COUNTRY COMPARATIVE GUIDES 2023

The Legal 500 Country Comparative Guides

Germany

FRANCHISE & LICENSING

Contributor

Bird & Bird

Dr. Jiri Jaeger

Partner | jiri.jaeger@twobirds.com

Jie Zhang

Senior Associate | jie.zhang@twobirds.com

Michael Brooks-Zavodsky

Counsel | michael.brooks-zavodsky@twobirds.com

This country-specific Q&A provides an overview of franchise & licensing laws and regulations applicable in Germany.

For a full list of jurisdictional Q&As visit **legal500.com/guides**

GERMANY
FRANCHISE & LICENSING

1. Is there a legal definition of a franchise and, if so, what is it?

The answer is no. There is no legal definition of a franchise in Germany. However, in Germany, a franchise or franchising is generally regarded as a sales and distribution system where franchise partners (as independent companies) are granted the right, in consideration for a certain remuneration (the franchise fee), to conduct a business using the franchisor's business concept, know-how and intellectual property rights (including trademark and copyright).

2. Are there any requirements that must be met prior to the offer and/or sale of a franchise? If so, please describe and include any potential consequences for failing to comply.

Yes. According to German law, there are mandatory pre-contractual disclosure requirements that would apply to the franchisor prior to the offer and/or sale of a franchise. According to these requirements, the franchise must, during the pre-contractual negotiations, disclose those material facts that will have a material impact on the success of the franchise and that may induce the potential franchisee to become part of the network. These requirements are imposed via the general legal principle of culpa in contrahendo, which is codified in Section 311 (2) of the German Civil Code ("GCC").

In the event of breach of these requirements the franchisee may be entitled to rescind the franchise agreement and to claim damages.

3. Are there any registration requirements for franchisors and/or franchisees? If so, please describe them and include any potential consequences for failing to comply. Is there an obligation to update existing registrations? If so, please describe.

There are no mandatory registration requirements for franchises in Germany.

4. Are there any disclosure requirements (franchise specific or in general)? If so, please describe them (i.e. when and how must disclosure be made, is there a prescribed format, must it be in the local language, do they apply to sales to sub-franchisees) and include any potential consequences for failing to comply. Is there an obligation to update and/or repeat disclosure (for example in the event that the parties enter into an amendment to the franchise agreement or on renewal)?

There are disclosure requirements in Germany. During the negotiations, the franchisor must generally disclose those material facts which will have a material impact on the success of the franchise and that may induce the potential franchisee to become part of the network.

The catalogue of information to be disclosed is derived from German case law and is not codified. In essence, the franchisor must inform the franchisee about the potential profitability of the franchise system. The extent of the disclosure duties also depends on the individual case, especially how versed the franchisee is in the business concerned. As an overall rule, information and data must be provided on the basis of which the franchisee can judge its (financial) risks as necessary investments, the period of initial losses and the chance to realize profits. In essence, the franchisor must inform the franchisee about the profitability of the franchise system.

German case laws require the franchisor to conduct pre-contractual disclose within a reasonable period prior to

entering into franchise agreements. For this reason, the franchise disclosure document must be provided to the prospective franchisee at least 14 days prior to the franchisee signing the franchise agreement.

There is no specific format or standard procedure as to how the disclosure must be made in Germany. Considering that the franchisors, in the event of a legal dispute, bear the burden of proof for fulfilling their pre-contractual duties of disclosure, it is common practice in Germany to standardize and document the pre-contractual clarification in writing, accompanied by providing certain recruitment literature (including indicative financial and commercial models, estimated costs, resource and staffing levels, and historical financial performance information) which are usually attached as Appendixes to the disclosure document. In this regard, it is important for the franchisors to let the potential franchisee confirm (e.g. by signing and dating the document on the signature page) that they have read and understood the information in the disclosure document and recruitment literature.

In terms of the disclosure language, there is no specific requirement for disclosure documents to be translated into the German language. However, for the practical reasons of avoiding misunderstanding and potential disputes, it is advisable that all the disclosure documents (including the draft franchise agreements and recruitment literature) should be in a language understandable to the specific potential franchisee.

In the constellation of sales to sub-franchisees, it is the duty of the sub-franchisor to make the necessary disclosure to the potential sub-franchisees and provide the proper information regarding the franchise system and how it works, including the potential for successful business operation.

Franchisors should be very cautious in marketing their franchises in Germany. Any failure to comply with the disclosure requirements would mean that the franchisee is entitled to claim damages. In such case, the franchisor must put the franchisee in the position it would have been in if the franchisor had fulfilled its disclosure obligations. As the franchisee may have not agreed to the franchise agreement under full disclosure, it may rescind the franchise agreement. The franchisor, therefore, can be ordered to pay all obtained franchise fees back to the franchisee and to reimburse the franchisee for all expenses incurred in connection with the franchised business.

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

In case the relevant information provided within the disclosure document becomes outdated prior to the conclusion of an amendment or on renewal, an update of the disclosure would then be necessary for the franchisor. For example, the franchisor would be obliged to give an update if the number of current franchisee outlets and the financial performance information have changed.

5. If the franchisee intends to use a special purpose vehicle (SPV) to operate each franchised outlet, is it sufficient to make disclosure to the SPVs' parent company or must disclosure be made to each individual SPV franchisee?

In Germany, there is no specific regulation on operating business through a SPV. To mitigate any potential risk of failing to comply with disclosure requirements, it is advisable to make disclosure to both the individual SPV franchisee and its parent company (which usually share the same directors).

6. What actions can a franchisee take in the event of mis-selling by the franchisor? Would these still be available if there was a disclaimer in the franchise agreement, disclosure document or sales material?

A mis-selling by the franchisor may be qualified as a violation of the pre-contractual obligation and would likely entitle the franchisee to rescind the franchise agreement and to claim damages.

In this context, it is not permissible under German law for a franchisor to exclude or limit any potential liability for pre-contractual misrepresentation by including disclaimer clauses in the franchise agreement. Something different would apply if there was a disclaimer (or limitation of liability clauses) in the pre-contractual disclosure document which attempts to limit the franchisor's liability specifically in case of violation of pre-contractual disclosure obligation.

7. Would it be legal to issue a franchise agreement on a non-negotiable, “take it or leave it” basis?

Yes, a non-negotiable pre-formulated franchise agreement is permissible under German law. Actually, if a franchise agreement, once adapted to German law, has been pre-formulated for use on many occasions and the clause at hand has not been individually negotiated, a German court will apply the Rules on Standard T&Cs (i.e. GTC law) in sections 305 – 310 of German Civil Code (“BGB”). In this case, such pre-formulated terms would be subject to a strict content control by the courts according to GTC law and any clauses that unreasonably disadvantage the other party would likely be declared as invalid by German courts if challenged by the franchisee.

8. How are trademarks, know-how, trade secrets and copyright protected in your country?

To make sure the trademarks enjoy brand protection in Germany, registration is needed. After the registration, trademark proprietors would be entitled to commence enforcement proceedings based upon their trademark rights. It is possible to obtain a preliminary injunction in Germany, even without an oral hearing, within a very short time, but any delay in issuing proceedings can mean that this right may fall away.

Franchisors can choose whether to register them as domestic German or European Union trademarks (EUTM) or international registrations. Most franchisors opt for EUTM registrations rather than German domestic registrations, although domestic registration is more common if it is a German-language mark used solely for a domestic German business. Franchisors can extend their trademarks to Germany as part of an international registration or subsequent designation, as Germany is a party to the Madrid Protocol.

Germany is a first-to-file jurisdiction, although unregistered marks can be acquired by way of usage if they have acquired a reputation in Germany, and Article 6 of the Paris Protocol also ensures that ‘well-known marks’ can be protected even if there is no evidence of use in Germany. The German Unfair Competition Act provides supplementary protection to trademarks.

In addition to pure trademark protection, the German Trademark Act also grants special protection for trade designations, which could be business names or titles of works. Their protection does not require a registration, but rather a certain level of usage of the trade designation by the proprietor. As trade designations are not contained within the trademark register, special search tools are required to identify existing prior third-party rights.

The new Act on the Protection of Trade Secrets (Gesetz zum Schutz von Geschäftsgeheimnissen) came into force on 26 April 2019 in Germany. This new Trade Secrets Act brings along many legal changes, including, for the first time in Germany, a legal definition of the term “trade secret”, increased legal requirements for confidentiality measures, the general permissibility of reverse engineering and new rules on the protection of trade secrets in civil proceedings. The new act offers new opportunities for enforcing trade secrets, but also places increased demands on trade secrets owners to ensure adequate confidentiality measures both within their internal organization and vis-à-vis third parties.

Know-how often does not meet the requirements for being protected through registration as specific intellectual property.

In Germany, know-how is mainly protected through non-disclosure agreements or confidentiality clauses in the franchise agreements. In addition, section 17 of the German Act of Unfair Competition protection protects against unlawful disclosure of know-how and business information.

Copyrights are protected by the German Copyright Act. Infringements of copyrights could lead to claims for i) injunctions, ii) damages or iii) destruction, recall or restitution of unlawfully produced or distributed copies.

9. Are there any franchise specific laws governing the ongoing relationship between franchisor and franchisee? If so, please describe them, including any terms that are required to be included within the franchise agreement.

There are no specific franchise laws governing the ongoing relationship between franchisor and franchisee in Germany. Therefore, the franchise relationship is governed by the general codes of law such as the general provisions of German contract law (the German Civil Code), commercial law (the German Commercial Code), competition law and unfair trade law. To ensure legal certainty, it is therefore recommended that one draw up the underlying franchise agreements in enough detail.

For example, the ongoing relationship between franchisor and franchisee is especially affected by agency laws if the franchisee commits to the ongoing

purchase of products and equipment. Such agency laws, inter alia, impose the duty on franchisors to pay compensation to franchisees on termination, the principle of good faith, the rule that unfair contracts are void and the principle that long-term contracts can be terminated for good reason, and cooling-off rights in accordance with European consumer protection law.

Antitrust law, based upon Article 101 of the Treaty on the Functioning of the European Union (TFEU), also has an impact on issues such as the grant of exclusivity, tying and price control.

Furthermore, a test of fairness by the rules on unfair contract terms will be imposed on any provision in a standard form agreement that has not been negotiated by the rules on unfair contract terms. In the light of this, special justification is generally needed if a provision deviates from the fallback position as set out in the Civil Code to the detriment of the franchisee.

Finally, several statutory provisions will be implicit in the agreement, such as a right of the franchisee to terminate and the franchisor's obligation to provide certain services. There is a great deal of case law on the question of what constitutes sufficient grounds for termination, so franchisors must be cautious when exercising or contesting this right.

10. Are there any aspects of competition law that apply to the franchise transaction (i.e. is it permissible to prohibit online sales, insist on exclusive supply or fix retail prices)? If applicable, provide an overview of the relevant competition laws.

All forms of competition restraints contained in franchise agreements, such as non-compete clauses, price-fixing, guaranteed exclusive areas and purchasing restrictions, are regulated by the European and German antitrust law.

Generally speaking, only active sales may be restricted, passive sales not. Sales via internet platform are expressly considered by the European competition law to be passive sales. Therefore, online sales cannot be prohibited.

There is also an antitrust law related limitation to price policy set by the franchisor: The franchisor is basically only entitled to set a maximum for the prices, whereas minimum or fixed price is inadmissible. Additionally, the franchisor is entitled to issue non-binding price recommendations.

In addition, recent case law (Munich Higher Reginal Court, Case 29 U 4165/18 Kart) ruled that advertising campaigns may have the effect of restricting competition, namely the franchisees' ability to determine their sale prices, if the franchisor set the resale price through the de facto binding effect of the ad campaign (if they have an anticompetitive effect, especially if they factually force the franchisees to offer the products for low prices).

11. Are in-term and post-term non-compete and non-solicitation clauses enforceable?

(In-term and post-term) non-compete clauses are enforceable in Germany, provided these clauses conform to the following permissible limits:

The period of post-contractual non-competes following termination/expiration must be "reasonable" according to German law. A period of 12 months is reasonable according to German case law.

Under German competition law, a post-term competition restriction must be limited to the premises from which the franchisee has been operating during the contractual term. Therefore, a post-term non-compete restriction is likely to be unenforceable in Germany from a competition law perspective, if the Territory where such restriction shall apply is larger than the specific premises from which the German franchisee has been operating.

Please note that as consideration for the post-term competition restriction, the Franchisee will have a statutory claim for a "waiting allowance" (taking into account his average monthly Gross Revenues) against IWG. Such a waiting allowance is mandatory under German law, even if most Franchisors see non-compete as a legitimate requirement.

That means, even if the current agreement is silent on this, the Franchisee will still have a statutory claim for a waiting allowance against IWG. We have not included any wording establishing the right to a "waiting allowance" on the basis we assume IWG does not want to encourage Franchisees to ask for it – however, that does not mean it will not apply, and Franchisees can still ask for it.

The non-solicitation clauses prohibiting soliciting or poaching employees is not enforceable in German court. This is due to a more recent ruling.

12. Are there any consumer protection laws that are relevant to franchising? Are

there any circumstances in which franchisees would be treated as consumers?

Section 513 of the Civil Code protects new businesses, including some franchisees, in relation to loans, respites or any other forms of financial aid, as well as instalment supply contracts. Specific statutory information requirements apply, and such franchisees may be entitled to withdraw from their contracts.

In the past, it has been heavily discussed within the German franchisee industry whether a franchisee, if qualified as a founder of a business, may be treated as a consumer and therefore have a cooling-off right (i.e., the right of withdrawal from the franchise agreement after signing).

- Meanwhile, this has been clarified by the case laws of the Higher Regional Court of Duesseldorf (NJW 2004, pp. 3192, 3193) and the German Federal Court of Justice (NJW 2005, pp. 1273, 1274). According to these case laws, a franchisee setting up a franchise business is not acting as a founder of a business (in the sense of Sec. 13 BGB), but as an entrepreneur (as per Sec. 14 BGB) when concluding the franchise agreement, since the conclusion of a franchise agreement in this context is considered by the courts as taking up entrepreneurial business activities. This means, a new franchisee, when concluding the franchise agreement as a contracting party, is not to be classified as a consumer and, therefore, is not entitled to the right of withdrawal according to Sec. 513 BGB.
- However, as an exception to this above rule, a franchisee, if it is a business founder according to section 513 BGB, may withdraw from the franchise agreement within 14 days if the franchise agreement relates to the sale of goods and provides for a purchase commitment in the form of purchase and delivery by instalments (cf. section 512 BGB).

In detail: Under German law – based on the EU Consumer Rights Directive –, special consumer protection rules apply to B2C contracts for the delivery of goods by instalments. These special rules aim to protect consumers because contracts for delivery by instalments, due to their longer-term and recurring purchase obligations, create similar obligations for those of a borrower. These rules apply to franchise agreements if they can be qualified as a so-called “contract for delivery by instalments” in the sense of Sec. 513, 510 BGB (in German: “Ratenlieferungsvertrag mit Bezugsverpflichtung”), with the right of withdrawal following from Sec. 355, 356c BGB.

Specifically, this means that a cooling-off right could be invoked if the following cumulative conditions are fulfilled:

- the franchisee is required under the franchise agreement to make consistent purchases of goods from the franchisor or other designated suppliers;
- the franchisee qualifies as a founder of a business;
- the cash payment (for their obligation for the recurring purchase of goods) related to the contract does not exceed EUR 75,000 (sec. 513 German Civil Code).

13. Is there an obligation (express or implied) to deal in good faith in franchise relationships?

In Germany, the good faith principle and concepts of fair dealing are implicit in all agreements and one of the fundamental principles under German law. Accordingly, franchisors cannot exercise their contractual rights or change their business formats with impunity. Although both franchisors and franchisees benefit from and carry reciprocal burdens, it is generally franchisors, as the dominant parties, that find they have to defend themselves from allegations of behaving unfairly or in bad faith. This is particularly the case when franchisors seek to issue disciplinary or other actions against their franchisees, so their actions need to be proportionate.

The practical effects of the good faith principle, based on several German case laws in the context of a franchise relationship, can be shown in the following examples:

- German law allows the franchisor to make certain (unilateral) system-relevant changes to the standards and manuals (e.g., changing the customer complaints handling process) and to demand their implementation by the franchisee. However, restrictions could apply if the amendment is considered to contravene the general principle of good faith. For this reason, the franchisor can only unilaterally make the changes if the request for modifications is communicated with sufficient notice and the changes do not unreasonably affect the franchisee.
- Also, there are restrictions imposed on the basis of the principle of good faith that apply to the franchisor’s rights to amend or withdraw approved products and supplies.

Accordingly, the franchisors can only exercise its (contractual) rights to amend or withdraw approved products and/or supplies to the extent that this appears necessary or expedient in view of the best possible functioning of the franchise system.
- Furthermore, restrictions imposed based on the good faith principle would apply to the way the franchisor receives or uses the advertising contribution or operates a national marketing fund (e.g., no unreasonable disadvantage for the franchisees).

14. Are there any employment or labour law considerations that are relevant to the franchise relationship? Is there a risk that the staff of the franchisee could be deemed to be the employees of the franchisor? What steps can be taken to mitigate this risk?

Some employers in low-skill businesses, such as contract cleaning, have been known to use a form of 'false franchising' as a way of reducing their liabilities to their employees. The German courts are very sensitive to this type of abuse and the Federal Labour Court's decision in the Eismann case (NJW 1997, 2973) established that franchisees can be deemed to be 'in fact' employees of a franchisor if the franchisor controls every aspect of an individual franchisee's business.

To mitigate the risk of the franchisee's staff being considered by the German courts to be the employees of the franchisor, the franchisor shall draw up the franchise agreements in such a way that gives the franchisee certain freedom to organize their self-employed business and avoid any implications in the agreement that indicate the franchisee's economic dependence on the franchisor.

15. Is there a risk that a franchisee could be deemed to be the commercial agent of the franchisor? What steps can be taken to mitigate this risk?

The major relevant risk is that the claim of a commercial agent for indemnity compensation upon termination according to section 896 German Commercial Code (HGB) may apply by analogy to the franchisee upon termination of the franchise agreement if the franchisor can continue (i.e., after termination) to derive substantial benefits from business with the customer base generated by the franchisee prior to termination.

In case of franchise agreements, the relevant section of the HGB which provides for the compensation payment may apply by way of analogy if i) the franchisee is part of the franchisor's sales organization in such a way that he is integrated into the system comparable to a sales agent, and ii) the franchisee must be obliged under the franchise agreement to transfer its customer data to the franchisor after termination of the franchise contract, enabling the franchisor to use the franchisee's customer base after termination of the franchise agreement.

There is not much the franchisor can do to avoid the above risk completely, especially not by stipulating there is no such claim in the agreement, as such a compensation claim of the franchisee as per § 89b HGB is qualified in Germany as mandatory provision and shall therefore apply despite the choice of law in favor of foreign law. Nevertheless, to mitigate such risk of being sued for indemnity payment, it is advisable for franchisors not to include any clauses in the agreement that could infer an obligation for the franchisee to inform the franchisor of customer names and contact details.

16. Are there any laws and regulations that affect the nature and payment of royalties to a foreign franchisor and/or how much interest can be charged?

There are no specific laws or regulations in Germany that regulate the nature and payment of royalties. These are rather subject to the mutual agreement between the two parties.

The amount of royalties payable under a franchise agreement is, however, subject to the general principles of public policy combating price gouging as per section 138 BGB.

17. Is it possible to impose contractual penalties on franchisees for breaches of restrictive covenants etc.? If so, what requirements must be met in order for such penalties to be enforceable?

Yes, it is possible. To make sure such penalties are enforceable, the amount of such penalties must – if contracting on general terms and conditions – not be excessively high and may not exceed the average damages typically to be anticipated in accordance with German GTC law.

18. What tax considerations are relevant to

franchisors and franchisees? Are franchise royalties subject to withholding tax?

Franchisor tax liabilities

Franchisors that are tax resident in Germany are liable for corporation tax of 15 per cent plus a solidarity surcharge that is added to the corporate income tax and set at a rate of 5.5 per cent of the corporate income tax rate (equaling an additional 0.825 per cent) and trade tax. Trade tax is a municipal tax. As such, tax rates are individually determined by each municipality (the German average is around 14 per cent). Withholding tax of 25 per cent is payable on dividends.

Royalty fees for the granting of rights under the German Copyright Act (e.g., software licences, although not the licences to use patents or trademarks) bear a reduced VAT rate of 7 per cent, while all other fees paid to the franchisor by the franchisee are subject to VAT at 19 per cent. The initial franchise fee is usually amortised over the duration of the franchise for income tax purposes.

Franchisee tax liabilities

In addition to corporation tax and the solidarity surcharge, trade tax is also payable by franchisees.

19. How is e-commerce regulated and does this have any specific implications on the relationship between franchisor and franchisee? For example, can franchisees be prohibited or restricted in any way from using e-commerce in their franchise businesses?

German regulations on e-commerce mainly derive from EU legislation, such as the directives on distance selling and on consumer rights. Franchisor or franchisee as E-commerce providers need to observe a variety of information obligations; failure to comply with these obligations can trigger extended rights of withdrawal for consumers, as well as possible competitor actions.

As already stated above (see above question 10), sales by the franchisee via internet platform is considered by the European competition law to be passive sales and cannot be effectively prohibited by the franchisor. Any prohibitions or restrictions on the franchisee's ability to use an e-commerce platform in the franchise agreements are considered to have an anticompetitive effect and are therefore not allowed.

20. What are the applicable data protection laws and do they have any specific implications for the franchisor/franchisee relationship? Does this have any specific implications in the franchising context?

The rules of data protection law play an important role in any dealings with the personal data of end users (and employees); these rules have a significant impact, for example, when franchisors run loyalty programs and promotional campaigns.

The major applicable data protection laws are: i) the Federal Data Protection Act ("BDSG"), ii) the Telemedia Act ("TMG"), iii) the Act against Unfair Competition ("UWG") and iv) the General Data Protection Regulation 2016/679 ("GDPR").

Any processing of personal data by the franchisee (and franchisor) must be based on the consent of the data subject or legal justification under law. Wherever a data controller transfers data outside the EU or EEA, for example, into the United States, measures to ensure an adequate level of data protection compliance must be met.

Further to that, there are also various sector-specific regulations, such as those that apply to providers of tele-media services under the German Telemedia Act, which is relevant for online marketing and user-tracking activities, or to internet service providers. Lack of compliance with data protection laws can lead to serious consequences, including monetary fines and cease-and-desist orders, as well as reputational issues and negative publicity in Germany.

21. Is the franchisor permitted to restrict the transfer of (a) the franchisee's rights and obligations under the franchise agreement or (b) the ownership interests in the franchisee?

Yes, the franchisor is permitted to restrict the transfer of the franchisee's rights and obligations within the franchise agreements. The same applies to the transfer of the ownership interests in the franchisee where the franchise can make such transfer subject to the prior consent of the franchisor.

22. Does a franchisee have a right to request a renewal on expiration of the

initial term? In what circumstances can a franchisor refuse to renew a franchise agreement? If the franchise agreement is not renewed or it if it terminates or expires, is the franchisee entitled to compensation? If so, under what circumstances and how is the compensation payment calculated?

Under German law, the renewal of a franchise agreement must occur on a mutual basis. The franchisor has the freedom to decide whether to renew or refuse to do so. Accordingly, if the franchise agreement is not renewed or it terminates or expires, the franchisee would not be entitled to compensation. Exceptions can arise from the general principle of good faith. For example, if a franchisor has already communicated with the franchisee about their intention to renew the agreement and continues to push the franchisee towards further investments prior to the contractual expiry, but finally allows the agreement to lapse, then this self-contradictory behavior of the franchisor, which may cause financial damages to the franchisee, may entitle the franchisee to claim damages.

Actually, most of the franchise agreements in Germany provide for the possibility of renewal, which is, however, often subject to the franchisee complying with certain pre-conditions (e.g., no substantial breach of contract during the term of the franchise agreement).

23. Are there any mandatory termination rights which may override any contractual termination rights? Is there a minimum notice period that the parties must adhere to?

Yes, there are statutory rights for both parties to terminate extraordinarily for good cause / important reason which is mandatory and cannot be abrogated.

Firstly, the parties can opt for a fixed term for the agreement. In such case, such agreement (with a definite term) can end either because of lapse of term or by termination for cause. A termination for convenience (even with the observance of certain notice period) prior to the expiry of the term is not permissible.

It is impossible to summarize here all the possible reasons for a termination for cause. The basic rule under German law is that a contract may be terminated for cause if one could not reasonably expect the terminating party to remain bound to the contract until the end of the regular term of the contract. Typical reasons for a termination for cause in franchise relations are e.g., the non-payment of franchise fees, violation of the non-compete obligation or other substantial breach of major obligations under the franchise agreement.

If the parties do not agree on such a fixed term in the agreement, then this agreement can be terminated either for good cause (see above) without observance of notice period) or for convenience (then of course only with prior notice). According to Section 89 HGB (applied by analogy), an agreement with indefinite term may be terminated with a prior notice of one month during the first year, two months' notice during the second year and three months' notice during the third through the fifth year. After a term of five years, the contractual relationship may only be terminated with a prior notice of six months.

However, the above notice periods only apply where the termination is not made for cause. Section 89a of the HGB provides that any agency contract (applicable to franchise agreement by analogy) can be terminated without observance of a notice period by either party if terminated for an important reason. Furthermore, if such termination results from the misbehavior of the other party, that latter party is obligated to compensate for any damage which occurred to the other party arising from the termination of the contractual relationship.

In terms of formalities, only a type of breach of contract that is of such nature that it destroys the trust in the relationship between the parties finally allows for immediate notice of termination. In all other circumstances, a prior formal warning must be given. The warning has to be comprised of a description of the alleged breaches and the breaching party has to be demanded to refrain from further breaches.

24. Are there any intangible assets in the franchisee's business which the franchisee can claim ownership of on expiry or termination, e.g. customer data, local goodwill, etc.

Depending on the circumstances how the franchisor can continue to derive substantial benefits from using the franchisee's customer data (e.g. customer names and contact details) post termination, the German courts may apply the statutory provision, namely section 89b HGB, by analogy, entitling the franchisee to a compensation payment (see more details under question 15).

25. What due diligence should both the franchisor and the franchisee undertake before entering into a franchise relationship?

Before entering into a franchise relationship, it is absolutely crucial for **prospective franchisees** to thoroughly investigate their proposed franchise opportunities (e.g. by analyzing the financial statements and data of the franchisor, reading the disclosure documents, talking to past and present franchisees or doing online research into the business and overall industry trends) with a focus on questions like i) what competitive strengths (e.g. recognized and strong brand) does the franchise system have compared to competitors on the market, ii) what are the franchisee's financial obligations, iii) whether the franchise network shows steady growth, iv) what are the market trends and whether the relevant business is sustainable and v) what kind of marketing and ongoing support does the franchisor offer.

For the franchisor, it is important to check whether the potential franchisee matches with the franchise business by determining their personal character, former entrepreneurial experience or financial condition.

26. How widespread is franchising and what are the most active sectors? Are there any specific economic, cultural or regulatory issues that make franchising particularly attractive?

Germany is a mature franchising market, with a good number of indigenous franchises ranging across more than 42 different sectors, from retail and fast food through hotels, education, car rental and domestic services to energy, health care and telecommunications. The three biggest and most active sectors are services (39 per cent), retail (31 per cent), and hotels and gastronomy (20 per cent).

According to the figures as of 2021 by the German Franchise Association, there are currently more than 920 active franchise systems and 141,821 franchise businesses in Germany, employing more than 787,207 employees, according to the German Franchising Association. The current annual turnover of the German franchise sector is estimated at about €135 billion.

27. Is there a national franchising association? Is membership required? If not, is membership commercially advisable? What are the additional obligations of the national franchising association?

The German Franchise Association e.V. (Deutscher Franchiseverband e.V.) is the official German organization for the German franchise industry and has currently approx. 300 members.

A membership with this association is not required for someone who intends to establish a franchise system in Germany. Despite this, a membership is recommended, as the association represents the interests of its members and the whole franchise community economically and politically, and also provides useful information and organizes some franchise training and webinars exclusive for the membership.

The association imposes no additional obligations on the members other than obliging them to comply with the association's code of ethics.

28. Are foreign franchisors treated differently to domestic franchisors? Does national law/regulation impose any debt/equity restrictions? Are there any restrictions on the capital structure of a company incorporated in your country with a foreign parent (thin capitalisation rules)?

Under German law, franchisors from EU and non-EU member states are not treated differently. There are also no restrictions on foreign entities incorporating local companies in Germany.

Foreign franchisors which wish to set up a local entity operating business usually choose the private limited liability company (German: GmbH) as the common form of corporate vehicle in Germany. Such corporate form requires a minimum share capital of €25,000 and limits corporate liability towards the creditors to the company's assets (and therefore offers the protection of its foreign parent).

Depending on the capital, liability risk considerations and tax implications, foreign franchisors can also choose other forms of business entities such as stock company (AG) which requires a minimum share capital of € 50,000.

29. Are there any requirements for

payments in connection with the franchise agreement to be made in the local currency?

There are no foreign exchange controls or restrictions on foreign currency payments applicable to cross-border franchising in Germany. It is prudent to ensure that franchise documentation states the currency in which payments should be made and the rate and time of currency conversion.

However, Foreign Trade Ordinance ("AWV") stipulates a reporting obligation for international money transfers made to and from Germany above €12,500, which is regulated in section 67 of AWV, in conjunction with section 11 of the Foreign Trade and Payments Act ("AWG"). Such reports must be made to the German Central Bank.

30. Must the franchise agreement be governed by local law?

In principle, parties are free to choose the governing law applicable to their contractual relationship (article 3 of Regulation (EC) No. 593/2008, 'Rome I').

However, both parties have to be aware of the fact that even if they exercise their right to choose the applicable law in favor of a foreign law other than that of Germany, this shall not prejudice the application of those provisions under German law that cannot be derogated from by agreement and are applicable to any situation falling within their scope irrespective of the law chosen (so-called overriding mandatory provisions in terms of Art. 9 Rome I). Examples are competition law, the German Foreign Trade Legislation, consumer protection law, Bankruptcy Law, and certain provisions of German Labor Legislation.

31. What dispute resolution procedures are available to franchisors and franchisees? Are there any advantages to out of court procedures such as arbitration, in particular if the franchise agreement is subject to a foreign governing law?

In the event of a dispute between a franchisor and franchisee, the main dispute resolution options open to the parties are i) mediation, ii) litigation and iii) arbitration.

The increase in international expansion of franchise network in recent decades has led to a huge upsurge in the use of arbitration as an out of court dispute resolution procedure. Arbitration has many advantages (e.g. over litigation) in an international franchise context as set out below:

- In Germany, arbitration proceedings are private and confidential, and the parties could therefore avoid any adverse publicity that often follows litigation and could have adverse effect on the rest of franchise network.
- Parties can choose arbitrators with franchise industry expertise or in-depth knowledge relevant to the particular issue in dispute.
- It is generally easier to enforce an arbitral award in another jurisdiction than it is a court judgment.
- The parties can choose a neutral location for the arbitration hearing as opposed to opting for one of the parties' national courts.

32. Does local law allow class actions by multiple franchisees?

At the End of 2018, a new type of declaratory action, the so-called Model Declaratory Action (Musterfeststellungsklage), was introduced into German law in the wave of the diesel emission affair of Volkswagen. These actions aim to promote the enforcement of consumer rights and combat unlawful behavior by mass-market businesses in situations where a large number of consumers are similarly adversely affected and the respective damages are relatively low.

However, such actions as a procedural mechanism are only open for consumers, which is not the case with the franchisees. As already stated above, it has been established by the German case laws that a franchisee setting up a franchise business is not considered to be taking up activities as a consumer, but as an entrepreneur (as per Sec. 14 German Civil Code). As a result, the new Model Declaratory Action would hardly be available to franchisees.

33. Must the franchise agreement and disclosure documents be in the local language?

German law doesn't require non-German franchisors to draw up their franchise agreements and disclosure documents in the German language.

However, for the practical reason of avoiding any misunderstandings or risk of potential disputes, it is advisable to draw up the agreement and disclosure document in bilingual form (it is possible here to make the English language as the prevailing version) or at

least to provide the franchisee with a convenient German translation.

34. Is it possible to sign the franchise agreement using an electronic signature (rather than a wet ink signature)?

There is no legal requirement under German law to sign the franchise agreement in written form (i.e. handwritten signature). So, there is no issue with a franchise agreement being signed using an electronic signature (e.g. via DocuSign) which is also often used in common practice.

35. Can franchise agreements be stored electronically and the paper version be destroyed?

For the existence of the franchise agreement, it is not necessary to store a paper version.

However, for the sake of evidence before German courts in case of disputes, the parties are discouraged from destroying the paper version. The alternative is to sign and store the franchise agreements using an electronic signature (e.g. via DocuSign).

36. Please provide a brief overview of current legal developments in your country that are likely to have an impact on franchising in your country.

types of distribution agreements (including franchises), namely the Vertical Block Exemption Regulation ("VBER"), which came into force on 1 June 2022.

The new VBER provides more leeway to business (including franchise system) on running exclusive and selective distribution systems, e.g. by providing a helpful list of the type of IPR (intellectual property rights) related restrictions considered legitimate in a franchise network and accepting a longer term for the franchisee's non-compete obligation in the franchise agreement (than the usual five-year maximum limit applicable to other types of distribution models).

37. In your opinion, what are the key lessons to be learned by franchisors as a consequence of the COVID-19 crisis?

The covid pandemic accelerated the roll-out of digital technologies and platforms across various industries and sectors including franchising.

Customers expect more convenience, personalization, and engagement through digitalization from franchise networks. The Franchisee industry needs to be prepared for these changing demands and trends. To cater for this, Franchisors are encouraged to provide the right digital tools, online training, and support services to help their franchisees optimize their products and services.

38. Do you foresee any significant commercial or legal developments that might impact on franchise relationships over the next year or so?

The new Price Indication Ordinance (PAngV) has been in force in Germany since May 28, 2022. The new PAngV requires, as a specific consumer protection law, that price quotations for goods and services should be transparent, comprehensible, and easily comparable (with competing products) for potential customers. In detail: the new PAngV imposes an obligation on the suppliers to specify the selling price and the unit price by providing consumers with the simplest possible means of assessing and comparing the prices and thus allowing them to make informed decisions on the basis of simple comparisons. The goal is to enable the average consumer to assess a price at first glance and understand it without further reflection.

The new PAngV generally applies to all B2C transactions, but not to B2B transactions (cf. section 1 PAngV). The PAngV is therefore of considerable importance for almost every franchise system in Germany.

Contributors

Dr. Jiri Jaeger
Partner
jiri.jaeger@twobirds.com

Jie Zhang
Senior Associate
jie.zhang@twobirds.com

Michael Brooks-Zavodsky
Counsel
michael.brooks-zavodsky@twobirds.com