle to Re-Emerge as Defenders of Investors' Rights*, 5 U.C. DAVIS BUS. L.J. 15 (2005).

⁹¹⁵ BUSINESS TORTS AND UNFAIR COMPETITION HANDBOOK, *supra* note 895, at 80.

⁹¹⁶ See generally Chinese Anti-Monopoly Law, *supra* note 672; Chinese Unfair Competition law, *supra* note 669.

⁹¹⁷ Chinese Unfair Competition Law, *supra* note 669, at arts. 1-4.

competition and free trade whether committed by private businesses or government-operated enterprises.

Examples of actions prohibited by private businesses include selling commodities for a lower price than their cost; tying sales or cartel arrangements; putting unreasonable conditions on sale transactions; conducting deceptive lottery sales; spreading false information to injure competitors; and the collusion of bidders to force bidding prices up or down.⁹¹⁸ Examples of actions prohibited by public enterprises include restricting purchasing to designated businesses, imposing limitations on the rightful activities of other businesses, and restricting commodities from entering local markets.⁹¹⁹ As for enforcement, the Chinese Competition Law allows authorities charged with its execution to inspect, supervise, investigate, inquire, or interrogate businesses and their property to achieve the purpose of the law.⁹²⁰ The Law also provides for financial penalties for any of the prohibited actions.⁹²¹

The laws regulating competition in Malaysia are numerous, the most important for our purposes being Article 28 of the Contracts Act of 1950⁹²² and the Trade Description Act of 1972.⁹²³ Article 28 provides that “every agreement by which anyone is restrained from

⁹¹⁸ *Id.* at arts. 5-15.

⁹¹⁹ *Id.* at arts. 6-7.

⁹²⁰ *Id.* at arts. 16-19; *see also* Trade Description Act of 1972, arts. 18-20 *Warta Kerajaan seri Paduka Baginda Gazette*, Sept. 30, 1972, *available at* http://www.commonlii.org/my/legis/consol_act/fa199895/ (Malaysia) [hereinafter *Malaysian Trade Description Act*].

⁹²¹ Chinese Unfair Competition Law, *supra* note 669, at arts. 20-32.

⁹²² Contracts Act of 1950, art. 28, *Warta Kerajaan seri Paduka Baginda Gazette*, 1 Jan. 2006, *available at* http://www.commonlii.org/my/legis/consol_act/ca19501974200/ (Malaysia) [hereinafter *Malaysian Contracts Act*]; *see* R. S. Khemani, J. William Rowley & Leonard Waverman, *South and South East Asia, Slow Implementation of Competition Law*, 25 INT'L BUS. L. 441, 448 (1997).

⁹²³ *See generally* *Malaysian Trade Description Act*, *supra* note 920.

exercising a lawful profession, trade or business of any kind is to that extent void.”⁹²⁴ The Malaysian Trade Description Act provides that using false descriptions of goods are deemed offenses whether with regard to quantity, manufacturing methodologies, composition, characteristics, quality, place and date of manufacture, and the like.⁹²⁵

Additionally, the Malaysian Trade Description Act provides financial penalties for any of the prohibited actions.⁹²⁶ The Act recognizes the principle of *respondeat superior* for the liability of employers.⁹²⁷ It gives controllers, deputy controllers, and assistant controllers appointed by persons who hold public office enforcement powers. The enforcement powers include the power to enter premises and inspect and seize goods and documents and to arrest any person whom the inspector has reason to believe has committed an offense under the Act.⁹²⁸

Narrowing the issue to franchising laws, the Malaysian Franchise Act is more comprehensive and decisive with regard to competition in the franchising context than the Chinese New Regulations and Measures governing franchises in China. The Malaysian Franchise Act requires franchisees to provide franchisors with written assurances that neither they nor their employees will participate in any activity similar to the franchised business during the term of the franchise agreement and for at least two years after the termination of the agreement.⁹²⁹ Any violation of this rule is deemed an offense that is punishable by the general penalty provided in the Act.⁹³⁰

⁹²⁴ Malaysian Contracts Act, *supra* note 922.

⁹²⁵ *Id.* at arts. 3-5, 14, 17.

⁹²⁶ Chinese Unfair Competition Law, *supra* note 669, at arts. 20-32.

⁹²⁷ Malaysian Trade Description Act, *supra* note 920, at arts. 26-31.

⁹²⁸ *Id.*; *see supra* Ch. III. Sec. 3 (2) (2) (discussing Enforcement and Remedies).

⁹²⁹ INTERNATIONAL FRANCHISING, *supra* note 165, at 290; Malaysian Franchise Act, *supra* note 673, at art. 27(1); *see also* MENDELSON, FRANCHISING LAW, *supra* note 54, at 400.

⁹³⁰ Malaysian Franchise Act, *supra* note 673, at art. 27(3).

In Egypt, the two main laws on competition are the Egyptian Intellectual Property Law, which deals with the disclosure of information that leads to unfair competition, and the Law on the Protection of Competition and the Prohibition of Monopolistic Practices, which covers anti-monopolistic actions.⁹³¹ Because Egypt has a single law covering competition and monopolistic practices, the proposed Egyptian franchising law should not deal with monopolistic practices of franchisors. It should instead refer to the application of the Monopolistic Practices Law. Nevertheless, the proposed Egyptian franchising law should have a provision confirming the franchisee's obligation to refrain from entering into any activity competitive to the franchisor's business, whether during the term of the franchise agreement or after its termination. Such a non-compete provision would protect franchisors against competitive actions by franchisees. The Malaysian Franchise Act should be followed in the respect because it requires a non-competition clause.

2.3 Scope of the Law

Discussing the scope of a given law helps determine which transactions the law regulates and accordingly, whether contracting parties need to consider the law when concluding agreements. The U.S. franchise law applies only to franchises located in the U.S. or its territories.⁹³² Hence, the only relevant factor when discussing the scope of application of the U.S. franchising law is location of the franchise. It seems that the logic behind restricting the application of the U.S. franchising law to franchises located in the U.S. is the fact that foreign

⁹³¹ The Protection of Competition and the Prohibition of Monopolistic Practices does not prohibit action harmful to fair competition if committed by governmental enterprises. *See* Law No. 3 of 2005 (Protection of Competition and the Prohibition of Monopolistic Practices Law), art. 9, *Al-Jarida Al-Rasmiyya*, Feb 15, 2005 (Egypt) [hereinafter Egyptian Competition Law].

⁹³² 16 C.F.R. § 436.2.

franchisees dealing with American franchisors outside the American territories are usually large and sophisticated investors who do not need to be protected by the U.S. law.⁹³³ As one scholar suggests, the U.S. law seeks to deal only with domestic franchise issues and not franchises located abroad.⁹³⁴

Under the Old Measures, to obtain governmental approval to franchise in China, a franchisor has to have a subsidiary company or two direct-sale stores in China for at least one year⁹³⁵ Hence franchisors had to establish company-owned operations in China before gaining governmental approval to franchise in China.⁹³⁶ By contrast, the Chinese New Regulations and the Archiving Measures allow this requirement to be met if the franchisor has the units outside China.⁹³⁷ This requirement, called the “two-plus-one” requirement, applies also to foreign franchisors.⁹³⁸ Additionally, the Archiving Measures require all franchisors to submit to the filing authority documentation of the two direct sales stores whether located inside or outside China.⁹³⁹ Nevertheless, both the Chinese New Regulations and the Archiving Measures are silent

⁹³³ THE FTC FRANCHISE RULE, *supra* note 642, at 6.

⁹³⁴ *Id.*

⁹³⁵ Article 7(4) of the Chinese Old Measures provide that “A franchisor shall have the following conditions: 4) Having at least two direct sales stores that have been undertaking the business for more than a year or direct sales stores established by its subsidiary companies or its holding companies within the territory of China.” *See* Measures for the Administration of Commercial Franchises, art. 7(4) (promulgated by the Ministry of Commerce, Dec. 30, 2004) (Lawinfochina) (China).

⁹³⁶ JLJ GROUP, *supra* note 623; *see also* SPENCER, *supra* note 41, at 183.

⁹³⁷ Jones & Wulff, *supra* note 657, at 58; *but see* Zhiqiong June Wang & Andrew Terry, *China’s Long March to a Franchise Law: The 2007 Franchise Regulation*, 2007 LAWASIA J. 79, 92 (2007).

⁹³⁸ *See* Chinese Archiving Measures, *supra* note 662, at art. 17 (providing that “An overseas franchiser shall follow these Measures to conduct franchise activities within the territory of China”).

⁹³⁹ INTERNATIONAL FRANCHISING, *supra* note 165, at 96. Also, Article 7 of the Chinese New Regulations provides that “[a] franchisor for engaging in franchise activities shall have two direct sales stores at least, and have conducted such business for more than one year.” Chinese New Regulations, *supra* note 237, at art. 7. Article 17 of the Archiving Measures provides that “[f]ranchisors from abroad engaging in franchise activities in China shall abide by these Rules” and Articles 5 and 6 provide that:

as to the conditions the two direct-sale stores must meet, such as whether the two direct-sale stores must be owned by the same franchisor franchising in China or whether they can be run by an affiliate.⁹⁴⁰ It is also unclear whether this requirement must be met only at the commencement of a franchise operation or if it must continue during operation of the franchised outlets in China.⁹⁴¹

The Malaysian Franchise Act is clearer than the Chinese New Regulations regarding foreign franchisors.⁹⁴² The Act applies when a franchising offer is made within Malaysia, an offer is made outside Malaysia but accepted in Malaysia, or the business operation takes place in Malaysia.⁹⁴³ The Act requires any franchisor, foreign or not, intending to sell a franchise that will be operated within the country to first get the Registrar's approval.⁹⁴⁴ The Act is criticized because it gives absolute discretion to the Registrar to refuse any application submitted by a foreign franchisor without having to provide any reasons for the determination.⁹⁴⁵ This provision could encourage foreign franchisors to attempt to circumvent the law by working with local franchisors.

A franchiser applying for archival filing shall submit the following documents to the archiving organ: 6) certificates issued by a competent commercial department of a city divided into districts based on the provision in Paragraph 2 of Article Seven; where direct sales stores owned by the franchiser are located beyond the territory of China

See Chinese Archiving Measures, supra note 662, at arts. 5-6, 17.

⁹⁴⁰ Jones and Wulff, *supra* note 657, at 58.

⁹⁴¹ *Id.* The Chinese New Regulations also provide for a penalty in case of non-fulfillment of the direct sales stores requirement. Article 24 provides that the violating party must revoke any action taken, pay a fine from 100,000 RMB and 500,000 RMB and the commerce department may seize any profits. Chinese New Regulations, *supra* note 237, at art. 24; *see* INTERNATIONAL FRANCHISING, *supra* note 165, at 99.

⁹⁴² MENDELSON, GUIDE TO FRANCHISING, *supra* note 150, at 399.

⁹⁴³ Malaysian Franchise Act, *supra* note 673, at art. 3.

⁹⁴⁴ *Id.*

⁹⁴⁵ *Id.*

The proposed Egyptian franchising law should combine the rules of both the Malaysian Franchise Act and the New Rule. As far as the Malaysian Franchise Act is concerned, it is clear and straightforward that it applies only to franchise transactions taking place in Malaysia. The New Rule provides an additional requirement that the franchise be located in the country of the national law. In addition, the proposed Egyptian law should avoid the restrictions on foreign franchisors imposed by the Chinese law requiring franchisors to have at least two direct-sale stores in China for at least one year.

2.4 Foreign Investment

Procedures that ease contracting, disclosure, and registration requirements for foreign investors attracts them to the local market. Only the U.S. law provides for direct facilities and incentives to promote foreign investment in the franchising sector. For example, the Old Rule required that foreign franchisors submit audited financial statements, but complying with these auditing standards were burdensome to non-American investors.⁹⁴⁶ Foreign investors had to hire American auditors to prepare and review the statements required by the Old Rule.⁹⁴⁷ The New Rule resolved this problem by allowing the submission of audited financial statements accepted by the foreign franchisor's country so long as the statements meet the requirements of the Securities and Exchange Commission.⁹⁴⁸ Also, while the Old Rule required that franchisors provide franchisees with disclosure documents at the "first personal meeting," the New Rule allows the franchisor to submit the disclosure documents within fourteen days of the franchisee

⁹⁴⁶ *Id.*

⁹⁴⁷ 16 C.F.R. § 436.6(u)(1); *see also* Jan S. Gilbert & Suzie Loonam, *FTC Releases Franchise Rule Compliance Guide*, 28 *FRANCHISE L.J.* 20, 21-22 (2008)

⁹⁴⁸ 16 C.F.R. § 436.6(u).

paying any fees or signing the franchise agreement.⁹⁴⁹ The New Rule also allows franchisors to first decide what type of agreement they will sign and then to place this information in the disclosure documents.⁹⁵⁰ This reduces the start-up, research, and market survey expenses paid by foreign franchisors unfamiliar with the American market.⁹⁵¹

Another example is that the Old Rule required that franchisees complete the franchise documents five days before signing them. In contrast, the New Rule does not require the parties to wait for five days after negotiations to be able to sign the agreement, thus saving time and expediting the conclusion of the transaction.⁹⁵² Additionally, the New Rule allows for the electronic submission of disclosure documents, saving travel and shipping expenses.⁹⁵³ Finally, certain transactions are exempted from the New Rule's disclosure requirements providing incentives to foreign investors to invest in franchising in the United States.⁹⁵⁴

There are no comparable provisions addressing these issues in the Chinese New Regulations or the Malaysian Franchise Act. Therefore, the proposed Egyptian franchising law should provide for as much flexibility with regard to procedures as is practicable to support foreign investment in the franchising industry. The features of the New Rule should be considered, especially with regard to procedural issues such as allowing for the submission of audited financial statements accepted by foreign franchisors' countries as long as the statements

⁹⁴⁹ § 436.5(w).

⁹⁵⁰ *Id.*

⁹⁵¹ *Id.*

⁹⁵² *Id.*

⁹⁵³ § 436.2(c); *see also* Oppenheim, *supra* note 652, at 17.

⁹⁵⁴ *See* discussion *infra* Ch. III.3 (discussing Disclosure and Registration Law in the United States, China, and Malaysia).

meet domestic requirements. Additionally, to promote franchising in Egypt, the exemptions provided by the New Rule should also be considered.⁹⁵⁵

2.5 Liability

Discussing liability entails both liability arising during pre-contractual negotiations and liability arising during performance of the contract, both between the contracting parties and toward third parties. Finally, indemnity and insurance issues should be explored. The following sections discuss each of these issues in more detail.

2.5.1 Liability Arising Out of Pre-contractual Negotiations

Once the parties sign the final documents, the classic rules of contracts apply. The time before conclusion of a final agreement, however, raises many issues that are not regulated by the classic rules of contract. Examples include rules applying to letters of intent, existence of pre-contractual disclosure obligations, and liability arising therefrom. Franchising laws seem to leave these issues to be regulated by the general laws of contracts, advertisement laws, and tort law among others. In the United States, neither the FTC nor state laws regulate disclosure requirements with respect to letters of intent. If, however, the letter of intent is binding disclosure should be required.⁹⁵⁶ Hence, the general rules provided by the FTC with respect to breach of disclosure requirements should apply.⁹⁵⁷ Liability arising from pre-contractual negotiations in

⁹⁵⁵ *Id.*

⁹⁵⁶ John R.F. Baer & Susan Grueneberg, *United States of America, in* INTERNATIONAL FRANCHISE SALES LAWS 20 (Andrew P. Loewinger & Michael K. Lindsey eds., 2011).

⁹⁵⁷ See discussion *infra* Ch. III.3 (discussing Disclosure and Registration Law in the United States, China, and Malaysia).

franchising transactions is specifically addressed in *Goodman v. Dicker*.⁹⁵⁸ In that case, the appellants, distributors for the Emerson Radio and Phonograph Corporation in D.C., tried to get a franchise to sell Emerson's products.⁹⁵⁹ The trial court had decided that the appellants had acted in a way that encouraged the appellees to put more money into preparing for the franchise.⁹⁶⁰ The Court of Appeals for the D.C. Circuit decided that this case involved pre-contractual representations and promises made by appellants that the franchise would be granted and that those promises had induced the appellees to take action. The Court of Appeals affirmed the trial court's decision that the appellants were liable for the money expended by the appellees in preparation to do business under the promised dealer franchise.⁹⁶¹

In China there are no provisions in the New Regulations applying to letters of intent or any other pre-contractual stage of a franchise transaction.⁹⁶² The general Chinese contract and tort laws apply to liability arising in pre-contractual negotiations, giving franchisees the right to void the franchise agreement in different situations such as in cases of fraud or misrepresentation in disclosure documents.⁹⁶³ Franchisors may also be held liable under the advertising law for any

⁹⁵⁸ *Goodman v. Dicker*, 169 F.2d 684 (D.C. Cir. 1948).

⁹⁵⁹ *Id.* at 684.

⁹⁶⁰ *Id.*

⁹⁶¹ *Id.* at 685.

⁹⁶² Yu Qin & Richard L. Wageman, *China*, in INTERNATIONAL FRANCHISE SALES LAWS 8 (Andrew P. Loewinger & Michael K. Lindsey eds., 2011).

⁹⁶³ Article 869 of the Chinese Civil Code provides that "During the Preliminary work, negotiations and other work conducted during the process of entering a contract, the parties shall have the duty of non-disclosure, protection and care according to the principle of good faith." LIANG HUIXING, THE DRAFT CIVIL CODE OF THE PEOPLE'S REPUBLIC OF CHINA, ENGLISH TRANSLATION 230-231 (Junwei Fu & Jacob S. Schneider eds., 2010). Article 870 also provides that:

1-The party who violates the obligations provided in the preceding article which causes the contract not to be established, or to be invalid, revoked or not ratified, and causes the other party to suffer losses, shall be liable for damages under the following circumstances:

fraud or misrepresentation contained in the disclosure documents.⁹⁶⁴ Moreover, the only pre-contractual liability organized by the Chinese law arises with respect to actual damages arising from franchisors' failure to comply with disclosure requirements.⁹⁶⁵

Similar to China, the Malaysian Franchise Act neither provides for any disclosure requirements before signing a letter of intent, nor regulates the pre-contractual liability of

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- a. deliberately concealing important facts relating to the conclusion of the contract or providing deliberately false information;
 - b. disclosure or unjustified use of others' business secrets which have been acquired or learned;
 - c. breaking off negotiation with obviously unjustified reasons or negotiating in bad faith;
 - d. violating the duty of protection which causes property damage or personal injuries to the other party;
 - e. causing the non-establishment or ineffectiveness of the contract while the other party rationally believes without fault that the contract may be established or effective;
 - f. other circumstances that obviously violate the principle of good faith.

2- The party who violates the duties regulated in the preceding paragraph and causes property damages or personal injuries to the other party or other closely related party shall be liable for damages.

3- when the People's Court confirms the pre-contractual liability regulated in the subsection (1) of this provision, normal business risks and transaction usage shall be taken into account.

Id. Article 871 provides that:

the method of pre-contractual liability shall be the payment of damages, the scope of which covers the loss incurred by the fact that one party relies on the validity of contract, but due to the negligence of the other party the contract is not established, or is ineffective, revoked or not ratified, and shall include the necessary expense for concluding the contract and the loss from the failure to take other opportunities for concluding the contract.

Id.

⁹⁶⁴ Misrepresentation constitutes a violation according to the Advertisement Law and the specified sanctions apply. Advertisement Law (promulgated by the Standing Comm. of the Nat'l People's Cong., Oct. 27, 1994, effective Feb. 1, 1995) (Lawinfochina) (China).

⁹⁶⁵ See discussion *infra* Ch. III. 3 (discussing Disclosure and Registration Law in the United States, China, and Malaysia).

franchise parties.⁹⁶⁶ Therefore, the general sanctions applicable in case of breach of disclosure requirements and the general rules of contract law would apply.⁹⁶⁷

⁹⁶⁶ See *infra* Ch. III. 2.5.1 (discussing Liability Arising Out of Pre-contractual Negotiations).

⁹⁶⁷ Article 15 of the Malaysian Contracts Act defines coercion as “committing, or threatening to commit any act forbidden by the Penal Code, or the unlawful detaining or threatening to detain, any property, to the prejudice of any person whatever, with the intention of causing any person to enter into an agreement.” Malaysian Contracts Act, *supra* note 922, at art. 15. In addition, Article 16 defines undue influence as:

(1) A contract is said to be induced by "undue influence" where the relations subsisting between the parties are such that one of the parties is in a position to dominate the will of the other and uses that position to obtain an unfair advantage over the other.

(2) In particular and without prejudice to the generality of the foregoing principle, a person is deemed to be in a position to dominate the will of another

(a) where he holds a real or apparent authority over the other, or where he stands in a fiduciary relation to the other; or

(b) where he makes a contract with a person whose mental capacity is temporarily or permanently affected by reason of age, illness, or mental or bodily distress.

(3) (a) Where a person who is in a position to dominate the will of another, enters into a contract with him, and the transaction appears, on the face of it or on the evidence adduced, to be unconscionable, the burden of proving that the contract was not induced by undue influence shall lie upon the person in a position to dominate the will of the other.

Id. at art. 16. Moreover, Article 17 defines fraud to:

include[] any of the following acts committed by a party to a contract, or with his connivance, or by his agent, with intent to deceive another party thereto or his agent, or to induce him to enter into the contract:

(a) the suggestion, as to a fact, of that which is not true by one who does not believe it to be true;

(b) the active concealment of a fact by one having knowledge or belief of the fact;

(c) a promise made without any intention of performing it;

(d) any other act fitted to deceive; and

(e) any such act or omission as the law specially declares to be fraudulent.

Id. at art. 17. Article 18 defines misrepresentations as:

(a) the positive assertion, in a manner not warranted by the information of the person making it, of that which is not true, though he believes it to be true;

(b) any breach of duty which, without an intent to deceive, gives an advantage to the person committing it, or anyone claiming under him, by misleading another to his prejudice, or to the prejudice of anyone claiming under him; and

Apart from the general rules of contracts related to pre-contractual liability, the proposed Egyptian franchising law should avoid the silence of the three systems on disclosure requirements during pre-contractual negotiations. Egypt should be more prudent and create a separate requirement of disclosure during pre-contractual negotiations that would reduce opportunities for fraudulent actions by the contracting parties. This is particularly necessary because the nature of the commitment and the effects of breach arising at this stage are not the same as those at the time of concluding the agreement.

(c) causing, however innocently, a party to an agreement to make a mistake as to the substance of the thing which is the subject of the agreement.

Id. at art. 18. The rule applying in case of coercion, fraud, or misrepresentation according to Article 19 of the Law is as follows:

(1) When consent to an agreement is caused by coercion, fraud, or misrepresentation, the agreement is a contract voidable at the option of the party whose consent was so caused.

(2) A party to a contract, whose consent was caused by fraud or misrepresentation, may, if he thinks fit, insist that the contract shall be performed, and that he shall be put in the position in which he would have been if the representations made had been true. Exception--If such consent was caused by misrepresentation or by silence, fraudulent within the meaning of section 17, the contract, nevertheless, is not voidable, if the party whose consent was so caused had the means of discovering the truth with ordinary diligence.

Id. at art. 19. In the same context, the rule applying to undue influence according to Article 20 is as follows:

When consent to an agreement is caused by undue influence, the agreement is a contract voidable at the option of the party whose consent was so caused. Any such contract may be set aside either absolutely or, if the party who was entitled to avoid it has received any benefit thereunder, upon such terms and conditions as to the court may seem just.

Id. at art. 20. Article 21 also provides that

Where both the parties to an agreement are under a mistake as to a matter of fact essential to the agreement, the agreement is void. Explanation--An erroneous opinion as to the value of the thing which forms the subject-matter of the agreement is not to be deemed a mistake as to a matter of fact.

Id. at art. 21. Finally Article 22 provides that: "A contract is not voidable because it was caused by a mistake as to any law in force in Malaysia; but a mistake as to a law not in force in Malaysia has the same effect as a mistake of fact," where Article 23 provides that: "A contract is not voidable merely because it was caused by one of the parties to it being under a mistake as to a matter of fact."

2.5.2 Contractual Liability and Liability to Third Parties

In the United States, vicarious liability arises when a third party claims a franchisor is legally responsible for an act or omission of a franchisee or any member of the franchisor's network.⁹⁶⁸ The common rule is that franchisors are vicariously liable only when there is a relationship between the franchisor and the member that constitutes an agency relationship. In *Ellison v. Burger King Corp.*, the Georgia court of appeals found that the franchisor was not responsible for battery a Burger King manager committed against a customer who complained about a lack of service.⁹⁶⁹ The court decided that the language of the franchise agreement was clear in establishing sole liability for employees of the franchisee.⁹⁷⁰ The criteria for franchisors' vicarious liability is the existence of actual agency as discussed in the Restatement of Agency, which tests whether franchisors control the everyday operation of the franchised business.⁹⁷¹ It may be inferred that the franchisor's regular right to control the general operations conducted by the franchisee does not answer the question of the franchisor's vicarious liability. Thus, the type of matters to which the right to control extends shall be considered.

In *Exxon Corp. v. Tidwell*, the Texas Supreme Court found that the franchisor's oil company should bear no liability for the injuries suffered by the franchisee's employee during a robbery, since the franchisor did not have control over the security of the franchise location at that specific time.⁹⁷² Courts usually consider three elements when deciding apparent agency

⁹⁶⁸ See generally Joseph H. King, Jr., *Limiting the Vicarious Liability of Franchisors for the Torts of Their Franchisees*, 62 WASH & LEE L. REV. 417 (2005).

⁹⁶⁹ *Ellison v. Burger King Corp.*, 670 S.E.2d 469 (Ga. Ct. App. 2008).

⁹⁷⁰ *Id.* at 821. Liability for employees includes hiring employees, observing their work, paying salaries, and determining the policies that apply thereof. See *id.*

⁹⁷¹ Restatement (Third) of Agency § 7.06 (2005); see also Perkins, Yatchak & Hadfield, *supra* note 379, at 174; see generally King, *supra* note 968, at 430-38.

⁹⁷² *Exxon Corp. v. Tidwell*, 867 S.W. 2d 19, 23 (Tex. 1993).

claims: whether the franchisor consciously or impliedly represented the franchisee to be its agent; whether a third party detrimentally changed his or her position in reliance on that representation; and whether the third party reasonably relied on that representation.⁹⁷³ Still, courts are reluctant to consider using franchisors' logos as evidence of the existence of apparent agency.⁹⁷⁴ For instance, in *Parker v. Domino's Pizza, Inc.*, the District Court of Appeal of Florida held that the existence of an agency relationship depends on the degree of control franchisors do or may exercise.⁹⁷⁵

In addition, direct liability arises in the case of injuries arising on the franchise premises where franchisors breach their duties to third parties, directly causing injury.⁹⁷⁶ Examples include instances where franchisors are liable for inspecting and fixing premises defects or when franchisors are responsible for designing or constructing franchise premises.⁹⁷⁷ In *Allen v. Greenville Hotel Partners*, for example, the plaintiff claimed the franchisor was liable for injuries suffered in a fire that occurred at the franchise premises.⁹⁷⁸ The plaintiff's main claim was that the franchisor had a duty to ask his franchisee to install sprinklers at the franchise premises, but the franchisor replied that he fulfilled this duty when he asked the franchisee to undertake renovations.⁹⁷⁹ The U.S. District Court for South Carolina held that the franchisor was not liable because asking franchisees for renovations was solely for the sake of maintaining the

⁹⁷³ *Allen v. Greenville Hotel Partners, Inc.*, 409 F. Supp. 2d 672, 680 (D.S.C. 2006); *see also* Perkins, Yatchak, & Hadfield, *supra* note 379, at 175.

⁹⁷⁴ Perkins, Yatchak, & Hadfield, *supra* note 379, at 174.

⁹⁷⁵ *Parker v. Domino's Pizza, Inc.*, 629 So. 2d 1026, 1026-27 (Fla. Dist. Ct. App. 1993).

⁹⁷⁶ Perkins, Yatchak, & Hadfield, *supra* note 379, at 177.

⁹⁷⁷ *Id.*

⁹⁷⁸ *Allen v. Greenville Hotel Partners, Inc.*, 409 F. Supp. 2d 672 (D.S.C. 2006).

⁹⁷⁹ *Id.* at 676-77.

uniform appearance and operation of the hotel chain.⁹⁸⁰ Conversely, *Vaughn v. Columbia Sussex Corp.* is an example of the rule that franchisors who are required by the franchise agreement to construct or design the premises are liable to third parties.⁹⁸¹

Both the Chinese and Malaysian franchising laws are silent on the issue of liability arising from the breach of a franchise agreement.⁹⁸²

Because the Egyptian Civil Code recognizes both vicarious and direct liability and clearly regulates them, the proposed Egyptian franchising law does not need to include separate provisions. Thus, franchising agreements should be regulated by the general rules governing contracts and there is no need for repetition.

2.5.3 Indemnity and Insurance Clauses

Franchise agreements typically include indemnification clauses requiring franchisees to indemnify franchisors for any settlements or judgments levied against franchisors for the franchisee's actions and costs associated with defending against those claims. In addition, franchise agreements usually require franchisees to list franchisors as an additional insured on the franchisee's liability policy. Passing the responsibility to the franchisee makes sense in a vicarious liability claim because it is the franchisee's negligence not the franchisor's that brought the franchisor into the litigation.⁹⁸³ Many states in the U.S. require an explicit indemnification

⁹⁸⁰ *Id.* at 678.

⁹⁸¹ *Vaughn v. Columbia Sussex Corp.*, 91 Civ. 1629, 1992 U.S. Dist. LEXIS 820 (S.D.N.Y. Jan. 27, 1992).

⁹⁸² Malaysian Franchise Act, *supra* note 673, at art. 30(1).

⁹⁸³ See generally Hewitt, *supra* note 379, at 35 (2010).

provision in the agreement for the franchisee's own negligence.⁹⁸⁴ Unlike the U.S., both the Chinese and Malaysian laws are silent on the indemnification issue. Indemnification clauses in Egypt are determined by the contract parties and are regulated by the provisions of the agreement in question.

2.6 Remedies

Franchising law should have comprehensive list of remedies available in case of breach of franchising agreements to give judges a broad discretionary power and a variety of options when deciding remedies. It would also help to reduce the chances of termination of the franchise agreement, as it is better for both parties to go back to a satisfactory contractual performance.

In the United States, remedies are available in different forms depending on whether the breach was of a franchise agreement, the franchise laws, or the disclosure and registration laws. Available remedies include injunctive relief, payment for goodwill, and repurchase of inventory.

A good example of damages is *Progressive Child Care Systems, Inc. v. Kids 'R' Kids International, Inc.*⁹⁸⁵ In this case, the franchisee was operating the franchisor's two childcare facilities under the trade name "Kids 'R' Kids" in return for 5% of the enrollment-based revenue.⁹⁸⁶ The franchisee stopped paying the franchisor royalties in March 2002 and started operating both facilities under the name "Legacy Learning Center." Kids 'R' Kids claimed breach of contract, breach of personal guaranty, fraud, and conspiracy.⁹⁸⁷ The jury awarded

⁹⁸⁴ Joyce Mazero, *Impact of Other Local Laws, in* FUNDAMENTALS OF INTERNATIONAL FRANCHISING 265 (Richard M. Asbill & Steven M. Goldman eds., 2001).

⁹⁸⁵ *Progressive Child Care Systems, Inc. v. Kids 'R' Kids International, Inc.*, No. 2-07-127-CV, 2008 Tex. App. LEXIS 8416 (Nov. 6, 2008).

⁹⁸⁶ *Id.* at *2.

⁹⁸⁷ *Id.* at *3.

\$1,385,008.72 to the franchisor for past and future royalties.⁹⁸⁸ The court of appeals of Texas affirmed and explained that under Georgia contract law (that governing the agreement) an injured party should be placed in the position in which it would have been absent the breach.⁹⁸⁹ Applying this principle, the court found that the injured party could claim damages for lost profits which entitled the franchisor to an amount of money equal to lost future royalties.⁹⁹⁰

Injunctive relief is aptly explained by *Petro Franchise Systems, LLC v. All American Properties, Inc.*⁹⁹¹ In that case, the franchisor started providing competing products in the exclusive territory of the franchisee and the franchisee refrained from paying royalties.⁹⁹² After negotiations, the parties entered a settlement agreement that required the franchisee to pay the franchisor the late royalties and to release any claims, but the franchisee failed to fulfill his obligations arising out of the settlement agreement causing the franchisor to terminate the agreement and sue for a preliminary injunction under the Lanham Act to prevent the franchisee from using his trademark.⁹⁹³ The franchisee claimed the franchisor breached its good faith obligation and accordingly sued for a preliminary injunction to prevent the franchisor from

⁹⁸⁸ *Id.* at *4.

⁹⁸⁹ *Id.* at *12.

⁹⁹⁰ *Id.* at 18; *see also* Deborah S. Coldwell et al., *Franchise Law*, 63 SMUL. REV. 577 (2010); Pitegoff & Garner, *supra* note 441, at 209-10. For more examples on damages as a remedy provided in case of breach of relationship laws *see* Westfield Ctr. Serv., Inc. v. Cities Serv. Oil Co., 432 A.2d 48 (1981) (awarding reasonable monetary compensation to the franchisee under New Jersey law); Hermanos, Inc. v. Campbell Soup Co., 797 F. Supp. 103 (D.P.R. 1993) (deciding that Puerto Rican law includes not only five times the average annual profit, but also other benefits such as goodwill monetary compensation); Boat & Motor Mart v. Sea Ray Boats, Inc., 825 F.2d 1285 (9th Cir. 1987) (deciding that under California law the remedy available is the repurchase of the inventory owned by the franchisee).

⁹⁹¹ *Petro Franchise Systems, LLC v. All Am. Prop., Inc.*, 607 F. Supp. 2d 781 (W.D. Tex. 2009).

⁹⁹² *Id.* at 782-86.

⁹⁹³ *Id.*

terminating the agreement.⁹⁹⁴ While the court found there to be no dispute over whether the franchisee failed to pay royalties, it found that the franchisor correctly followed the termination procedure after the franchisee stopped paying.⁹⁹⁵ Moreover, the court found that losing the franchise does not represent irreparable harm to the franchisee particularly because this harm could be compensated through monetary damages.⁹⁹⁶ On the other hand, though, if the franchisee were to continue to use the franchisor's trademarks without authorization, the franchisor would suffer irreparable harm. The court, therefore, granted the franchisor's request for a preliminary injunction.⁹⁹⁷

One possible remedy for termination without good cause and for declining renewal, is making the franchisor buy the franchisee's inventory.⁹⁹⁸ Arkansas, for example, requires the franchisor to repurchase the franchisee's inventory if the franchisor ends the franchise agreement without good cause.⁹⁹⁹ Michigan applies the same rule to both termination and non-renewal.¹⁰⁰⁰ The inventory required to be re-purchased by the franchisor varies. Connecticut, Hawaii, and Washington, for example, provide that inventory includes supplies, equipment, and furnishings.¹⁰⁰¹ Similarly, the financial compensation paid by the franchisor in such a case varies from one state to another. While California requires "the lower of the fair wholesale market

⁹⁹⁴ *Id.*

⁹⁹⁵ *Id.* at 789.

⁹⁹⁶ *Id.* at 795.

⁹⁹⁷ *Id.* at 794. Many state franchise laws also allow injunctive relief such as Arkansas, Nebraska, and New Jersey, *See Pitegoff & Garner, supra* note 441, at 214.

⁹⁹⁸ Pitegoff & Garner, *supra* note 441, at 210-11.

⁹⁹⁹ ARK. CODE. ANN. § 4-72-209 (2012).

¹⁰⁰⁰ Pitegoff & Garner, *supra* note 441, at 211.

¹⁰⁰¹ *Id.*

value or the price paid by the franchisee,” Connecticut requires “fair and reasonable compensation,” and Michigan requires “the fair market value at the time of expiration of the franchise’s inventory, supplies, equipment, fixtures, and furnishings.”¹⁰⁰²

Finally, some states, such as Indiana, Minnesota, Mississippi, Missouri, Nebraska, New Jersey, and Virginia, do not require a franchisor to repurchase a franchisee’s inventory, but to pay damages for loss of goodwill. The issue of goodwill may be confusing sometimes as the term usually refers to a brand’s value as associated with a trademark. Accordingly goodwill is associated with the franchisor and not the franchisee. Some scholars interpret the goodwill rule in franchising on the basis that a franchisee also develops goodwill in the business called “sweat equity.”¹⁰⁰³ Sweat equity means building a value for the business without being associated to the trademark that reflects the “going concern” where franchisees build the success of their business on their own.¹⁰⁰⁴ Illinois, for example, requires payment for goodwill in case of non-renewal. Similarly, Hawaii requires payment for loss of goodwill in case of non-renewal unless one year of notice is given by the franchisor.¹⁰⁰⁵

Chinese law does not provide penalties for general breaches of duty, only for specific breaches of the particular duties mentioned in the text. Most remedies provided by the Chinese New Regulations are financial. For example, Article 26 of the New Regulations provides for a fine of between 10,000 CNY and 50,000 CNY and requires correcting the mistake in case of using the promotion funds for other purposes other than for promotion.¹⁰⁰⁶ Similarly, Article 27

¹⁰⁰² *Id.*

¹⁰⁰³ *Id.* at 212

¹⁰⁰⁴ *Id.*

¹⁰⁰⁵ *Id.*

¹⁰⁰⁶ Chinese New Regulations, *supra* note 237, at art. 26.

of the Regulations requires the franchisor to make corrections and to pay a fine of between 30,000 CNY and 300,000 CNY in cases where the wrongdoer engaged in misleading advertisement actions.¹⁰⁰⁷

Finally, most of the remedies provided by the Malaysian Franchise Act are monetary. The Malaysian Franchise Act has a very specific system of penalties and calls breaches of the obligations imposed by the Act offences. Examples include failing to refund a franchisee for expenses he paid upon termination of the franchise agreement by the franchisee during the “cooling off period”¹⁰⁰⁸ and non-fulfillment of the Promotion Fund obligation’s requirements provided by the Act.¹⁰⁰⁹ Examples also include non-fulfillment of confidentiality obligations¹⁰¹⁰ and the franchisor’s declining to renew the franchise agreement.¹⁰¹¹ Similarly, examples include making untrue or misleading statements of material facts, or engaging in any act, practice or course of business that operates or would operate as a fraud or deceit upon any person in relation to an offer to sell or a sale of a franchise.¹⁰¹²

Offences under the Malaysian Franchise Act makes a person liable for a fine of between 5,000 MYR and 50,000 MYR for the first offence committed, and a fine of 10,000 MYR or imprisonment for a term not exceeding five years, or both. The Act also allows a competent court to declare the franchise agreement between the franchisor and any franchisee to be null and void, to order that the franchisor refund any form of payment which he has obtained from any

¹⁰⁰⁷ *Id.* at art. 27.

¹⁰⁰⁸ Malaysian Franchise Act, *supra* note 673, at art. 18(5).

¹⁰⁰⁹ *Id.* at art. 22.

¹⁰¹⁰ *Id.* at art. 26.

¹⁰¹¹ *Id.* at art. 32.

¹⁰¹² *Id.* at art. 37.

franchisee, or to prohibit the franchisor from making any new franchise agreements or appointing any new franchisee, upon charging the franchisor of the first offence.¹⁰¹³

The proposed Egyptian franchising law should refer to the remedies available under the general rules of contracts found in the Egyptian Civil Code that regulate performance of contracts in a comprehensive way.¹⁰¹⁴ The Egyptian law, however, should follow the U.S. law and add provisions on both the repurchase of inventory and payment for goodwill since they are not recognized by Egyptian contract law.

2.7 Good Faith

The principle of good faith and fair dealing encompasses different standards that vary between civil and common law countries and depends on the nature and requirements of each contractual relationship. The majority of civil law countries generally require good faith in contracts. Similarly, common law countries impose a duty of good faith and fair dealing in the performance and enforcement of contracts whether in statutes or through the courts.¹⁰¹⁵ In addition to the general rules regulating good faith and fair dealing, contracting parties usually include in their agreements a provision on good faith and fair dealing.¹⁰¹⁶ Good faith and fair dealing provisions in franchise agreements may be referred to explicitly, impliedly, or by reference.

¹⁰¹³ *Id.* at art. 39.

¹⁰¹⁴ See generally Egyptian Civil Law, *supra* note 503, at arts. 126, 203, 221.

¹⁰¹⁵ Robert S. Adler & Richard A. Macc, *Good Faith: A New Look at an Old Doctrine*, 28 AKRON L. REV. 31, 42 (1994).

¹⁰¹⁶ Andrew Terry & Cary Di Lernia, *Franchising and the Quest for the Holy Grail: Good Faith or Good Intentions?*, 33 MELBOURNE U. L. R. 542, 549 (2009).

In the United States, good faith and fair dealing with respect to franchise relationships is dealt with at different levels. Generally speaking, all contractual relationships, including franchise relationships, are subject to the statutory regulations and judicial principles governing contractual transactions, including good faith and fair dealing.¹⁰¹⁷ The Uniform Commercial Code (“UCC”) defines good faith as “honesty in fact and the observance of reasonable commercial standards of fair dealing.”¹⁰¹⁸ Also, the Restatement (Second) of Contracts imposes on the contracting parties the duty of good faith and fair dealing in performing their obligations.¹⁰¹⁹ The American jurisprudence understands the covenant of good faith and fair dealing as requiring the contracting parties to perform their contractual duties in an honest and reasonable way.¹⁰²⁰ In *Brassil v. Maryland Casualty. Co.*, the New York Court of Appeals confirmed the existence of an implied obligation of good faith in all written agreements.¹⁰²¹ In the same context, the federal District Court for the Southern District of Florida in *Allpattah Services, Inc. v. Exxon Corp.*, held that an implied covenant of good faith and fair dealing prohibits either party from exercising discretionary powers granted by the contractual relationship in an unjust way.¹⁰²²

¹⁰¹⁷ *Id.*; see also Joel Iglesias, *Applying The Implied Covenant of Good Faith and Fair Dealing to Franchises*, 40 HOUS. L. REV. 1423, 1433 (2004).

¹⁰¹⁸ U.C.C. § 1-201(b)(20) (2011).

¹⁰¹⁹ Restatement (Second) of Contracts § 205 (1981).

¹⁰²⁰ *Days Inn Worldwide, Inc. v. Sai Baba, Inc.*, 300 F. Supp. 2d 583, 590 (N.D. Ohio 2004); see also *Julian v. Christopher*, 575 A.2d 735 (Md. 1990).

¹⁰²¹ *Brassil v. Maryland Cas. Co.*, 104 N.E. 622, 624 (N.Y. 1914).

¹⁰²² *Allapattah Serv., Inc. v. Exxon Corp.*, 61 F. Supp. 2d 1308 (S.D. Fla. 1999).

Though the New Rule does not refer to the implied covenant of good faith and fair dealing,¹⁰²³ good faith and fair dealing principles are dealt with explicitly at the state level and by both the PMPA and the ADFA. According to the ADFA, “good faith” means the obligation of franchise parties, employees, agents, and any other concerned party to act in a just way towards one another.¹⁰²⁴ Also, any negotiations or communications should be made in good faith.¹⁰²⁵ The PMPA’s purpose is to keep the power balanced between the parties to gasoline franchise agreements.¹⁰²⁶ Good faith under the PMPA is a subjective criterion that requires courts to test the intent of franchisors rather than their actions.¹⁰²⁷

In addition, many states have specialized franchise laws that regulate the substantive relationships, rights, and obligations among franchising parties.¹⁰²⁸ These substantive state franchise regulations usually require the franchising parties to act in good faith and consider fair dealing and reasonable commercial practices.¹⁰²⁹

The applications of good faith and fair dealing in contractual franchise relationships are numerous including in advertising, payments, distribution processes, renovations, accounting,

¹⁰²³ Frank J. Cavico, *The Covenant of Good Faith and Fair Dealing in the Franchise Business Relationship*, 6 BARRY L. REV. 61, 76 (2006).

¹⁰²⁴ 15 U.S.C. §§ 1221-1225 (“‘good faith’ shall mean the duty of each party to any franchise, and all officers, employees, or agents thereof to act in a fair and equitable manner toward each other so as to guarantee the one party freedom from coercion, intimidation, or threats of coercion or intimidation from the other party: Provided, That recommendation, endorsement, exposition, persuasion, urging or argument shall not be deemed to constitute a lack of good faith.”).

¹⁰²⁵ *Id.*

¹⁰²⁶ *Saberi v. Shell Oil Prod. No. C 04-2413 MHP*, 2005 U.S. Dist. LEXIS 4215 (N.D. Cal. Mar. 17, 2005).

¹⁰²⁷ Cavico, *supra* note 1023, at 66-68.

¹⁰²⁸ *Id.* at 71.

¹⁰²⁹ *Id.* For instance Washington requires the franchising parties to deal in good faith, WASH. REV. CODE § 19.100.180 (1) (2012). Also, Iowa imposes on franchise parties a duty of good faith, which means, according to the language of the code, honesty and consideration of commercial fair dealing, whether in performing or enforcing the rights and obligations arising out of a franchise agreement, IOWA CODE § 523H.10 (2011). Moreover, Arkansas enjoins franchisors from dealing except fairly and in good faith. ARK. CODE ANN. § 4-72-206 (6) (2008).

franchise agreement renewal, agreement termination, and goods pricing.¹⁰³⁰ In *Pinnacle Pizza Company, Inc., v. Little Caesar Enterprises, Inc.*, Pinnacle, the franchisee, alleged that Little Caesar (LCE), the franchisor, breached the franchise contract and the covenant of good faith and fair dealing when it started using the advertisement slogan “Hot n’ Ready” that was created by the franchisee, without obtaining the franchisee’s permission.¹⁰³¹ The District Court for the District of South Dakota granted the franchisor summary judgment on all claims and the Court of Appeals affirmed.¹⁰³² The Court of Appeals explained that the franchisor’s acts did not breach the covenant of good faith as they were in accordance with the franchise agreement that provided: “Franchise Owner expressly acknowledges that any and all goodwill associated with said Proprietary Marks, including any goodwill which might be deemed to have arisen or to arise in the future through the activities of any Licensee of LITTLE CAESAR, inures directly and exclusively to the benefit of LITTLE CAESAR.”¹⁰³³

Territorial exclusivity may also run afoul of good faith and fair dealing in franchising transactions. The criterion for whether operating other franchises in the same area by the franchisor breaches the covenant of good faith and fair dealing is whether the franchise agreement explicitly provides for the franchisee’s territorial exclusive right. Thus, if the franchise agreement does not explicitly grant the franchisee an exclusive territory, the majority of U.S. courts will not consider it a breach of the covenant of good faith and fair dealing if the franchisor were to open other franchises in the area.¹⁰³⁴ A few courts, however, may consider it a

¹⁰³⁰ See generally Cavico, *supra* note 1023.

¹⁰³¹ *Pinnacle Pizza Company, Inc., v. Little Caesar Enterprises, Inc.*, 598 F.3d 970, 971 (U.S. App. 2010).

¹⁰³² *Id.* At 982.

¹⁰³³ *Id.* At 980.

¹⁰³⁴ Cavico, *supra* note 1023, at 86.

breach of good faith for franchisors to operate other franchises in the same area even where no territorial clause specifically forbids it.¹⁰³⁵ In all cases, it is against good faith and fair dealing for the franchisor to grant proximate franchises in a way that causes loss to the franchisees and that prevent the franchisees from achieving the expected benefits of their operated businesses.¹⁰³⁶

Another application of good faith and fair dealing in franchise agreements relates to franchise fees. In *Shell Oil v. HRN, Inc.*, the franchisees, HRN, claimed that their contractual inability to negotiate over the high franchised gasoline prices imposed by the franchisor, Shell, through the franchise agreements was a breach of the UCC good faith and fair dealing principle.¹⁰³⁷ The Supreme Court of Texas found that the price imposed by Shell was high;¹⁰³⁸ however, the court decided that the UCC neither requires the price to be equal to a fair market price to be a good faith price nor does it command a competitive price from every dealer.¹⁰³⁹ Hence, the court concluded that Shell had not breached the good faith requirements of the UCC.¹⁰⁴⁰

Moreover, the covenant of good faith and fair dealing has many applications in the renewal of a franchisor-franchisee relationship. In *BP West Coast Products LLC v. Robert Greene*, the franchisor, BP, notified its franchisee, Robert Greene, one year before the expiration of the franchise agreement that it did not intend to renew the agreement, citing PMPA Section 2802(b)(3)(D), which allows the sale of a franchised premises as long as the sales decision is

¹⁰³⁵ *Id.*

¹⁰³⁶ *Id.*

¹⁰³⁷ *Shell Oil. v. HRN, Inc.*, 144 S.W.3d 429, 432 (Tex. 2004).

¹⁰³⁸ *Id.* at 437.

¹⁰³⁹ *Id.* at 437.

¹⁰⁴⁰ *Id.* at 438.

made in good faith and in the regular course of business.¹⁰⁴¹ BP asked the District Court for the Eastern District of California to rule that it had not breached PMPA when it refused to renew the franchise agreement¹⁰⁴² to which Greene filed a counterclaim.¹⁰⁴³ The court held that the criterion of good faith is subjective and governs intent rather than consequences as long as the franchisor does not act discriminatorily or outside the normal course of business.¹⁰⁴⁴ The court decided that there had been no breach of the covenant of good faith and fair dealing and that BP's decision not to renew the agreement and to sell the premises was reasonable and not outside the normal course of business.¹⁰⁴⁵

In China, good faith and fairness requirements are dealt with in the Chinese Contract Law.¹⁰⁴⁶ The General Principles of the Civil Law¹⁰⁴⁷ require contracting parties to abide by the doctrine of good faith while performing any of the obligations arising from their contractual relationship.¹⁰⁴⁸ Further, Chinese scholars consider good faith to be one of the most important

¹⁰⁴¹ BP West Coast Products LLC v. Greene, 318 F. Supp. 2d 987, 1011 (E.D. Cal. 2004).

¹⁰⁴² *Id.*

¹⁰⁴³ *Id.*

¹⁰⁴⁴ *Id.* at 1021; *but see* Iglesias, *supra* note 1017, at 1451 (explaining that the criterion of good faith is whether the franchising agreement party maintaining discretion exercises in a reasonable way or in contradiction with the reasonable expectations that are based not on subjective desires rather than economic facts).

¹⁰⁴⁵ BP West Coast Products LLC v. Greene, 318 F. Supp. 2d 987, 1021 (E.D. Cal. 2004).

¹⁰⁴⁶ Chinese Contract Law, *supra* note 665, at art. 6; *see also* MENDELSON, FRANCHISING LAW, *supra* note 54, at 391.

¹⁰⁴⁷ Prior to the adoption of the Chinese Contract Law, China had enacted the Economic Contract Law in 1981, the Foreign Economic Contract Law in 1985, and the Law on Technology Contracts in 1987. DANIEL C. K. CHOW, THE LEGAL SYSTEM OF THE PEOPLE'S REPUBLIC OF CHINA 337-39 (2003) (stating that the various Chinese contract laws were enacted in an effort to support China's transition from a planned economy to a transition economy, as part of Deng Xiaoping's economic reforms after the end of the Cultural Revolution in 1976).

¹⁰⁴⁸ Chunlin Leonhard, *A Legal Chameleon: An Examination of the Doctrine of Good Faith in Chinese and American Contract Law*, 25 CONN. J. INT'L L. 305, 310 (2010) (citing Wang Liming & Xu Chuanxi, *Fundamental Principles of China's Contract Law*, 13 COLUM. J. ASIAN L. 1, 4 (1999)).

principles in Chinese contract law.¹⁰⁴⁹ Good faith in the Chinese legal system covers all stages of contracting, from pre-contractual negotiations through performance and the post-termination stage.¹⁰⁵⁰ The principle of good faith is considered the most effective guarantee of contractual performance.¹⁰⁵¹ It also guides the courts when filling the gaps in Chinese law, particularly because fast social and economic changes take place in China and require legal response.¹⁰⁵² For instance, in *Chong Qing City Cheng Kou County Lan Tian Village Nursery v. China Agricultural Bank Cheng Kou*, the plaintiff asked the defendant bank to extend its loan but the bank refused because it thought the plaintiff's failure to pay his previous loan made such an extension too risky. The plaintiff claimed a breach of good faith. The lower court decided that refusing to lend to the plaintiff did not breach the principle of good faith. The three main elements that the court considered were whether the defendant intended to enter into an agreement with the plaintiff, whether the defendant intended to harm the plaintiff, and whether the defendant participated in any activity that affected interests of the plaintiff.¹⁰⁵³ The appellate court reversed the decision, though, because the bank had failed to respond timely to the plaintiff's request, constituting a breach of good faith during the pre-contractual stage. The appellate court observed that, "during the process of forming a loan contract, both parties to the potential contract owe each other a duty of care, such as mutual assistance, mutual care, mutual protection, and mutual notification, which is consistent with the principle of good faith."¹⁰⁵⁴

¹⁰⁴⁹ *Id.*

¹⁰⁵⁰ *Id.* at 311.

¹⁰⁵¹ *Id.* at 312.

¹⁰⁵² *Id.*

¹⁰⁵³ *Id.*

¹⁰⁵⁴ *Id.*

In addition to the general rules of contracts, the Chinese franchise law explicitly provides for the importance of good faith in franchise transactions. The Chinese New Regulations require franchising parties to act in accordance with the principles of “free will, fairness, honesty and good faith.”¹⁰⁵⁵

Finally, the Malaysian Franchise Act requires franchising parties to act honestly and reasonably.¹⁰⁵⁶ The Act provides examples of unreasonable practices in franchise transactions such as overvaluing franchise fees, any conduct in which risk exceeds the expected return, and any conduct unnecessary to protect the lawful interests of the parties.¹⁰⁵⁷

Though the Egyptian general rules of contracts require that a contract be performed in good faith, the proposed Egyptian franchising law should have a separate provision on good faith to clarify how the broad concept can be particularized in the context of franchising.¹⁰⁵⁸ To make this provision effective, it should follow the Malaysian law since it gives examples of violations of good faith in franchising transactions. It is also recommended that the good faith provision provide penalties for violations of the provision’s requirements by any of the contracting parties. Providing a penalty for violation would ensure a robust application of the principles of good faith and fair dealing, protecting weak parties in case any of the agreement provisions are drafted in favor of one of the parties, and reducing the probability of future disputes.

2.8 Agreement Formation

¹⁰⁵⁵ Chinese New Regulations, *supra* note 237, at art. 4; *see also* SPENCER, *supra* note 41, at 185.

¹⁰⁵⁶ Malaysian Franchise Act, *supra* note 673, at art. 29(1); *see also* MENDELSON, FRANCHISING LAW, *supra* note 54, at 400.

¹⁰⁵⁷ Malaysian Franchise Act, *supra* note 673, at art. 29 (2); *see also* SPENCER, *supra* note 41, at 202.

¹⁰⁵⁸ Egyptian Civil Law, *supra* note 503, at art. 147.

2.8.1 Form

Exploring the form of a franchise agreement requires discussing several issues such as whether a franchise agreement needs to be in writing and the consequences of oral agreements. It is also important to discuss whether a franchise agreement must include specific provisions, without which the agreement would be void.

In the United States, the New Rule allows oral or written franchise agreements as long as the relationship satisfies the franchise elements.¹⁰⁵⁹ In other words, a business transaction is deemed to be a franchise relationship under the New Rule so long as it satisfies the elements of a franchise regardless of the name the parties use to describe the relationship and whether the parties actually perform the duties arising under it.¹⁰⁶⁰ Conversely, the relationship is not considered a franchise relationship even if the parties call it one, if it does not meet the elements

¹⁰⁵⁹ 16 C.F.R. § 436.1(h). At the state level, however, the rule in respect of oral franchise agreement depends on each state law as some states recognize the enforceability of oral franchise agreements while others do not and a third category of states is silent on this issue. Zellweger, *supra* note 232, at 137. A good example of a state law that requires a franchise agreement to be in writing is Mississippi's franchise law which provides that: "franchise" means a written arrangement for a definite or indefinite period." MISS. CODE § 75-24-51(6) (2012). Also, Virginia's franchise law defines a franchise as "a written contract or agreement." VA. CODE ANN. § 13.1-559 (2012). Examples of state laws that are silent on this issue include Indiana's franchise law that defines a franchise as "a contract," IND. CODE § 23-2-2.5-1 (2012), and Delaware's franchise law provides that "franchise means a contract or other arrangement governing the business relationship within this State between a franchised distributor and a franchisor." DEL. CODE ANN. tit. 6, § 2551(3) (2011). Finally, a good example of a state that does not require a franchise agreement to be in writing is Alaska where a franchise is defined as "an agreement, whether express, implied, oral, or written, between two or more persons in Alaska." ALASKA STAT. § 45.45.7 (2012). Courts, however, give strong attention to the parties' intent as to whether they plan to abide by an oral agreement. Zellweger, *supra* note 232, at 180. In *R.G. Group, Inc. v. Horn & Hardart Co.*, the U.S. Court of Appeals for the Second Circuit interpreted the New York law to mean that an oral agreement may be enforceable as long as the parties intend to make it binding and as long as they agree on all the significant provisions of the agreement. *R.G. Group, Inc. v. Horn & Hardart Co.*, 751 F.2d 69, 75 (2d Cir. 1984); *see also* Zellweger, *supra* note 232, at 180. Similarly, the enforceability of an oral franchise agreement depends on the course of conduct between the contracting parties. *See* Zellweger, *supra* note 232, at 181. In *Dunafon v. Taco Bell Corp.*, a federal district court in Missouri concluded that under Missouri law, a franchise agreement can exist without being in writing as long as the exchanged statements between the parties together with the course of conduct refer to the existence of a valid franchise agreement. *See id.* at 182.

¹⁰⁶⁰ THE FTC FRANCHISE RULE, *supra* note 642, at 17-18.

of a franchise.¹⁰⁶¹ The only formality recognized by the New Rule is that a franchise agreement is not valid until signed, even if the franchisee pays all the fees before signing the agreement.¹⁰⁶²

Both the Chinese New Regulations and the Malaysian Franchise Act, however, require that the franchise agreement be in writing.¹⁰⁶³ In the same context, both the Chinese and Malaysian laws require inclusion of specific information in a franchise agreement that if absent invalidates the agreement. Necessary information includes that relating to the parties' information, fees, duration, termination of the agreement, training, operation standards, advertising, the parties' rights and obligations, and provisions regarding the settlement of disputes.¹⁰⁶⁴ The Malaysian Franchise Act explicitly provides that a franchise agreement lacking

¹⁰⁶¹ *Id.*

¹⁰⁶² *Id.* at 19.

¹⁰⁶³ INTERNATIONAL FRANCHISING, *supra* note 165, at 98. Article 11 of the Chinese New Regulations provide that "For engaging in franchise activities, the franchiser and the franchisee shall conclude a written franchise contract." Chinese New Regulations, *supra* note 237, at art. 11. Similarly, Article 18(1) of the Malaysian Franchise Act provides that "A franchise agreement shall be in writing." Malaysian Franchise Act, *supra* note 673, at art. 18(1).

¹⁰⁶⁴ See Chinese New Regulations, *supra* note 237, at art. 19; Article 18(2) of the Malaysian Franchise Act provides that:

- (2) A franchise agreement shall contain but is not limited to:
 - (a) the name and description of the product and business under the franchise;
 - (b) the territorial rights granted to the franchisee;
 - (c) the franchise fee, promotion fee, royalty or any related type of payment which may be imposed on the franchisee, if any;
 - (d) the obligations of the franchisor;
 - (e) the obligations of the franchisee;
 - (f) the franchisee's rights to use the mark or any other intellectual property, pending the registration or after the registration of the franchise;
 - (g) the conditions under which the franchisee may assign the rights under the franchise;
 - (h) a statement on the cooling off period as provided in subsection;
 - (i) a description pertaining to the mark or any other intellectual property owned or related to the franchisor which is used in the franchise;

the required information shall be null and void.¹⁰⁶⁵ Moreover, the Act provides for what it calls a “cooling off period.”¹⁰⁶⁶ The cooling off period is a period agreed upon by the parties, not exceeding more than seven working days from the day the agreement is finalized, during which the franchisee enjoys the right to terminate the franchise agreement.¹⁰⁶⁷ If the franchisee decides to terminate the agreement, the franchisee has to provide reasonable compensation for the franchisor’s expenses in preparing for the franchise agreement.¹⁰⁶⁸

The general rule of Egyptian contract law is that a contractual relationship does not need to be in writing to be valid. This rule, however, has some exceptions that are comprehensively stated by the governing law. Examples include the exception provided by the Egyptian Civil Law that business associations’ articles of incorporation must be in writing, otherwise they are invalid.¹⁰⁶⁹ Similarly, the Egyptian Commercial Law requires that a transfer of technology agreement be in writing.¹⁰⁷⁰ Applying the general rules of contract law, franchising agreements neither need to be written nor are they required to include specific provisions. Nevertheless, the proposed Egyptian franchising law should make an exception to the general rule and follow the

(j) if the agreement is related to a master franchisee, the franchisor's identity and the rights obtained by the master franchisee from the franchisor;

(k) the type and particulars of assistance provided by the franchisor;

(l) the duration of the franchise and the terms of renewal; and

(m) the effect of termination or expiration of the franchise agreement.

Malaysian Franchise Act, *supra* note 673, at art. 18(2).

¹⁰⁶⁵ INTERNATIONAL FRANCHISING, *supra* note 165, at 90; Malaysian Franchise Act, *supra* note 673, at art. 18(3).

¹⁰⁶⁶ See SPENCER, *supra* note 41, at 201.

¹⁰⁶⁷ Malaysian Franchise Act, *supra* note 673, at art. 18(4).

¹⁰⁶⁸ *Id.* at art. 18(5).

¹⁰⁶⁹ Egyptian Civil Law, *supra* note 503, at art. 507(1).

¹⁰⁷⁰ Egyptian Commercial Law, *supra* note 504, at art. 74(1).

Chinese and Malaysian examples by requiring that a franchise agreement be written and include specific provisions, the absence of which will void the agreement. Requiring written franchise agreements and inclusion of specific provisions would facilitate the process of proof in any future disputes.

2.8.2 Minimum Term

Many franchising laws require a minimum term for the franchise agreement, the violation of which may result in invalidation of the agreement.¹⁰⁷¹ The reason behind this rule appears to be the protection of franchisees that need to be given a proper amount of time to see the results of investing their capital in franchising transactions. Some developing countries also seem to view long-term agreements favorable as it results in tax concessions.¹⁰⁷²

In the United States, neither the New Rule nor state laws establish any minimum period for a franchise agreement to be valid. This means the duration is determined by the will of the parties.¹⁰⁷³ Though the Chinese New Regulations set a minimum duration of three years for all franchise agreements,¹⁰⁷⁴ this term is not mandatory since parties are allowed to agree

¹⁰⁷¹ UNIDROIT, *supra* note 82, at 48-49.

¹⁰⁷² *Id.*

¹⁰⁷³ Craig R. Tractenberg, Robert B. Calihan, & Ann Marie Luciano, *Legal Considerations in Franchise Renewals*, 23 FRANCHISE L.J. 198, 198 (2003).

¹⁰⁷⁴ SPENCER, *supra* note 41, at 184.

otherwise.¹⁰⁷⁵ Conversely, the Malaysian Franchise Act provides for a minimum term of at least five years,¹⁰⁷⁶ taking into account the parties' rights of earlier termination provided by Article 33.

The Egyptian contract law recognizes the freedom of contracting parties to set the term of their contract except in very few situations where the law itself provides the minimum term of the agreement. For example, the technology transfer agreement is required to be at least five years and is considered void if less than that length.¹⁰⁷⁷ The proposed Egyptian franchising law should incorporate a provision similar to the Malaysian Franchise Act that provides a minimum term for franchise agreements. This would guarantee protection of franchisees against abusive or wrongful termination of a franchise agreement.

2.8.3 Renewal

Renewal of franchise agreements in the United States is regulated at the state level. Many states limit situations where franchisors may decline renewal to cases where good cause is shown and for only nondiscriminatory purposes.¹⁰⁷⁸ Also, many states require notice of the franchisor's intention not to renew. Iowa law, for example, requires that the franchisee be "notified of the franchisor's intent not to renew at least six months prior to the expiration date or any extension

¹⁰⁷⁵ INTERNATIONAL FRANCHISING, *supra* note 165, at 98. Article 13 of the Chinese New Regulations provides that "[u]nless it is otherwise agreed upon by the franchisee, the franchise term as stipulated in the franchise contract may not be less than three years. When the franchisor and the franchisee renew the franchise contract, the preceding paragraph may not apply." Chinese New Regulations, *supra* note 237, at art. 13.

¹⁰⁷⁶ INTERNATIONAL FRANCHISING, *supra* note 165, at 290; *see also* Malaysian Franchise Act, *supra* note 673, at art. 25; *see also* SPENCER, *supra* note 41, at 202.

¹⁰⁷⁷ Egyptian Commercial Law, *supra* note 504, at art. 86.

¹⁰⁷⁸ Tractenberg, Calihan, & Luciano, *supra* note 1073, at 203.

of the franchise agreement.”¹⁰⁷⁹ Moreover, many states require franchisors to pay compensation for non-renewal. The Washington Franchise Investment Protection Act, for example, makes it:

an unfair or deceptive act or practice or an unfair method of competition and therefore unlawful and a violation of this chapter for any person to (i) Refuse to renew a franchise without fairly compensating the franchisee for the fair market value, at the time of expiration of the franchise....¹⁰⁸⁰

In *Thompson v. Atlantic Richfield*, the U.S. District Court for the Western District of Washington concluded that the Washington Franchise Investment Protection Act does not allow automatic renewal of a franchise agreement after the lapse of its duration, but requires paying compensation to the franchisee for non-renewal.¹⁰⁸¹ In the same context, the Michigan Franchise Investment Law declares void any “provision that permits a franchisor to refuse to renew a franchise without fairly compensating the franchisee by repurchase or other means for the fair market value at the time of expiration of the franchisee’s inventory, supplies, equipment, fixtures, and furnishings.”¹⁰⁸²

Finally, the question of whether modifications can be required as a condition of renewal arises in particular in evergreen agreements and in jurisdictions that are reluctant to accept franchisors’ economic interests as grounds for nonrenewal.¹⁰⁸³ Evergreen agreements are renewable regardless of whether the language of the agreement provides for renewal.¹⁰⁸⁴ In such cases, to protect franchisors’ rights to improve the franchised system, courts usually support the franchisor’s right of conditional renewal even when such conditions are related to increased

¹⁰⁷⁹ IOWA CODE § 523H.8 (2011).

¹⁰⁸⁰ WASH. REV. CODE § 19.100.180 (2012).

¹⁰⁸¹ *Thompson v. Atl. Richfield*, 649 F. Supp. 969 (W.D. Wash. 1986).

¹⁰⁸² MICH. COMP. L. § 445.1527 (2006).

¹⁰⁸³ Tractenberg, Calihan, & Luciano, *supra* note 1073, at 205.

¹⁰⁸⁴ *Id.* at 198.

royalties, dispute resolution provisions, and the like.¹⁰⁸⁵ The reason behind accepting such conditional renewal is to help franchisors achieve the expected effectiveness of the franchise operations.¹⁰⁸⁶ In the same context, courts usually do not consider it a breach of good faith and fair dealing when franchise agreements do not explicitly refer to a franchisor's right to modify the agreement in case of renewal.¹⁰⁸⁷ Of course, franchisors must always consider the duties and obligations imposed by franchise laws in general, such as observing antidiscrimination obligations against various franchisees or offering renewal to certain franchisees under certain terms and declining other franchisees' right of renewal under similar terms.¹⁰⁸⁸

Unlike the Chinese New Regulations which do not provide specific rules governing renewal of franchise agreements,¹⁰⁸⁹ the Malaysian Franchise Act provides strict rules regarding renewal.¹⁰⁹⁰ In fact, the Act gives the franchisee the right to extend the franchise agreement at any time before it terminates by giving the franchisor written notice and the franchisor cannot refuse such an extension unless a breach has been committed by the franchisee.¹⁰⁹¹ In such cases, the agreement extends for a similar duration with the same provisions or better ones for the franchisee.¹⁰⁹² Moreover, the Act penalizes franchisors who refuse to renew the franchise agreement without compensating the franchisee in two instances: first, when the franchisee is barred by the franchise agreement, from conducting a similar business under a different

¹⁰⁸⁵ *Id.* at 205.

¹⁰⁸⁶ *Id.* at 205.

¹⁰⁸⁷ *Payne v. McDonald's Corp.*, 957 F. Supp. 749 (D. Md. 1997).

¹⁰⁸⁸ *Tractenberg, Calihan, & Luciano*, *supra* note 1073, at 206.

¹⁰⁸⁹ *Id.*

¹⁰⁹⁰ *MENDELSON, FRANCHISING LAW*, *supra* note 54, at 401.

¹⁰⁹¹ *Malaysian Franchise Act*, *supra* note 673, at art. 34(1).

¹⁰⁹² *Id.* at art. 34(2)-(3).

trademark within the same territory¹⁰⁹³; and second, when the franchisor does not notify the franchisee in writing of his intent not to renew the franchise agreement at least six months before the expiration of the franchise agreement.¹⁰⁹⁴

Contract renewal under the Egyptian contract law is an issue of contractual arrangement between contracting parties except in limited cases like agency.¹⁰⁹⁵ The proposed Egyptian franchising law should avoid both the extremist attitude of the Chinese law, which is silent on renewal, and the Malaysian law, which grants franchisees absolute rights to extend the agreement any time before its expiration and penalizes franchisors who decline renewal in specific cases. The U.S. approach is the most reasonable as it creates a balance between franchisors' and franchisees' interests in renewal. Hence, the Egyptian law should allow franchisors to decline renewal if they have good cause and the decision is made on a non-discriminatory basis, with written notice delivered at a reasonable time before termination. Otherwise, franchisees need to be compensated.

2.8.4 Transfer

The importance of regulating transfer is that the franchisor may want to replace the franchisee or the franchisee may need to quit and look for another person to take his place in the business.

¹⁰⁹³ *Id.* at art. 32 (providing that non-renewing franchisors are punished where, “(a) the franchisee is barred by the franchise agreement, or by the refusal of the franchisor at least six months before the expiration date of the franchise agreement to waive any portion of the franchise agreement which prohibits the franchisee, from continuing to conduct substantially the same business under another mark in the same area subsequent to the expiration of the franchise agreement . . .”)

¹⁰⁹⁴ *Id.* at art. 32 (providing that non-renewing franchisors are punished also, where, “(b) the franchisee has not been given a written notice of the franchisor’s intent not to renew the franchise agreement at least six months prior to the expiration date of the franchise agreement.”)

¹⁰⁹⁵ In agency relationships, the principal owes the agent compensation to be determined by the competent judge if the principal refuses to renew the agency agreement. Egyptian Commercial Law, *supra* note 504, at art. 189.

In the United States, state laws handle the issue of transfer from varying perspectives. A franchisor cannot unreasonably withhold its consent to the transfer of the franchise. For instance, a franchisee may transfer the franchised business on condition that the transferee meets the reasonable qualifications of the franchisor so long as those qualifications are based upon legitimate business concerns.¹⁰⁹⁶ For example, in *Mike Smith Pontiac, GMC, Inc. v. Mercedes-Benz of North America, Inc.*, the Eleventh Circuit decided that the only reasonable grounds for a franchisor's objection to a transfer are the transferee's moral character or failure to meet the franchisor's written, reasonable, and uniformly applied standards or qualifications.¹⁰⁹⁷ Additionally, the proposed transferee may be required to meet all the requirements of the franchisor such as training programs, payment of transfer fees, and obligations imposed by the franchise agreement.¹⁰⁹⁸

A franchisor must have good cause to decline a transfer.¹⁰⁹⁹ Additionally, some states require franchisees to notify the franchisor of his intent to transfer the franchise and to include specific information in the notice such as the transferee's name, address, and business experience.¹¹⁰⁰ In *Chrysler Corp. v. Bowshier*, Bowshier filed a protest with the Ohio Motor

¹⁰⁹⁶ IOWA CODE § 523H.5(1) (2011).

¹⁰⁹⁷ *Mike Smith Pontiac, GMC, Inc. v. Mercedes-Benz of N. Am., Inc.*, 32 F.3d 528, 531 (11th Cir. 1994)

¹⁰⁹⁸ IOWA CODE § 523H.5(3).

¹⁰⁹⁹ HAW. REV. STAT. § 482E-6(2)(I) (2011).

¹¹⁰⁰ The Arkansas Franchise Practices Act provides that

It shall be a violation of this subchapter for any franchisee to transfer, assign, or sell a franchise or interest therein to another person unless the franchisee first notifies the franchisor of that intention by written notice, setting forth in the notice of intent the prospective transferee's name, address, statement of financial qualification, and business experience during the previous five years.

ARK. CODE ANN. § 4-72-205(b)(1) (2008). Similarly, the Iowa Code provides that

A franchisee shall give the franchisor no less than sixty days' written notice of a transfer which is subject to the provisions of this section, and on request from the franchisor shall provide in writing

Vehicle Dealers Board claiming that Chrysler neither approved nor refused the purchase transaction within thirty days of receipt of the transfer notice as required under the applicable regulation.¹¹⁰¹ The Court of Common Pleas held that Chrysler had not violated the thirty-day notice requirement, because the period did not start until Chrysler received all the information it asked Bowshier to submit. In the court's estimation, that arrangement permitted franchisors time to require any information needed to decide on transfer processes.¹¹⁰² The appellate court reversed, reasoning that the thirty-day period starts when the franchisor receives written notice informing about the transfer.¹¹⁰³

Finally, some states allow transfer to the franchisee's heirs on condition that the heirs satisfy the qualifications required of a franchise purchaser. Otherwise, they have the right to transfer the franchise to a third party who meets the requirements.¹¹⁰⁴

the ownership interests of all persons holding or claiming an equitable or beneficial interest in the franchise subsequent to the transfer or the franchisee, as appropriate.

IOWA CODE § 523H.5.

¹¹⁰¹ Chrysler Corp. v. Bowshier, No. 01AP-921, 2002 Ohio 1443, 2002 Ohio App. LEXIS 1425, at *1 (Mar. 28, 2002).

¹¹⁰² *Id.* at *3.

¹¹⁰³ *Id.* at *1-3.

¹¹⁰⁴ Examples include Arkansas, California, Indiana, Nebraska, New Jersey, and others. Franchise Investment Law in California provides that:

No franchisor shall deny the surviving spouse, heirs, or estate of a deceased franchisee or the majority shareholder of the franchisee the opportunity to participate in the ownership of the franchise under a valid franchise agreement for a reasonable time after the death of the franchisee or majority shareholder of the franchisee. During that time the surviving spouse, heirs, or estate of the deceased shall either satisfy all of the then current qualifications for a purchaser of a franchise or sell, transfer, or assign the franchise to a person who satisfies the franchisor's then current standards for new franchisees. The rights granted pursuant to this section shall be granted subject to the surviving spouse, heirs or estate of the deceased maintaining all standards and obligations of the franchise.

CAL. BUS. & PROF. CODE § 20027(a) (2012). Similarly, Indiana's Franchise Act provides that:

It is unlawful for any franchisor who has entered into any franchise agreement with a franchisee who is either a resident of Indiana or a nonresident operating a franchise in Indiana to engage in

The Chinese New Regulations give the franchisee the right to transfer his franchise with the franchisor's consent.¹¹⁰⁵ The Malaysian Franchise Act does not deal with transfer issues.

The proposed Egyptian franchising law should avoid the silence of the Malaysian law on the issue of transfer. It is also recommended to combine the rules provided by the Chinese and U.S. law in this respect. Thus, it should require the franchisor's consent to transfer a franchise agreement because the franchisor is not obliged to accept a contracting party he did not choose. In the same context, the law may also require a franchisee to grant the franchisor the right of first refusal before offering transfer of the franchise to a third party.

2.8.5 Termination

Termination is one of the most important issues that may arise with respect to franchise agreements because termination ends the franchising parties' relationship and all the rights and obligations attached. Hence, franchising laws have strict rules regarding termination in order to protect both contracting parties, particularly franchisees, against abusive termination and to reduce the amount of disputes and losses arising out of termination.

In the United States, franchisors are allowed to terminate the franchise agreement if they have good cause. The definition of good cause varies among the states. Some states define good cause as the franchisee's failure to comply with the franchisor's requirements.¹¹⁰⁶ Other states

any of the following acts and practices in relation to the agreement: . . . (3) Denying the surviving spouse, heirs, or estate of a deceased franchisee the opportunity to participate in the ownership of the franchise under a valid franchise agreement for a reasonable time after the death of the franchisee, provided that the surviving spouse, heirs, or estate maintains all standards and obligations of the franchise.

IND. CODE § 23-2-2.7-2 (2012).

¹¹⁰⁵ Chinese New Regulations, *supra* note 237, at art. 18; *see also* SPENCER, *supra* note 41, at 185.

¹¹⁰⁶ Minnesota Franchise Act provides that:

define good cause to include a franchisee's failure to satisfy non-discrimination requirements in the franchise agreement, failure to act in good faith, and voluntary acts impairing execution of the franchise agreement.¹¹⁰⁷ In *Betsy-Len Motor Hotel Corp. v. Holiday Inn, Inc.*, the Virginia Supreme Court concluded that, although a franchise agreement cannot be terminated without "reasonable cause," the Virginia statute does not necessitate renewing a franchise agreement once it terminates.¹¹⁰⁸ Some states, such as Mississippi, do not have a good cause rule for termination.¹¹⁰⁹

For example, in *FMS, Inc. v. Volvo Construction. Equipment North America, Inc.*, FMS

No person may terminate or cancel a franchise except for good cause. "Good cause" means failure by the franchisee to substantially comply with the material and reasonable franchise requirements imposed by the franchisor including, but not limited to:

- (1) the bankruptcy or insolvency of the franchisee;
- (2) assignment for the benefit of creditors or similar disposition of the assets of the franchise business;
- (3) voluntary abandonment of the franchise business;
- (4) conviction or a plea of guilty or no contest to a charge of violating any law relating to the franchise business; or
- (5) any act by or conduct of the franchisee which materially impairs the good will associated with the franchisor's trademark, trade name, service mark, logotype or other commercial symbol.

MINN. STAT. § 80C.14 (2012). Nebraska Franchise Act provides that "[i]t shall be a violation of sections 87-401 to 87-410 for a franchisor to terminate, cancel or fail to renew a franchise without good cause." NEB. REV. STAT. § 87-404 (2012). The New Jersey Franchise Act provides that:

It shall be a violation of this act for a franchisor to terminate, cancel or fail to renew a franchise without good cause. For the purposes of this act, good cause for terminating, canceling, or failing to renew a franchise shall be limited to failure by the franchisee to substantially comply with those requirements imposed upon him by the franchise.

N.J. STAT. ANN. § 56:10-5 (2012).

¹¹⁰⁷ ARK. CODE ANN. § 4-72-202(7) (2008).

¹¹⁰⁸ *Betsy-Len Motor Hotel Corp. v. Holiday Inns, Inc.*, 385 S.E.2d 559 (Va. 1989); *see also* Tractenberg, Calihan, & Luciano, *supra* note 1073, at 199. Additionally, the Virginia Retail Franchise Act provides that "[i]t shall be unlawful for a franchisor to cancel a franchise without reasonable cause or to use undue influence to induce a franchisee to surrender any right given to him by any provision contained in the franchise." VA. CODE § 13.1-564. (2012).

¹¹⁰⁹ MISS. CODE ANN. § 75-24-53 (2012).

and Samsung Construction Equipment America Corporation entered into a dealer agreement under which FMS was authorized to sell Samsung's equipment.¹¹¹⁰ Samsung, however, sold its entire business to Volvo which in turn undertook Samsung's contractual obligations to its dealers, including FMS.¹¹¹¹ Volvo, however, was allowed to manufacture and sell equipment under the Samsung name only for a period of three years and then would be required to market the equipment under its own name. Volvo then terminated its contractual relationships with most of the Samsung dealers, including FMS. Post-termination FMS brought suit against Volvo claiming termination without good cause.¹¹¹² Volvo argued that rebranded equipment under the Volvo name constituted a discontinuation of the franchise goods which in turn constituted good cause to terminate the dealer agreement with FMS under the applicable Maine law.¹¹¹³ The Seventh Circuit reversed the decision of the district court deciding that Volvo was entitled to judgment in its favor as it had a good cause to terminate the dealer agreement.¹¹¹⁴

In its explanation, the appellate court cited the provision on good cause in the Maine law, which provides: "[t]here is good cause when the manufacturer discontinues production or distribution of the franchise goods."¹¹¹⁵ The court explained that Volvo was required by the Maine law to continue to supply goods to FMS as long as it sold the equipment under the Samsung name.¹¹¹⁶ When Volvo started selling the equipment under its own name, though, that

¹¹¹⁰ FSM, Inc., v. Volvo Constr. Equip. N. Am., Inc., 557 F.3d 760 (7th Cir. 2009).

¹¹¹¹ Id.

¹¹¹² Id.

¹¹¹³ Id. At 762.

¹¹¹⁴ Id. At 759.

¹¹¹⁵ Id. At 765, Citing ME. REV. STAT. ANN. tit. 10, § 1363(3)(C), (3)(C)(4).

¹¹¹⁶ Id.

would be considered a discontinuation of the goods provided for in the dealer agreement and would constitute good cause to terminate the agreement with FMS.¹¹¹⁷

Examples of good cause include, but are not limited to: franchisees underreporting sales to franchisors, failing to report profits to franchisors, submission of false information on profits, and failure to pay royalties or advertisement fees.¹¹¹⁸ Market withdrawal can also be considered good cause. Several cases are now pending in jurisdictions that do not specifically authorize market withdrawal as grounds for termination and non-renewal.¹¹¹⁹ In *Harter Equipment, Inc. v. Volvo Construction Equipment North America, Inc.*, the U.S. District Court for the District of New Jersey refused to grant the franchisor's motion for summary judgment based on total market withdrawal because its motivation for the withdrawal remained a factual issue.¹¹²⁰ The district court reasoned that if the market withdrawal was not motivated by economic necessity, then the applicable standard of good cause had not been met.¹¹²¹

In addition to good cause, many states explicitly provide for good faith as a requirement to terminate a franchise agreement.¹¹²² Moreover, some states require the franchisor to give the

¹¹¹⁷ *Id.*

¹¹¹⁸ *Crothwait Equip. Co. v. John Deere Co.*, 992 F.2d 525 (5th Cir. 1993); *Two Men & a Truck/Int'l Inc. v. Two Men & a Truck/Kalamazoo, Inc.*, 494 F. Supp. 500 (W.D. Mich 1996); *Dunkin Donuts of Am., Inc. v. Middletown Donut Corp.*, 495 A. 2d 66 (N.J. 1985).

¹¹¹⁹ *Tractenberg, Calihan, & Luciano, supra* note 1073, at 202.

¹¹²⁰ *See generally Harter Equip., Inc. v. Volvo Constr. Equip. N. Am.*, Civ. No. 3-01-CV-04040, 2004 U.S. Dist. LEXIS 31142 (D.N.J. Aug. 4, 2004).

¹¹²¹ *Id.*

¹¹²² Examples include California, Connecticut, Delaware, Hawaii, Indiana, Michigan, and Minnesota. *See* ARK. STAT. ANN. § 4-72-202(8) (2008); CAL. BUS. & PROF. CODE § 20025 (2012); DEL. CODE ANN., tit. 6 § 2552 (2011); HAW. REV. STAT. § 482E-6 (1) (2011); MICH. COMP. L. § 445.1527(e) (2006); MINN. STAT. § 80C.14(4) (2012).

franchisee notice of its intent to terminate the franchise agreement. The notice duration varies among the states, but is usually thirty, sixty, or ninety days.¹¹²³

Finally, many relationship laws grant franchisees time to cure any mistakes or deficiencies that may give franchisors the legal right to terminate or refuse to renew the agreement.¹¹²⁴ This period of time varies depending on the reason for the termination.¹¹²⁵ While the franchisor should try to give the franchisee a reasonable period of time, it is unreasonable to ask the franchisor to give the franchisee time in instances of insolvency, criminal actions, or repeated bad acts by the franchisee.¹¹²⁶

In *LJL Transportation, Inc. v. Pilot Air Freight Corp.*, the issue before the Pennsylvania Supreme Court was whether the franchisee's default, which was a breach of the agreement, gave the franchisor the right to terminate the agreement immediately despite its explicit provision that the breaching party could attempt to cure the default before the agreement would be terminated.¹¹²⁷ The court answered the question in the affirmative because Pilot Air Freight Corp., the franchisor, knew that LJL Transportation, the franchisee, had intentionally diverted

¹¹²³ The Illinois Franchise Disclosure Act of 1987 provides that: "after being given notice thereof and a reasonable opportunity to cure such default, which in no event need be more than 30 days." 815 ILL. COMP. STAT. § 705/19(a) (2012). Minnesota Franchise Law provides that "[n]o person may terminate or cancel a franchise unless: (i) that person has given written notice setting forth all the reasons for the termination or cancellation at least 90 days in advance of termination or cancellation." MINN. STAT. § 80C.14. New Jersey Franchise Act provides that:

[i]t shall be a violation of this act for any franchisor directly or indirectly through any officer, agent, or employee to terminate, cancel, or fail to renew a franchise without having first given written notice setting forth all the reasons for such termination, cancellation, or intent not to renew to the franchisee at least 60 days in advance of such termination, cancellation, or failure to renew.

N.J. STAT. § 56:10-5 (2012).

¹¹²⁴ FOX & SCHAEFFER, *supra* note 678, § 3.03.

¹¹²⁵ ARK. STAT. ANN. § 4-72-204(d); CAL. BUS. & PROF. CODE § 20020; HAW. REV. STAT. § 482E-6(2)(H); MICH. COMP. LAWS § 445.1527(c); MINN. STAT. § 80C.14(3); WASH. REV. CODE § 19.100.180(2)(j) (2012); WIS. STAT. § 135.04 (2011).

¹¹²⁶ FOX & SCHAEFFER, *supra* note 678, § 3.03.

¹¹²⁷ *LJL Transp. Inc. v. Pilot Air Freight Corp.*, 962 A.2d 639, 648 (Pa. 2009).

shipments to another business to avoid reporting revenues and paying royalties to Pilot.¹¹²⁸ Pilot terminated the franchise agreement without giving the franchisee any chance to cure.¹¹²⁹ The court held that LJJ's mistake was a fatal breach of the franchise agreement that gave the franchisor the right of immediate termination of the franchise agreement without providing notice or any reasonable period of time for the franchisee to fix his mistake.¹¹³⁰

The termination rules in the Chinese New Regulations favor franchisees. For instance, Article 12 allows the franchisee to terminate a franchise agreement, by his own will, following a specific period after the date of signing the agreement.¹¹³¹ Also, Article 23 gives the franchisee the right to terminate the franchise agreement if the franchisor hides any information or gives any wrong information that he is required to disclose under the Chinese New Regulations.¹¹³²

In Malaysia, the Franchise Act allows termination for good cause. According to the Act, good cause exists when the franchisee breaches any term of the agreement and fails to cure within fourteen days of notification in writing by the franchisor.¹¹³³ Other examples of good cause include franchisees' assignment of the franchise without franchisors' agreement, intentional impairment of business operations, committing a criminal offence that affects the goodwill of the business, or frequent failure to abide by franchise agreement provisions.¹¹³⁴

¹¹²⁸ *Id.* at 644.

¹¹²⁹ *Id.*

¹¹³⁰ *Id.* at 648.

¹¹³¹ Article 12 of the Chinese New Regulations provides that "[i]t shall be stipulated in the franchise contract concluded between the franchisor and the franchisee that the franchisee may unilaterally terminate the contract within a certain term after the franchise contract has been signed." *See* Chinese New Regulations, *supra* note 237, at art. 12.

¹¹³² INTERNATIONAL FRANCHISING, *supra* note 165, at 98; *see also* Chinese New Regulations, *supra* note 237, at art. 23.

¹¹³³ Chinese New Regulations, *supra* note 237, at art. 31(1)-(2).

¹¹³⁴ *Id.* at art. 31(3); *see also* SPENCER, *supra* note 41, at 202.

Termination rules under Egyptian law differ according to the nature of the contractual relationship. The proposed Egyptian franchising law should combine the different rules provided by the U.S., Chinese, and Malaysian schemes to provide a comprehensive set of termination rules. Thus, the proposed Egyptian franchising law should provide franchisors a right of termination for good cause and should explain precisely what good cause entails. It should also give example situations for termination like the U.S. and Malaysian laws. Moreover, subject to appropriate exceptions such as in case of insolvency, criminal actions, or repeated bad acts by the franchisee the Egyptian law should grant franchisees time to cure any mistakes or deficiencies that may otherwise give the franchisor the legal right to terminate or refuse to renew the agreement. Finally, to create equilibrium between franchising parties' rights of termination, the Egyptian law should follow the Chinese law and allow franchisees the right to terminate the franchise agreement in certain cases such as when franchisors intentional fail to meet disclosure requirements. A reasonable period for termination notice should also be required in all cases, from the party seeking termination.

2.9 Franchise Brokers

The issue of franchise brokers is not usually discussed in franchise statutes. The U.S. law has very few rules on this issue while the Chinese law does not discuss it at all. The only law that provides an in depth discussion of brokerage in franchising is the Malaysian law.

In the United States, very few states regulate the issue of brokers. For instance, the Hawaii Franchise Investment Law defines a franchise broker as a person who participates in franchise sales whether directly or indirectly.¹¹³⁵ The Illinois Franchise Disclosure Act provides

¹¹³⁵ HAW. REV. STAT. § 482E-2 (2011).

that the term franchise broker includes any person who represents a franchisor whether through making offers or selling a franchise, as long as he is not the franchisor or an affiliate, officer, director, or employee of the franchisor.¹¹³⁶ Although the New Rule does not specifically define the word broker, it defines the term “franchise seller” to include any person who offers, sells, or arranges the sale of a franchise, whether this person is the franchisor’s employee, representative, agent, sub-franchisor, or third-party broker as long as he is involved in the process of the sale of the franchise.¹¹³⁷ The New Rule requires disclosure of the name, business address, and telephone number of franchise sellers, including brokers.¹¹³⁸ It also prohibits franchise sellers, including brokers, from making statements that are not in compliance with the disclosed information.¹¹³⁹

What makes the Malaysian Franchise Act unique is that it has a separate section on franchise brokers, defining them as franchisors’ representatives who sell the franchised business on the franchisor’s behalf.¹¹⁴⁰ A broker is not an employee, director, or officer of any of the franchising parties.¹¹⁴¹ The Act requires franchise brokers to register themselves with the Registrar for one year unless otherwise provided by the Registrar.¹¹⁴² To be registered, franchise brokers are required to meet the conditions provided by the Malaysian Franchise Broker Regulations as well as any other conditions imposed by the Registrar.¹¹⁴³ Individual franchise

¹¹³⁶ 815 ILL. COMP. STAT. § 705/3 (2012).

¹¹³⁷ 16 C.F.R. § 436.1(j). Unlike the New Rule, brokers were jointly responsible with franchisors, under the Old Rule, to prepare disclosure documents. *See* THE FTC FRANCHISE RULE, *supra* note 642, at 19.

¹¹³⁸ 16 C.F.R. § 436.5(w).

¹¹³⁹ 16 C.F.R. § 436.9.

¹¹⁴⁰ Malaysian Franchise Act, *supra* note 673, at art. 4.

¹¹⁴¹ *Id.*

¹¹⁴² *Id.* at art. 14.

¹¹⁴³ *Id.*

brokers must be Malaysian, with at least three years' experience in franchise management.¹¹⁴⁴ Corporate franchise brokers are required to be registered under the Malaysian Companies Act of 1965 and to have experienced employees satisfying the same conditions required of individual brokers.¹¹⁴⁵ Finally, franchise brokers are subject to the same rules of confidentiality governing franchisees.¹¹⁴⁶

The Egyptian Commercial Law has a separate section on brokerage in general. The general rules on brokerage may apply to franchising brokers. The proposed Egyptian franchising law, however, should define a franchising broker and regulate its work. This is particularly important because the general rules on brokerage in Egyptian Commercial Law do not deal with disclosure issues or confidentiality obligations of a broker. Hence, the proposed Egyptian franchising law should follow the U.S. definition of a franchising broker because it not only provides a general definition like the Malaysian law, but also excludes other actors from the definition of a franchise broker such as affiliates, officers, directors, and employees. The Egyptian law should also combine the rules governing brokers' issues found in the U.S. and Malaysian laws such as requiring disclosure of brokers' information, prohibiting brokers from making statements that are not in compliance with disclosed information, requiring brokers to register themselves with the Registrar, and providing rules of confidentiality. The Egyptian law should not include a citizenship or residency requirement, as is found in the Malaysian law, as there is no compelling rationale for this requirement. The condition of experience, though, is logical because franchising transactions are complicated and require a certain degree of knowledge and experience to avoid confusion and disputes.

¹¹⁴⁴ Franchise Qualifications of a Franchise Broker Regulations 1999, *supra* note 675, at art. 2(1).

¹¹⁴⁵ *Id.* at art. 2(2).

¹¹⁴⁶ *See infra* Ch. III Sec. 2 9 (discussing Franchise Brokers)

2.10 Prohibitions Against Discrimination

Prohibitions against discrimination guarantee equal treatment of different franchisees by their franchisor. Prohibitions against discrimination are particularly important in master franchise agreements where sub-franchisees are committed through franchising agreements with common provisions to run the business of the master franchisor. Prohibitions against discrimination should consider the different circumstances surrounding each franchising transaction. For example, differences between franchisees in terms of the time the transaction was concluded or the training needed may lead to acceptable discrimination in franchise agreement provisions.

In the United States, the prohibition against discrimination of franchisees is governed at the federal level by Title 42, Section 1981 of the United States Code which prohibits discrimination among franchisees on the basis of race.¹¹⁴⁷ The burden of proof of discrimination is always on the franchisee who must show a prima facie case of discrimination.¹¹⁴⁸ A franchisee can prove discrimination by showing that he qualifies for the franchise, that he was denied the right to conclude the franchise agreement, and that another franchisee, outside the protected class, took his chance.¹¹⁴⁹

In *International House of Pancakes v. Albarghouthi*, the plaintiff, International House of Pancakes, served its franchisee, Albarghouthi, with a termination notice and sued him, claiming that he had misused its trademark and committed unfair competitive practices.¹¹⁵⁰ In response,

¹¹⁴⁷ 42 U.S.C. § 1981.

¹¹⁴⁸ Carla Wong McMillian & Kelly J. Baker, *Discrimination Claims and Diversity Initiatives: What's a Franchisor to Do?*, 28 FRANCHISE L.J. 71, 73 (2008).

¹¹⁴⁹ *Id.*

¹¹⁵⁰ *Int'l House of Pancakes v. Albarghouthi*, No. 04-CV-02264-MSK-MEH, 2007 U.S. Dist. LEXIS 65934, at *8 (D. Colo. Sept. 6, 2007).

the franchisee complained of discrimination against him by the franchisor based on his Arab-American origin.¹¹⁵¹ The U.S. District Court for Colorado rejected the franchisee's claim because the circumstances were different and a single instance of differential treatment is insufficient to support a discrimination claim.¹¹⁵²

Similarly, in *Pointer v. Building Stars Advantage*, the plaintiff and would-be franchisee's application for a franchise was denied because of a number of gaps in his employment history.¹¹⁵³ There was no evidence of race discrimination against the African-American plaintiff and accordingly he failed to establish a prima facie case of discrimination, particularly because a white prospective franchisee's application was denied for the same reason.¹¹⁵⁴

Once a claimant establishes a prima facie case of discrimination, the burden of proof shifts to the defendant to show non-discriminatory evidence sufficient to defeat the claimant's allegations.¹¹⁵⁵ In *Elkhatib v. Dunkin' Donuts, Inc.*, the franchisee sued Dunkin' Donuts for discrimination when it refused to renew the franchise agreement because the franchisee failed to carry the full breakfast sandwich product line.¹¹⁵⁶ The franchisee responded that he had not sold sandwiches because the Arab market did not support consumption of pork for religious and traditional reasons and argued that the real reason for non-renewal was discrimination, particularly because he had tried to relocate to a more advantageous location.¹¹⁵⁷ The district

¹¹⁵¹ *Id.*

¹¹⁵² *Id.* at *40-41.

¹¹⁵³ *Pointer v. Bldg. Stars Advantage*, No. 4:03-CV-01237-HEA, 2004 U.S. Dist. LEXIS 25053 at *7-8 (8th Cir. Dec. 14, 2004).

¹¹⁵⁴ *Id.*

¹¹⁵⁵ McMillian & Baker, *supra* note 1148, at 73.

¹¹⁵⁶ *Elkhatib v. Dunkin' Donuts, Inc.*, 493 F.3d 827, 829 (7th Cir. 2007).

¹¹⁵⁷ *Id.*

court granted the franchisor's motion for summary judgment, holding that the claim was one of religious, rather than racial, discrimination and thus was not covered by Section 1981.¹¹⁵⁸

The Seventh Circuit explained that in granting the motion for summary judgment, the district court assumed that dealing in pork was related to religion rather than to race.¹¹⁵⁹ This assumption lead the court to exclude the application of Section 1981 since it only covers racial, and not religious, discrimination.¹¹⁶⁰ The appellate court then explained that Elkhatib could prove a *prima facie* case of discrimination, and accordingly shift the burden of proof to Dunkin' Donuts to demonstrate a non-discriminatory reason for its actions, by showing evidence that: “(1) he belongs to a protected class; (2) he met Dunkin Donuts' legitimate expectations with regard to the franchise agreement; (3) he suffered an adverse action; and (4) similarly-situated non-protected individuals were treated more favorably.”¹¹⁶¹ The court concluded that since Elkhatib belonged to a protected class and had suffered an adverse action, that the only two arguments in question were whether Elkhatib failed to meet Dunkin Donuts expectations since he could not serve the full line of products and whether other franchisees were treated more favorably.¹¹⁶²

In reply to the first argument, the Court illustrated that Dunkin' Donuts permitted three other franchisees in the area not to carry any breakfast sandwiches at all when repositioning the stores or adjusting their displays, while Elkhatib had carried the breakfast sandwiches except for

¹¹⁵⁸ *Id.*

¹¹⁵⁹ *Id.* At 829.

¹¹⁶⁰ *Id.*

¹¹⁶¹ *Id.*

¹¹⁶² *Id.*

the meat products.¹¹⁶³ Additionally, despite his not having carried pork products for twenty years, Elkhatib's stores received positive reviews.¹¹⁶⁴ In its discussion of the second argument, the court explained that though none of the three franchises in the Chicago area who refused to carry the full breakfast sandwiches were owned by Arabs, they were still similarly-situated to Elhatib.¹¹⁶⁵ Thus, the Court concluded that the other three franchisees and Elkhatib were identical; all of them failed to carry part or all of the breakfast products, and that since the franchise agreement's terms did not indicate any exceptions, Dunkin' Donuts had discriminated against Elkhatibe when it treated him differently from the other franchisees.¹¹⁶⁶ Accordingly, the Seventh Circuit reversed the district court decision.¹¹⁶⁷

Additionally, though it appears that Section 1981 gives standing only to natural persons, courts have generally held that in certain circumstances corporations, including franchisee corporations, can acquire a racial identity for purposes of Section 1981. In *Calderon v. Southwestern Bell Mobile Systems LLC*, the district court permitted the franchisee corporation, whose president, owner, and majority stockholder were Hispanic, to sue under Section 1981 when all of the alleged acts of discrimination related to the franchisee corporation's business operations.¹¹⁶⁸ These allegations included failure to uphold contractual obligations to minority franchisees, refusal to enter into contracts with minority franchisees, and refusal to rent or sell

¹¹⁶³ *Id.* At 832

¹¹⁶⁴ *Id.*

¹¹⁶⁵ *Id.* At 831

¹¹⁶⁶ *Id.* At 831

¹¹⁶⁷ *Id.* at 832.

¹¹⁶⁸ See generally *Calderon v. Sw. Bell Mobile Sys. LLC*, No. 02 C 9134, 2004 U.S. Dist. LEXIS 25356, at *7-11 (N.D. Ill. Dec. 13, 2004).

certain cellular telephones to minority franchisees.¹¹⁶⁹ The court further held that the individual owner of the franchisee corporation did not have standing to sue because the alleged discrimination was directed at the franchisee corporation rather than the individual.¹¹⁷⁰

Unlike Section 1981, which prohibits discrimination on the basis of race during the entire term of the franchise relationship, state laws prohibit discrimination on the basis of religion, color, and other factors, but only at specific times in the franchisor-franchisee relationship.¹¹⁷¹ For instance, the Washington Franchise Investment Protection Act prohibits discrimination among franchisees with respect to goods, services, equipment, rentals, advertising services, and royalties paid unless the discrimination is reasonable, not arbitrary, and based on differences in the length of the relationships.¹¹⁷² Also, the Michigan Franchise Investment Law invalidates any provision in a franchise agreement that allows a franchisor to deny renewal on terms available to other franchisees of the same class or type or under similar circumstances.¹¹⁷³ Similarly, the Indiana Franchise Act explicitly prohibits unfair discrimination among franchisees¹¹⁷⁴ and the Illinois Franchise Disclosure Act contains a section on discrimination against franchisees.¹¹⁷⁵ Additionally, Iowa's franchise relationship law prohibits a franchisor from discriminating against a proposed transferee of a franchise on the basis of race, color, national origin, religion, sex, or disability.¹¹⁷⁶

¹¹⁶⁹ *Id.*

¹¹⁷⁰ *Id.*

¹¹⁷¹ McMillian & Baker, *supra* note 1148, at 78.

¹¹⁷² WASH. REV. CODE § 19.100.180(2)(c) (2012).

¹¹⁷³ MICH. COMP. L. § 445.1527(e) (2006).

¹¹⁷⁴ IND. CODE § 23-2-2.7-2(5) (2012).

¹¹⁷⁵ 815 ILL. COMP. STAT. § 705/18 (2012).

¹¹⁷⁶ The Illinois Franchise Disclosure Act provides that:

The Chinese New Regulations do not address discrimination against franchisees, but the Malaysian Franchise Act regulates the franchisor's obligation not to discriminate against franchisees. As a general rule, Article 20 of the Malaysian Franchise Act prohibits franchisors from discriminating against franchisees regarding, for example, paid fees or royalties, supplied goods, services or equipment, and advertising services.¹¹⁷⁷ Discrimination is not prohibited, however, in certain cases identified in the Act.¹¹⁷⁸ Examples include discrimination related to differences in time of concluding franchise agreements and differences among franchisees' needs regarding capital, training, experience, or other qualifications.¹¹⁷⁹ Other permissible discrimination includes that related to governmental efforts to promote specific goods or

It shall be an unfair franchise practice and a violation of this Act for any franchisor to unreasonably and materially discriminate between franchisees operating a franchised business located in this State in the charges offered or made for franchise fees, royalties, goods, services, equipment, rentals or advertising services, if such discrimination will cause competitive harm to a franchisee who competes with a franchisee that received the benefit of the discrimination, unless and to the extent that any classification of or discrimination between franchisees is:

- (a) based on franchises granted at different times, and such discrimination is reasonably related to such differences in time;
- (b) related to one or more programs for making franchises available to persons with insufficient capital, training, business experience or education, or lacking other qualifications;
- (c) related to local or regional experimentation with or variations in product or service lines or business formats or designs;
- (d) related to efforts by one or more franchisees to cure deficiencies in the operation of franchise businesses or defaults in franchise agreements; or
- (e) based on other reasonable distinctions considering the purposes of this Act and is not arbitrary.

Id.

¹¹⁷⁷ Malaysian Franchise Act, *supra* note 673, at art. 20.

¹¹⁷⁸ *Id.* at art. 20 (a)-(b).

¹¹⁷⁹ *Id.* at art. 20 (c)-(d).

services, franchisees' needs to treat deficits or problems arising with business operations, and any other reasonable bases.¹¹⁸⁰

The proposed Egyptian franchising law should follow both the U.S. and Malaysian laws prohibiting discrimination among franchisees on bases such as color, religion, sex, or other similar reasons. It should also prohibit discrimination with respect to goods and equipment supplied, services provided such as training, royalties conveyed, and renewal or transfer terms. Additionally, the Malaysian Franchise Act has a unique rule that creates equilibrium between franchisors' and franchisees' interests by allowing discrimination in specific cases when capital needs, experience, or other requirements from franchisees are different. The Egyptian law should provide a list of situations where discrimination is acceptable and will not be deemed a breach of the law or against justice.

2.11 Advertisement

Advertisement provisions refer to announcements made by franchisors regarding their business to attract franchisees for the conclusion of franchise transactions. Regulating advertisements protects franchisees from false, misleading, or non-comprehensive advertisements made by franchisors.

In the United States, advertising is defined variously by the states but at the core, they all define advertising to be any method of communication whether through print, telephone, TV or radio broadcasting.¹¹⁸¹ Many states require franchisors to register their advertising materials within a specific period of time before using the advertisement. For instance, some state laws

¹¹⁸⁰ *Id.* at art. 20 (e).

¹¹⁸¹ MICH. COMP. L. § 445.1501 (2006); MINN. STAT. § 80C.01 (2012); N.D. CENT. CODE § 51-19-01 (2011); WASH. REV. CODE § 19.100.010 (2012).

prohibit any person from publishing any franchise offer unless a true advertisement is filed, otherwise the advertisement needs to be exempted.¹¹⁸² Some other state laws do not punish false advertisements published in good faith.¹¹⁸³ Many states explicitly prohibit including any false or misleading information in the advertisement and require that the advertisement consider any state standards and be consistent with disclosure documents.¹¹⁸⁴

¹¹⁸² N.D. CENT. CODE, § 51-19-01; WASH. REV. CODE § 19.100.010; CAL. CORP. CODE § 31156 (2012); MINN. STAT. § 80C.09.

¹¹⁸³ MICH. COMP. L. § 445.1524.

¹¹⁸⁴ The Michigan Franchise Investment Law, for example, provides that:

A person shall not publish an advertisement concerning the offer or sale of a franchise in this state if the advertisement contains a statement that is false or misleading or omits to make any statement necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

MICH. COMP. L. § 445.1525. Also, the Minnesota Franchise Act provides that:

No person shall publish or cause to be published in this state any advertisement concerning any franchise after the commissioner has found that the advertisement contains any statement that is false or misleading or omits to make any statement necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, and has so notified the person by written order. The order may be issued without prior notice or hearing. At any time after the issuance of the order, the person desiring to use the advertisement may in writing request a hearing on the order. Upon the receipt of such a written request, the matter shall be set for hearing to commence within 15 days after such receipt unless the person making the request consents to a later date. After the hearing, which shall be conducted in accordance with the provisions of chapter 14, the commissioner shall, by written order, either affirm, modify, or vacate the order.

MINN. STAT. § 80C.09. Similarly, the Franchise Investment Law in North Dakota provides that

No person may publish any advertisement concerning any franchise in this state after the commissioner finds that the advertisement contains any statement that is false or misleading or omits to make any statement necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading and so notifies the person in writing. Such notification may be given summarily without notice of hearing. At any time after the issuance of a notification under this subsection, the person desiring to use the advertisement may request in writing that the order be rescinded. Upon the receipt of such a written request, the matter must be set down for hearing to commence within fifteen business days after such receipt unless the person making the request consents to a later date. After such hearing, the commissioner shall determine whether to affirm and continue or to rescind such order.

N.D. CENT. CODE § 51-19-10.

In China, Article 17 of the Chinese New Regulations obliges franchisors to use the fees paid by franchisees for advertisement in the way agreed upon by the parties.¹¹⁸⁵ It requires franchisors to explain to franchisees, at a convenient time, the exact promotions and advertisements on which the fees will be spent.¹¹⁸⁶ Article 26 allows the commerce department to ask franchisors to cease any actions taken in violation of Article 17.¹¹⁸⁷ It also imposes a fine of 10,000 CNY to 50,000 CNY for violation.¹¹⁸⁸ Article 17 also prohibits franchisors from using fraudulent promotions.¹¹⁸⁹ Article 27 allows the commerce department to ask franchisors to cease any actions taken in violation of Article 17 and to impose a fine between 30,000 CNY and 300,000 CNY.¹¹⁹⁰

The Malaysian Franchise Act is silent on the issue of promotion, marketing, or advertisement except with regard to the promotion fund mentioned earlier.¹¹⁹¹ The Malaysian Franchise Act, however, provides an additional rule on advertisements that is related to registration.¹¹⁹² Franchisors wishing to advertise the selling or buying of franchises must submit a copy of this advertisement to the Registrar five days, or less if approved by the Registrar,

¹¹⁸⁵ Chinese New Regulations, *supra* note 237, at art. 17; *see also* SPENCER, *supra* note 41, at 185.

¹¹⁸⁶ Chinese New Regulations, *supra* note 237, at art. 17.

¹¹⁸⁷ *Id.* at art. 26.

¹¹⁸⁸ *Id.*

¹¹⁸⁹ *Id.* at art. 17.

¹¹⁹⁰ *Id.*

¹¹⁹¹ *See supra* Ch. III. 2.2.4 (discussing Fees).

¹¹⁹² INTERNATIONAL FRANCHISING, *supra* note 165, at 288.

before publishing, distributing, or using the advertisement.¹¹⁹³ The Act gives the Registrar the right to prevent the use of any false or misleading advertisements.¹¹⁹⁴

The proposed Egyptian franchising law should follow the Chinese or U.S. franchising laws and define advertisements to avoid any confusion in this regard. It is also recommended to prohibit false advertisements in order to provide more protection to franchisees. Finally, the proposed Egyptian franchising law should follow the Malaysian Act and require the registration of advertisements to guarantee greater protection to franchisees.

2.12 Settlement of Disputes

The importance of regulating the settlement of disputes in franchising laws arises in countries that have long and complicated litigation procedures that make recourse to arbitration more efficient. Also, some countries consider recourse to their courts a matter of public order and are therefore reluctant to accept arbitration or other alternative methods of settlement of disputes. Finally, some franchise agreement arbitration clauses are drafted in favor of big businesses.¹¹⁹⁵ In all of these situations and similar situations, statutory interference may be required to encourage efficient settlement of disputes.

In the United States, the main purpose of the Federal Arbitration Act (“FAA”) is to encourage parties to use arbitration instead of the courts.¹¹⁹⁶ The FAA provides that any doubt

¹¹⁹³ Malaysian Franchise Act, *supra* note 673, at art. 57.

¹¹⁹⁴ *Id.* at art. 57.

¹¹⁹⁵ *Id.*

¹¹⁹⁶ Kevin M. Kennedy, *Drafting an Enforceable Franchise Agreement Arbitration Clause*, 22 FRANCHISE L.J. 112, 112 (2002).

over arbitrability should be settled in favor of arbitration.¹¹⁹⁷ Hence, enforcing arbitration agreements may be easier and faster than enforcing judicial settlements.¹¹⁹⁸ Also, courts follow the FAA and enforce franchise agreement arbitration clauses, leaving very few chances for franchisees to avoid arbitration clauses.¹¹⁹⁹

Courts usually favor arbitration clauses in franchise agreements.¹²⁰⁰ In *Rossi Fine Jewelers, Inc. v. Gunderson*, the rectors or officers, or any current directors or officers of a parent or affiliate must have more than two years of experience in the same type of business; and (2) the parties must have a reasonable basis to anticipate that sales arising from the relationship will not eSouth Dakota Supreme Court affirmed the trial court's decision mandating arbitration.¹²⁰¹ In this case, the plaintiff franchisee claimed that the franchisor gave up its right to arbitration since it delayed four months in asking to enforce the arbitration clause, not all defendants were subject to the arbitration clause, and not all claims were arbitrable.¹²⁰² The court decided a delay of four months did not waive the arbitration clause and that the clause extended to all defendants in the case.¹²⁰³

Conversely, *Stevens v. Tes Franchising* produced a different result.¹²⁰⁴ The U.S. District Court for Connecticut denied the defendant's claim to compel arbitration.¹²⁰⁵ The franchise

¹¹⁹⁷ *Id.*

¹¹⁹⁸ *Id.*

¹¹⁹⁹ *Id.*

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agreement in that case provided that disputes related to the agreement would be settled by arbitration where other parts of the agreement provided that the parties could submit their disputes to state courts.¹²⁰⁶ The franchisee claimed that the agreement was vague and the district court agreed finding that, although the FAA applied, the FAA itself refers to state law principles governing the agreement and one of those principles required that any vague term in an agreement be interpreted against the drafter, who was the franchisor.¹²⁰⁷

Arbitration clauses in franchise agreements, like most contractual agreements, also usually defer to institutions to administer arbitration;¹²⁰⁸ nearly 97% of arbitration clauses in U.S. franchise agreements provide for the American Arbitration Association to administer arbitration.¹²⁰⁹ There is no readily apparent standard arbitration clause because arbitration clauses need to consider the possibility of being enforced under an applicable law.¹²¹⁰ Also, an arbitration clause must take into account the particular needs of the franchise system.¹²¹¹ Furthermore, arbitration is very dynamic, requiring franchisors to update their arbitration agreements.¹²¹²

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MICH. COMP. L. § 445.1525. Also, the Minnesota Franchise Act p

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The Chinese New Regulations are silent with regard to the settlement of disputes arising out of franchise agreements. Generally speaking, litigation entails many challenges for disputing parties, particularly foreign investors. Examples include costs, time, evidentiary difficulties, pre-emptive measures, enforcement difficulties, and widespread corruption.¹²¹³ As a civil law country, the discretionary power of the Chinese courts to interpret the laws is very limited as that power is restricted to the National People's Congress and its Standing Committee.¹²¹⁴ Accordingly, arbitration became popular in China as it is a signatory to the New York Convention of 1958 which makes it easier to recognize and enforces foreign arbitral awards.¹²¹⁵ Difficulties, however, still arise with respect to the enforcement of both local arbitral awards and judicial decisions for many reasons, the most important of which is the “corruption culture.”¹²¹⁶

The Malaysian Franchise Act provides a general rule that confirms the franchising parties’ right to conclude any settlement agreement when required.¹²¹⁷ It also confirms that none of its rules prevent any civil actions or arbitration procedures.¹²¹⁸

In Egypt and the entire Middle East, arbitration as an alternative method of dispute resolution is preferable by the contracting parties because it guarantees confidentiality and supports the special needs of commercial reputations and trade secrets particularly in regard to agreements related to transfer of technology or know-how. The importance of regulating the

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settlement of disputes in general and arbitration in particular arises in Egypt and the whole Middle East because the judiciaries are accused of being influenced by the executive branches of government.¹²¹⁹

In Egypt, the Arbitration Law has three primary functions: 1) it distinguishes between national and international arbitration as the law applies to any arbitration held in Egypt;¹²²⁰ 2) it gives the parties to an arbitration absolute freedom to choose the procedural and substantive law applicable to the arbitration;¹²²¹ 3) it applies to both domestic and international arbitration and does not take a rigid position with regard to the place of arbitration leaving the parties free to agree to hold the arbitration in Egypt or abroad.¹²²² Generally, the Egyptian Arbitration Law allows contracting parties to freely choose the procedural and substantive law applicable to the arbitration if they decide to submit their disputes to arbitration. This rule has some exceptions. For example, arbitration in a technology transfer agreement that is deemed to be a matter of public order is accordingly required to be subject to Egyptian substantive and procedural arbitration laws and any agreement to arbitrate under a different foreign law is null and void.¹²²³ Some critics argue that these protective technology transfer rules discourage foreign investors

st a hearing on the order. Upon the receipt of such a written request, the matter shall be set for hearing to commence within 15 days after such receipt unless the person making the request consents to a later date. After the hearing, which shall be conducted in accordance with the provisions of chapter 14, the commissioner shall, by written order, either affirm, modify, or vacate the order.

MINN. STAT. § 80C.09. Similarly, the Franchise Investment Law in North Dakota provides that

No person may publish any advertisement concerning any franchise in this state after the commissioner finds that the advertisement contains any statement that is false or misleading or omits to make any statement nec

essary in order to make the statements made, in light of the circumstances under which they

were made, not misleading and so

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from transferring technology to Egypt.¹²²⁴ The Egyptian legislature may prefer to adopt a similar rule when it comes to franchise agreements because, similar to technology transfer agreements, they include the transfer of know-how and may be accused of favoring a specific party, whether the licensor in a transfer of technology agreement or the franchisor in a franchising agreement. It is strongly recommended, however, that the proposed Egyptian franchising law avoid this rule because it reduces contractual parties' desire to resort to arbitration if they do not have the freedom to choose the applicable arbitration laws.

2.13 Rights and Obligations of the Parties

None of the three legal systems provide comprehensive lists of the rights and obligations of franchising parties. The reason may be the difficulty of restricting rights and obligations arising out of franchising transactions as they vary according to the nature and requirements of each transaction. Some laws, however, provide more examples of rights and obligations than others. The Chinese New Regulations, for instance, provide for a franchisor's obligation to provide training, guidance on operation of the franchised business, and technical support to franchisees.¹²²⁵ It also provides for franchisees' obligations of confidentiality. Moreover, China has a general obligation that the franchised goods and services satisfy all legal requirements.¹²²⁶ In the same context, the Malaysian Franchise Act provides for franchisors' obligations to assist

rily without notice of hearing. At any time after the issuance of a notification under this subsection, the person desiring to use the advertisement

t may request in writing that the order be rescinded. Upon the receipt of such a written request

, the matter must be set down for hearing to commence within fifteen business days after such receipt unless the person making the request consents to a later date. After such hearing, the commissioner shall determine whether to affirm and continue or to rescind such

franchisees in operating the franchised business, to supply required materials, and to provide any services.¹²²⁷

It may be difficult for the Egyptian law to outline all rights and obligations arising out of a franchising agreement. Nevertheless, the Egyptian law should provide for the minimum rights and obligations that are most common in franchise agreements such as confidentiality, non-competition, providing training by the franchisor, and the like.

3. Disclosure and Registration Law in the United States, China, and Malaysia

3.1 Disclosure

Disclosure and registration are the most important issues arising in franchising to the extent that in some countries franchise laws are essentially disclosure laws. Disclosure laws require franchisors to disclose to potential franchisees specific, material information that would highly affect the franchisee's decision whether to invest.¹²²⁸ Registration rules require registering disclosure documents with the competent governmental agency.¹²²⁹

order.

N.D. CENT. CODE § 51-19-10.

¹²²⁷ Chinese New Regulations, *supra* note 237, at art. 17; *see also* SPENCER, *supra* note 41, at 185.

¹²²⁸ Chinese New Regulations, *supra* note 237, at art. 17.

¹²²⁸ *Id.* at art. 26.

¹²²⁸ *Id.*

¹²²⁸ *Id.* at art. 17.

¹²²⁸ *Id.*

¹²²⁸ *See supra* Ch. III. 2.2.4 (discussing Fees).

Disclosure and registration requirements give franchisees access to necessary information about the franchised business, the franchisor, and the potential franchise agreement. Having access to such information assists potential franchisees in reaching an informed investment decision and helps the franchisor to be more confident that the franchisee meets his requirements as he concludes the transaction knowing that all the necessary information has been disclosed by the franchisor.¹²³⁰ Moreover, disclosure and registration reduce the chances for fraud, misunderstanding between the contracting parties, and false expectations based on uncertain assumptions.¹²³¹ Further, disclosure and registration reduce the chances the franchise will fail as both parties come to know all the necessary information about the other.

Issues required to be disclosed, the format of disclosure, and the language of disclosure varies from one country to another.¹²³² The most common issues requiring disclosure include information about the franchisor, such as the background of its officers and directors, litigation history, bankruptcy history, and financial statements. Disclosed issues also include information on the franchised system such as intellectual property information, advertising programs, and training programs. Moreover, information on franchisors' requirements from franchisees such as

¹²²⁸ INTERNATIONAL FRANCHISING, *supra* note 165, at 288.

¹²²⁹ Malaysian Franchise Act, *supra* note 673, at art. 57.

¹²³⁰ *Id.* at art. 57.

¹²³⁰ *Id.*

¹²³⁰ Kevin M. Kennedy, *Drafting an Enforceable Franchise Agreement Arbitration Clause*, 22 FRANCHISE L.J.

112, 11

2 (2002).

¹²³² *Id.*

¹²³² *Id.*

¹²³² *Id.*

site selection, restrictions on sales, and initial investment are included. Finally, information on the proposed agreement such as initial fees, territorial rights, dispute resolutions, term, transfer, and termination of the agreement are usually included.¹²³³ The U.S., China, and Malaysia, all have disclosure laws.

Explaining disclosure and registration requires elaboration on the scope of disclosure laws, the timing of disclosure, protecting the confidentiality of disclosed information, remedies available for breach of disclosure requirements, and the information required to be disclosed. The discussion of registration requires an explanation of the process of registration, enforcement methodologies, and the remedies available for breach of registration requirements.

3.1.1 Scope of Disclosure Laws

In the United States, the New Rule is basically a disclosure law and applies to all franchise transactions located in the United States or any of its territories.¹²³⁴ The New Rule, however, exempts from its scope of application various transactions that merit discussion. These exemptions are:

3.1.1.1 Minimum Payment Exemption

The FTC excludes transactions where required payments to the franchisor, made from anytime before the transaction until six months after commencing operation of the franchised business, is less than \$500.¹²³⁵ In other words, if the franchisor does not ask his franchisee to pay him or any of his affiliates more than \$500 within the first six months of operation, the deal is

¹²³³ W. Andrew Scott, Jeffrey H. Wolf, & Allan P. Hillm

an, *Franchising from A(Arbitration) to T(Termination)*, 22 FRANCHISE L.J. 192, 192 (2002).

exempt under the FTC Rule. Though these kinds of transactions constitute franchise transactions, they include low risk of financial loss.¹²³⁶

3.1.1.2 Fractional Franchise

A fractional franchise is an extension of, or an addition to, a product or service that the franchisee is already offering to the public. A fractional franchise is commonly found in grocery stores, hotels, universities, airports, or facilities where the product or service offered is within the confines of another business. The rationale for this exemption is that the prospective franchisee should have the business acumen necessary to evaluate the costs, profits, and potential risks and benefits of the franchised business. Accordingly, the franchisee is unlikely to be misled through an incomplete or inaccurate disclosure.¹²³⁷

For a franchise to be fractional and accordingly exempted from disclosure, it has to satisfy two conditions: (1) the franchisee, any of the franchisee's current did exceed 20% of the franchisee's total dollar volume in sales during the first year of operation.¹²³⁸ Starbucks is a prime example of fractional franchising with almost 4,000 franchised outlets existing in various stores, hotels, and airports without submitting disclosure documents.¹²³⁹ That is because Starbucks accepts applications from franchisees that already have their own business like bookstores where the cost of extending the services of Starbucks inside is low.¹²⁴⁰ Thus, all that the franchisee incurs is the payment of royalties and other fees to the franchisor in addition to

¹²³⁷ *Id.* at 191.

¹²³⁸ 16 C.F.R. § 436.8(a)(2).

¹²³⁹ Leonard D. Vines, Beata Krakus, & Karen Satterlee, *Fractional Franchise Exemption: Friend or Foe?*, 30 *FRANCHISE L.J.* 72, 74 (2010).

¹²⁴⁰ *Id.*

facilitates costs such as specific equipment because the franchisee already has the place, utility connections, employees, and other required facilities.¹²⁴¹

3.1.1.3 Leased Departments Exemption

The leased department franchise relationship is also exempted from disclosure.¹²⁴² The leased department exemption refers to independent retailers who lease space from other larger businesses to sell their own goods and services, such as photography stores or beauty salons, in return for fees where the host businesses have a degree of control. The leased department exemption is similar to the fractional franchise but without the 20% cap on gross sales. This kind of business, however, is not exempted if the retailer asks the lessee to buy goods directly from him or his suppliers.¹²⁴³

3.1.1.4 Oral Contracts

The FTC excludes oral franchises that lack written evidence of the terms of the franchise agreement from the duty of disclosure.¹²⁴⁴ The logic behind this exemption seems to be the difficulty of proof arising in this type of agreement, particularly when it comes to enforcement.¹²⁴⁵ Accordingly, if there is any writing that may prove the terms of the agreement, the exemption would not apply even if the agreement lacks signatures.¹²⁴⁶

¹²⁴¹ *Id.* at 72.

¹²⁴² 16 C.F.R. § 436.8(a)(3).

¹²⁴³ Satterlee & Curran, *supra* note 651, at 194.

¹²⁴⁴ 16 C.F.R. § 436.8(a)(7).

¹²⁴⁵ Satterlee & Curran, *supra* note 651, at 194.

¹²⁴⁶ Grueneberg & Solish, *supra* note 617, at 10.

3.1.1.5 Petroleum Marketers and Resellers Exemption

Any transaction covered by the PMPA is exempted from disclosure requirements.¹²⁴⁷ The reason for this is that the PMPA has its own disclosure system.¹²⁴⁸

3.1.1.6 Sophisticated Investor Exemption

The sophisticated investor exemption means that franchisees, whether individuals or corporations, that have been in business¹²⁴⁹ for at least five years and who have net assets of at least \$5 million are exempted from the disclosure process.¹²⁵⁰ The two requirements can be satisfied by parents or affiliates of the franchisee.¹²⁵¹ The net assets of the franchisee are determined through a balance sheet.¹²⁵² The significance of this exemption to foreign franchisors is that it requires only one investor from a group of investors to meet the requirement.¹²⁵³ The basis of this exemption is that large and experienced entities such as hotels, corporations, and others can protect their interests without the need for disclosure.¹²⁵⁴

¹²⁴⁷ 16 C.F.R. § 436.8(a)(4).

¹²⁴⁸ Oppenheim, *supra* note 652, at 13.

¹²⁴⁹ Whether the company has been involved in franchising business for five years or any other kind of business. *See id.*; *see also* 16 C.F.R. § 436.8(a)(5)(ii).

¹²⁵⁰ The New Rule provides that “[t]he franchisee (or its parent or any affiliates) is an entity that has been in business for at least five years and has a net worth of at least \$5 million. 16 C.F.R. § 436.8(a)(5)(i); *see generally* Carl E. Zwister, *Amended FTC Franchise Rule Eases International Franchising*, FRANCHISING WORLD (Apr. 2007), <http://www.franchise.org/franchise-news-detail.aspx?id=33642>.

¹²⁵¹ *Id.*

¹²⁵² 16 C.F.R. § 436.8(a)(5)(ii).

¹²⁵³ *See generally* Zwister, *supra* note 1250.

¹²⁵⁴ Satterlee & Curran, *supra* note 651, at 193.

3.1.1.7 Large Investment Exemption

The large investment exemption applies in cases where the initial amount invested is at least \$1 million, excluding the cost of unimproved land and funds obtained from the franchisor or its affiliates.¹²⁵⁵ In cases where a single franchisee is composed of more than one investor, at least one of the investors must invest at the \$1 million level; thus, a group of ten investors investing in \$ 100, 000 each does not qualify for the exemption.¹²⁵⁶ Additionally, the \$1 million is calculated in light of the costs provided by the New Rule and not future franchisee obligations such as rent, royalties, or advertising.¹²⁵⁷ The basis for this exemption is that franchisees initially investing large amounts of money are probably able to collect all the necessary information with regard to a franchised business even without a disclosure requirement.¹²⁵⁸ Finally, the prospective franchisee is required to sign an acknowledgment that the franchise is exempt from the New Rule because the franchisee will initially invest at least \$1 million.¹²⁵⁹ Some scholars argue the acknowledgment should be part of the franchise agreement itself.¹²⁶⁰

¹²⁵⁵ 16 C.F.R. § 436.8(a)(5)(ii) provides that

The franchisee's initial investment, excluding any financing received from the franchisor or an affiliate and excluding the cost of unimproved land, totals at least \$1million and the prospective franchisee signs an acknowledgment verifying the grounds for the exemption. The acknowledgment shall state that: "the franchise sale is for more than \$1million – excluding the cost of unimproved land and any financing received from the franchisor or an affiliate— and thus is exempted from the Federal Trade Commission's Franchise Rule disclosure requirements, pursuant to 16 CFR § 436.8 (a) (5) (i).

¹²⁵⁶ Wells & Wieczorek, *supra* note 651, at 106. The rationale behind this rule, as articulated in the FTC Franchise Rule Compliance Guide, is that "[t]he large investment exemption is premised on the assumption that a franchisee's ability to pay a large sum equates with sophistication. That assumption fails when no one investor standing alone is investing at the requisite threshold level. For purposes of this provision, a husband and wife can be considered a single individual since their assets are typically commingled. *See* FRANCHISE RULE COMPLIANCE GUIDE, *supra* note 685.

¹²⁵⁷ *See generally id.*

¹²⁵⁸ Satterlee & Curran, *supra* note 651, at 193.

¹²⁵⁹ *Id.* at 194.

¹²⁶⁰ Satterlee & Curran, *supra* note 651, at 194.

3.1.1.8 Officers, Owners, Managers Exemption

This rule aims at exempting franchisors from disclosure when selling at least 50% of the franchise to officers, owners, managers, general partners, or other individuals with management responsibility who, within sixty days of the purchase date, will have been working for the franchise unit for at least two years before purchasing the franchise from the franchisor.¹²⁶¹ The exemption also applies when selling the franchise to people who have owned at least a 25% stake in the franchise for a two-year period ending no later than sixty days before the sale.¹²⁶² Thus, the exemption applies to any person who acquires 50% of the ownership in an American franchised company and operates it inside the United States.¹²⁶³ The basis of this exemption is that the franchisee is familiar with the franchise and is not in need of disclosure.¹²⁶⁴

At the state level, fifteen states have their own pre-sale disclosure and registration laws.¹²⁶⁵ In the mid-1970s franchise administrations in the states, working under the quasi-governmental North American Securities Administrators Association (“NASAA”), developed the UFOC disclosure guidelines to harmonize the disclosure requirements of the Old Rule and state disclosure rules.¹²⁶⁶ The New Rule modified the Old Rule which means that the UFOC guidelines no longer meet the requirements of the New Rule which led NASAA to respond in

¹²⁶¹ Oppenheim, *supra* note 652, at 15.

¹²⁶² Zwister, *supra* note 1250.

¹²⁶³ *Id.*

¹²⁶⁴ Satterlee & Curran, *supra* note 651, at 194.

¹²⁶⁵ Baer & Grueneberg, *supra* note 956, at 7.

¹²⁶⁶ *See generally* Marks, *supra* note 58.

June 2008, by issuing new guidelines that fit with the amendments provided by the New Rule and helped states to conform with the New Rule.¹²⁶⁷

Though some states adopted the new guidelines, others states still need to consider the New Rules because they retain some provisions inconsistent with both the New Rule and the 2008 NASAA Guidelines.¹²⁶⁸ Some states responded quickly in amending their disclosure rules, like South Dakota, which adopted a new franchise registration law;¹²⁶⁹ others, however, still need to resolve lingering inconsistencies. In all cases, the New Rule provides a minimum standard of disclosure that states must uphold but they are free to implement stricter requirements.¹²⁷⁰

In China, the Chinese Contracts Law lays down a general rule of disclosure by providing that if any of the parties causes loss to the other by concealing information or providing false information, that party shall be liable for damages.¹²⁷¹ In *Huang Haiyan v. Beijing Hansen Cosmetology Co.*, the plaintiff claimed that the franchisor gave him false information that the trademark of the franchised cosmetic shop was internationally famous and was registered. The plaintiff claimed the defendant gave him misleading information to encourage him to enter the franchise agreement and that that constituted a breach of the duty to disclose.¹²⁷² The Beijing Chaoyang District People's Court confirmed that the franchisor violated disclosure rules and declared the agreement null.¹²⁷³ The court explained that the purpose of disclosure is to help

¹²⁶⁷ *Id.*

¹²⁶⁸ *Id.*

¹²⁶⁹ *Id.*

¹²⁷⁰ Spandorf & Forseth, *supra* note 645, at 132.

¹²⁷¹ Chinese Contract Law, *supra* note 665, at art. 43.

¹²⁷² Jones & Wulff, *supra* note 657, at 60 (summarizing the case of *Huang Haiyan v. Beijing Hansen Cosmetology Co.*).

¹²⁷³ *Id.* at 61.

franchisees become more familiar with the franchised business and to help them decide whether to accept a franchise offer. Accordingly, violating the duty to disclose is fraud.¹²⁷⁴ Additionally, the Chinese New Regulations lay down the main principles governing disclosure and refer to the Chinese Disclosure Measures for more details on how to establish a comprehensive disclosure system.¹²⁷⁵

The Malaysian law pays less attention to disclosure than both the U.S. and Chinese laws. The Malaysian Franchise Act does not address disclosure other than a brief reference to the franchisor's obligation to submit disclosure documents before signing the franchise agreement.¹²⁷⁶ Also, the Malaysian Franchise Forms and Fees include a form demonstrating how a disclosure document should look and listing all information to be disclosed.¹²⁷⁷

The proposed Egyptian franchising law should follow the disclosure rules such as those adopted by the U.S. with respect to the scope of application of the disclosure law and the exemptions provided because the U.S. law is more comprehensive than the laws of China and Malaysia. The U.S. has an entire law on disclosure unlike the Chinese and Malaysian schemes that refer to disclosure among other rules discussing relationship and registration issues. The Egyptian law should exempt from disclosure certain kinds of transactions because reducing the number of required procedures will save time, effort, and costs. That, in turn, will encourage investment in the franchising sector. Recommended exemptions include the minimum payment, fractional franchise, leased department, and officers, owners, and manager's exemptions. The

¹²⁷⁴ *Id.*

¹²⁷⁵ Chinese New Regulations, *supra* note 237, at art. 20 (providing that “[a] franchiser shall set up and carry out disclosure in accordance with the provisions as prescribed by the commerce department of the State Council”); *see also* MENDELSON, FRANCHISING LAW, *supra* note 54, at 391.

¹²⁷⁶ Malaysian Franchise Act, *supra* note 673, at art. 15.

¹²⁷⁷ Franchise Forms and Fees Regulations 1999, *supra* note 674, § 7.

Egyptian law should not adopt the oral contracts exemption since it does not fit into the Egyptian framework as the Egyptian law should require writing for all franchise agreements to be valid. Moreover, the petroleum marketers and resellers' transactions exemption will not work for Egypt. These transactions are exempted in the United States because they are subject to a separate disclosure system provided by the Petroleum Marketers Act, but in Egypt there is no separate law dealing with disclosure in petroleum transactions.

3.1.2 Timing of Disclosure

In the United States, the New Rule requires that disclosure take place fourteen days¹²⁷⁸ before paying the consideration, executing the franchise agreement,¹²⁷⁹ or any time earlier if the franchisee reasonably requires disclosure.¹²⁸⁰ Though the New Rule did not define a reasonable request, it is argued that a request is not reasonable at least until discussions about purchase of the franchise take place.¹²⁸¹ Moreover, the New Rule provides that if any material and unilateral changes or amendments are made by the franchisor, those changes have to be communicated to the franchisee seven days before signing the agreement.¹²⁸² Disclosure documents are considered delivered once they are delivered by hand, faxed, emailed, or sent to the address of the franchisee by first class mail three days before the required date.¹²⁸³ The New Rule allows electronic disclosure through email and by allowing access to a website that has the disclosure

¹²⁷⁸ See Wells & Wiczorek, *supra* note 651, at 107.

¹²⁷⁹ 16 C.F.R. § 436.2(a).

¹²⁸⁰ § 436.9 (e).

¹²⁸¹ Wells & Wiczorek, *supra* note 651, at 107.

¹²⁸² 16 CFR 436.2(b); *see also* Baer & Grueneberg, *supra* note 956, at 21.

¹²⁸³ 16 C.F.R. § 436.2(c).

documents.¹²⁸⁴ In such a case, the New Rule requires that the franchisor use a format that allows the franchisee to store, download, or print the disclosure documents to be able to maintain them for future reference.¹²⁸⁵

The Chinese New Regulations and the Chinese Measures for the Administration of Information Disclosure require franchisors to submit both the franchise contract and disclosure documents thirty days before the conclusion of a franchise contract.¹²⁸⁶ In the same context, the Measures require the franchisor to give precise and confirmed information and in case of any change to any of the disclosed information, to notify the franchisee.¹²⁸⁷ The Malaysian Franchise Act requires franchisors to provide disclosure documents to potential franchisees at least ten days before signing a franchise agreement.¹²⁸⁸

The proposed Egyptian franchising law should require the disclosure period to be, like the Chinese New Regulations, thirty days. Having thirty days is more reasonable than the ten days provided by the Malaysian Franchise Law and the fourteen days provided in the U.S. In the same context, the thirty days should take place before the fees are due like under the U.S. law. This will make it easy for the parties to decide when the thirty days start. Specially, the time of signature, provided by the Malaysian law, does not make sense because a signature is not required for conclusion of an agreement.

¹²⁸⁴ *Id.*

¹²⁸⁵ § 436.6 (b).

¹²⁸⁶ Chinese New Regulations, *supra* note 237, at art. 21; *contra* Chinese Measures for the Administration of Information Disclosure, *supra* note 663, at art. 4; *see also* SPENCER, *supra* note 41, at 182.

¹²⁸⁷ Chinese New Regulations, *supra* note 237, at art. 23.

¹²⁸⁸ Malaysian Franchise Act, *supra* note 673, at art. 51; *see also* SPENCER, *supra* note 41, at 201; *see also* Mohd Bustaman Hj Abdullah & Wong Sai Fong, *Malaysia, in* INTERNATIONAL FRANCHISE SALES LAWS 6 (Andrew P. Loewinger & Michael K. Lindsey eds., 2011),

U.S. law also provides extra rules, that are provided by neither the Chinese nor Malaysian laws, and which the proposed Egyptian law should follow. Examples include requiring franchisors to inform franchisees of any changes taking place with respect to disclosed information and referring to methods appropriate for disclosure. Finally, electronic disclosure may not be a suitable option presently, as the Egyptian technological system may not be adequate.

3.1.3 Protecting the Confidentiality of Disclosed Information

Neither the U.S. nor Malaysian laws devote attention to the issue of protecting the confidentiality of disclosed information to the extent of the Chinese Measures for Administration of Information Disclosure. The Chinese Measures provide for a franchisor's right to conclude a confidentiality agreement with the franchisee before disclosing any information to him.¹²⁸⁹ In the same context, the Measures require the franchisee to issue the franchisor a receipt, to be signed by both parties, that the franchisee received the disclosure documents.¹²⁹⁰ The proposed Egyptian franchising law should also require the franchisee to issue the franchisor a receipt for the disclosure documents.

3.1.4 Remedies

In the United States, if a franchisor fails to comply with the basic disclosure requirements it may be liable under the FTC Act.¹²⁹¹ These standards give the FTC the power to impose civil

¹²⁸⁹ See Chinese Measures for the Administration of Information Disclosure, *supra* note 663, at art. 7.

¹²⁹⁰ *Id.* at art. 8.

¹²⁹¹ 16 C.F.R. § 436.6(a).

penalties of up to \$10,000 per violation.¹²⁹² The FTC can also order rescission, reformation, damages, or a combination of these remedies.¹²⁹³ Moreover, the FTC can issue cease-and-desist orders.¹²⁹⁴ State laws provide for private rights of action for rescission, damages, punitive damages, and the like.¹²⁹⁵

The Chinese New Regulations provide for a penalty of 10,000 CNY to 50,000 CNY, or 50,000 CNY to 100,000 CNY in case of serious breach, in addition to making the franchisor take action to correct the breach.¹²⁹⁶ The Chinese Measures for the Administration of Information Disclosure provide for a similar sanction in addition to allowing the franchisee to terminate the franchise agreement.¹²⁹⁷ The Malaysian Franchise Act provides that any failure to comply with disclosure instructions is an offence.¹²⁹⁸

The proposed Egyptian franchising law should combine the remedies provided by the three systems. In other words, Egypt should adopt the civil penalties and fines provided by all three schemes in addition to the rescission, cease orders, and damages provided by the U.S. law and the corrective actions required by the Chinese law.

3.1.5 Information to be Disclosed

¹²⁹² 15 U.S.C. § 45(m)(1).

¹²⁹³ 15 U.S.C. § 57(b); *see also* Bailey & Wiczorek, *Franchise Disclosure Issues*, in FUNDAMENTALS OF FRANCHISING, 98-99.

¹²⁹⁴ 15 U.S.C. § 45(b).

¹²⁹⁵ *Sellinger v. Freeway Mobile Home Sales, Inc.*, 521 P.2d 1119 (Ariz. 1974).

¹²⁹⁶ Chinese Measures for the Administration of Information Disclosure, *supra* note 663, at art. 28.

¹²⁹⁷ *Id.*

¹²⁹⁸ Malaysian Franchise Act, *supra* note 673, at art. 15; *see supra* Section 2-6 (Remedies).

The U.S. law is more comprehensive and organized than both the Chinese and Malaysian laws regarding what information must be disclosed. The New Rule requires a cover page before receipt of the disclosure documents that provides information about the franchisor, a sample of the trademark, a description of the business, the initial investment, the franchisee's contact information, and information for publication on the FTC's website and in its print publication.¹²⁹⁹ All information must be written in plain language in a single document.¹³⁰⁰ The New Rule also requires that the franchisor place each item under the appropriate heading to clarify whether the item is applicable to the situation and to avoid adding any information other than that required. He must inform the franchisee of any prerequisites for obtaining or reviewing disclosure documents in a particular format.¹³⁰¹

The New Rule, furthermore, requires the franchisor to provide updated disclosure documents as of the close of the most recent fiscal year and to make revisions to the documents within 120 days of the most recent fiscal year.¹³⁰² Moreover, the franchisor is required to provide franchisees with revisions to the disclosure documents each quarter of the fiscal year.¹³⁰³ The New Rule requires master franchisors to disclose in master franchise agreements information related to their sub-franchisors as well and not only information related to master franchisors.¹³⁰⁴

¹²⁹⁹ 16 C.F.R. § 436.3.

¹³⁰⁰ § 436.6(b).

¹³⁰¹ § 436.6(b)-(i).

¹³⁰² § 436.7(a).

¹³⁰³ § 436.7 (b).

¹³⁰⁴ § 436.6 (f).

In addition, the New Rule requires a specific table of contents with certain information to be included in a specific order after the cover page and before mentioning disclosure items.¹³⁰⁵ There are twenty-three items that require disclosure of different information. Items one, two, and three require the disclosure of the franchisor's and any predecessors', affiliates', or agents' information.¹³⁰⁶ It also requires disclosure of information about the franchised business such as type of business entity, location, the market of the franchised goods and services, and laws and regulations.¹³⁰⁷ While item three requires disclosure of the litigation and arbitration history of the franchisor, item four asks for disclosure of the franchisor's bankruptcy history.¹³⁰⁸ Items five, six, and seven demand disclosure of different financial issues related to the franchisor such as payments for goods or services provided by the franchisor, fees to be paid by the franchisee, and estimated initial investment amounts to be paid by the franchisee.¹³⁰⁹ Item eight requires disclosure of the sources from which the franchisee is required to purchase or lease required supplies and equipment.¹³¹⁰ Regarding the franchise agreement, items nine through twelve deal with disclosure regarding franchise agreement information such as the franchisee's obligations, assistance provided by the franchisor, and exclusivity and any other territorial issues.¹³¹¹ In addition, items thirteen and fourteen deal with aspects of intellectual property such as trademarks, service marks, copyrights, and patents.¹³¹² Going back to the franchise agreement,

¹³⁰⁵ § 436.4.

¹³⁰⁶ § 436.6(a)-(b).

¹³⁰⁷ *Id.*

¹³⁰⁸ § 436.6(c)-(d)

¹³⁰⁹ § 436.6(e)-(f).

¹³¹⁰ § 436.6(h).

¹³¹¹ § 436.6(h), (j).

¹³¹² § 436.6(m).

item fifteen provides for disclosure of any obligations to participate in the operation of the franchised business.¹³¹³ In the same context, item sixteen requires disclosure of any restrictions with respect to the goods or services to be sold.¹³¹⁴ Likewise, item seventeen asks for disclosure of all information regarding renewal, termination, transfer, or dispute resolution.¹³¹⁵ Items eighteen and nineteen discuss miscellaneous issues such as information about public figures used in advertising and financial performance information such as past sales, income, and profits.¹³¹⁶ Item twenty concentrates on information about franchised outlets.¹³¹⁷ Item twenty-one goes back to financial issues and requires disclosure of the franchisor's financial statements for the last two years.¹³¹⁸ Finally item twenty-two asks for submission of a copy of all agreements related to the franchise offer such as the franchise agreement, any lease agreements, and purchase agreements. Item twenty-three requests copies of the receipt of acknowledgment of the disclosure documents.¹³¹⁹

The Chinese New Regulations provide a list of information required to be disclosed.¹³²⁰ This includes information related to the franchisor's name, domicile, legal representative, registered capital, business scope, commercial franchise activities, and basic information on

¹³¹³ § 436.6(o).

¹³¹⁴ § 436.6(p).

¹³¹⁵ § 436.6(q).

¹³¹⁶ § 436.6(r)-(s).

¹³¹⁷ § 436.6(t)(1).

¹³¹⁸ § 436.6(u).

¹³¹⁹ § 436.6(w).

¹³²⁰ Chinese Measures for the Administration of Information Disclosure, *supra* note 663, at arts. 5, 22; *see also* INTERNATIONAL FRANCHISING, *supra* note 165, at 97.

previously archived disclosures.¹³²¹ It also requires disclosure of all information on any associated company that provides goods or services to the franchisor, and bankruptcy information for the franchisor or its associated company for the previous five years. Additionally, records of any illegal business operations, financial and accounting reports, any audit reports from the last two years, and records of any major illegal operation of the franchisor that resulted in fines of between 300,000 CNY and 500,000 CNY or imprisonment.¹³²² Furthermore, disclosure is required of digests of the financial statements for the last two years, the investment budget for the franchise outlet, quantity, distribution and business evaluation of franchisees currently existing in China, and information on the franchise agreement.¹³²³ This includes the type and amount of franchising fees and payment methods, prices and requirements for providing the franchisee with products, services and equipment, a sample franchise contract, and basic information on the franchise expenditure.¹³²⁴

Though the Regulations' provisions on disclosure are self-explanatory, the list above is not exclusive.¹³²⁵ That is important because Article 42 of the Contract Law of China provides that if any of the contracting parties intentionally hide any relevant information or provide false information, he should be responsible for any losses.¹³²⁶ A prime example is found in a decision of the Intermediate People's Court, in which the franchisee claimed that the franchisor had breached the franchise agreement because he did not provide financial statements for the two

¹³²¹ Chinese New Regulations, *supra* note 237, at arts. 22, 28; *see also* INTERNATIONAL FRANCHISING, *supra* note 165, at 97.

¹³²² Chinese New Regulations, *supra* note 237, at arts. 22, 28,

¹³²³ *Id.* at art. 22.

¹³²⁴ *Id.*

¹³²⁵ *See* SPENCER, *supra* note 41, at 201.

¹³²⁶ Chinese Contract Law, *supra* note 665, at art. 42.

years preceding the year the agreement was concluded. The court agreed because Article 23 of the Chinese New Regulations requires the franchisor to submit accurate, true, and complete information to the franchisee and if any information is not available, that the franchisor must so inform the franchisee. The franchisor appealed, claiming that the franchisee did not ask for disclosure of the two financial statements in question. The appellate court affirmed the trial court's decision, holding that the Chinese New Regulations impose an obligation on the franchisor to disclose all required items whether the franchisee asks for them or not.¹³²⁷

Finally, the Malaysian Franchise Act, through Form 1 of the Malaysian Franchise Forms and Fees, requires that disclosure documents be examined thoroughly and compared with the franchise agreement and that if there be any inconsistency, that the franchise agreement shall prevail.¹³²⁸ The information to be disclosed under the Malaysian Act is similar to the Chinese Regulations.¹³²⁹ It requires disclosure of information related to the franchisor.¹³³⁰

In addition, the Malaysian Franchise Act requires disclosing information on the franchised system.¹³³¹ Similarly, information about the franchise agreement should be disclosed.¹³³² Lastly, information on investment and costs shall be disclosed.¹³³³

Because the U.S. law is the only one that regulates all organizational aspects related to disclosure, including the use of a cover page, the language, and specific structure of disclosure,

¹³²⁷ See also Paul Jones, *Franchise Litigation in China: Are You Ready?*, LJM'S FRANCHISING BUS. & L. ALERT, Apr. 2011, at 1.

¹³²⁸ Franchise Forms and Fees Regulations 1999, *supra* note 674, § 7.

¹³²⁹ *Id.*

¹³³⁰ *Id.*

¹³³¹ *Id.*

¹³³² *Id.*

¹³³³ *Id.*

the proposed Egyptian law should follow the U.S. method. The Egyptian law should require a cover page listing titles of required information to be disclosed. It should also require that all information be in Arabic in case of domestic transactions and in English accompanied with Arabic translation in case of international transactions. It should require franchisors to provide updated information, at least of the most recent year and to review the information on a quarterly basis. The law should also require disclosure of sub-franchisor information.

The Malaysian law has a unique rule that should also be adopted by the Egyptian law, requiring conformity between the information provided in the disclosure documents and the franchise agreement. If the two conflict, then the proposed Egyptian law is recommended to give the franchisee the right to choose which document should prevail; the disclosure documents or the agreement. Many reasons stand behind this argument. Giving the franchisee the right to choose works as a compensatory method since the party in breach is the franchisor. Also, knowing from the start that the franchisee will be the person who decides which documents will prevail in case of contradiction would reduce the chances that franchisors would provide different information in the disclosure document from that provided in the agreement. Moreover, this would also encourage consistency between all documents and would require heightened attention by the franchisor to the information disclosed.

Finally, regarding the information required to be disclosed, the U.S. law provides the most comprehensive list and therefore the Egyptian law should adopt a list similar to that of the U.S. The Egyptian law is, however, advised to follow the Chinese law and provide that this list is not exclusive and that additional information may need to be disclosed if required by the franchisee and material to the transaction. This rule would provide both parties with more

flexibility and protect franchisees that may need access to information that varies according to the nature of each transaction.

3.2 Registration

In the United States, neither the New Rule nor any federal agencies deal with registration requirements.¹³³⁴ Federal laws, however, do not prevent states from requiring registration¹³³⁵ and the registration requirements of fifteen states do not conflict with federal law.¹³³⁶ Most states exempt specific transactions from registration. Exemptions vary among the states with the most common being the large franchisor exemption that is available to franchisors who meet specific minimum net worth and experience requirements.¹³³⁷ The requirements vary from one state to another. Some states require a \$5 million net worthwhile others require \$10 million. Some states require 5 years of experience while others require a different number of years.¹³³⁸ Another common exemption includes a sale of a franchise made by a franchisee for his own account.¹³³⁹

Unlike the disclosure process that was treated with more detail under the U.S. and Chinese laws than the Malaysian law, the registration and filing process is more comprehensive in the Malaysian law as it provides for all forms of applications, reports, and notices that need to

¹³³⁴ SPENCER, *supra* note 41, at 147.

¹³³⁵ *Id.*

¹³³⁶ *Id.*

¹³³⁷ Spandorf & Forseth, *supra* note 645, at 138.

¹³³⁸ *See, e.g.*, CAL. CORP. CODE § 31101 (2012); N.D. CENT. CODE § 51-19-04 (2011); *see also* Spandorf & Forseth, *supra* note 645, at 138.

¹³³⁹ CAL. CORP. CODE § 31102.

be considered by franchisors.¹³⁴⁰ Accordingly, the potential Egyptian law is recommended to follow the general scheme of registration provided by the Malaysian law.

3.2.1 Mechanism of Registration

In the United States, franchisors submit registration applications to state agencies.¹³⁴¹ Registration application usually consists of a page giving information about the franchisor, a certification page signed by the applicant's representative before a notary public, an agreement for service of process which allows the service of documents upon the state authority as agent for the franchisor, and two copies of the disclosure documents. There is also a supplemental information form that refers to any denial of registration previously issued in any other state, copies of advertisement literature, the auditor's consent, application fees, and the sales agent disclosure form for sales agents authorized by the franchisor to solicit the franchise in the state.¹³⁴² The application must also be accompanied by a cover page for all registered documents and a statement that registration is not an approval of the franchise opportunity and registration does not guarantee the accuracy of information in the disclosure documents.¹³⁴³ Usually the review process takes a set period of time, the day after which registration becomes automatically effective.¹³⁴⁴

The registration agencies are usually granted the right to deny an application in various situations such as the franchisor's failure to comply with the state's law. This also includes the

¹³⁴⁰ Franchise Forms and Fees Regulations 1999, *supra* note 674.

¹³⁴¹ Spandorf & Forseth, *supra* note 645, at 140.

¹³⁴² *Id.* at 141.

¹³⁴³ *Id.* at 143-44.

¹³⁴⁴ CAL. CORP. CODE § 31116(b).

situation where a person identified in the franchisor's application or disclosure documents is convicted of a felony or found subject to liability in a civil action due to a cause related to the franchise's sale. The reason behind allowing the registrar to deny the application in the latter situation is that allowing registration in this case may pose a risk to the prospective franchisee.¹³⁴⁵ Registration usually expires at the end of the registration period, usually one year, unless renewal takes place with the addition of any changes that took place during the year.¹³⁴⁶

An amendment application must be filed to amend or change any of the information on the registration application.¹³⁴⁷ Most states require franchisors to provide documents showing financial ability to prove he will be able to meet the agreed upon obligations for services and to provide support to the franchisees to prevent undercapitalized franchisors from getting franchisees' initial fees for their own working capital.¹³⁴⁸ Alternatively, franchisors can show financial ability by offering a personal guarantor who audits the financial statement filed with the registration application.¹³⁴⁹

The Chinese New Regulations and the Chinese Measures for the Administration of Information Disclosure require the franchisor to submit specific documents to the Ministry of Commerce within fifteen days of the date on which the franchise agreement is concluded.¹³⁵⁰ The Chinese Archiving Measures list the documents that the franchisor must submit to register

¹³⁴⁵ Spandorf & Forseth, *supra* note 645, at 144-45.

¹³⁴⁶ *Id.* at 147.

¹³⁴⁷ *Id.* at 149.

¹³⁴⁸ *Id.* at 157.

¹³⁴⁹ *Id.* at 157-60.

¹³⁵⁰ INTERNATIONAL FRANCHISING, *supra* note 165, at 97; *see also* Chinese New Regulations, *supra* note 237, at art. 8; Chinese Measures for the Administration of Information Disclosure, *supra* note 663, at art. 6; SPENCER, *supra* note 41, at 182.

the franchise agreement.¹³⁵¹ These documents include primary information on the transaction, potential franchised outlets in China, working license, trademark registration certificate, the two-plus-one requirement, a copy of the franchise agreement, a description of the operations manual, any required approvals, and a commitment certificate issued and sealed by the franchisor's legal representatives.¹³⁵² Some of these documents must be filed online while others are required to be submitted in hard copy.¹³⁵³ Article 7 of the Chinese Archiving Measures provides that if any of the information supplied by the franchisor changes, the franchisor must apply for "alteration" within thirty days.¹³⁵⁴ Moreover, Article 8 requires the franchisor to report any changes to the franchise agreement by March 31 of each year.¹³⁵⁵ Furthermore, Article 9 requires the franchisor to confirm the clarity, completeness, and validity of all submitted documents.¹³⁵⁶

Once the franchisor submits the required documents, the competent authority shall archive the documents within ten days of submission unless the documents are incomplete.¹³⁵⁷ After that the competent authority must notify the Ministry of Commerce of the registration within ten days.¹³⁵⁸ Article 13 requires the competent authority to keep any documents or information submitted by the franchisor confidential; however, Article 14 allows specific identifying information to be available online to the public.¹³⁵⁹

¹³⁵¹ Chinese Archiving Measures, *supra* note 662.

¹³⁵² *Id.* at art. 5.

¹³⁵³ *Id.*

¹³⁵⁴ *Id.* at art. 7.

¹³⁵⁵ *Id.* at art. 8.

¹³⁵⁶ *Id.* at art. 9.

¹³⁵⁷ *Id.* at art. 10.

¹³⁵⁸ *Id.*

¹³⁵⁹ INTERNATIONAL FRANCHISING, *supra* note 165, at 97.

The Malaysian Franchise Act requires registration before making any offer to sell a franchise and non-compliance with this requirement is a penalized offense.¹³⁶⁰ The Malaysian Franchise Act gives the Registrar broad discretionary power to decide whether to accept or refuse registration, providing reasons in the case of refusal, and discretionary power to impose conditions for approval.¹³⁶¹ In return, franchisors can appeal to the Minister within one month of the date the applicant is notified of the Registrar's decision.¹³⁶² The Registrar may decline registration of foreign franchisors without giving reasons.¹³⁶³

Under the Malaysian Franchise Act, the process of registration takes place by submitting a registration application as set forth in the Malaysian Franchise Forms and Fees and other documents as mentioned in the Act to the Registrar.¹³⁶⁴ The Registrar is a public officer appointed by the Minister.¹³⁶⁵ The registration documents include all disclosure documents, a copy of the franchise agreement, the operations manual, the training manual, and financial statements.¹³⁶⁶

The Malaysian Franchise Act also provides that a registration application is deemed withdrawn if removed by the applicant at any time before being approved or if the applicant does not submit the required information on time.¹³⁶⁷ In all cases, the Registrar is required to inform the applicant, in writing, of his final decision. The registration becomes effective on the day

¹³⁶⁰ Malaysian Franchise Act, *supra* note 673, at art. 6.

¹³⁶¹ *Id.* at art. 8(1).

¹³⁶² Malaysian Franchise Act, *supra* note 673, at art. 18.

¹³⁶³ Abdullah & Fong, *Malaysia*, in INTERNATIONAL FRANCHISE SALES LAWS, *supra* note 1288, at 6.

¹³⁶⁴ Malaysian Franchise Act, *supra* note 673, at art. 7.

¹³⁶⁵ See SPENCER, *supra* note 41, at 201; see also INTERNATIONAL FRANCHISING, *supra* note 165, at 288.

¹³⁶⁶ Malaysian Franchise Act, *supra* note 673, at art. 7.

¹³⁶⁷ *Id.* at art. 8(4).

mentioned in the written notice issued to the applicant by the Registrar.¹³⁶⁸ In such a case, the Registrar will notify the applicant in writing explaining the nature and purpose of the action and giving the applicant the chance to respond in writing within fourteen days.¹³⁶⁹ The Registrar also has the right to take any future action, when necessary to protect the franchisees, if any deficiencies notified by the Registrar to the applicant have not been corrected based on the annual reports submitted by the franchisor.¹³⁷⁰ The franchisor, however, retains the right to cancel the registration and the Registrar must cancel it as long as the franchisor is not granting any rights under the franchise.¹³⁷¹ In all cases, the franchisor is required to submit an annual report to the Registrar within thirty days of the end of the first year of registration.¹³⁷² The applicant is required to submit any required information or modifications of documents as required by the Registrar.¹³⁷³ Finally, the Act provides for the establishment of an advisory board composed of experienced experts in franchising to issue non-binding advisory opinions to the Minister and Registrar on issues related to franchising when required.

3.2.2 Enforcement and Remedies

¹³⁶⁸ INTERNATIONAL FRANCHISING, *supra* note 165, at 289; *see also* Malaysian Franchise Act, *supra* note 673, at arts. 9-10.

¹³⁶⁹ INTERNATIONAL FRANCHISING, *supra* note 165, at 289; *see also* Malaysian Franchise Act, *supra* note 673, at art. 12; SPENCER, *supra* note 41, at 201.

¹³⁷⁰ INTERNATIONAL FRANCHISING, *supra* note 165, at 289; *see also* Malaysian Franchise Act, *supra* note 673, at art. 16(3)(b).

¹³⁷¹ Malaysian Franchise Act, *supra* note 673, at art. 13.

¹³⁷² INTERNATIONAL FRANCHISING, *supra* note 165, at 289; *see also* Malaysian Franchise Act, *supra* note 673, at art. 16.

¹³⁷³ INTERNATIONAL FRANCHISING, *supra* note 165, at 289; *see also* Malaysian Franchise Act, *supra* note 673, at art. 16.

In the United States, disclosure laws can be violated in numerous ways, such as by franchisors failing to register their disclosure documents, intentionally hiding information, or providing false statements.¹³⁷⁴ Enforcement powers take different forms that allow the competent authorities, for example, to issue cease-and-desist orders to prohibit franchise sales, to conduct investigations, to seek injunctive orders, and to obtain restitution on behalf of victims.¹³⁷⁵ Criminal penalties are also available and violation of registration rules is usually punished as a felony.¹³⁷⁶ Also, private remedies are allowed such as damages recovery, equitable relief, and rescission of the agreement.¹³⁷⁷ A franchisor's failure to register disclosure documents, however, does not make the franchise agreement null unless state law provides for the franchisee's right to void the agreement, typically for willful failure.¹³⁷⁸

The Chinese New Regulations and the Chinese Measures for Administration of Information Disclosure impose different types of penalties and procedures depending on the degree of the breach if the registration rules are violated. Article 4 of the Chinese Measures for Administration of Information Disclosure allows anybody to report a violation.¹³⁷⁹ Article 11 grants authority to cancel registration for violation of the disclosure requirements.¹³⁸⁰ Also, a fine of between 10,000 CNY and 50,000 CNY that is increased to 50,000 CNY to 100,000 CNY if

¹³⁷⁴ Pitegoff & Garner, *supra* note 441, at 170.

¹³⁷⁵ *People v. Speedee Oil Change Sys., Inc.*, No. 5058639, 1997 Cal. LEXIS 2179 (Cal. Sup. Ct. Apr. 23, 1997); MD. CODE ANN. § 14-210(k); *see also* Pitegoff & Garner, *supra* note 441, at 170-71.

¹³⁷⁶ Pitegoff & Garner, *supra* note 441, at 171.

¹³⁷⁷ *Id.*

¹³⁷⁸ *TKO Fleet Enter., Inc. v. Elite Limousine Plus, Inc., Inc.*, 708 N.Y.S.2d 593 (Sup. Ct. 2000).; CAL. CORP. CODE § 31300 (2012); *see also*, Pitegoff & Garner, *supra* note 441, at 173.

¹³⁷⁹ Chinese Measures for the Administration of Information Disclosure of Commercial Franchises, *supra* note 663.

¹³⁸⁰ *Id.*

payment is not made within a fixed period may be imposed.¹³⁸¹ A special fine of between 10,000 CNY and 50,000 CNY exists for violating the obligation to notify the competent authority of any change in the franchise agreement, in addition to making all required corrections.¹³⁸²

Compared to the Chinese law, the Malaysian law has a simpler approach to penalties. The Malaysian Franchise Act provides for general penalties that include a fine of between 5,000 MYR and 50,000 MYR or five years in prison for a first offence and a fine of 10,000 MYR or five years in prison for each subsequent offense.¹³⁸³ Also, the franchise agreement may be declared null, the franchisor may be required to refund any money the franchisee paid to him, and the franchisor may be prevented from entering any new agreements.¹³⁸⁴ The Act provides for an additional rule that the Registrar can compound any offense, as long as it is permitted by the competent minister and after attaining the consent of the public prosecutor. The person committing the offence will be required to pay any amount of money not exceeding half the maximum limit of the fine within the period specified in the written notice.¹³⁸⁵

The Malaysian Franchise Act authorizes the Registrar or any of its deputies to take enforcement action with the written approval of the competent minister.¹³⁸⁶ Enforcement investigations include the activities of franchisors, franchisees, or brokers.¹³⁸⁷ The powers of an authorized official include the power to enter premises to inspect, search, seize, or seal anything

¹³⁸¹ Chinese New Regulations, *supra* note 237; *see also* Chinese Measures for the Administration of Information Disclosure of Commercial Franchises, *supra* note 663.

¹³⁸² *Id.*

¹³⁸³ Malaysian Franchise Act, *supra* note 673, at art. 39(1); *see also supra* Sec. 2-6.

¹³⁸⁴ Malaysian Franchise Act, *supra* note 673, at art. 39.

¹³⁸⁵ *Id.* at art. 41(1).

¹³⁸⁶ *Id.* at art. 42.

¹³⁸⁷ *Id.* at art. 43.

for the purposes of investigation.¹³⁸⁸ Exercising such powers may take place with or without a warrant.¹³⁸⁹ In addition, the Malaysian Franchise Act provides for the institution of a franchise advisory board composed of a maximum of fifteen persons experienced in franchising issues chosen by the minister.¹³⁹⁰ The role of the advisory board is to issue non-binding advisory opinions to the minister and Registrar on issues related to franchising when required.¹³⁹¹

The best model to follow for registration in the proposed Egyptian franchising law is the Malaysian Franchise Act. That is because it provides more detail on the registration process and sets forth standards for all forms, applications, reports, and notices that need to be considered during registration. Registration must take place before making any offer to sell a franchise. Giving the Registrar broad discretionary power to accept or refuse registration and to impose conditions for approval may not be the best option in Egypt as it may lead to abuse of power or corruption. There should, therefore, be supervision through the Ministry of Trade and Industry or something similar, to provide oversight. It is also important to provide franchisors with the right to appeal the Registrar's decision to the Minister within a specific period of time and the Registrar should be required to give reasons for declining a registration.

The law should require certain registration forms to be filed with the disclosure documents, a copy of the franchise agreement, the operations manual, the training manual, financial statements, and any additional documents required by the Registrar. The Registrar should be established by a competent minister and its duties specifically spelled out.

¹³⁸⁸ *Id.* at arts. 44, 45.

¹³⁸⁹ *Id.* at art. 44.

¹³⁹⁰ *Id.* at art. 35; *see also* SPENCER, *supra* note 41, at 204.

¹³⁹¹ Malaysian Franchise Act, *supra* note 673, at art. 36.

Furthermore, submitting false or misleading documents should be a criminal offense. The law should determine the day registration becomes effective as well, which is likely the day mentioned in the written notice issued by the Registrar. The Registrar should be granted the right to withdraw registration if franchisors do not correct deficiencies once the Registrar notifies them. Also, franchisors should be required to notify the Registrar of any modifications or changes to the submitted documents.

Additionally, the law should provide penalties for violating the registration rules, whether by franchisors or Registrar employees. Furthermore, enforcement guarantees should be provided such as allowing the Registrar to conduct investigations including, if necessary, the power to enter the premises and to inspect, search, seize, and seal anything for the investigation.

Finally, the Malaysian Franchise Act provides for a unique rule that should be adopted by the proposed Egyptian franchising law, which is the establishment of an advisory board composed of experienced experts in franchising to issue non-binding advisory opinions to the minister and Registrar on issues related to franchising when required.

Conclusion

This Chapter compared the franchising rules in three legal systems: the U.S. franchise law as an example of a common law legal system; the Chinese franchise law as an example of a civil law system; and the Malaysian franchise law as an example of a Muslim legal system. In the United States, franchising transactions are regulated at both the federal and state levels. Federal law is a disclosure law that may be useful when drafting similar provisions in the Egyptian law. Both the Chinese and Malaysian laws deal primarily with substantive issues rather

than disclosure and registration. This may provide guidance for drafting the provisions of the Egyptian law dealing with relationship rules.

Some legal issues related to franchising are not dealt with through franchising laws; rather, other general laws such as contract law, competition law, and intellectual property law are applicable. These issues should not be addressed in the proposed Egyptian franchising law but should be left to the general laws in Egypt dealing with similar issues, except for gap-filling provisions where no appropriate provision is found elsewhere.

Chapter IV will include the conclusions based on this comparative discussion and recommendations for the proposed Egyptian franchising law to consider.

CHAPTER IV

COMPARATIVE REFLECTIONS AND A PROPOSED FRANCHISING LAW FOR EGYPT

Introduction

This Chapter applies the findings of the comparative analytical study provided in Chapter Three, of the U.S., Chinese, and Malaysian franchising laws, to Egyptian franchising relationships. This Chapter describes each rule that should be adopted by the proposed Egyptian franchising law on the various franchise relationship issues and the reasons behind adopting each specific recommended rule. The Chapter then proposes a format for the provisions of the model law that could be adopted by Egypt.

Although one could not present provisions covering different legal issues that are connected indirectly to franchising, such as rules related to the transfer of a franchise agreement and settlement of disputes arising from franchise agreement, the reality is that most of these areas of the law are regulated under different Egyptian laws. Hence, any suggestions to amend or change any of these rules would lead to the change of the original law. Accordingly, a reference is made in this Chapter to the original laws covering these general rules. The majority of the recommendations made in this Chapter concentrate on the direct rules that affect franchising relationships and are not provided by any other Egyptian law including the definition and elements of a franchise, rights and obligations of franchising parties, advertising a franchise offer, and disclosure and registration rules.

1. Implications of Substantive Rules

1.1 Definition

The recommended law should provide a definition of franchising that clearly includes all of the related elements of the different aspects of franchising. The definition should include the

elements of licensing the use of intellectual property, the control exercised by the franchisor over the franchised business, payment of fees by the franchisee, and the marketing plan. Moreover, the proposed definition should make a manifest distinction between franchising and other forms of business agreements with features common to franchising. The law should make clear that once an agreement satisfies the specified elements of a franchise agreement, it will be interpreted as a franchise agreement regardless of the name given to the agreement by the parties. This will help to avoid future disputes between the contracting parties as to the nature of the agreement. The recommended law should also avoid restricting franchising to enterprises and excluding small individual investors, otherwise the retail industry investors in Egypt, who represent the majority of franchisees, may be discouraged from investing in the franchising sector.

Accordingly, the proposed Egyptian franchising law is recommended to follow the New Rule that details all elements of a franchise and includes franchise transactions between enterprises and individuals.¹³⁹² The recommended law should also follow the Malaysian law and mirror its clear distinction between franchising and other similar agreements.¹³⁹³ In this way, the proposed law will avoid the Chinese New Regulations' broad and confusing definition of franchising and the Chinese provision that makes franchising exclusive to enterprises and excludes individual investors.¹³⁹⁴ Limiting franchising to enterprises would eliminate small Egyptian investors that should be encouraged, through incentives, to invest in the franchising industry, particularly in the retail sector.

¹³⁹² *See supra* Ch. III. 2.1 (discussing The Main Features of Franchising Relationship Rules in the United States, Chinese, and Malaysian: Definition).

¹³⁹³ *Id.*

¹³⁹⁴ *Id.*

The following legislative text is recommended to define a franchise in the proposed Egyptian franchising law:

Without prejudice to Article 136 of the Egyptian Civil Law on Community of Interests, franchise means a contract, agreement, or arrangement, either expressed or implied, between two or more persons where:

- a) The franchisor grants the franchisee the right to operate a business to offer, sell, or distribute goods, services, or commodities that are associated with the franchisor's trademark, service mark, trade name, or any intellectual property as long as this intellectual property is owned by the franchisor, the franchisor is its registered user, or the franchisor is licensed to use it and/or permit others to use it.
- b) The franchisee operates the franchised business according to the franchise business plan/ system or marketing plan as determined by the franchisor during the term of the franchise agreement.
- c) The franchisor possesses the authority to exercise continuous control over the operation of the franchised business during the term of the franchise agreement.
- d) The franchisor is responsible for providing continuous and significant assistance to the franchisee's method of business operation, in accordance with Registration rules provided by this Law.
- e) The franchise relationship shall not be at any time regarded as a partnership, service contract, and agency, and sales representation, basic licensing agreement to use a trademark, distribution ship, or employment relationship.
- f) The franchisee, in return for the grant of the right to operate the franchised business, makes a required payment, or other form of consideration, directly or indirectly, to the franchisor or its affiliate.
- g) If the franchisor requires the franchisee to pay any type of fees before the conclusion of the franchise agreement, the franchisor has to explain to the franchisee, in writing, the purposes of these payments and the conditions and methods for a refund.
- h) Any fees paid by the franchisee to be used for the promotion, marketing, advertisement, or any other publicity purposes, shall be used for the purposes as agreed upon in writing.

In all cases the rate of any required payments made by the franchisee shall be consistent with the rate provided in the disclosure documents and if any contradiction arises the rate provided in the disclosure documents shall prevail.

1.2 Elements of A Franchise

1.2.1 Control and Assistance

The proposed Egyptian franchising law should make clear that control and assistance is one of the essential elements of a franchise transaction. This is intended to reduce future disputes

between the contracting parties about whether the franchisor is required to provide assistance to the franchisee and to reduce the franchisee's chances of resistance to the franchisor's control if the franchise agreement does not have clear provisions on control and assistance. The law should require that assistance be significant to avoid fraudulent behavior by franchisors, for example, providing only minor assistance when significant assistance is needed. Finally, assistance should be continuous throughout the duration of the franchise agreement to guarantee more protection for franchisees.

The proposed law is recommended to follow both the U.S. and the Malaysian laws as they clearly provide for both significant and continuing assistance and they give examples of significant assistance.¹³⁹⁵ In this way, the law will avoid the vagueness of the Chinese law which is silent on issues such as continuity and significance.¹³⁹⁶

The relevant provisions on Control and Assistance can be found in the legislative text on the definition of a franchise,¹³⁹⁷ and the rights and obligations of the parties.¹³⁹⁸

1.2.2 Marketing Plans

A franchisee should be required to operate the business in accordance with the franchisor's instruction and assistance through the provided training, recommendations, and standards. Making the marketing plan optional would reduce the importance of the plan as one of

¹³⁹⁵ See *supra* Ch. III. 2. 2.1 (discussing The Main Features of Franchising Relationship Rules in the United State, China, and Malaysia: Control and Assistance).

¹³⁹⁶ *Id.*

¹³⁹⁷ See *supra* Ch. III.2.1 (discussing The Main Features of Franchising Relationship Rules in the United State, China, and Malaysia: Definition).

¹³⁹⁸ See *supra* Chapter III.2.13 (discussing The Main Features of Franchising Relationship Rules in the United State, China, and Malaysia: Rights and Obligations of the Parties).

the core elements of franchising. It would also reduce the franchisor's ability to supervise a franchisee's conduct and could affect the franchisor's goodwill.

Accordingly, the proposed law should follow the California Franchise Relations Act since it encompasses a comprehensive definition of a marketing plan.¹³⁹⁹ The proposed Egyptian franchising law should, however, avoid the only exception to this rule recognized by a U.S. court, that the marketing plan element is satisfied, "[W]hen the franchisee has a right but not an obligation to use the plan."¹⁴⁰⁰

The relevant provisions on Marketing Plans can be found in the legislative text on the definition of a franchise.¹⁴⁰¹

1.2.3 Community of Interests

The proposed Egyptian franchising law should require the existence of a community of interests in franchise transactions because the general rules of contract law in Egypt require only the existence of a cause as one of the elements of a contract. Article 136 of the Egyptian Civil Law provides that any contract that does not have a mutual reason or an exchange of interests between the contracting parties, is void.¹⁴⁰² Accordingly, the Egyptian law is recommended to follow the U.S. law and require a community of interests as one of the franchising element.¹⁴⁰³

¹³⁹⁹ See *supra* Ch. III.2.2.2 (discussing The Main Features of Franchising Relationship Rules in the United State, China, and Malaysia: Marketing Plan).

¹⁴⁰⁰ *Id.* See also, *To-Am Equip. Co. v. Mitsubishi Caterpillar Forklift Am., Inc.*, 152 F.3d 658, 661 (7th Cir. 1997); *Pitegoff & Garner*, *supra* note 441, at 190.

¹⁴⁰¹ See *supra* Ch. III.2.1 (discussing The Main Features of Franchising Relationship Rules in the United State, China, and Malaysia: Definition).

¹⁴⁰² Egyptian Civil Law, *supra* note 503, at art. 136

¹⁴⁰³ *Id.*; see also Ch. III. 2.2. 3 (discussing The Main Features of Franchising Relationship Rules in the United State, China, and Malaysia: Community of Interests).

The following legislative text is recommended on community of interests in the proposed Egyptian franchising law:

A franchising agreement is a synallagmatic, commutative contract in which the franchisor and franchisee have a community of interests consisting of an interdependent common financial interest in the success of the franchised business.

1.2.4 Fees

The proposed Egyptian franchise law should make clear that payment of franchise fees is one of the elements of a franchise. In other words, a franchisee is required to pay a franchisor fees in return for the right to use the franchisor's intellectual property, marketing plan, training services, and other facilities produced by the franchisor.

Additionally, to avoid future disputes among the franchising parties and to facilitate the process of franchising, the proposed law should be flexible and make clear that payment methods, types of fees paid, and persons paying and receiving the fees are flexible issues to be agreed upon by the parties. Addressing these issues will make it easier for parties to agree on straightforward provisions on fees in their franchising agreements.

Furthermore, to avoid contradiction or fraud by any of the parties, the law should require that all statements regarding fees be the same in both the franchise agreement and disclosure documents. The proposed law should also mandate that the description of fees and other issues related to fees, such as payment methods, be in writing.

Accordingly, to emphasize fees as one of the basic elements of a franchise transaction, the Egyptian law may follow any of the three analyzed systems as all three clearly emphasize the importance of fees.¹⁴⁰⁴ Regarding definition and types of fees, payment methods, payment

¹⁴⁰⁴ See *supra* Ch. III.2.2.4 (discussing The Main Features of Franchising Relationship Rules in the United State, China, and Malaysia: Fees).

schedules, who should pay, and any other rules related to fees,¹⁴⁰⁵ the proposed law is recommended to follow the New Rule rather than the Chinese and Malaysian laws.¹⁴⁰⁶ That is because the U.S. law, unlike the Chinese New Regulations and the Malaysian Act, has a general and broader rule that covers the different types of fees to be paid, payment methods, whether payment can be made by a franchisee or its representatives, and so forth.¹⁴⁰⁷

Additionally, the proposed law should require the contracting parties to provide a separate clause in their agreement describing all issues related to fees and that fees charged must be in accordance with those mentioned in the disclosure documents. Providing such a rule will facilitate proof of fee issues in future disputes. Both the Malaysian and Chinese laws can be followed in this regard as they each have a comprehensive rule discussing such a clause.¹⁴⁰⁸ The U.S. law does not have a parallel rule. In the same context, the proposed law should provide a penalty for breach of the commitment to provide a separate clause in the agreement describing issues related to fees. The Chinese Regulations is the only law that mentions the issue of penalties, therefore the proposed Egyptian law is encouraged to follow its rule.¹⁴⁰⁹

In addition to requiring a writing outlining all fee issues, the law should also require written proof of any payment made before the franchise agreement was finalized, the purpose of that payment, and the conditions warranting a refund of that payment. Having this rule will protect franchisees from fraud, deception, or denial by franchisors of receiving any money from franchisees. This is especially important in the context of retail franchises or small franchises.

¹⁴⁰⁵ *Id.*

¹⁴⁰⁶ *Id.*

¹⁴⁰⁷ *Id.*

¹⁴⁰⁸ *Id.*

¹⁴⁰⁹ *Id.*

The proposed Egyptian law is recommended to follow the Malaysian law in this regard because it is the only law that provides for a similar rule.¹⁴¹⁰

The relevant provisions on fees can be found in the legislative text on the definition of a franchise.

1.2.5 Intellectual Property

1.2.5.1 Trademarks

In view of the fact that Egypt has an independent law that regulates trademarks, the proposed Egyptian franchising law need not include any separate rules on trademarks except a general reference that the law regulating trademarks in franchise transactions is the Egyptian Intellectual Property Law. To state trademark rules in the proposed law would lead to the duplication of rules in both the Egyptian Intellectual Property Law and the proposed Egyptian franchise law.¹⁴¹¹ The guiding laws in this respect are the Chinese Regulations and the Malaysian Act that refer to the application of their intellectual property laws regarding use of trademarks in franchise agreements.¹⁴¹²

Nevertheless, other references to trademarks in the proposed franchising law appear necessary. For example, licensing the use of trademarks is the core of franchising transactions. The Malaysian Act may be used as guidance in this respect because it mandates that a franchise agreement provide for the franchisee's right to use the authorized mark .¹⁴¹³

¹⁴¹⁰ *Id.*

¹⁴¹¹ *Id.*

¹⁴¹² *See supra* Ch. III.2.2.5 (discussing The Main Features of Franchising Relationship Rules in the United State, China, and Malaysia: Licensing the Use of Intellectual Property).

¹⁴¹³ *Id.*

The following legislative text is recommended on trademark and intellectual property for the proposed Egyptian franchise law:

Licensing the use of a franchisor's trademark, service mark, trade name, or any other similar intellectual property should take place in accordance with the Law on Protection of Intellectual Property No. 82 of 2002.

1.2.5.2 Trade Secrets

Similar to trademarks, trade secrets are comprehensively protected under the Egyptian Intellectual Property Law and therefore the proposed franchising law does not need to provide many rules on trade secrets aside from a general provision that affirms the importance of their protection as confidential information. The proposed franchising law may refer to the application of the general rules on undisclosed information provided by Egyptian Intellectual Property Law in this respect.¹⁴¹⁴ Nevertheless, the proposed franchising law should require the franchisee to provide written confirmation to the franchisor that the franchisee will not disclose any of the confidential information delivered to him by the franchisor in the context of the operation of the franchised business. The Malaysian Act may be followed in this respect, as it explicitly requires this written confirmation.¹⁴¹⁵

Moreover, the law is recommended to require that the confidentiality obligation continue to run after the termination of the franchise agreement for a reasonable period of time to guarantee protection of the franchisor's confidential information. Proper penalties must be imposed for breach of the franchisees' obligation to keep the information confidential.

The following legislative text is recommended on trade secrets and intellectual property in general in the proposed Egyptian law:

¹⁴¹⁴ *Id.*

¹⁴¹⁵ *Id.*

In addition to considering the Law on Protection of Intellectual Property No. 82 of 2002 and the Law on the Protection of Competition and the Prohibition of Monopolistic Practices No. 3 of 2005, the following shall be considered:

a) A franchisee has to give the franchisor a written assurance that the franchisee and his employees will not disclose any information contained in the operation manual, obtained while undergoing training organized by the franchisor, or any other information given by the franchisor to the franchisee where the franchisee is notified in writing that it is deemed to be a confidential information, during the franchise term and for two years after termination of the franchise agreement.

1.2.5.3 Unfair Competition

As mentioned earlier, Egypt has two laws that deal with competition. The Egyptian Intellectual Property Law deals with disclosure of information that leads to unfair competition and the Egyptian Competition Law deals with anti-monopolistic actions.¹⁴¹⁶ Accordingly, the proposed franchising law is recommended to have only a general provision conferring protection on franchisors against competitive franchisee activities with a penalty for breach of this provision. The Malaysian Act's requirement that franchisees provide franchisors with written assurance of non-competition both during the performance of the agreement and for two years after its termination is a reasonable rule that should be followed by the proposed Egyptian franchising law.¹⁴¹⁷

The following legislative text is recommended on unfair competition in the Egyptian proposed law:

In addition to considering the Law on Protection of Intellectual Property No. 82 of 2002 and the Law on the Protection of Competition and the Prohibition of Monopolistic Practices No. 3 of 2005, the following shall be considered:

a) The franchisee shall give the franchisor a written assurance that the franchisee and his employees will not carry on any other business similar to the franchised

¹⁴¹⁶ The Protection of Competition and the Prohibition of Monopolistic Practices does not prohibit action harmful to fair competition if committed by governmental enterprises. *See* Egyptian Competition Law, *supra* note 931, at art. 9.

¹⁴¹⁷ *See supra* Ch.III. Sec. 2 (2) (5) (discussing The Main Features of Franchising Relationship Rules in the United State, China, and Malaysia: Licensing the Use of Intellectual Property).

business during the term of the franchise agreement and for two years after the termination of the franchise agreement.

1.3 Scope of the Law

The proposed Egyptian franchising law is recommended to adopt the rule that franchise transactions are regulated by the proposed law if the franchise sale or offer, acceptance, or both take place in Egypt as long as the franchise is located in Egypt. This rule would guarantee regulation of all franchising transactions. Thus, the Egyptian law should follow both the New Rule and the Malaysian law in this respect.¹⁴¹⁸ Accordingly, the law will apply to transactions taking place in Egypt in instances where the offer, acceptance, or performance of the franchise contract takes place in Egypt.

The Egyptian law is also recommended to require any franchisor intending to sell a franchise to a non-Egyptian to first get the Registrar's approval. This requirement is justified by the fact that franchising agreements may include the transfer of complicated technology or technology that needs to be authorized by the government before entering the country or being used by the public. The Egyptian law is recommended to follow the Malaysian law in this respect because Malaysia is the only country that has such a restriction.¹⁴¹⁹ The Registrar's decision may be appealed to the competent minister if the Registrar declines.¹⁴²⁰ This guarantees that more than one competent authority will review the decision.

The law is also recommended to avoid the Chinese law's restrictions on foreign franchisors that require having at least two direct sales stores in China that have been in

¹⁴¹⁸ See *supra* Ch. III.2.3 (discussing The Main Features of Franchising Relationship Rules in the United State, China, and Malaysia: Scope of Application).

¹⁴¹⁹ *Id.*

¹⁴²⁰ *Id.*

operation for at least one year.¹⁴²¹ The Egyptian law should encourage foreign investment and accordingly, should avoid procedures making foreign investment difficult .

The following legislative text is recommended to define the scope of the proposed Egyptian law:

- a) This Law applies to any franchise transaction taking place in Egypt. Franchise transactions are deemed to be taking place in Egypt if, on condition that the franchised business is operated in Egypt:
 - i) An offer to sell or buy a franchise is made in Egypt and accepted within or outside Egypt;
 - ii) An offer is made outside Egypt, but accepted within Egypt; or
- b) If any of the provisions of this Law and any other laws contradict; the provisions of this Law shall prevail.
- c) A franchisor who intends to sell a franchise in Egypt to a person who is not an Egyptian citizen shall obtain the approval of, and be subject to the conditions which may be imposed by, the Registrar according to Registration rules provided by this Law.
- d) A foreign person who intends to sell a franchise in Egypt shall submit an application to the Registrar according to Registration rules provided by this Law.
- i) A person, who is aggrieved by any decision of the Registrar under Paragraphs (c) and (d) of this Section, may appeal to the Minister within a month from the date the decision of the Registrar is communicated to the person, in accordance with the rules regulating appeal of the Registrar's Decision provided by this Law.

1.4 Foreign Investment

The Egyptian law is strongly recommended to provide as many accommodations as possible for foreign investors. Due to the economic chaos following the January Revolution, Egypt needs to regain the confidence and attention of its investors. This will help to revive the Egyptian economy and shorten the economic recovery period. Examples of accommodations may include those provided by the U.S. law such as allowing submission of audited financial

¹⁴²¹ *Id.*

statements acceptable by foreign franchisors' countries and exempting specific types of transactions from disclosure procedures.¹⁴²²

The proposed Egyptian law should be as flexible as possible to support foreign investment in the franchising industry. The features of the New Rule may be considered in this regard, including requiring submission of disclosure documents in a reasonable period of time.¹⁴²³

The relevant provisions on Foreign Investment can be found in the legislative text on Disclosure.¹⁴²⁴

1.5 Liability

1.5.1 Liability Arising Out of Pre-Contractual Negotiations

The recommended Egyptian franchising law should provide explicit rules on disclosure during pre-contractual negotiations in addition to the general rules of both the Egyptian Civil and Commercial Laws on liability during pre-contractual negotiations. Providing rules regulating each contracting party's actions and sanctions for breaching those rules would deter fraudulent behavior or breach of disclosure requirements before contracting by any of the parties. Hence, the proposed law is recommended to avoid the silence of the American, Chinese, and Malaysian systems on disclosure during pre-contractual negotiations.¹⁴²⁵

¹⁴²² See *supra* Ch. III.2.4 (discussing The Main Features of Franchising Relationship Rules in the United State, China, and Malaysia: Foreign Investment).

¹⁴²³ *Id.*

¹⁴²⁴ See *supra* Ch. III.3 (discussing The Main Features of Franchising Relationship Rules in the United State, China, and Malaysia: Disclosure).

¹⁴²⁵ *Id.*

In addition, because the three legal systems studied are silent on confidentiality obligations during pre-contractual negotiations, the Egyptian law should not follow any of them.¹⁴²⁶ The Egyptian law is recommended to provide a confidentiality requirement for any information disclosed to franchisees before the conclusion of the franchise agreement to avoid misuse of any of the information provided.

The following legislative text is recommended to regulate the liability arising out of pre-contractual negotiations in the proposed Egyptian law:

- a) During the negotiations prior to the conclusion of the franchising agreement, the franchisor shall reveal to the franchisee any potential risks that may accompany the operation of the franchised business and in particular risks related to the effects of the transferred know-how on the environment, public health, or safety of lives and property. The franchisor should further provide the franchisee with access to the means known thereto whereby the licensee can avoid such risks;
- b) The franchisee must provide the franchisor a written assurance that the franchisee will not disclose any information revealed to him during the pre-contractual negotiations as long as the franchisee is notified in writing that this information is deemed to be confidential.
- c) It is unlawful for any person in connection with the offer, sale, or purchase of any franchise directly or indirectly to make any untrue statement of a material fact or omit any material fact that is required to be stated therein.

1.5.2 Contractual Liability and Liability to Third Parties

The Egyptian Civil Law provides a general rule that applies to both vicarious and direct liability and to different types of contracts. The Law provides that a master is liable for the damage caused by an unlawful act of his servant so long as the act was committed in the course of or as a result of, the servant's contractual relationship with the master.¹⁴²⁷ The Law does not distinguish between vicarious and direct liability, rather it provides a general rule that a master is

¹⁴²⁶ *Id.*

¹⁴²⁷ Egyptian Civil Law, *supra* note 503, at art. 174.

liable for injuries caused by his servant as long as the injury arises during the performance of a task related to the scope of the work for the master.¹⁴²⁸ A master-servant relationship exists when a person controls and supervises his follower's behavior.¹⁴²⁹ These general rules should apply to franchisors-franchisees contractual relationships, as franchise relationships encompass a degree of control exercised by the franchisor.¹⁴³⁰

Hence, the proposed Egyptian franchising law does not need to provide rules on vicarious liability as it is explicitly regulated by the general rules of the Egyptian Civil Law. The Egyptian law would be following the approach of the Chinese and Malaysian laws that leave the issue of vicarious liability to be regulated by general rules of contracts.¹⁴³¹

The following legislative text is recommended to regulate the liability to third party in franchising agreements:

In respect of liability to third parties arising in connection with franchise agreements, Article 174 of the Egyptian Civil Law shall apply.

1.5.3 Indemnity and Insurance Clauses

Indemnification clauses in Egypt are usually outside the scope of the laws. Thus, indemnification clauses are left to be regulated by the agreement of the contracting parties. Accordingly, the proposed franchising law is need not have provisions on indemnification.

1.6 Remedies

¹⁴²⁸ *Id.*

¹⁴²⁹ *Id.*

¹⁴³⁰ *See supra* Ch. III. 2.1 (discussing The Main Features of Franchising Relationship Rules in the United State, China, and Malaysia: Control and Assistance).

¹⁴³¹ *See supra* Ch. 2.5.2 (discussing The Main Features of Franchising Relationship Rules in the United State, China, and Malaysia: Contractual Liability and Liability to Third Parteis).

Providing remedies for breach of any of the law's requirements will encourage better compliance with the law. In this respect, the Egyptian Civil Law provides general rules on damages and injunctive relief.¹⁴³² The Egyptian Civil Law requires the specific performance of obligations arising out of agreements unless performance is impossible in which case monetary compensation can be paid. According to the Egyptian Civil Law, the court estimates the amount of damages to be paid, unless otherwise provided for in the agreement or by law.¹⁴³³ Damages include losses suffered, lost profits,¹⁴³⁴ and compensation for non-monetary harms such as pain, suffering, loss of consortium, disfigurement, damage to reputation, and loss of mental or physical capacities.¹⁴³⁵ Hence, the proposed franchising law should not provide for any new rules in this respect because the general rules of the Egyptian Civil Law would apply to franchisor-franchisee relationships.

Nevertheless, the proposed Egyptian franchising law is recommended to provide rules on the repurchase of inventory and payment for goodwill as long as the Egyptian Civil Law does not provide any rules in this respect. Requiring the franchisor to buy the franchisee's inventory if the franchisor terminates or refuses to renew the franchise agreement without good cause would protect franchisees by reducing the likelihood of franchisors terminating the franchise relationship in an abusive way. The U.S. law's rules on payment for goodwill and repurchase of inventory may be used as guidance.¹⁴³⁶

¹⁴³² Egyptian Civil Law, *supra* note 503, at art. 203.

¹⁴³³ *Id.* at arts. 126, 221.

¹⁴³⁴ *Id.* at art. 221.

¹⁴³⁵ *Id.* at art. 222.

¹⁴³⁶ *See supra* Ch. III.2.6 (discussing The Main Features of Franchising Relationship Rules in the United State, China, and Malaysia: Remedies).

The following legislative text is recommended on remedies in the proposed Egyptian law:

a) Beside the general rules provided by the Egyptian Civil Law and applicable to the performance of a contract, remedies for breach, injunctive relief, and any other consequences arising thereof, the franchisor shall, upon termination of the franchise agreement without good cause, at the franchisee's option, repurchase at the franchisee's net cost, the franchisee's inventory, supplies, equipment, and furnishings purchased by the franchisee from the franchisor or its approved sources; however, no compensation shall be allowed for the personalized items which have no value to the franchisor.

b) Any fraudulent act committed by the franchisee that leads to the destruction of the franchisor's goodwill should result in the payment of damages for loss of goodwill. The amount of damages to be paid is to be determined by the court if not agreed upon by the franchising parties.

1.7 Good Faith

The Egyptian Civil Law provides a general requirement that a contract must be performed in good faith.¹⁴³⁷ It also requires parties fulfilling their obligations under a contract to consider any obligation required by the law, customs, equity, or reasonable requirements of similar contracts.¹⁴³⁸ Additionally, the Egyptian Civil Law requires that the interpretation of a contract's provision should take into consideration the joint intentions of the contracting parties in light of industry custom, the course of dealing between the parties, and the trust and confidence that is supposed to exist between the parties.¹⁴³⁹

Beside the general rules on good faith in performing contracts, the proposed Egyptian franchising law should provide specific rules on good faith in franchising transactions. The importance of having separate provisions in the proposed law on good faith and fair dealing is because a violation of the covenant of good faith and fair dealing in franchising may result in severe consequences. For example, destruction of the franchisor's goodwill or loss of the

¹⁴³⁷ Egyptian Civil Law, *supra* note 503, at art. 147.

¹⁴³⁸ *Id.* at art. 148(1).

¹⁴³⁹ *Id.* at art. 150(2).

franchisee's capital invested in the franchised business. Also, franchise relationships are very complicated and full of controversies that produce particular meanings and standards for good faith and fair dealing. Examples of these controversies include advertising and marketing processes, territorial rights, pricing of goods, renewal, transfer, and termination.

Accordingly, the proposed Egyptian law should define good faith in franchise agreements and require the franchising parties, their employees, agents, and any other concerned party to act in a fair way toward the other party. The law should also provide examples of good faith while performing the franchise agreements such as the reasonableness of franchise fees and the provision of significant assistance by franchisors. The definition and examples of good faith provided by the Malaysian Franchise Act should be followed in this respect¹⁴⁴⁰ because it is the only law that provides examples of good faith in franchising transactions.

The good faith provision is also recommended to provide penalties. Providing a penalty will encourage strict application of the principle and protect weaker parties in case any of the agreement's provisions are unfairly drafted in favor of one of the parties and also reduces the likelihood of future disputes.

Finally, the proposed law should avoid the Chinese rule on good faith because it is not comprehensive and provides only a general rule without explaining the application of good faith in the context of franchising and the penalties to be applied in case of breach.¹⁴⁴¹

The following legislative text is recommended to define good faith in franchise agreements in the Egyptian proposed law:

¹⁴⁴⁰ See *supra* Ch. III.2.7 (discussing The Main Features of Franchising Relationship Rules in the United State, China, and Malaysia: Good Faith).

¹⁴⁴¹ *Id.*

- a) Franchising parties shall act in good faith. Good faith means the duty of each of the franchising parties and their officers, employees, or agents to act in a fair and equitable manner to guarantee a certain degree of freedom from coercion, intimidation, or threats of coercion or intimidation.
- b) A breach of good faith shall include:
- i) Substantial and unreasonable overvaluation of fees and prices;
 - ii) Conduct which is unnecessary and unreasonable in relation to the risks to be incurred by one party;
 - iii) Conduct that is not reasonably necessary for the protection of the legitimate business interests of the franchising parties or the franchised business;
 - iv) Making untrue statements of a material fact or omitting to state a necessary material fact;
 - vi) Dishonesty or trickery;
 - vii) Violation of reasonable commercial standards of fair dealing; or
 - v) Engaging in any fraudulent act, practice, or course of business or deceit upon any person.

1.8 Agreement Formation

1.8.1 Form

The general rule provided by the Egyptian Civil Law is that a contract is concluded the moment parties exchange their assent to the agreement, unless another law requires special formalities for the conclusion of a specific contract such as a writing or delivery of a specific object.¹⁴⁴² Expressing a party's will to contract may take place in writing, by committing an action that confirms the party's will to conclude the contract, or by implied expressions if neither the law nor the parties require explicit expressions.¹⁴⁴³ Some specific laws, however, provide exceptions to this general rule. Examples include the exception provided by the Egyptian Civil Law that business associations' articles of incorporations have to be written otherwise they are

¹⁴⁴² *Id.* at art. 89.

¹⁴⁴³ *Id.* at art. 90.

deemed to be invalid ¹⁴⁴⁴ and the requirement of the Egyptian Commercial Law that a transfer of technology agreement has to be written.¹⁴⁴⁵

The proposed Egyptian franchising law is recommended to require that franchise agreements be in writing with certain information such as the parties' personal information, fee requirements, duration, training needs, operation standards, and consumers' rights and liabilities. The proposed law should also provide that if the agreement is not in writing, it will be voidable at the franchisee's choice. Rendering deficient agreements void serves to protect the interests of franchisees, to encourage efficiency, and to mitigate future problems. Additionally, since the proposed Egyptian law allows for termination by the franchisor in cases where the franchisee refuses or otherwise fails to comply with the agreement's provisions, the voiding requirement serves as a kind of balance between franchisors' and franchisees' rights. The reasons behind a writing requirement include facilitating the process of proof in future disputes and protecting franchisees, particularly in a country like Egypt where most franchisees are small corporations or individuals dealing with international or multinational companies. Franchising agreements also usually include the transfer of complicated know-how and the attendant complicated rights and obligations arising thereof which also necessitates the need for writing. Accordingly the Chinese and Malaysian laws should be followed in this respect since they require franchise agreements to be in writing.¹⁴⁴⁶

The following legislative text is recommended on the form of a franchise agreement in the Egyptian proposed law:

¹⁴⁴⁴ *Id.* at art. 507(1).

¹⁴⁴⁵ Egyptian Commercial Law, *supra note* 504, at art. 74(1).

¹⁴⁴⁶ *See supra* Ch. III.2.8.1 (discussing The Main Features of Franchising Relationship Rules in the United State, China, and Malaysia: Agreement Formation: Form).

- i) A franchise agreement shall be in writing.
- ii) A franchise agreement shall contain, at least:
 - (1) Basic information with respect to the franchisor and the franchisee;
 - (2) Name and description of the product(s) and/or business under the franchise;
 - (3) The territorial rights granted to the franchisee;
 - (4) The franchise fee, promotion fee, royalties, or any related type of payment which may be imposed on the franchisee, if any
 - (5) The obligations of the franchisor;
 - (6) The obligations of the franchisee;
 - (7) The franchisee's rights to use the mark or any other intellectual property, pending the registration or after the registration of the franchise;
 - (8) A description pertaining to the mark or any other intellectual property owned or related to the franchisor which is used in the franchise;
 - (9) The conditions under which the franchisee may assign the rights under the franchise;
 - (10) The type and particulars of assistance provided by the franchisor;
 - (11) The duration of the franchise agreement and the terms of renewal;
 - (12) The effect of termination or expiration of the franchise agreement;
 - (13) Sale promotion, advertising and publicity with respect to the products or services;
 - (14) Liabilities for breach of contract;
 - (15) Dispute resolution methods; and
 - (16) Any other issues agreed upon by the franchising parties.
- iii) Failure to comply with Paragraph (i) of this Section. shall render the franchise agreement voidable at the option of the franchisee. Shall the franchisee decides to continue the agreement, the franchisee shall be entitled of a compensation decided by the competent judge.

1.8.2 Minimum Term

The rule under the Egyptian Civil Law is that contracting parties have the freedom to set the terms of their contract unless the law itself provides for minimum terms. For example, the technology transfer rule that requires a duration of at least five years otherwise it is considered void.¹⁴⁴⁷

The proposed Egyptian franchising law is recommended to require a minimum duration of five years for franchise agreements.¹⁴⁴⁸ Providing a minimum term will allow franchisees time

¹⁴⁴⁷ Egyptian Commercial Law, *supra* note 504, at art. 86.

¹⁴⁴⁸ Egyptian law has a similar rule with regard to technology licensing agreements. *Id.* at art. 86.

to run their businesses properly. The proposed Egyptian franchising law should follow the Malaysian Franchise Act because it requires a minimum term of five years.¹⁴⁴⁹ In addition, the Egyptian law should avoid the silence of the U.S. law with respect to the minimum duration of franchise agreements and the vague rule of the Chinese law that leaves it optional to the parties.

The following legislative text is recommended on the term of a franchise agreement in the Egyptian proposed law:

A franchise term shall be five years or longer. Renewal periods after the initial term may be for a period shorter than five years.

1.8.3 Renewal

The general rule of contracts in the Egyptian legal system is that renewal is left to the agreement of the contracting parties, except in limited instances such as agency. When an agency agreement term terminates, the principal is not allowed to refuse to renew it if the agent asks.¹⁴⁵⁰ In franchising, the proposed Egyptian law is recommended to require franchisors to accept renewal if requested by franchisees unless the franchisor has good cause to decline. The proposed Egyptian franchising law should follow the U.S. law which requires renewal unless good cause to deny the renewal exists, thus creating balance between franchisors' and franchisees' interests in renewal.¹⁴⁵¹ The proposed franchising law is recommended to avoid both

Each party to the technology transfer contract may, after the lapse of five years from the contract date, apply for either terminating the contract or reconsidering the conditions thereof by amending them in the light of the prevailing general economic conditions. The said application may be resubmitted every five years, unless another period is agreed upon.

Id.

¹⁴⁴⁹ See *supra* Ch. III. 2.8.2 (discussing The Main Features of Franchising Relationship Rules in the United State, China, and Malaysia: Minimum Terms).

¹⁴⁵⁰ Egyptian Commercial Law, *supra* note 504, at art. 189.

¹⁴⁵¹ See *supra* Ch. III.2.8.1 (discussing The Main Features of Franchising Relationship Rules in the United State, China, and Malaysia: Form).

Chinese and Malaysian attitudes on renewal. This is because they seem extremist.¹⁴⁵² The Chinese law is silent on the issue of renewal and the Malaysian law grants franchisees absolute rights to extend the agreement at any time before its expiration and penalizes franchisors that decline renewal.¹⁴⁵³

The following legislative text is recommended on the renewal of franchise agreements in the proposed Egyptian law:

- i) A franchisor shall not refuse to renew a franchise unless both of the following apply:
 - (1) The franchisee has been notified of the franchisor's intent not to renew at least six months prior to the expiration date or any extension of the franchise agreement and
 - (2) Any of the following circumstances exist:
 - (a) Good cause, as defined in Section 8 (e) (ii), provided that the refusal of the franchisor to renew is not arbitrary or capricious;
 - (b) The franchisor and franchisee agree, in writing, not to renew the franchise; or
 - (c) The franchisor completely withdraws from, directly or indirectly, distributing its products or services in the geographic market served by the franchisee, provided that upon expiration of the franchise, the franchisor agrees not to seek to enforce any covenant of the non-renewed franchisee not to compete with the franchisor or franchisees of the franchisor.
- ii) As a condition of renewal of the franchise, a franchise agreement may require that the franchisee meet the current requirements for franchises and that the franchisee execute a new agreement incorporating the current terms and fees for new franchises.

1.8.4 Transfer

The general rules of contracts leave the issue of transfer to be dealt with through the contractual relationship. Accordingly, the proposed Egyptian franchising law should regulate the issue of transfer of a franchise agreement to avoid any legislative gaps. The proposed Egyptian law should adopt the rule that a franchisee may not transfer the franchise agreement except with

¹⁴⁵² *Id.*

¹⁴⁵³ *Id.*

authorization from the franchisor. The reason behind this suggestion is that a franchisor is not required to accept a contracting party he did not choose. In the same context, the law should also require a franchisee to grant the franchisor the right of first refusal before offering transfer of the franchise to a third party. Similarly, the Egyptian law is not recommended to require a franchisor to have good cause to decline transfer but rather grant the franchisor the absolute right to decline. Hence, the Egyptian law may combine the rules provided by both the Chinese and U.S. law in this respect.¹⁴⁵⁴ The Chinese law provides a reasonable rule on transfer that allows the transfer of a franchise agreement on condition of the agreement of the franchisor.¹⁴⁵⁵ Also, the U.S. law prohibits a franchisor from withholding his consent to the transfer as long as the transferee meets the reasonable qualifications of the franchisor.¹⁴⁵⁶ The proposed Egyptian franchising law is recommended to avoid the Malaysian attitude on transfer because the Malaysian Act is silent in this respect.¹⁴⁵⁷

The following legislative text is recommended on the transfer of franchise agreements in the proposed Egyptian law:

- i) The franchisee may transfer the franchised business to a transferee, provided that:
 - (1) The franchisee obtains previous authorization of the franchisor that the franchisor permits transfer to the transferee;
 - (2) The transferee satisfies the reasonable current qualifications of the franchisor for new franchisees. For the purpose of this Section, a reasonable current qualification for a new franchisee is a qualification based upon a legitimate business reason;

¹⁴⁵⁴ See *supra* Ch. III.2.8.1 (discussing The Main Features of Franchising Relationship Rules in the United State, China, and Malaysia: Form).

¹⁴⁵⁵ *Id.*

¹⁴⁵⁶ *Id.*

¹⁴⁵⁷ *Id.*

- (3) The franchisor may exercise a right of first refusal contained in a franchise agreement after receipt of a proposal from the franchisee to transfer the franchise; and
- (4) The franchisor may amend any of the transferred franchise agreement provisions in accordance with this Law.
- ii) In all cases, the franchisor may require as a condition of a transfer any of the following:
- (1) That the transferee successfully complete a reasonable training program;
 - (2) That a reasonable transfer fee be paid to reimburse the franchisor for the franchisor's reasonable and actual expenses directly attributable to the transfer;
 - (3) That the franchisee pays or makes provisions reasonably acceptable to the franchisor to pay any amount due the franchisor or the franchisor's affiliate; or
 - (4) That the financial terms of the transfer comply at the time of the transfer with the franchisor's current financial requirements for franchisees.
- iii) A franchisee shall give the franchisor no less than ninety days written notice of a transfer.
- iv) A franchisor shall not discriminate against a proposed transferee of a franchise on the basis of race, color, national origin, religion, sex, or disability.
- v) A franchisor, as a condition to a transfer of a franchise, shall not obligate a franchisee to undertake obligations or relinquish any rights unrelated to the franchise proposed to be transferred, or to enter into a release of claims broader than a similar release of claims by the franchisor against the franchisee that is entered into by the franchisor.

1.8.5 Termination

The Egyptian Civil Law's general rule on termination is that if one of the parties does not perform his obligations, the other party may, after notifying him, ask the breaching party to perform his obligations or rescind the contract.¹⁴⁵⁸ In such instances, the parties can also agree that the contract will be automatically rescinded on the condition of notification.¹⁴⁵⁹ The Egyptian Commercial Law, however, has specific termination rules with regard to specific types of commercial contracts, such as technology license agreements and commercial agency. For

¹⁴⁵⁸ Egyptian Civil Law, *supra* note 503, at arts. 157-58

¹⁴⁵⁹ *Id.*

instance, the Egyptian Commercial Law allows a contracting party to refuse to renew the agreement once it ends as long as compensation is paid to the other party.¹⁴⁶⁰

The proposed Egyptian law should provide for franchisors' right of termination for good cause and should explain precisely what good cause means. It should also provide examples of good cause that could result in termination of a franchise agreement. Good cause may include the franchisee's breach and failure to fix such breach after notification in writing by the franchisor or a franchisee's assignment of the franchise without the franchisor's agreement. Other examples may include the franchisee's failure to satisfy non-discrimination requirements in the franchise agreement, failure to act in good faith, or voluntary acts impairing execution of the franchise agreement. The proposed Egyptian law should grant franchisees time to cure any mistakes or deficiencies that may give the franchisor the legal right to terminate or refuse to renew the agreement. Furthermore, the Egyptian law should require written notice and good faith as additional conditions to termination. This would reduce the potential for termination and ensure more stability in the franchise relationship.

Hence, the proposed Egyptian franchising law may follow both the U.S. and Malaysian laws in this respect because both of them have straightforward and flexible rules that allow termination on the condition of good cause.¹⁴⁶¹ They also require franchisors to grant franchisees time to cure any mistakes to avoid termination.¹⁴⁶² Besides, providing for a termination notice

¹⁴⁶⁰ Egyptian Commercial Law, *supra* note 504, at art. 86.

¹⁴⁶¹ See *supra* Ch. III.2.8.5 (discussing The Main Features of Franchising Relationship Rules in the United State, China, and Malaysia: Termination).

¹⁴⁶² *Id.*

informs franchisees of the franchisor's intention to terminate at a reasonable time before the termination to avoid surprise.¹⁴⁶³

Finally, the Egyptian law should allow franchisees to terminate the franchise agreement in certain cases such as for a franchisor's intentional failure to meet disclosure requirements. This would create balance between the franchising parties' rights of termination. The Chinese law should be followed in this respect because it is the only one that allows franchisees to terminate the franchise agreement.¹⁴⁶⁴

The following legislative text is recommended on the termination of franchise agreements in the proposed Egyptian law:

- i) The franchise agreement may not be terminated before the expiry of its term unless:
 - (1) Franchising parties mutually agree to a termination; or
 - (2) The court decides that there are certain conditions in the franchise agreement that merit the agreement to be terminated.
- ii) The franchisor shall have the right to terminate the franchise agreement before the expiry of its terms only if the franchisor has good cause for the termination, provided that the franchisor gives the franchisee a written notice of such termination at least ninety days in advance of such termination. Good cause includes, among others:
 - (1) Refusal or failure of a franchisee to comply substantially with the franchise agreement of the franchise agreement or any other relevant agreement entered into between the franchisor and franchisee;
 - (2) The failure of the franchisee to remedy the breach committed by him or any of his employees within the period stated in a written notice given by the franchisor, which shall not be less than fourteen days, for the breach to be remedied;
 - (3) The franchisee's assignment of the franchise rights in breach of transfer rules provided by this Law;
 - (4) Voluntary abandonment by the franchisee of the franchised business;
 - (5) A criminal conviction of the franchisee that substantially impairs the goodwill associated with the franchisor's mark or other intellectual property;
 - (6) The franchisee's failure to comply with confidentiality rules provided by this Law; and

¹⁴⁶³ *Id*

¹⁴⁶⁴ *Id.*

(7) The franchisee's failure to comply with competition rules provided by this Law.

iii) Provided that the franchisee gives the franchisor a written notice of such termination at least ninety days in advance of such termination, the franchisee shall have the right to terminate the franchise agreement if:

- the franchisor conceals any information or provides false information in breach of disclosure rules provided by this Law; and
- in case of refusal or failure of a franchisor to comply substantially with the franchise agreement or any other relevant agreement entered into between the franchisor and franchisee.

1.9 Franchise Brokers

The Egyptian Commercial Law regulates brokerage contracts in a separate section for commercial brokerage.¹⁴⁶⁵ The Egyptian Commercial Law defines a brokerage contract as one in which one party undertakes, for a second party, to search for a third person to conclude certain contracts with the first party.¹⁴⁶⁶ Brokerage in franchising requires special rules that should be adopted by the proposed franchising law without contradicting any of the general rules provided by the Egyptian Commercial Law. Accordingly, the proposed Egyptian franchising law is recommended to provide specific rules on franchise brokers. Specifically, because brokerage in franchising is of a special nature, particularly since franchise brokers may come across confidential information related to know-how or other sensitive information that needs to be protected by its owner.

Hence, the proposed Egyptian law is recommended to provide a comprehensive definition of a broker that distinguishes it from other franchisor affiliates, officers, directors, and employees. The U.S. law may be followed in this respect because it defines a broker as a franchisor's representative in making offers or selling a franchise provided he is not any of the

¹⁴⁶⁵ Egyptian Commercial Law, *supra* note 504, at art. 192-207.

¹⁴⁶⁶ *Id.*

franchisor's affiliates, officers, directors, or employees.¹⁴⁶⁷ The definition in the Malaysian law should be avoided because it is very general and does not exclude other actors from the franchising broker definition.¹⁴⁶⁸

Additionally, the Egyptian law is recommended to require the disclosure of brokers' information, and to prohibit brokers from making statements that are not in compliance with disclosed information. It should also require brokers to register themselves with the Registrar and provide for a broker's obligation of confidentiality. The U.S. and Malaysian laws may be followed in this respect because both laws regulate all details related to franchise brokers such as demanding disclosure of all information related to brokers and requiring brokers to be registered.¹⁴⁶⁹

Finally, the Egyptian law is not recommended to require a broker to be Egyptian as there is no compelling rationale for this requirement. The Malaysian law should be avoided in this respect because it requires franchise brokers to be nationals.¹⁴⁷⁰ The required experience condition provided by the Malaysian law, however, is suggested, as franchising transactions are complicated and require knowledge and experience to avoid confusion and disputes.¹⁴⁷¹

The following legislative text is recommended on franchise brokers in the proposed Egyptian law:

- a) Franchise broker means any person engaged in the business of representing a franchisor in offering for sale or selling a franchise and is not a franchisor, an

¹⁴⁶⁷ See *supra* Ch. III.2.9 (discussing The Main Features of Franchising Relationship Rules in the United State, China, and Malaysia: Franchise Brokers).

¹⁴⁶⁸ *Id.*

¹⁴⁶⁹ *Id.*

¹⁴⁷⁰ *Id.*

¹⁴⁷¹ *Id.*

affiliate of a franchisor, or an officer, director or employee of a franchisor, or an affiliate of a franchisor with respect to such franchise.

b) A franchise broker shall register himself with the Registrar by filing any required information. To register with the Registrar, a franchise broker must meet the following conditions:

i) An individual broker must have experience in franchise management for at least three years and an academic qualification of a bachelor's degree level or its equivalent; and

ii) A company broker shall be legally instituted under the Companies Law No. 159 of 1981 and shall have employees with experience in franchise management for at least three years and an academic qualification of a bachelor's degree level or its equivalent.

1.10 Prohibition Against Discrimination

The proposed Egyptian franchising law should prohibit discrimination among franchisees on the basis of color, religion, sex, or other similar reasons. It should also prohibit discrimination with respect to goods and equipment supplied, services provided such as training, royalties conveyed, and renewal or transfer terms. Both the U.S. and Malaysian laws may be followed in this respect since they provide separate provisions on the prohibition of discrimination against franchisees.¹⁴⁷²

The proposed Egyptian franchising law should not prohibit discrimination in case of variations between franchisees such as requiring different levels of training, and requiring different capital to establish the franchised business. Thus, having different circumstances surrounding the conclusion of the franchise agreement or differences between franchisee requirements or expectations from the franchisor allows differential treatment of franchisees. The Egyptian law should provide for situations in which discrimination is appropriate. The Malaysian law should be followed in this respect because it provides an exception to the rule of prohibition

¹⁴⁷² See *supra* Ch. III. 2.10 (discussing The Main Features of Franchising Relationship Rules in the United State, China, and Malaysia: Prohibition against Discrimination).

against discrimination in cases where there are differences between franchisees or franchise agreements.¹⁴⁷³

The following legislative text is recommended on prohibition against discrimination in the proposed Egyptian law:

- a) It shall be an unfair franchise and a contravention of this Law for any franchisor to unreasonably and materially discriminate between franchisees operating a franchise in the charges offered or made for franchise fees, royalties, goods, services, equipment, rentals or advertising services if such discrimination will cause competitive harm to a franchisee who competes with a franchisee who receives the benefit of the discrimination, unless and to the extent that any classification of or discrimination between franchisees is:
- i) Based on franchises granted at different times, and such discrimination is reasonably related to the differences in time;
 - ii) Related to one or more programs for making franchises available to persons with insufficient capital, training, business experience or education, or lacking other qualifications;
 - iii) Related to efforts by the Government or any of its agencies to promote variation in products or service lines or business formats or designs;
 - iv) Related to efforts by one or more franchisees to cure deficiencies in the operation of franchised businesses or defaults in franchise agreements; or
 - v) Based on other reasonable distinctions considering the purposes of this Law and is not arbitrary.

1.11 Advertisements

The proposed Egyptian franchising law should require franchisors to register advertisements offering their franchises for approval before being published, distributed, or used in any way. This will provide more protection for franchisees against fraudulent actions by franchisors or from misleading offers and will also grant franchisors more reliability. The Malaysian Franchise Act may be followed when drafting a general requirement of registering franchise offers.¹⁴⁷⁴ That is due to the fact that the Malaysian Franchise Act requires franchisors

¹⁴⁷³ *Id.*

¹⁴⁷⁴ See *supra* Ch. III. 2.11 (discussing The Main Features of Franchising Relationship Rules in the United State, China, and Malaysia: Advertisement).

wishing to sell franchises to submit a copy of their advertisement to the Registrar before proceeding to publish the advertisement.¹⁴⁷⁵ The Malaysian law goes further to give the Registrar the ability to prevent misleading advertisement.¹⁴⁷⁶

Moreover, the proposed Egyptian law should provide a comprehensive definition of advertisement and its methodologies; written, printed, recorded telephone message, or spoken information as long as it is related to offering or selling a franchise. The U.S. law may be followed with respect to defining franchise offer advertisements because it provides a comprehensive definition that regulates different methods of advertising and advertising materials.¹⁴⁷⁷ The law is also recommended to prohibit false advertisements and to penalize franchisors that misuse the advertising fees collected from franchisees. The U.S. law may be followed in this respect as it explicitly prohibits untrue advertisements, provides penalties for false advertisement, requires that advertisement information be consistent with disclosure documents, and clearly mandates good faith in advertising.¹⁴⁷⁸

The following legislative text is recommended on advertising franchises in the proposed Egyptian law:

- a) A person who wishes to publish, distribute or use any advertisement offering to sell or to buy a franchise under this Law, shall file with the Registrar one original copy of the advertisement at least seven days before the first publication, distribution or use of the advertisement or such shorter period as may be approved by the Registrar, or unless the advertisement has been exempted from this section by the Registrar.
- b) The Registrar may, by order, prohibit the use of any advertising deemed to be false, fraudulent, misleading or deceptive.

¹⁴⁷⁵ *Id.*

¹⁴⁷⁶ *Id.*

¹⁴⁷⁷ *Id.*

¹⁴⁷⁸ *Id.*

c) The Registrar's decision may be appealed in accordance with the rules regulating appeal of the Registrar's decision provided by this Law.

1.12 Settlement of Disputes

Arbitration in Egypt is governed by the Egyptian Arbitration Law No. 27 of 1994 ("Egyptian Arbitration Law"), which is modeled on the United Nations Commission on International Trade Law ("UNCITRAL") Model Law.¹⁴⁷⁹ The Egyptian Commercial Law, however, is very protective of certain agreements, such as technology licensing agreements. In other words, there are very protective arbitration rules regarding these agreements that differ from the general, more flexible rules of the Egyptian Arbitration Law. For example, the Egyptian Arbitration Law gives parties to arbitration the freedom to choose the procedural and substantive law applicable to the arbitration, while it dictates that arbitration in technology licensing agreements is subject to Egyptian substantive and procedural law, which means that any agreement to arbitrate under foreign law is void.¹⁴⁸⁰ Accordingly, any foreign investor arbitrating a technology transfer agreement in Egypt is obliged to conduct the arbitration in Egypt and abide by Egyptian substantive and procedural laws and that can discourage foreign investors from transferring technology to Egypt.¹⁴⁸¹ Therefore, the franchising law is recommended to avoid similar rules. The importance of this arises in light of the fact that Middle Eastern countries are generally characterized by weak judiciaries that are not independent from their executive branches, which may interfere with the judicial process. Egypt, for example, has a highly

¹⁴⁷⁹ *Id.*

¹⁴⁸⁰ Egyptian Commercial Law, *supra* note 504, at art. 87.

¹⁴⁸¹ EL-KALOUBY, SAMEHA, THE EXPLANATION OF THE EGYPTIAN COMMERCIAL LAW PART TWO (2005) (author's translation of title, book available in Arabic) 106.

developed judiciary, but it is often under pressure from the executive branch.¹⁴⁸² As a result, arbitration is the most effective solution when there is conflict resulting from a complicated agreement such as a franchise.¹⁴⁸³

The Egyptian law should provide a general rule confirming the franchising parties' right to conclude any settlement agreement when required. The Malaysian Franchise Act should be followed in this respect because it provides for provisions on arbitration. The U.S. and Chinese laws should be avoided. Particularly because the Chinese law is silent with respect to settlement of disputes and the U.S. law does not provide conclusive rules.

The following legislative text is recommended on the settlement of disputes arising from franchise agreements in the proposed Egyptian law:

- a) Franchising parties may enter into a settlement agreement or execute a general release regarding a potential or actual civil action filed with respect of the franchise.
- b) The parties may agree to settle disputes amicably or through arbitration.

1.13 Rights and Obligations of Franchising Parties

The Egyptian law should provide a list of the franchising parties' rights and obligations. This list need not be exclusive, thus allowing more flexibility depending on the nature of each transaction. The list should provide examples of the minimum standard of rights and obligations in a franchise agreement.

The following legislative text is recommended on the rights and obligations of franchising parties in the proposed Egyptian law:

- a) The rights and obligations of the franchising parties arising of a franchise agreement include, among others:

¹⁴⁸² Lindsey, *supra* note 28, at 13.

¹⁴⁸³ *Id.*

- i) The franchisor's obligation to provide the franchisee with a written notice about a breach of the franchise agreement by the franchisee and allow the franchisee a reasonable time, of at least fourteen days, to remedy the breach.
- ii) The franchisor's obligation to provide the franchisee with assistance to operate the franchised business.
- iii) The franchisor's obligation to continuously provide business guidance, technical support, and business training to the franchisee in accordance with the stipulated contents and methods.
- iv) The franchisor's obligation not to require the franchisee to purchase or lease goods or services from the franchisor or from a designated source of supply unless such restrictive purchasing agreements are reasonably necessary for a lawful purpose justified on business grounds.
- v) The franchisor's obligation not to discriminate against franchisees.
- vi) The franchisor's obligation not to restrict a franchisee from associating with other franchisees or from participating in a trade association and the obligation to not retaliate against a franchisee for engaging in these activities.
- vii) The franchisee's obligation to pay the franchise fees, royalties, promotion fees, or any other payment as provided in the franchise agreement.
- viii) The franchisee's obligation of confidentiality.
- ix) The franchisee's obligation of non-competition imposed.
- x) The mutual obligations of the franchising parties to protect the consumer's interests at all times in accordance with the Egyptian Consumer Protection Law No. 67 of 2006.

2. Implications of Disclosure Rules

2.1 Scope of Disclosure Law

The Egyptian law does not recognize a disclosure system with respect to any civil or commercial agreement, save for a few general obligations requiring a contracting party not to hide information that may be useful to the other party in the course of good faith and fair dealing.¹⁴⁸⁴ Accordingly, requiring the proposed Egyptian franchising law to establish a disclosure and registration system with respect to franchising transactions is a challenge that would require the establishment of a new agency working under a novel system to deal with

¹⁴⁸⁴ Egyptian Civil Law, *supra* note 503, at art. 148; *see also* Egyptian Commercial Law, *supra* note 504, at art. 77. The only rules on disclosure in the Egyptian Commercial Law are provided in respect of transfer of technology agreements. However, even disclosure rules on technology transfer agreements provide general obligations on the licensor to provide the licensee with all the required information and data needed to make use of the transferred technology, but do not have a comprehensive or well-organized disclosure system. *See* Egyptian Commercial Law, *supra* note 504, at art. 77

disclosure and registration issues. The proposed Egyptian franchising law should provide a general obligation that franchisors need to submit disclosure documents before signing franchise agreements. The law should exempt from disclosure certain kinds of transactions to save time, effort, costs, and to encourage investment in the franchising sector. Recommended exemptions include the minimum payment exemption that excludes franchise transactions where franchisees do not pay more than \$500 during the six months before starting operation of the franchised business. This exemption is logical because disclosure aims at protecting franchisees who put significant capital into real investment risks by entering into franchise relationships and accordingly need disclosure of as much information as possible.¹⁴⁸⁵ In addition, providing such exemptions would encourage small businesses with limited capital to conclude franchising transactions that would keep the investment cycle running.

There should also be a fractional franchises exemption that would exclude franchise transactions that are just extensions of producing goods or services that are already offered by the franchisee within the confines of another business. Having previous business experience reduces the chances the franchisee might be misled and accordingly, requiring disclosure may not be as important.¹⁴⁸⁶ The proposed Egyptian law should also adopt a leased departments exemption; an officers, owners, and manager's exemption; a sophisticated investor exemption; and a large investment exemption. Leased departments exemptions exclude franchise relationships with independent retail franchisees who lease franchise outlets inside other business facilities such as hotels or beauty salons, allowing business owners to keep a degree of control

¹⁴⁸⁵ See *supra* Ch. III.2.3 (discussing The Main Features of Franchising Relationship Rules in the United State, China, and Malaysia: Scope of Application of the Law).

¹⁴⁸⁶ *Id.*

over operation of the business.¹⁴⁸⁷ Franchisees in these kinds of transactions may not be vulnerable to fraudulent or misleading offers.¹⁴⁸⁸ Sophisticated investor exemptions include franchisees who have been in business for at least five years and have huge net assets.¹⁴⁸⁹ These franchisees are usually experienced entities who can protect their financial interests and who are less likely to be subject to the risk of being misled by franchisors through false information and accordingly, may not need disclosure.¹⁴⁹⁰ Large investment exemptions exclude new franchisees investing huge amounts since they have a high capacity to collect all relevant information with regard to a franchised business even without disclosure requirements.¹⁴⁹¹ In addition, the proposed Egyptian franchising law should adopt an officers, owners, and managers exemption that excludes franchise transactions selling at least 50% of the franchise to “[O]fficers, owners, managers, general partners, or other individuals with management responsibility who, within 60 days from the purchase date, have been working for the sold franchise unit for at least two years before purchasing the franchise from the franchisor”¹⁴⁹² That is logical since these persons have been involved with the franchise and are less in need of disclosure.¹⁴⁹³

To draft the exemptions mentioned above, the proposed Egyptian franchising law should follow the example provided by the U.S. law as it provides for all these exemptions, unlike both

¹⁴⁸⁷ *Id.*

¹⁴⁸⁸ *Id.*

¹⁴⁸⁹ *Id.*

¹⁴⁹⁰ *Id.*

¹⁴⁹¹ *Id.*

¹⁴⁹² *Id.*

¹⁴⁹³ *Id.*

the Chinese and Malaysian laws which do not exempt any franchise transactions from disclosure rules.¹⁴⁹⁴

The only two exemptions not recommended for the Egyptian law are the oral contracts exemption, which does not fit into the Egyptian law because it should require franchise agreements to be in writing, and the petroleum marketers and resellers' transactions exemption because Egypt does not have a separate disclosure system like in the U.S.¹⁴⁹⁵

2.2 Timing of Disclosure

Concerning the time of disclosure, the proposed Egyptian franchising law is recommended to ask for disclosure thirty days before the conclusion of a franchise agreement. The reason for requiring disclosure thirty days prior to conclusion of the agreement is to provide sufficient time for franchisees to make a final decision after an opportunity to review all the documents provided by the franchisor. The law to be followed in this respect is the Chinese New Regulations because it requires franchisors to submit disclosure documents and the franchise agreement thirty days before conclusion of the agreement.¹⁴⁹⁶ The Malaysian Act and the New Rule should be avoided because they provide for ten and fourteen day periods respectively and this appears to be insufficient for a franchisee to have a proper chance to examine the disclosure documents.¹⁴⁹⁷

¹⁴⁹⁴ *Id.*

¹⁴⁹⁵ *Id.*

¹⁴⁹⁶ *See supra* Ch. III.3.2 (discussing The Main Features of Franchising Relationship Rules in the United State, China, and Malaysia: Disclosure: Timing of Disclosure).

¹⁴⁹⁷ *Id.*

Additionally, the thirty-day requirement should be determined by the date of the conclusion of the agreement. The Chinese law should be followed in this respect as it contains a similar requirement that disclosure take place thirty days before conclusion of the agreement.

Finally, the proposed Egyptian franchising law should require franchisors to inform franchisees of any changes to the information disclosed. The Egyptian law should follow the U.S. New Rule in this respect because it is the only law that refers to this obligation.¹⁴⁹⁸ Finally, electronic disclosure may not be workable in the proposed franchising law because the Egyptian technological system is not yet ready to provide such an electronic disclosure system.

2.3 Protecting the Confidentiality of Disclosed Information

Concerning the protection of the confidentiality of disclosed information, the proposed Egyptian law is recommended to provide an explicit provision that requires franchisees to keep disclosed information confidential. The law to be followed here is the Chinese law because it provides the strictest rules on confidentiality of disclosed information, to the extent that it requires franchising parties to conclude a confidentiality agreement regarding disclosed information.¹⁴⁹⁹ The Egyptian law, however, is not recommended to require a confidentiality agreement because entering into such agreements should be left to the discretion of the contracting parties.

2.4 Remedies

¹⁴⁹⁸ *Id.*

¹⁴⁹⁹ *See supra* Ch. III. 3.3 (discussing The Main Features of Franchising Relationship Rules in the United State, China, and Malaysia: Disclosure: Protecting Confidentiality of the Disclosed Information).

With respect to the remedies available for breach of any of the disclosure provisions, the proposed Egyptian franchising law should provide penalties to guarantee the proper application of disclosure requirements. Penalties may include civil penalties such as fines, contractual consequences such as rescission of the franchise agreement, or judicial penalties including cease orders and judgments for damages. The proposed law should combine the different types of penalties from the three legal systems studied. The types of penalties and amounts of fines imposed in case of breach may be borrowed from the Malaysian Act. That is particularly relevant knowing that the Malaysian exchange rate is closer to the Egyptian currency than the Chinese and American. Also, the Malaysian legal market is kind of similar to the Egyptian market, particularly in terms of economy, social life, and political life which makes it more suitable from a social point of view to follow the Malaysian Act in terms of penalties imposed. Hence, the proposed Egyptian law should require penalties similar to those required by the Malaysian law such as fines of between five and fifty thousand Egyptian pounds in case of breach of good faith obligations or for violation of the prohibition against discrimination.

2.5 Information to be Disclosed

Regarding the information to be disclosed, the proposed Egyptian law should provide a list of required information. The list of items provided by the New Rule serves as a useful reference in this respect as it is exhaustive, inclusive, and regulates different aspects of a franchise transaction.¹⁵⁰⁰

The proposed Egyptian franchising law should not make the list of information required to be disclosed restrictive. The list should be thorough and should elaborate on the different

¹⁵⁰⁰ See *supra* Ch. III.3.5 (discussing The Main Features of Franchising Relationship Rules in the United State, China, and Malaysia: Disclosure: Information to be Disclosed).

aspects of the franchise transaction, but should also be flexible to allow for more information to be included depending on the nature of the transaction and the circumstances surrounding its conclusion. Hence, the proposed Egyptian franchising law should provide a provision such as the one provided by the Chinese law that the list of items to be disclosed is not restrictive and more items may need to be included depending upon the nature of each franchising relationship.¹⁵⁰¹

The following legislative text is recommended on disclosure in the proposed Egyptian law:

- a) The franchisor shall, at least 30 days prior to the conclusion of the franchise agreement, disclose to the franchisee in writing the information required under this Section.
- b) Before disclosure, the franchisee must give the franchisor a written assurance that the franchisee and his employees will not disclose any information contained in the disclosure documents.
- c) After the franchisor discloses information to the franchisee, the franchisee shall issue a signed receipt of acknowledgment of the contents of the information obtained from the franchisor.
- d) The rules provided by this Section do not apply if the franchisor can establish any of the following:
 - i) The total of the required payments, or commitments to make a required payment, to the franchisor or an affiliate that are made any time from before to within six months after commencing operation of the franchisee's business is less than 500 Egyptian Pounds.
 - ii) The franchise relationship is a fractional franchise.
 - iii) Franchisee's initial investment, excluding any financing received from the franchisor or an affiliate and excluding the cost of unimproved land, totals at least one million Egyptian Pounds and the prospective franchisee signs an acknowledgment verifying the grounds for the exemption. This exemption applies only if at least one individual prospective franchisee in an investor-group qualifies for the exemption by investing at the threshold level stated in this section.
 - iv) The franchisee (or its parent or any affiliates) is an entity that has been in business for at least five years and has a net worth of at least 5 million Egyptian Pounds.
 - v) One or more purchasers of at least a 50% ownership interest in the franchise: within 60 days of the sale, has been, for at least two years, an officer, director, general partner, individual with management responsibility for the offer and sale of the franchisor's franchises or the administrator of the franchised network; or

¹⁵⁰¹ *Id.*

within 60 days of the sale, has been, for at least two years, an owner of at least a 25% interest in the franchisor.

e) The following information should be disclosed by the franchisor:

i) Information related to the franchisor, and any parent companies, predecessors, and affiliates:

(1) The name and principal business address of the franchisor; any parents; and any affiliates that offer franchises in any line of business or provide products or services to the franchisees of the franchisor.

(2) The name and principal business address of any predecessors during the 10-year period immediately before the close of the franchisor's most recent fiscal year.

(3) The name that the franchisor uses and any names it intends to use to conduct business.

(4) The identity and principal business address of the franchisor's agent for service of process.

(5) The type of business organization used by the franchisor (for example, corporation, partnership) and the country in which it is organized.

(6) Whether the franchisor operates businesses of the type being franchised.

(7) The business to be conducted by the franchisee.

(8) Any laws or regulations specific to the industry in which the franchise business operates.

(9) The franchisor's directors, trustees, general partners, principal officers, and any other individuals who will have management responsibility relating to the sale or operation of franchises offered by this document.

ii) Information related to whether the franchisor, a predecessor, a parent or affiliate that induces franchise sales by promising to back the franchisor financially, has or has had against him:

(1) An administrative, criminal, or material civil action alleging a violation of a franchise, antitrust, or securities law, or alleging fraud, unfair or deceptive practices, or comparable allegations;

(2) Civil actions, other than ordinary or routine litigation incidental to the business, which are material in the context of the number of franchisees and the size, nature, or financial condition of the franchise system or its business operations; and

(3) Any material civil action involving the franchise relationship in the last fiscal year.

(4) For each action above, state the title, case number or citation, the initial filing date, the names of the parties, the forum, and the relationship of the opposing party to the franchisor, and summary opinion of counsel concerning any action if counsel consent to use the summary opinion and the full opinion is attached to the disclosure document (if possible).

iii) Any information related to any pending bankruptcy proceedings or proceedings that took place during the 10-year period immediately before the date of this disclosure document against the franchisor, any parent, predecessor, affiliate, officer, or general partner of the franchisor, or any other individual who will have management responsibility relating to the sale or operation of franchises

offered by this document, and any other proceedings under the laws of foreign nations relating to bankruptcy shall be disclosed.

iv) Information related to fees:

(1) The initial fees and any conditions under which these fees are refundable. If the initial fees are not uniform, disclose the range or formula used to calculate the initial fees paid in the fiscal year before the issuance date and the factors that determined the amount. For this section, "initial fees" mean all fees and payments, or commitments to pay, for services or goods received from the franchisor or any affiliate before the franchisee's business opens, whether payable in lump sum or installments.

(2) All other fees that the franchisee must pay to the franchisor or its affiliates, or that the franchisor or its affiliates impose or collect in whole or in part for a third party.

(3) Payment method, due date, to whom payment should be made, whether each payment is non-refundable, or describe the circumstances under which a payment is refundable.

v) Information related to the estimated initial investment:

(1) Training expenses;

(2) Real property, whether purchased or leased;

(3) Equipment, fixtures, other fixed assets, construction, remodeling, leasehold improvements, and decorating costs, whether purchased or leased;

(4) Inventory to begin operating;

(5) Security deposits, utility deposits, business licenses, and other prepaid expenses; and

(6) If the franchisor or an affiliate finances part of the initial investment, the amount that it will finance, the required down payment, the annual interest rate, rate factors, and the estimated loan repayments.

vi) Information related to restrictions on sources of products and services:

(1) The franchisee's obligations to purchase or lease goods, services, supplies, fixtures, equipment, inventory, computer hardware and software, real estate, or comparable items related to establishing or operating the franchised business either from the franchisor, its designee, or suppliers approved by the franchisor, or under the franchisor's specifications. Include obligations to purchase imposed by the franchisor's written agreement or by the franchisor's practice. In particular, disclose the following:

(a) The good or service required to be purchased or leased;

(b) Whether the franchisor or its affiliates are approved suppliers or the only approved suppliers of that good or service;

(c) Any supplier in which an officer of the franchisor owns an interest;

(d) How the franchisor grants and revokes approval of alternative suppliers;

(e) Whether the franchisor issues specifications and standards to franchisees, sub-franchisees, or approved suppliers. If so, describe how the franchisor issues and modifies specifications;

(f) Whether the franchisor or its affiliates will or may derive revenue or other material consideration from required purchases or leases by franchisees;

- (g) The estimated proportion of these required purchases and leases by the franchisee to all purchases and leases by the franchisee of goods and services in establishing and operating the franchised businesses;
 - (h) If a designated supplier will make payments to the franchisor from franchisee purchases, disclose the basis for the payment (for example, specify a percentage or a flat amount);
 - (i) The existence of purchasing or distribution cooperatives;
 - (j) Whether the franchisor negotiates purchase arrangements with suppliers, including price terms, for the benefit of franchisees; and
 - (k) Whether the franchisor provides material benefits (for example, renewal or granting additional franchises) to a franchisee based on a franchisee's purchase of particular products or services or use of particular suppliers.
- vii) Information related to the obligations of the franchising parties:
- (1) Site selection and acquisition/lease;
 - (2) Pre-opening purchase/leases;
 - (3) Site development and other pre-opening requirements;
 - (4) Initial and ongoing training;
 - (5) Opening;
 - (6) Fees;
 - (7) Compliance with standards and policies/operating manuals;
 - (8) Trademarks and proprietary information;
 - (9) Restrictions on products/services offered;
 - (10) Warranty and customer services requirements;
 - (11) Territorial development and sales quotas;
 - (12) Ongoing produce/service purchases;
 - (13) Maintenance, appearance, and remodeling requirements;
 - (14) Insurance;
 - (15) Indemnifications;
 - (16) Inspections and audits;
 - (17) Transfer;
 - (18) Renewal;
 - (19) Post-termination obligations;
 - (20) Non-competition covenants;
 - (21) Dispute resolution;
- viii) Information related to financing:
- (1) The terms of each financing arrangement, including leases and installment contracts, which the franchisor, its agent, or affiliates offer directly or indirectly to the franchisee. This should include:
 - (a) What the financing covers (for example, site acquisition, construction or remodeling, initial or replacement equipment or fixtures, opening or ongoing inventory or supplies, or other continuing expenses).
 - (b) The identity of each lender providing financing and their relationship to the franchisor (for example, affiliate).
 - (c) The amount of financing offered or, if the amount depends on an actual cost that may vary, the percentage of the cost that will be financed.

- (d) The rate of interest, plus finance charges, expressed on an annual basis. If the rate of interest, plus finance charges, expressed on an annual basis, may differ depending on when the financing is issued, state what that rate was on a specified recent date.
- (e) The number of payments or the period of repayment.
- (f) The nature of any security interest required by the lender.
- (g) Whether a person must personally guarantee the debt, and if so, whether the guarantor must be a person other than the franchisee .
- (h) Whether the debt can be prepaid and the nature of any prepayment penalty.
- (i) The franchisee's potential liabilities upon default such as obligations to pay court costs and attorney's fees incurred in collecting the debt, and liabilities from cross defaults such as those resulting directly from non-payment of parties other than the franchisor, or indirectly from the loss of business property.
- (2) Whether the loan agreement requires franchisees to waive defenses or other legal rights (for example, confession of judgment), or bars franchisees from asserting a defense against the lender, the lender's assignee or the franchisor. If so, describe the relevant provisions.
- (3) Whether the franchisor's practice or intent is to sell, assign, or discount to a third party all or part of the financing arrangement. If so, state:
- (a) The assignment terms, including whether the franchisor will remain primarily obligated to provide the financed goods or services; and
- (b) That the franchisee may lose all its defenses against the lender as a result of the sale or assignment.
- (4) Whether the franchisor or an affiliate receives any consideration for placing financing with the lender. If such payments exist:
- (a) Disclose the amount or the method of determining the payment; and
- (b) Identify the source of the payment and the relationship of the source to the franchisor or its affiliates.
- ix) Information related to assistance and training:
- (1) The franchisor's principal assistance and related obligations of both the franchisor and franchisee as follows:
- (a) The franchisor's pre-opening assistance obligations to the franchisee, including any assistance in locating a site and negotiating the purchase or lease of the site. State whether the franchisor generally owns the premises and leases it to the franchisee, whether the franchisor selects the site or approves an area in which the franchisee selects a site, whether and how the franchisor must approve a franchisee-selected site, factors that the franchisor considers in selecting or approving sites, and the time limit for the franchisor to locate or approve or disapprove the site and the consequences if the franchisor and franchisee cannot agree on a site.
- (b) Assistance with conforming the premises to local ordinances and building codes and obtaining any required permits, if any.
- (c) Assistance with constructing, remodeling, or decorating the premises, if any.
- (d) Assistance with hiring and training employees.
- (e) Assistance with providing for necessary equipment, signs, fixtures, opening inventory, and supplies. State whether the franchisor provides these items directly

or only provides the names of approved suppliers, whether the franchisor provides written specifications for these items, and whether the franchisor delivers or installs these items.

(f) The typical length of time between the earlier of the signing of the franchise agreement or the first payment of consideration for the franchise and the opening of the franchisee's business. Describe the factors that may affect the time period, such as ability to obtain a lease, financing or building permits, zoning and local ordinances, weather conditions, shortages, or delayed installation of equipment, fixtures, and signs.

(g) The franchisor's obligations to the franchisee during the operation of the franchise, including any assistance in developing products or services the franchisee will offer to its customers, establishing prices, establishing and using administrative, bookkeeping, accounting, and inventory control procedures, and resolving operating problems encountered by the franchisee.

(h) The advertising, marketing, and promotions programs for the franchise system, including the franchisor's obligation to conduct advertising such as the media the franchisor may use, the source of the advertising, whether the franchisor must spend any amount on advertising in the area or territory where the franchisee is located, if franchisor permits franchisee to use their own advertising material, whether there is an advertising council composed of franchisees that advises the franchisor on advertising policies, whether the franchisee must participate in any other advertising fund. Disclose if not all advertising funds are spent in the fiscal year in which they accrue, how the franchisor uses the remaining amount, including whether franchisees receive a periodic accounting of how advertising fees are spent. Disclose the percentage of advertising funds, if any, that the franchisor uses principally to solicit new franchise sales.

(i) Whether the franchisor requires the franchisee to buy or use electronic cash registers or computer systems. If so, describe the systems generally in non-technical language, including the types of data to be generated or stored in these systems, and state the cost of purchasing or leasing the systems, any obligation of the franchisor, any affiliate, or third party to provide ongoing maintenance, repairs, upgrades, or updates, any obligations of the franchisee to upgrade or update any system during the term of the franchise, and, if so, any contractual limitations on the frequency and cost of the obligation, the annual cost of any optional or required maintenance, updating, upgrading, or support contracts, and whether the franchisor will have independent access to the information that will be generated or stored in any electronic cash register or computer system. If so, describe the information that the franchisor may access and whether there are any contractual limitations on the franchisor's right to access the information.

(j) The table of contents of the franchisor's operating manual provided to franchisees as of the franchisor's last fiscal year-end or a more recent date. State the number of pages devoted to each subject and the total number of pages in the manual as of this date. This disclosure may be omitted if the franchisor offers the prospective franchisee the opportunity to view the manual before buying the franchise.

x) Information related to territory:

- (1) Whether the franchise is for a specific location or a location to be approved by the franchisor.
 - (2) The conditions under which the franchisor will approve the relocation of the franchised business or the franchisee's establishment of additional franchised outlets.
 - (3) Franchisee options, rights of first refusal, or similar rights to acquire additional franchises.
 - (4) Whether the franchisor grants an exclusive territory and whether continuation of territorial exclusivity depends on achieving a certain sales volume, market penetration, or other contingency, and the circumstances when the franchisee's territory may be altered.
 - (5) Any restrictions on the franchisor from soliciting or accepting orders from consumers inside the franchisee's territory, including whether the franchisor or an affiliate has used or reserves the right to use other channels of distribution, such as the Internet, catalog sales, telemarketing, or other direct marketing sales, to make sales within the franchisee's territory using the franchisor's trademarks, whether the franchisor or an affiliate has used or reserves the right to use other channels of distribution, such as the Internet, catalog sales, telemarketing, or other direct marketing, to make sales within the franchisee's territory of products or services under trademarks different from the ones the franchisee will use under the franchise agreement. And any compensation that the franchisor must pay for soliciting or accepting orders from inside the franchisee's territory.
 - (6) Any restrictions on the franchisee from soliciting or accepting orders from consumers outside of his or her territory, including whether the franchisee has the right to use other channels of distribution, such as the Internet, catalog sales, telemarketing, or other direct marketing, to make sales outside of his or her territory.
 - (7) If the franchisor or an affiliate operates, franchises, or has plans to operate or franchise a business under a different trademark and that business sells or will sell goods or services similar to those the franchisee will offer, description shall be given for the similar goods and services, the different trademark, whether outlets will be franchisor owned or operated, whether the franchisor or its franchisees who use the different trademark will solicit or accept orders within the franchisee's territory, the timetable for the plan, how the franchisor will resolve conflicts between the franchisor and franchisees and between the franchisees of each system regarding territory, customers, and franchisor support, and the principal business address of the franchisor's similar operating business.
- xi) Information related to trademarks:
- (1) Each trademark licensed to the franchisee, the date and identification number of each trademark registration, whether the franchisor has filed all required affidavits, and whether any registration has been renewed.
 - (2) Any pending court litigation regarding the franchisor's use or ownership rights in a trademark.
 - (3) Any currently effective agreements that significantly limit the franchisor's rights to use or license the use of trademarks listed in this section in a manner material to the franchise.

(4) Whether the franchisor must protect the franchisee's right to use the principal trademarks listed in this section, and must protect the franchisee against claims of infringement or unfair competition arising out of the franchisee's use of the trademarks.

(5) The franchisee's obligation to notify the franchisor of the use of, or claims of rights to, a trademark identical to or confusingly similar to a trademark licensed to the franchisee.

(6) Whether the franchise agreement requires the franchisor to participate in the franchisee's defense and/or indemnify the franchisee for expenses or damages if the franchisee is a party to an administrative or judicial proceeding involving a trademark licensed by the franchisor to the franchisee, or if the proceeding is resolved unfavorably to the franchisee

(7) The franchisee's rights under the franchise agreement if the franchisor requires the franchisee to modify or discontinue using a trademark

(8) Whether the franchisor knows of either superior prior rights or infringing uses that could materially affect the franchisee's use of the trademarks in the place where the franchised business will be located.

xii) Information related to the obligation to participate in the operation of the franchise business.

(1) The franchisee's obligation to participate personally in the direct operation of the franchisee's business and whether the franchisor recommends participation. Include obligations arising from any written agreement or from the franchisor's practice.

(2) Any restrictions that the franchisee must place on its manager (for example, maintain trade secrets, covenants not to compete).

xiii) Information related to restrictions on what the franchisee may sell:

(1) Any franchisor-imposed restrictions or conditions on the goods or services that the franchisee may sell or that limit access to customers, including any obligation on the franchisee to sell only goods or services approved by the franchisor, any obligation on the franchisee to sell all goods or services authorized by the franchisor, and whether the franchisor has the right to change the types of authorized goods or services and whether there are limits on the franchisor's right to make changes.

xiv) Information related to renewal, transfer, and termination:

(1) Length of the franchise agreement.

(2) Renewal or extension of the term.

(3) Termination by franchisee or franchisor.

(4) Assignment of the franchise agreement.

(5) Franchisor's right of first refusal.

(6) Franchisor's option to purchase franchisee's business.

(7) Death or disability of franchisee.

(8) Non-competition covenants during the term of the franchise.

(9) Modification of the franchise agreement.

(10) Integration/merger clause.

(11) Dispute resolution by arbitration.

(12) Choice of Forum.

(13) Choice of Law.

xv) Information related to outlets:

(1) The total number of franchised and company-owned outlets for each of the franchisor's last three fiscal years. For purposes of this Section, "outlet" includes outlets of a type substantially similar to that offered to the prospective franchisee.

(2) The projected new franchised and company-owned outlets.

(3) The name and city, and current business telephone number, or if unknown, the last known home telephone number of every franchisee who had an outlet terminated, canceled, not renewed, or otherwise voluntarily or involuntarily ceased to do business under the franchise agreement during the most recently completed fiscal year or who has not communicated with the franchisor within 10 weeks of the disclosure document issuance date.

(4) If a franchisor is selling a previously-owned franchised outlet now under its control, disclose the following additional information for that outlet for the last five fiscal years.

xvi) Information related to financial statements:

(1) The following financial statements are to be included after being audited by an independent certified accountant. Present financial statements that compare at least two fiscal years.

(a) The franchisor's balance sheet for the previous two fiscal year-ends before the disclosure document issuance date.

(b) Statements of operations, stockholders' equity, and cash flows for each of the franchisor's previous three fiscal years.

(2) When a franchisor owns a direct or beneficial controlling financial interest in a subsidiary, its financial statements should reflect the financial condition of the franchisor and its subsidiary.

(3) Include separate financial statements for the franchisor and any sub-franchisor, as well as for any parent that commits to perform post-sale obligations for the franchisor or guarantees the franchisor's obligations. Attach a copy of any guarantee to the disclosure document.

(4) A start-up franchise system that does not yet have audited financial statements may phase-in the use of audited financial statements by providing, at a minimum, the following:

(a) The franchisor's first partial or full fiscal year selling franchises (an unaudited opening balance sheet)

(b) The franchisor's second fiscal year selling franchises (audited balance sheet opinion as of the end of the first partial or full fiscal year selling franchises)

(c) The franchisor's third and subsequent fiscal year selling franchise (all required financial statements for the previous fiscal year).

xvii) Submit a copy of all proposed agreements regarding the franchise offering, including the franchise agreement and any lease, options, purchase, and any other related agreements.

xviii) Submit an acknowledgment that the disclosure document summarizes certain provisions of the franchise agreement and other information in plain language.

xix) General Instructions

(1) All information in the disclosure document shall be current as of the close of the franchisor's most recent fiscal year. After the close of the fiscal year, the franchisor shall, within 120 days, prepare revised disclosure documents, after which a franchise seller may distribute only the revised document and no other disclosure documents.

(2) The franchisor shall, within a reasonable time after the close of each quarter of the fiscal year, prepare revisions to be attached to the disclosure documents to reflect any material change to the disclosures included, or required to be included, in the disclosure documents. Each prospective franchisee shall receive the disclosure documents and the quarterly revisions for the most recent period available at the time of disclosure.

(3) If applicable, the annual update shall include the franchisor's first quarterly update, either by incorporating the quarterly update information into the disclosure documents, or through an addendum.

xx) It is an unfair or deceptive act or practice in violation of this Section, for any franchisor to:

(1) Make any claim or representation, orally, visually, or in writing, that contradicts the information required to be disclosed by this Section.

(2) Disclaim or require a prospective franchisee to waive reliance on any representation made in the disclosure document or in its exhibits or amendments.

3. Implications of Registration Rules

The proposed Egyptian franchising law should explicitly require franchisors to register their documents including the franchise agreement, disclosure documents, operations manual, training manual, and financial statements, before franchise offers are made. This would provide more authentication and reliability to franchise documents. Though the proposed Egyptian franchising law should give the Registrar the discretionary power to accept or refuse registration of a franchisor's documents and to impose whatever reasons the Registrar finds necessary for registration approval, this discretionary power should not be absolute. In other words, if the registration is denied, the Registrar should give reasons for the refusal. Also, the Registrar's decision should be appealable to another competent authority, namely the competent minister, to prevent abuse of power by the Registrar's employees.

Moreover, the proposed Egyptian franchising law should provide for the creation of form registration documents to save time and effort and to ensure a better quality of services. Additionally, the proposed Egyptian franchising law should determine the day registration becomes effective and that day should be printed in a written notice to be issued by the Registrar and communicated to the franchisor. Furthermore, franchisors should have an ongoing obligation to notify the Registrar of any modifications or changes to the submitted documents.

To make the registration rules more effective, the Registrar should be given the power to investigate and take any other required measures to ensure the veracity of the information provided. In the same context, the Registrar should be granted the right to withdraw registration if franchisors do not correct any deficiencies that they are notified of by the Registrar. Similarly, to guarantee effective enforcement of the registration rules, the law should allow the Registrar to conduct investigations in case of breach of registration rules such as providing misleading documents for registration.

Also, the law should provide penalties for submitting false or misleading information to the Registrar and for breaching any of the registration rules provided by the law. Finally, the proposed franchising law should provide for the establishment of an advisory board composed of experienced legal and technical experts in franchising to issue non-binding advisory opinions to the Registrar, as well as to the Minister of Trade and Industry, on issues related to franchising when required. Establishing this board would be helpful in facilitating the Registrar's job and producing better franchising services to franchisors.

The proposed Egyptian franchising law should provide registration rules such as those provided by the Malaysian Franchise Act¹⁵⁰² because it has the most comprehensive rules on

¹⁵⁰² See *supra* Ch. III.3.2 (discussing The Main Features of Franchising Relationship Rules in the United State, China, and Malaysia: Registration).

registration.¹⁵⁰³ In other words, it regulates the Registrar's job, filing process, penalties applied for breach of any of registration rules, enforcement mechanisms, and the establishment of an advisory board to assist the Registrar in performing its job.¹⁵⁰⁴

The following legislative text is recommended on registration rules in the proposed Egyptian law:

a) Appointment of the Registrar

(i) The Minister may appoint a public officer as a Registrar of Franchises and such number of Deputy Registrars of Franchises, Assistant Registrars of Franchises and other officers as may be necessary for the purposes of this Law.

(ii) The Registrar shall, subject to the general direction and control of the Minister, perform the duties imposed and exercise the powers conferred on him under this Law.

(iii) The Deputy Registrar, Assistant Registrars and other officers shall be under the direction and control of the Registrar.

(iv) The Deputy Registrar and Assistant Registrars may perform all the duties and exercise all the powers passed to them by the Registrar under this Law.

(v) All officers appointed under this section shall be deemed to be public servants within the meaning of the Egyptian Penal Code.

b) Registration Process

(i) A franchisor shall register his franchise with the Registrar before he can make an offer to sell the franchise to any person.

(ii) A franchisor shall make an application to register his franchise by submitting to the Registrar the application in the prescribed form together with:

(1) The complete disclosure documents with all the necessary particulars filled in;

(2) A sample of the franchise agreement;

(3) The operation manual of the franchise;

(4) The training manual of the franchise;

(5) A copy of the latest audited accounts, financial statements, and the reports, if any, of the auditors and directors of the applicant; and

(6) Any other additional information or documents as may be required by the Registrar for the purpose of determining the application.

(iii) At any time after receiving an application and before a determination is made, the Registrar may, by written notice, require the applicant, or the director or manager of the applicant, to provide additional information or documents.

(iv) An application under this Section may be withdrawn at any time before it is approved or refused.

¹⁵⁰³ *Id.*

¹⁵⁰⁴ *Id.*

(v) If any additional information or document required under this Section is not provided by the applicant or his director or manager within the time specified in the requirement or any extension of time granted by the Registrar, the application shall be deemed to have been withdrawn and shall not be further considered, but without prejudicing any new application being made by the applicant.

c) Approval or Refusal of Application for Registration

(i) Upon receipt of an application for registration together with the information or documents required under this Section, the Registrar may approve or refuse the application, and shall give the reason for refusal.

(ii) An application for registration which is approved under this Section may be subject to such conditions as the Registrar may impose.

(iii) Upon approving an application, the Registrar may require the applicant to pay such amount of fees as may be prescribed.

(iv) The Registrar shall give the applicant a written notice of his decision.

d) Effective Date of Registration of a Franchise

(i) If the registration of a franchise is approved, the registration shall be effective on the date stated in the written notice given by the Registrar and such date shall be after the date of the filing of all the required information or documents.

e) Period of Effectiveness

(i) The registration of a franchise shall continue to be effective unless the Registrar issues an order made by written notice to the applicant or the franchisor to suspend, terminate, prohibit or deny the sale or registration of the franchise under this Law.

f) Amendments to Disclosure Documents

(i) If there is any material change in the disclosure documents, the applicant or his director or manager shall amend the documents according to the prescribed form.

(ii) The Registrar may, at any time, require additional information on the amendments made under this Section.

g) Notice of Suspension or Termination of the Registration

(i) If the Registrar proposes to suspend, terminate, prohibit or deny the sale or registration of a franchise, he shall give the applicant or the franchisor written notice of his intention to do so, specifying the nature of the proposed action and the grounds on which he proposes to take such action, and he shall give the applicant or the franchisor an opportunity to make a written representation on the matter within fourteen days from the date of service of the notice.

(ii) After the expiry of the period of fourteen days and after considering any representation made by the applicant or franchisor, the Registrar shall decide whether to proceed with the proposed action or to take no further action.

(iii) The Registrar shall give the applicant or franchisor written notice of his decision under Section 15 (g) (i) and the decision shall take effect from the date on which the written notice is served on the applicant or franchisor.

h) Cancellation of Registration

(i) A franchisor may, at any time after the franchise term, apply to the Registrar for cancellation of the registration of the franchise from the register.

(ii) The Registrar shall accordingly cancel the registration of the franchise from the register if he is satisfied that the franchisor is no longer granting rights under the franchise.

i) Annual Report

(i) Annually the franchisor shall, within thirty days from the anniversary date of the registration, submit a report to the Registrar in the prescribed form.

(ii) The report shall contain the disclosure documents which have been updated.

(iii) The Registrar may review the report and disclosure documents and:

(1) Notify the franchisor if any additional information or modification of the disclosure documents is to be included or deleted; or

(2) Issue an order to suspend, terminate, prohibit or deny the sale or registration of the franchise in the public interest or for the purpose of protecting prospective franchisees until any deficiencies specified by the Registrar have been corrected.

j) Appeal of the Registrar's Decision

(i) A person who is aggrieved by any decision of the Registrar under this Section may appeal to the Minister within one month from the date the decision is communicated to the person.

(ii) The Minister's decision on the appeal shall be final.

k) Franchise Advisory Board

(i) Franchise Advisory Board shall be established under this Law.

(ii) The Franchise Advisory Board shall consist of such persons, not exceeding fifteen in number, as the Minister may appoint.

(iii) The members of the Franchise Advisory Board to be appointed shall be persons who have knowledge and experience in matters relating to franchises.

(iv) The members of the Franchise Advisory Board may receive such remuneration as may be prescribed for their services.

(v) The Franchise Advisory Board shall advise the Minister and the Registrar on matters relating to franchises, and the due administration and enforcement of laws relating to franchises.

vi) The Minister and the Registrar shall not be bound to act upon the advice or report of the Franchise Advisory Board.

Conclusion

Although there are variations in legal sources, the role of the judiciary, and differences in legislative interpretation between common, civil, and Islamic legal systems, most franchising rules in these systems have common features. Thus, the remarkable differences between franchising rules in various legal systems depend to a great extent on other factors such as the market demands for franchising relationships and the available legal investment tools.

Keeping this fact in mind and for the purpose of improving the legal franchising environment in Egypt, this Chapter offered some suggestions for the creation of an Egyptian franchising law based on the comparative analysis undertaken in Chapter Three.

CONCLUDING REMARKS

Egypt is a rapidly growing and emerging market that is considered to be the franchising center of the Middle East. Egyptian business and legal protocols are quite consistent with those of the EU and North America, which opens the door to expanding franchising services between Egypt and other areas of the world and promoting foreign investment in the Egyptian franchising sector. Nevertheless, there is notably less awareness of the franchising business model in Egypt because neither the Egyptian laws nor case precedents address franchise agreements. The time is ripe for establishing franchising laws in Egypt in order to face the economic, investment, and legal challenges that have arisen in the aftermath of the January Revolution.

This dissertation aimed at providing a legal framework to regulate franchising as an essential business sector for the development of the Egyptian economy. Within this topic, the existing franchising laws from the world's main legal systems – common law, civil law, and Islamic law – were examined. In essence, this dissertation compared and evaluated the regional legal franchising systems and practices from the U.S., China, and Malaysia, drawing lessons from analyzing their models to assist in designing future rules that may create a legal framework for franchising in Egypt. Such a comparison is necessary for providing a franchising legal framework that is capable of accommodating different business structures and that can adapt to both domestic and international conditions and opportunities. The study then goes beyond a critical analysis by arguing for selective legislative approaches to be adopted by the proposed Egyptian franchising law and provides a franchising model law that could work in Egypt.

The study's main finding is that although there are certainly differences among the franchising laws of different legal systems, the number of material similarities is superseding. Consequently, the fact that Egypt is a civil law country should not necessitate that Egypt follow

other civil law franchising models. Rather it can borrow rules from the common law systems as long as those rules address the needs of the franchising market in Egypt. Thus, the model law analysis recommends following the U.S. in various issues that are not dealt with by the civil laws or that are dealt with more comprehensively by the U.S. law than by other laws. Likewise, some rules are recommended to be adopted from the Chinese franchise laws, not only because China is a civil law country, but because these rules would work better in the Egyptian franchising legal environment.

Another important outcome of this study stems from the examination of the Islamic legal system as represented in the Malaysian franchise law. Although Islamic law may affect the business needs of franchising, such as market demand and the types of franchised goods and services, it does not directly affect the legal requirements of a franchising law. Therefore, the fact that Islamic law is the main source of law in Egypt may not weigh very heavily when drafting a franchising law in Egypt.

Moreover, by comparing and analyzing the characteristics of franchising laws with varying perspectives, I argue in favor of an Egyptian franchise law that addresses the different franchising legal issues including disclosure rules, substantive rules regulating the relationship between the franchising parties, and registration rules. While disclosure rules help to ensure that franchisees are provided with proper information to assist them in reaching a well informed investment decision, substantive rules guide franchising parties to better conclude and perform franchise agreements. Registration rules guarantee the authenticity and transparency of franchising documents produced by franchisors and the credibility of other persons involved in the franchising process such as franchise brokers.

Nevertheless, one can add to the findings that a franchising law can still be comprehensive even if it focuses only on the concepts that have a direct connection with franchising aside from the other general issues dealt with through other laws. Examples include enforcement issues, consumer protection, force majeure, and tax issues. Accordingly, the proposed Egyptian franchising law can still be comprehensive by regulating franchising specialties and incorporating by reference the provisions of other laws that affect franchising.

What distinguishes this research from other similar studies is that it addresses an example from each of the world's legal systems – common law, civil law, and Islamic law. Hence, the recommendations given in this dissertation are comprehensive because they take into account the perspectives of the main world legal systems on the issue of franchising. Moreover, this study contributes to the literature by proposing a balance between the different interests that need to be reconciled in a franchising law. In other words, an outstanding franchising law should not only address the needs of the local market but also the expectations of business partners engaging in more than one jurisdiction. In the same context, examining the Islamic perspective takes into consideration the interests of the large number of investors concerned about Islamic investment sensitivities. In summary, the results obtained through this dissertation can potentially contribute to the establishment of an Egyptian franchising law that would inclusively enhance franchising transactions in Egypt and the entire Middle East.

APPENDIX

LAW NUMBER (-) FOR THE YEAR 2012

LAW ON FRANCHISING

In the name of the People

The President of the Arab Republic of Egypt

The People's Assembly has ratified the law of which the provisions are as follows:

Introductory provisions:

Article 1

Along with compliance to the Egyptian Commercial Law and the provisions prescribed in special laws, the provisions of the attached law shall apply to franchising transactions.

Article 2

This law shall be published in the Official Gazette and it shall be sealed with the seal of the country and enforced as law of the country.

Issued on (_/_/_.).

Article 3

In the case of conflict between the rules of this Law and the rules of any international convention adhered to by the Arab Republic of Egypt, the rules of such international convention shall prevail.

The President of the Arab Republic of Egypt;

Franchising Law

1) Definitions

- a) *Affiliate* means an entity controlled by, controlling, or under common control with, another entity;
- b) *Advertisement* means any publication, circular, notice, or any oral or written communication, whether broadcasted by electronic or any other publishing media, or any form of electronic communications to the public for the purpose of offering the sale of a franchise or promoting the sale of a franchise;
- c) *Disclose, state, describe, and list* means to present all material facts accurately, clearly, concisely, and legibly in Arabic, when the agreement is between two Egyptian entities and in both Arabic and English when the agreement is between a foreign entity and an Egyptian;
- d) *Fees* include royalties, advertising fees, or any other required payments that the franchisee pays to the franchisor or an affiliate of the franchisor, directly or indirectly, either by contract or by practical necessity, as a condition of obtaining, commencing operation of the franchise, or performing the franchise agreement.
- e) *Fiscal year* refers to the franchisor's fiscal year;
- f) *Fractional franchise* means a franchise relationship that satisfies the following criteria when the relationship is created:
 - i) The franchisee, any of the franchisee's current directors or officers, or any current directors or officers of a parent or affiliate, has more than two years of experience in the same type of business; and
 - ii) The parties have a reasonable basis to anticipate that the sales arising from the relationship will not exceed 20% of the franchisee's total dollar volume in sales during the first year of operation.

- g) *Franchise broker* means a person or company doing business as an agent or representative of a franchisor to sell a franchise to any person for a certain consideration but does not include any employee of the franchise or franchisee;
- h) *Franchisee* means any person who is granted a franchise;
- i) *Franchisor* means any person who grants a franchise and participates in the franchise relationship. Unless otherwise stated, it includes sub-franchisors. For purposes of this definition, a "sub-franchisor" means a person who functions as a franchisor by engaging in both pre-sale activities and post-sale performance;
- j) *Mark* includes a trademark, service mark, symbol, design, brand, heading, label, ticket, name, signature, word and letter or any combination of them;
- k) *Minister* means the Minister of Trade and Industry for the time being;
- l) *Parent* means an entity that controls another entity directly, or indirectly through one or more subsidiaries;
- m) *Predecessor* means a person from whom the franchisor acquired, directly or indirectly, the major portion of the franchisor's assets;
- n) *Principal business address* means the street address of a person's home office in Egypt. A principal business address cannot be a post office box or private mail drop;
- o) *Prospective franchisee* means any person (including any agent, representative, or employee) who approaches or is approached by a franchise seller to discuss the possible establishment of a franchise relationship;
- p) *Registrar, Deputy Registrar, and Assistant Registrar* mean respectively the Registrar of Franchises, a Deputy Registrar of Franchises and an Assistant Registrar of Franchises appointed under Section 15 (a) of this Law; and

q) *Written, in writing* means any documents or information in printed form or in any form capable of being preserved in tangible form and read. It includes: type-set, word processed or handwritten document; information on computer disk or CD-ROM; or information sent via email. It does not include mere oral statements;

2) Scope of Application of the Law

a) This Law applies to any franchise transaction taking place in Egypt. Franchise transactions are deemed to be taking place in Egypt if, on condition that the franchised business is operated in Egypt:

i) An offer to sell or buy a franchise is made in Egypt and accepted within or outside Egypt;

ii) An offer is made outside Egypt, but accepted within Egypt; or

b) If any of the provisions of this Law and any other laws contradict; the provisions of this Law shall prevail.

c) A franchisor who intends to sell a franchise in Egypt to a person who is not an Egyptian citizen shall obtain the approval of, and be subject to the conditions which may be imposed by, the Registrar according to Section 15 of this Law.

d) A foreign person who intends to sell a franchise in Egypt shall submit an application to the Registrar according to Section 15 of this Law.

e) A person, who is aggrieved by any decision of the Registrar under Paragraphs (c) and (d) of this Section, may appeal to the Minister within a month from the date the decision of the Registrar is communicated to the person, in accordance with Section 15 (j) of this Law.

3) Franchise Relationship

Without prejudice to Article 136 of the Egyptian Civil Law on Community of Interests, franchise means a contract, agreement, or arrangement, either expressed or implied, between two or more persons where:

- a) The franchisor grants the franchisee the right to operate a business to offer, sell, or distribute goods, services, or commodities that are associated with the franchisor's trademark, service mark, trade name, or any intellectual property as long as this intellectual property is owned by the franchisor, the franchisor is its registered user, or the franchisor is licensed to use it and/or permit others to use it.
- b) The franchisee operates the franchised business according to the franchise business plan/system or marketing plan as determined by the franchisor during the term of the franchise agreement.
- c) The franchisor possesses the authority to exercise continuous control over the operation of the franchised business during the term of the franchise agreement.
- d) The franchisor is responsible for providing continuous and significant assistance to the franchisee's method of business operation, in accordance with Sections 13 (ii), 14 (ix), and 15 of this Law.
- e) The franchise relationship shall not be at any time regarded as a partnership, service contract, and agency, and sales representation, basic licensing agreement to use a trademark, distributorship, or employment relationship.
- f) A franchising agreement is a synallagmatic, commutative contract in which the franchisor and franchisee have a community of interests consisting of an interdependent common financial interest in the success of the franchised business.

- g) The franchisee, in return for the grant of the right to operate the franchised business, makes a required payment, or other form of consideration, directly or indirectly, to the franchisor or its affiliate.
- h) If the franchisor requires the franchisee to pay any type of fees before the conclusion of the franchise agreement, the franchisor has to explain to the franchisee, in writing, the purposes of these payments and the conditions and methods for a refund.
- i) Any fees paid by the franchisee to be used for the promotion, marketing, advertisement, or any other publicity purposes, shall be used for the purposes as agreed upon in writing.
- j) In all cases the rate of any required payments made by the franchisee shall be consistent with the rate provided in the disclosure documents and if any contradiction arises the rate provided in the disclosure documents shall prevail.

4) Intellectual Property

- a) Licensing the use of a franchisor's trademark, service mark, trade name, or any other similar intellectual property shall take place in accordance with the Law on Protection of Intellectual Property No. 82 of 2002.
- b) In addition to considering the Law on Protection of Intellectual Property No. 82 of 2002 and the Law on the Protection of Competition and the Prohibition of Monopolistic Practices No. 3 of 2005, the following shall be considered:
 - i) A franchisee has to give the franchisor a written assurance that the franchisee and his employees will not disclose any information contained in the operation manual, obtained while undergoing training organized by the franchisor, or any other information given by the franchisor to the franchisee where the franchisee is notified

in writing that it is deemed to be a confidential information, during the franchise term and for two years after termination of the franchise agreement.

- ii) The franchisee shall give the franchisor a written assurance that the franchisee and his employees will not carry on any other business similar to the franchised business during the term of the franchise agreement and for two years after the termination of the franchise agreement.

5) Liability

a) Liability Arising Out of Pre-Contractual Negotiations

- i) During the negotiations prior to the conclusion of the franchising agreement, the franchisor shall reveal to the franchisee any potential risks that may accompany the operation of the franchised business and in particular risks related to the effects of the transferred know-how on the environment, public health, or safety of lives and property. The franchisor should further provide the franchisee with access to the means known thereto whereby the licensee can avoid such risks;
- ii) The franchisee must provide the franchisor a written assurance that the franchisee will not disclose any information revealed to him during the pre-contractual negotiations as long as the franchisee is notified in writing that this information is deemed to be a confidential.
- iii) It is unlawful for any person in connection with the offer, sale, or purchase of any franchise directly or indirectly to make any untrue statement of a material fact or omit any material fact that is required to be stated therein.

b) Contractual Liability and Liability to Third Parties

- i) In respect of liability to third parties arising in connection with franchise agreements, Article 174 of the Egyptian Civil Law shall apply.

6) Remedies

- a) Beside the general rules provided by the Egyptian Civil Law and applicable to the performance of a contract, remedies for breach, injunctive relief, and any other consequences arising thereof, the franchisor shall, upon termination of the franchise agreement without good cause, at the franchisee's option, repurchase at the franchisee's net cost, the franchisee's inventory, supplies, equipment, and furnishings purchased by the franchisee from the franchisor or its approved sources; however, no compensation shall be allowed for the personalized items which have no value to the franchisor.
- b) Any fraudulent act committed by the franchisee that leads to the destruction of the franchisor's goodwill should result in the payment of damages for loss of goodwill. The amount of damages to be paid is to be determined by the court if not agreed upon by the franchising parties.

7) Good Faith

- a) Franchising parties shall act in good faith. Good faith means the duty of each of the franchising parties and their officers, employees, or agents to act in a fair and equitable manner to guarantee a certain degree of freedom from coercion, intimidation, or threats of coercion or intimidation.
- b) The following conducts are examples of a failure to exercise good faith :
 - i) Substantial and unreasonable overvaluation of fees and prices;
 - ii) Conduct which is unnecessary and unreasonable in relation to the risks to be incurred by one party;

- iii) Conduct that is not reasonably necessary for the protection of the legitimate business interests of the franchising parties or the franchised business;
- iv) Making untrue statements of a material fact or omitting to state a necessary material fact; or
- v) Engaging in any fraudulent act, practice, or course of business or deceit upon any person.

8) Formation of Agreements

a) Form

- i) A franchise agreement shall be in writing.
- ii) A franchise agreement shall contain, but is not limited to:
 - (1) Basic information with respect to the franchisor and the franchisee;
 - (2) Name and description of the product(s) and/or business under the franchise;
 - (3) The territorial rights granted to the franchisee;
 - (4) The franchise fee, promotion fee, royalties, or any related type of payment which may be imposed on the franchisee, if any
 - (5) The obligations of the franchisor;
 - (6) The obligations of the franchisee;
 - (7) The franchisee's rights to use the mark or any other intellectual property, pending the registration or after the registration of the franchise;
 - (8) A description pertaining to the mark or any other intellectual property owned or related to the franchisor which is used in the franchise;
 - (9) The conditions under which the franchisee may assign the rights under the franchise;

- (10) The type and particulars of assistance provided by the franchisor;
- (11) The duration of the franchise agreement and the terms of renewal;
- (12) The effect of termination or expiration of the franchise agreement;
- (13) Sale promotion, advertising and publicity with respect to the products or services;
- (14) Liabilities for breach of contract;
- (15) Dispute resolution methods; and
- (16) Any other issues agreed upon by the franchising parties.

iii) Failure to comply with Paragraph (i) of this Section, shall render the franchise agreement voidable at the option of the franchisee. Shall the franchisee decides to continue the agreement, the franchisee shall be entitled of a compensation decided by the competent judge.

b) Minimum Terms

A franchise term shall not be less than five years.

c) Renewal

i) A franchisor shall not refuse to renew a franchise unless both of the following apply:

(1) The franchisee has been notified of the franchisor's intent not to renew at least six months prior to the expiration date or any extension of the franchise agreement and

(2) Any of the following circumstances exist:

(a) Good cause, as provided in Section 8 (e) (ii), provided that the refusal of the franchisor to renew is not arbitrary or capricious;

(b) The franchisor and franchisee agree, in writing, not to renew the franchise; or

- (c) The franchisor completely withdraws from, directly or indirectly, distributing its products or services in the geographic market served by the franchisee, provided that upon expiration of the franchise, the franchisor agrees not to seek to enforce any covenant of the non-renewed franchisee not to compete with the franchisor or franchisees of the franchisor.
 - ii) As a condition of renewal of the franchise, a franchise agreement may require that the franchisee meet the current requirements for franchises and that the franchisee execute a new agreement incorporating the current terms and fees for new franchises.
- d) Transfer
 - i) The franchisee may transfer the franchised business to a transferee, provided that:
 - (1) The franchisee obtains previous authorization of the franchisor that the franchisor permits transfer to the transferee;
 - (2) The transferee satisfies the reasonable current qualifications of the franchisor for new franchisees. For the purpose of this Section, a reasonable current qualification for a new franchisee is a qualification based upon a legitimate business reason;
 - (3) The franchisor may exercise a right of first refusal contained in a franchise agreement after receipt of a proposal from the franchisee to transfer the franchise; and
 - (4) The franchisor may amend any of the transferred franchise agreement provisions in accordance with this Law.
 - ii) In all cases, the franchisor may require as a condition of a transfer any of the following:

- (1) That the transferee successfully complete a reasonable training program;
 - (2) That a reasonable transfer fee be paid to reimburse the franchisor for the franchisor's reasonable and actual expenses directly attributable to the transfer;
 - (3) That the franchisee pays or makes provisions reasonably acceptable to the franchisor to pay any amount due the franchisor or the franchisor's affiliate; or
 - (4) That the financial terms of the transfer comply at the time of the transfer with the franchisor's current financial requirements for franchisees.
- iii) A franchisee shall give the franchisor no less than ninety days written notice of a transfer.
- iv) A franchisor shall not discriminate against a proposed transferee of a franchise on the basis of race, color, national origin, religion, sex, or disability.
- v) A franchisor, as a condition to a transfer of a franchise, shall not obligate a franchisee to undertake obligations or relinquish any rights unrelated to the franchise proposed to be transferred, or to enter into a release of claims broader than a similar release of claims by the franchisor against the franchisee that is entered into by the franchisor.
- e) Termination
- i) The franchise agreement may not be terminated before the expiry of its term unless:
 - (1) Franchising parties mutually agree to a termination; or
 - (2) The court decides that there are certain conditions in the franchise agreement that merit the agreement to be terminated.
 - ii) The franchisor shall have the right to terminate the franchise agreement before the expiry of its terms only if the franchisor has good cause for the termination, provided

that the franchisor gives the franchisee a written notice of such termination at least ninety days in advance of such termination. Good cause includes, among others:

- (1) Refusal or failure of a franchisee to comply substantially with the franchise agreement or any other relevant agreement entered into between the franchisor and franchisee;
- (2) The failure of the franchisee to remedy the breach committed by him or any of his employees within the period stated in a written notice given by the franchisor, which shall not be less than fourteen days, for the breach to be remedied;
- (3) The franchisee's assignment of the franchise rights in breach of the rules provided by Section 8 (d) of this Law;
- (4) Voluntarily abandonment by the franchisee of the franchised business;
- (5) A criminal conviction of the franchisee that substantially impairs the goodwill associated with the franchisor's mark or other intellectual property;
- (6) The franchisee's failure to comply with Section 4 (b) (ii) of this Law; and
- (7) The franchisee's failure to comply with Section 4 (b) (i) of this Law.

iii) The franchisee shall have the right to terminate the franchise agreement if the franchisor conceals any information or provides false information in breach of Section 14 of this Law, provided that the franchisee gives the franchisor a written notice of such termination at least ninety days in advance of such termination.

9) Franchise Brokers

- a) Franchise broker means any person engaged in the business of representing a franchisor in offering for sale or selling a franchise and is not a franchisor, an affiliate of a

franchisor, or an officer, director or employee of a franchisor, or an affiliate of a franchisor with respect to such franchise.

b) A franchise broker shall register himself with the Registrar by filing any required information. To register with the Registrar, a franchise broker must meet the following conditions:

- i) An individual broker must have experience in franchise management for at least three years and an academic qualification of a bachelor's degree level or its equivalent; and
- ii) A company broker shall be legally instituted under the Companies Law No. 159 of 1981 and shall have employees with experience in franchise management for at least three years and an academic qualification of a bachelor's degree level or its equivalent.

10) Prohibition Against Discrimination

a) It shall be an unfair franchise and a contravention of this Law for any franchisor to unreasonably and materially discriminate between franchisees operating a franchise in the charges offered or made for franchise fees, royalties, goods, services, equipment, rentals or advertising services if such discrimination will cause competitive harm to a franchisee who competes with a franchisee who receives the benefit of the discrimination, unless and to the extent that any classification of or discrimination between franchisees is:

- i) Based on franchises granted at different times, and such discrimination is reasonably related to the differences in time;
- ii) Related to one or more programs for making franchises available to persons with insufficient capital, training, business experience or education, or lacking other qualifications;

- iii) Related to efforts by the Government or any of its agencies to promote variation in products or service lines or business formats or designs;
- iv) Related to efforts by one or more franchisees to cure deficiencies in the operation of franchised businesses or defaults in franchise agreements; or
- v) Based on other reasonable distinctions considering the purposes of this Law and is not arbitrary.

11) Advertisements

- a) A person who wishes to publish, distribute or use any advertisement offering to sell or to buy a franchise under this Law, shall file with the Registrar one original copy of the advertisement at least seven days before the first publication, distribution or use of the advertisement or such shorter period as may be approved by the Registrar, or unless the advertisement has been exempted from this section by the Registrar.
- b) The Registrar may, by order, prohibit the use of any advertising deemed to be false, fraudulent, misleading or deceptive.
- c) The Registrar's decision under Section 11 (b) may be appealed in accordance with Section 15 (j) of this Law.

12) Settlement of Disputes

- a) Franchising parties may enter into a settlement agreement or execute a general release regarding a potential or actual civil action filed with respect of the franchise.
- b) The parties may agree to settle disputes amicably or through arbitration.

13) Rights and Obligations of the Franchising Parties

- a) The rights and obligations of the franchising parties arising of a franchise agreement include, among others:

- i) The franchisor's obligation to provide the franchisee with a written notice about a breach of the franchise agreement by the franchisee and allow the franchisee a reasonable time, of at least fourteen days, to remedy the breach.
- ii) The franchisor's obligation to provide the franchisee with assistance to operate the franchised business.
- iii) The franchisor's obligation to continuously provide business guidance, technical support, and business training to the franchisee in accordance with the stipulated contents and methods.
- iv) The franchisor's obligation not to require the franchisee to purchase or lease goods or services from the franchisor or from a designated source of supply unless such restrictive purchasing agreements are reasonably necessary for a lawful purpose justified on business grounds.
- v) The franchisor's obligation not to discriminate against franchisees in accordance with Section 10 of this Law.
- vi) The franchisor's obligation not to restrict a franchisee from associating with other franchises or from participating in a trade association and the obligation to not retaliate against a franchisee for engaging in these activities.
- vii) The franchisee's obligation to pay the franchise fees, royalties, promotion fees, or any other payment as provided in the franchise agreement, in accordance with Section 3 (g), (h), and (i) of this Law.
- viii) The franchisee's obligation of confidentiality imposed Section 4 (b) (a) of this Law.

ix) The franchisee's obligation of non-competition imposed by Section 4 (b) (ii) of this Law.

x) The mutual obligations of the franchising parties to protect the consumer's interests at all times in accordance with the Egyptian Consumer Protection Law No. 67 of 2006.

14) Disclosure

a) The franchisor shall, at least 30 days prior to the conclusion of the franchise agreement, disclose to the franchisee in writing the information required under this Section.

b) Before disclosure, the franchisee must give the franchisor a written assurance that the franchisee and his employees will not disclose any information contained in the disclosure documents.

c) After the franchisor discloses information to the franchisee, the franchisee shall issue a signed receipt of acknowledgment of the contents of the information obtained from the franchisor.

d) The rules provided by this Section do not apply if the franchisor can establish any of the following:

i) The total of the required payments, or commitments to make a required payment, to the franchisor or an affiliate that are made any time from before to within six months after commencing operation of the franchisee's business is less than 500 Egyptian Pounds.

ii) The franchise relationship is a fractional franchise.

iii) Franchisee's initial investment, excluding any financing received from the franchisor or an affiliate and excluding the cost of unimproved land, totals at least 1 million Egyptian Pounds and the prospective franchisee signs an acknowledgment verifying

the grounds for the exemption. This exemption applies only if at least one individual prospective franchisee in an investor-group qualifies for the exemption by investing at the threshold level stated in this section.

- iv) The franchisee (or its parent or any affiliates) is an entity that has been in business for at least five years and has a net worth of at least 5 million Egyptian Pounds.
 - v) One or more purchasers of at least a 50% ownership interest in the franchise: within 60 days of the sale, has been, for at least two years, an officer, director, general partner, individual with management responsibility for the offer and sale of the franchisor's franchises or the administrator of the franchised network; or within 60 days of the sale, has been, for at least two years, an owner of at least a 25% interest in the franchisor.
- e) The following information should be disclosed by the franchisor:
- i) Information related to the franchisor, and any parent companies, predecessors, and affiliates:
 - (1) The name and principal business address of the franchisor; any parents; and any affiliates that offer franchises in any line of business or provide products or services to the franchisees of the franchisor.
 - (2) The name and principal business address of any predecessors during the 10-years period immediately before the close of the franchisor's most recent fiscal year.
 - (3) The name that the franchisor uses and any names it intends to use to conduct business.
 - (4) The identity and principal business address of the franchisor's agent for service of process.

- (5) The type of business organization used by the franchisor (for example, corporation, partnership) and the country in which it was organized.
 - (6) Whether the franchisor operates businesses of the type being franchised.
 - (7) The business to be conducted by the franchisee.
 - (8) Any laws or regulations specific to the industry in which the franchise business operates.
 - (9) The franchisor's directors, trustees, general partners, principal officers, and any other individuals who will have management responsibility relating to the sale or operation of franchises offered by this document.
- ii) Information related to whether the franchisor, a predecessor, a parent or affiliate that induces franchise sales by promising to back the franchisor financially, has or has had against him:
- (1) An administrative, criminal, or material civil action alleging a violation of a franchise, antitrust, or securities law, or alleging fraud, unfair or deceptive practices, or comparable allegations;
 - (2) Civil actions, other than ordinary or routine litigation incidental to the business, which are material in the context of the number of franchisees and the size, nature, or financial condition of the franchise system or its business operations;
and
 - (3) Any material civil action involving the franchise relationship in the last fiscal year.
 - (4) For each action identified in Paragraphs (1), (2), and (3) of this Section, state the title, case number or citation, the initial filing date, the names of the parties, the

forum, and the relationship of the opposing party to the franchisor, and summary opinion of counsel concerning any action if counsel consent to use the summary opinion and the full opinion is attached to the disclosure document (if possible).

iii) Any information related to any pending bankruptcy proceedings or proceedings that took place during the 10-year period immediately before the date of this disclosure document against the franchisor, any parent, predecessor, affiliate, officer, or general partner of the franchisor, or any other individual who will have management responsibility relating to the sale or operation of franchises offered by this document, and any other proceedings under the laws of foreign nations relating to bankruptcy shall be disclosed.

iv) Information related to fees:

(1) The initial fees and any conditions under which these fees are refundable. If the initial fees are not uniform, disclose the range or formula used to calculate the initial fees paid in the fiscal year before the issuance date and the factors that determined the amount. For this section, "initial fees" mean all fees and payments, or commitments to pay, for services or goods received from the franchisor or any affiliate before the franchisee's business opens, whether payable in lump sum or installments.

(2) All other fees that the franchisee must pay to the franchisor or its affiliates, or that the franchisor or its affiliates impose or collect in whole or in part for a third party.

- (3) Payment method, due date, to whom payment should be made, whether each payment is non-refundable, or describe the circumstances under which a payment is refundable.
- v) Information related to the estimated initial investment:
- (1) Training expenses;
 - (2) Real property, whether purchased or leased;
 - (3) Equipment, fixtures, other fixed assets, construction, remodeling, leasehold improvements, and decorating costs, whether purchased or leased;
 - (4) Inventory to begin operating;
 - (5) Security deposits, utility deposits, business licenses, and other prepaid expenses;
and
 - (6) If the franchisor or an affiliate finances part of the initial investment, the amount that it will finance, the required down payment, the annual interest rate, rate factors, and the estimated loan repayments.
- vi) Information related to restrictions on sources of products and services:
- (1) The franchisee's obligations to purchase or lease goods, services, supplies, fixtures, equipment, inventory, computer hardware and software, real estate, or comparable items related to establishing or operating the franchised business either from the franchisor, its designee, or suppliers approved by the franchisor, or under the franchisor's specifications. Include obligations to purchase imposed by the franchisor's written agreement or by the franchisor's practice. In particular, disclose the following:
 - (a) The good or service required to be purchased or leased;

- (b) Whether the franchisor or its affiliates are approved suppliers or the only approved suppliers of that good or service;
- (c) Any supplier in which an officer of the franchisor owns an interest;
- (d) How the franchisor grants and revokes approval of alternative suppliers;
- (e) Whether the franchisor issues specifications and standards to franchisees, sub-franchisees, or approved suppliers. If so, describe how the franchisor issues and modifies specifications;
- (f) Whether the franchisor or its affiliates will or may derive revenue or other material consideration from required purchases or leases by franchisees;
- (g) The estimated proportion of these required purchases and leases by the franchisee to all purchases and leases by the franchisee of goods and services in establishing and operating the franchised businesses;
- (h) If a designated supplier will make payments to the franchisor from franchisee purchases, disclose the basis for the payment (for example, specify a percentage or a flat amount);
- (i) The existence of purchasing or distribution cooperatives;
- (j) Whether the franchisor negotiates purchase arrangements with suppliers, including price terms, for the benefit of franchisees; and
- (k) Whether the franchisor provides material benefits (for example, renewal or granting additional franchises) to a franchisee based on a franchisee's purchase of particular products or services or use of particular suppliers.

vii) Information related to the obligations of the franchising parties:

- (1) Site selection and acquisition/lease;

- (2) Pre-opening purchase/leases;
 - (3) Site development and other pre-opening requirements;
 - (4) Initial and ongoing training;
 - (5) Opening;
 - (6) Fees;
 - (7) Compliance with standards and policies/operating manuals;
 - (8) Trademarks and proprietary information;
 - (9) Restrictions on products/services offered;
 - (10) Warranty and customer services requirements;
 - (11) Territorial development and sales quotas;
 - (12) Ongoing produce/service purchases;
 - (13) Maintenance, appearance, and remodeling requirements;
 - (14) Insurance;
 - (15) Indemnifications;
 - (16) Inspections and audits;
 - (17) Transfer;
 - (18) Renewal;
 - (19) Post-termination obligations;
 - (20) Non-competition covenants;
 - (21) Dispute resolution;
- viii) Information related to financing:

- (1) The terms of each financing arrangement, including leases and installment contracts, which the franchisor, its agent, or affiliates offer directly or indirectly to the franchisee. This should include:
 - (a) What the financing covers (for example, site acquisition, construction or remodeling, initial or replacement equipment or fixtures, opening or ongoing inventory or supplies, or other continuing expenses).
 - (b) The identity of each lender providing financing and their relationship to the franchisor (for example, affiliate).
 - (c) The amount of financing offered or, if the amount depends on an actual cost that may vary, the percentage of the cost that will be financed.
 - (d) The rate of interest, plus finance charges, expressed on an annual basis. If the rate of interest, plus finance charges, expressed on an annual basis, may differ depending on when the financing is issued, state what that rate was on a specified recent date.
 - (e) The number of payments or the period of repayment.
 - (f) The nature of any security interest required by the lender.
 - (g) Whether a person other than the franchisee must personally guarantee the debt.
 - (h) Whether the debt can be prepaid and the nature of any prepayment penalty.
 - (i) The franchisee's potential liabilities upon default such as obligations to pay court costs and attorney's fees incurred in collecting the debt, and liabilities from cross defaults such as those resulting directly from non-payment, or indirectly from the loss of business property.

- (2) Whether the loan agreement requires franchisees to waive defenses or other legal rights (for example, confession of judgment), or bars franchisees from asserting a defense against the lender, the lender's assignee or the franchisor. If so, describe the relevant provisions.
 - (3) Whether the franchisor's practice or intent is to sell, assign, or discount to a third party all or part of the financing arrangement. If so, state:
 - (a) The assignment terms, including whether the franchisor will remain primarily obligated to provide the financed goods or services; and
 - (b) That the franchisee may lose all its defenses against the lender as a result of the sale or assignment.
 - (4) Whether the franchisor or an affiliate receives any consideration for placing financing with the lender. If such payments exist:
 - (a) Disclose the amount or the method of determining the payment; and
 - (b) Identify the source of the payment and the relationship of the source to the franchisor or its affiliates.
- ix) Information related to assistance and training:
- (1) The franchisor's principal assistance and related obligations of both the franchisor and franchisee as follows:
 - (a) The franchisor's pre-opening assistance obligations to the franchisee, including any assistance in locating a site and negotiating the purchase or lease of the site. State whether the franchisor generally owns the premises and leases it to the franchisee, whether the franchisor selects the site or approves an area in which the franchisee selects a site, whether and how the franchisor

must approve a franchisee-selected site, factors that the franchisor considers in selecting or approving sites, and the time limit for the franchisor to locate or approve or disapprove the site and the consequences if the franchisor and franchisee cannot agree on a site.

- (b) Assistance with conforming the premises to local ordinances and building codes and obtaining any required permits, if any.
- (c) Assistance with constructing, remodeling, or decorating the premises, if any.
- (d) Assistance with hiring and training employees.
- (e) Assistance with providing for necessary equipment, signs, fixtures, opening inventory, and supplies. State whether the franchisor provides these items directly or only provides the names of approved suppliers, whether the franchisor provides written specifications for these items, and whether the franchisor delivers or installs these items.
- (f) The typical length of time between the earlier of the signing of the franchise agreement or the first payment of consideration for the franchise and the opening of the franchisee's business. Describe the factors that may affect the time period, such as ability to obtain a lease, financing or building permits, zoning and local ordinances, weather conditions, shortages, or delayed installation of equipment, fixtures, and signs
- (g) The franchisor's obligations to the franchisee during the operation of the franchise, including any assistance in developing products or services the franchisee will offer to its customers, establishing prices, establishing and

using administrative, bookkeeping, accounting, and inventory control procedures, and resolving operating problems encountered by the franchisee.

- (h) The advertising, marketing, and promotions programs for the franchise system, including the franchisor's obligation to conduct advertising such as the media the franchisor may use, the source of the advertising, whether the franchisor must spend any amount on advertising in the area or territory where the franchisee is located, if franchisor permits franchisee to use their own advertising material, whether there is an advertising council composed of franchisees that advises the franchisor on advertising policies, whether the franchisee must participate in any other advertising fund. Disclose if not all advertising funds are spent in the fiscal year in which they accrue, how the franchisor uses the remaining amount, including whether franchisees receive a periodic accounting of how advertising fees are spent. Disclose the percentage of advertising funds, if any, that the franchisor uses principally to solicit new franchise sales.
- (i) Whether the franchisor requires the franchisee to buy or use electronic cash registers or computer systems. If so, describe the systems generally in non-technical language, including the types of data to be generated or stored in these systems, and state the cost of purchasing or leasing the systems, any obligation of the franchisor, any affiliate, or third party to provide ongoing maintenance, repairs, upgrades, or updates, any obligations of the franchisee to upgrade or update any system during the term of the franchise, and, if so, any contractual limitations on the frequency and cost of the obligation, the

annual cost of any optional or required maintenance, updating, upgrading, or support contracts, and whether the franchisor will have independent access to the information that will be generated or stored in any electronic cash register or computer system. If so, describe the information that the franchisor may access and whether there are any contractual limitations on the franchisor's right to access the information.

(j) The table of contents of the franchisor's operating manual provided to franchisees as of the franchisor's last fiscal year-end or a more recent date. State the number of pages devoted to each subject and the total number of pages in the manual as of this date. This disclosure may be omitted if the franchisor offers the prospective franchisee the opportunity to view the manual before buying the franchise.

x) Information related to territory:

- (1) Whether the franchise is for a specific location or a location to be approved by the franchisor.
- (2) The conditions under which the franchisor will approve the relocation of the franchised business or the franchisee's establishment of additional franchised outlets.
- (3) Franchisee options, rights of first refusal, or similar rights to acquire additional franchises.
- (4) Whether the franchisor grants an exclusive territory and whether continuation of territorial exclusivity depends on achieving a certain sales volume, market

penetration, or other contingency, and the circumstances when the franchisee's territory may be altered.

- (5) Any restrictions on the franchisor from soliciting or accepting orders from consumers inside the franchisee's territory, including whether the franchisor or an affiliate has used or reserves the right to use other channels of distribution, such as the Internet, catalog sales, telemarketing, or other direct marketing sales, to make sales within the franchisee's territory using the franchisor's trademarks, whether the franchisor or an affiliate has used or reserves the right to use other channels of distribution, such as the Internet, catalog sales, telemarketing, or other direct marketing, to make sales within the franchisee's territory of products or services under trademarks different from the ones the franchisee will use under the franchise agreement. And any compensation that the franchisor must pay for soliciting or accepting orders from inside the franchisee's territory.
- (6) Any restrictions on the franchisee from soliciting or accepting orders from consumers outside of his or her territory, including whether the franchisee has the right to use other channels of distribution, such as the Internet, catalog sales, telemarketing, or other direct marketing, to make sales outside of his or her territory.
- (7) If the franchisor or an affiliate operates, franchises, or has plans to operate or franchise a business under a different trademark and that business sells or will sell goods or services similar to those the franchisee will offer, description should be given for the similar goods and services, the different trademark, whether outlets will be franchisor owned or operated, whether the franchisor or its franchisees

who use the different trademark will solicit or accept orders within the franchisee's territory, the timetable for the plan, how the franchisor will resolve conflicts between the franchisor and franchisees and between the franchisees of each system regarding territory, customers, and franchisor support, and the principal business address of the franchisor's similar operating business.

xi) Information related to trademarks:

- (1) Each trademark licensed to the franchisee, the date and identification number of each trademark registration, whether the franchisor has filed all required affidavits, and whether any registration has been renewed.
- (2) Any pending court litigation regarding the franchisor's use or ownership rights in a trademark.
- (3) Any currently effective agreements that significantly limit the franchisor's rights to use or license the use of trademarks listed in this section in a manner material to the franchise.
- (4) Whether the franchisor must protect the franchisee's right to use the principal trademarks listed in this section, and must protect the franchisee against claims of infringement or unfair competition arising out of the franchisee's use of the trademarks.
- (5) The franchisee's obligation to notify the franchisor of the use of, or claims of rights to, a trademark identical to or confusingly similar to a trademark licensed to the franchisee.
- (6) Whether the franchise agreement requires the franchisor to participate in the franchisee's defense and/or indemnify the franchisee for expenses or damages if

the franchisee is a party to an administrative or judicial proceeding involving a trademark licensed by the franchisor to the franchisee, or if the proceeding is resolved unfavorably to the franchisee

(7) The franchisee's rights under the franchise agreement if the franchisor requires the franchisee to modify or discontinue using a trademark

(8) Whether the franchisor knows of either superior prior rights or infringing uses that could materially affect the franchisee's use of the trademarks in the place where the franchised business will be located.

xii) Information related to the obligation to participate in the operation of the franchise business.

(1) The franchisee's obligation to participate personally in the direct operation of the franchisee's business and whether the franchisor recommends participation. Include obligations arising from any written agreement or from the franchisor's practice.

(2) Any restrictions that the franchisee must place on its manager (for example, maintain trade secrets, covenants not to compete).

xiii) Information related to restrictions on what the franchisee may sell:

(1) Any franchisor-imposed restrictions or conditions on the goods or services that the franchisee may sell or that limit access to customers, including any obligation on the franchisee to sell only goods or services approved by the franchisor, any obligation on the franchisee to sell all goods or services authorized by the franchisor, and whether the franchisor has the right to change the types of

authorized goods or services and whether there are limits on the franchisor's right to make changes.

xiv) Information related to renewal, transfer, and termination:

- (1) Length of the franchise agreement.
- (2) Renewal or extension of the term.
- (3) Termination by franchisee or franchisor.
- (4) Assignment of the franchise agreement.
- (5) Franchisor's right of first refusal.
- (6) Franchisor's option to purchase franchisee's business.
- (7) Death or disability of franchisee.
- (8) Non-competition covenants during the term of the franchise.
- (9) Modification of the franchise agreement.
- (10) Integration/merger clause.
- (11) Dispute resolution by arbitration.
- (12) Choice of Forum.
- (13) Choice of Law.

xv) Information related to outlets:

- (1) The total number of franchised and company-owned outlets for each of the franchisor's last three fiscal years. For purposes of this Section, "outlet" includes outlets of a type substantially similar to that offered to the prospective franchisee.
- (2) The projected new franchised and company-owned outlets.
- (3) The name and city, and current business telephone number, or if unknown, the last known home telephone number of every franchisee who had an outlet

terminated, canceled, not renewed, or otherwise voluntarily or involuntarily ceased to do business under the franchise agreement during the most recently completed fiscal year or who has not communicated with the franchisor within 10 weeks of the disclosure document issuance date.

- (4) If a franchisor is selling a previously-owned franchised outlet now under its control, disclose the following additional information for that outlet for the last five fiscal years.

xvi) Information related to financial statements:

- (1) The following financial statements are to be included after being audited by an independent certified accountant. Present financial statements that compares at least two fiscal years.
 - (a) The franchisor's balance sheet for the previous two fiscal year-ends before the disclosure document issuance date.
 - (b) Statements of operations, stockholders equity, and cash flows for each of the franchisor's previous three fiscal years.
- (2) When a franchisor owns a direct or beneficial controlling financial interest in a subsidiary, its financial statements should reflect the financial condition of the franchisor and its subsidiary.
- (3) Include separate financial statements for the franchisor and any sub-franchisor, as well as for any parent that commits to perform post-sale obligations for the franchisor or guarantees the franchisor's obligations. Attach a copy of any guarantee to the disclosure document.

- (4) A start-up franchise system that does not yet have audited financial statements may phase-in the use of audited financial statements by providing, at a minimum, the following:
- (a) The franchisor's first partial or full fiscal year selling franchises (an unaudited opening balance sheet)
 - (b) The franchisor's second fiscal year selling franchises (audited balance sheet opinion as of the end of the first partial or full fiscal year selling franchises)
 - (c) The franchisor's third and subsequent fiscal year selling franchise (all required financial statements for the previous fiscal year).
- xvii) Submit a copy of all proposed agreements regarding the franchise offering, including the franchise agreement and any lease, options, purchase, and any other related agreements.
- xviii) Submit an acknowledgment that the disclosure document summarizes certain provisions of the franchise agreement and other information in plain language.
- xix) General Instructions
- (1) All information in the disclosure document shall be current as of the close of the franchisor's most recent fiscal year. After the close of the fiscal year, the franchisor shall, within 120 days, prepare revised disclosure documents, after which a franchise seller may distribute only the revised document and no other disclosure documents.
 - (2) The franchisor shall, within a reasonable time after the close of each quarter of the fiscal year, prepare revisions to be attached to the disclosure documents to reflect any material change to the disclosures included, or required to be included, in the

disclosure documents. Each prospective franchisee shall receive the disclosure documents and the quarterly revisions for the most recent period available at the time of disclosure.

(3) If applicable, the annual update shall include the franchisor's first quarterly update, either by incorporating the quarterly update information into the disclosure documents, or through an addendum.

xx) It is an unfair or deceptive act or practice in violation of this Section, for any franchisor to:

(1) Make any claim or representation, orally, visually, or in writing, that contradicts the information required to be disclosed by this Section.

(2) Disclaim or require a prospective franchisee to waive reliance on any representation made in the disclosure document or in its exhibits or amendments.

15) Registration

a) Appointment of the Registrar

i) The Minister may appoint a public officer as a Registrar of Franchises and such number of Deputy Registrars of Franchises, Assistant Registrars of Franchises and other officers as may be necessary for the purposes of this Law.

ii) The Registrar shall, subject to the general direction and control of the Minister, perform the duties imposed and exercise the powers conferred on him under this Law.

iii) The Deputy Registrar, Assistant Registrars and other officers shall be under the direction and control of the Registrar.

iv) The Deputy Registrar and Assistant Registrars may perform all the duties and exercise all the powers passed to them by the Registrar under this Law.

v) All officers appointed under this section shall be deemed to be public servants within the meaning of the Egyptian Penal Code.

b) **Registration Process**

i) A franchisor shall register his franchise with the Registrar before he can make an offer to sell the franchise to any person.

ii) A franchisor shall make an application to register his franchise by submitting to the Registrar the application in the prescribed form together with:

(1) The complete disclosure documents with all the necessary particulars filled in;

(2) A sample of the franchise agreement;

(3) The operation manual of the franchise;

(4) The training manual of the franchise;

(5) A copy of the latest audited accounts, financial statements, and the reports, if any, of the auditors and directors of the applicant; and

(6) Any other additional information or documents as may be required by the Registrar for the purpose of determining the application.

iii) At any time after receiving an application and before a determination is made, the Registrar may, by written notice, require the applicant, or the director or manager of the applicant, to provide additional information or documents.

iv) An application under this Section may be withdrawn at any time before it is approved or refused.

v) If any additional information or document required under this Section is not provided by the applicant or his director or manager within the time specified in the requirement or any extension of time granted by the Registrar, the application shall be

deemed to have been withdrawn and shall not be further considered, but without prejudicing any new application being made by the applicant.

c) Approval or Refusal of Application for Registration

- i) Upon receipt of an application for registration together with the information or documents required under this Section, the Registrar may approve or refuse the application, and shall give the reason for refusal.
- ii) An application for registration which is approved under this Section may be subject to such conditions as the Registrar may impose.
- iii) Upon approving an application, the Registrar may require the applicant to pay such amount of fees as may be prescribed.
- iv) The Registrar shall give the applicant a written notice of his decision.

d) Effective Date of Registration of a Franchise

- i) If the registration of a franchise is approved, the registration shall be effective on the date stated in the written notice given by the Registrar and such date shall be after the date of the filing of all the required information or documents.

e) Period of Effectiveness

- i) The registration of a franchise shall continue to be effective unless the Registrar issues an order made by written notice to the applicant or the franchisor to suspend, terminate, prohibit or deny the sale or registration of the franchise under this Law.

f) Amendments to Disclosure Documents

- i) If there is any material change in the disclosure documents, the applicant or his director or manager shall amend the documents according to the prescribed form.

- ii) The Registrar may, at any time, require additional information on the amendments made under this Section.
- g) Notice of Suspension or Termination of the Registration
- i) If the Registrar proposes to suspend, terminate, prohibit or deny the sale or registration of a franchise, he shall give the applicant or the franchisor written notice of his intention to do so, specifying the nature of the proposed action and the grounds on which he proposes to take such action, and he shall give the applicant or the franchisor an opportunity to make a written representation on the matter within fourteen days from the date of service of the notice.
 - ii) After the expiry of the period of fourteen days mentioned in Section 15 (g) (i) of this Law, and after considering any representation made by the applicant or franchisor, the Registrar shall decide whether to proceed with the proposed action or to take no further action.
 - iii) The Registrar shall give the applicant or franchisor written notice of his decision under Section 15 (g) (i) and the decision shall take effect from the date on which the written notice is served on the applicant or franchisor.
- h) Cancellation of Registration
- i) A franchisor may, at any time after the franchise term, apply to the Registrar for cancellation of the registration of the franchise from the register.
 - ii) The Registrar shall accordingly cancel the registration of the franchise from the register if he is satisfied that the franchisor is no longer granting rights under the franchise.
- i) Annual Report

- i) Annually the franchisor shall, within thirty days from the anniversary date of the registration, submit a report to the Registrar in the prescribed form.
- ii) The report shall contain the disclosure documents which have been updated.
- iii) The Registrar may review the report and disclosure documents and:
 - (1) Notify the franchisor if any additional information or modification of the disclosure documents is to be included or deleted; or
 - (2) Issue an order to suspend, terminate, prohibit or deny the sale or registration of the franchise in the public interest or for the purpose of protecting prospective franchisees until any deficiencies specified by the Registrar have been corrected.
- j) Appeal of the Registrar's Decision
 - i) A person who is aggrieved by any decision of the Registrar under this Section may appeal to the Minister within one month from the date the decision is communicated to the person.
 - ii) The Minister's decision on the appeal shall be final.
- k) Franchise Advisory Board
 - i) Franchise Advisory Board shall be established under this Law.
 - ii) The Franchise Advisory Board shall consist of such persons, not exceeding fifteen in number, as the Minister may appoint.
 - iii) The members of the Franchise Advisory Board to be appointed shall be persons who have knowledge and experience in matters relating to franchises.
 - iv) The members of the Franchise Advisory Board may receive such remuneration as may be prescribed for their services.

- v) The Franchise Advisory Board shall advise the Minister and the Registrar on matters relating to franchises, and the due administration and enforcement of laws relating to franchises.
- vi) The Minister and the Registrar shall not be bound to act upon the advice or report of the Franchise Advisory Board.

16) Penalties

- a) The breach of Sections 4, 5, 7, 8 (b), (c), (d), and (e), 9 (b), 10, 11, 13, 14, and 15 of this Law, makes a person liable for:
 - i) A fine of not less than five thousand Egyptian pounds and not more than fifty thousand Egyptian pounds, for the first time; and
 - ii) For a second or subsequent breach, to a fine of no less than ten thousand Egyptian pounds or to imprisonment for a term exceeding five years or to both.
 - iii) Upon sentencing a breach for a first or second time, the court may, upon the request of the injured party:
 - (1) Declare the franchise agreement between the franchisor and any franchisee to be null and void;
 - (2) Order that the breaching party refund any form of payment obtained; or
- b) If a breach against any provision of this Law has been committed by a body corporate, any person who at the time of committing of the breach was a director, manager, secretary or other similar officer of the body corporate or was purporting to act in any such capacity, or was in any manner or to any extent responsible for the management of any of the affairs of such body corporate, or was assisting in such management, shall be

deemed to have committed that breach unless, having regard to the nature of his functions in that capacity and to all circumstances, he proves:

- i) That the breach was committed without his knowledge, consent or connivance; and
 - ii) That he took all reasonable precautions and exercised due diligence to prevent the commission of the breach.
- c) Where any functionary of the Registrar or any other officials concerned with the application of this Law abuse their authorities, neglect their duties or resort to cheats and a crime is committed, they shall be subject to the Egyptian Penal Code.

17) Miscellaneous

- a) The Minister may make regulations for all or any of the following purposes:
 - i) Prescribing the forms, procedure and other requirements for the purposes of this Law;
 - ii) Prescribing the form and content of disclosure documents;
 - iii) Prescribing the fees or charges to be paid to the Registrar in respect of the registration of a franchise and the manner for collecting and disbursing such fees or charges;
 - iv) Prescribing the procedure for appeal under this Law;
 - v) Prescribing the procedure and requirements for the registration of any franchise granted or sold in or outside Egypt by a franchisor or a franchise broker before the commencement of this Law;
 - vi) Prescribing the remuneration for the services of the Franchise Advisory Board; and
 - vii) Providing for such other matters as are contemplated by, or necessary for giving full effect to, the provisions of this Law and for their due administration.

18) Severability

If any provision of this Law is stayed or held invalid, the remainder will remain in force.

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