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Germany

FRANCHISE & LICENSING

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

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

No, there is no legal definition of a franchise under German law. However, a franchise is generally defined as being a distribution system where business partners (the franchisees) are allowed to use an established business concept against a fee (the franchise fee).

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. The main requirement that must be met prior to the offer and/or sale of a franchise is the pre-contractual disclosure – it is not required by German statutory law (as no franchise-specific laws exist). However, this requirement has been developed under the general principle of good faith (s. also Question 13), as stipulated especially in sections 242 and 311 of the German Civil Code ("BGB"). In the event of non-compliance, the franchisee may declare the agreement void if the franchisee entered it by a mistake wilfully induced by the franchisor (section 123 BGB), terminate the franchise agreement for cause (section 314 BGB) and 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.

No, German law does not provide for any franchise-specific registration requirements for the franchisor or the franchisee. Registration obligations may be required, nonetheless, for associated rights, such as trademarks (s. Question 8).

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 no franchise-specific disclosure requirements under German statutory law. Nevertheless, the general good faith requirement applies, pursuant to sections 242 and 311 BGB. Case law (starting with the Higher Regional Court of Munich, 16 September 1993, case no. 6 U 5495/92) requires the franchisor to disclose any circumstances that may affect the agreement's purpose. Such disclosure shall be provided within a reasonable period (two to four weeks may regularly suffice) before concluding the franchise agreement (or any preliminary contract with binding effect, including area development franchise agreements or master franchises). There is no prescribed format – however, it should be made in writing for the sake of proof.

The disclosure must be updated in case the information disclosed becomes obsolete prior to concluding the franchise agreement – as may be the case if the turnover information provided on the basis of the pilot operation sinks below the forecast disclosed (cf. Higher Regional Court of Cologne, 24 April 2009, case no. 6 U 70/08, juris, para. 23).

As to the language, in general all documents should be in a language understood especially by the franchisee, for the practical reason of avoiding misunderstandings and disputes upfront.

Sub-franchisors are, towards their sub-franchisees, also obliged to make pre-contractual disclosure. Sub-franchisors must disclose all the information required by the franchisees as basis for their decision to join the franchise system, including information about the franchise and the allocation of tasks between the master- and the sub-franchisor and the sub-franchisees. This also includes the extent of the licence forming the basis of the master franchise agreement and therefore also of the sub-franchise agreement, including the potential consequences in case of termination.

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?

SPVs are not subject to any specific regulation under German law. Therefore, the general disclosure principles and requirements outlined above apply.

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?

Mis-selling may be qualified as a violation of the obligation to comply with the principle of good faith and may likely entail cause for immediate termination and compensation obligations.

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

Yes, non-negotiable franchise agreements are legal under German law. In fact, franchise agreements are usually standard agreements – as they aim at creating a consistent franchise system. If the franchise agreement is made of pre-drafted contractual rules provided by the franchisor for a multiple number of franchisees, it will under German law be qualified as "general terms and conditions". General terms and conditions are subject to quite strict statutory rules (sections 305–310 BGB), providing that any provision contrary to the principle of good faith is void (section 307 BGB).

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

Trademarks are best protected through registration. Registration on a national level is filed with the German Patent and Trade Mark Office (DPMA) in Munich. EU-wide protection can be achieved by filing the registraiton with the European Union Intellectual Property Office (EUIPO) in Alicante. For international protection beyond the European Union, the application needs to be filed with the World Intellectual Property Organization (WIPO) in Madrid. Protection, starting on the date of filing, initially lasts for a period of 10 years – and can be renwed against a respective fee.

Know-how does often not always meet the requirements for being protected through registration as specific intellectual property. Instead, know-how is rather protected by non-disclosure agreements..

Coprights are protected under the German Copyright Act, allowing the author to exclusively exploit his or her work exclusively – without registration and even without providing a copyright notice.

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.

Neither in Germany nor in Europe is there a specific (or even harmonized) franchise law, such as a franchise act. Instead, the franchise relationship is governed by the general rules of German civil law. In order to ensure legal clarity for both parties, it is therefore advisable to draw up the franchise contract in as much detail as possible.

Depending on the concrete scope of the franchise agreement, different provisions of German civil law can be of importance. For example, the contractual design can be covered by provisions of lease (section 535 BGB et seq.) or loan law (section 488 BGB et seq.). When drafting the franchise contract, special attention must also be paid to the – very strict – German laws on general terms and conditions (section 305 BGB et seq.). Finally, all contracts must be subject to the general provisions on good faith (section 242 BGB) as well as to the prohibition against violating applicable (protective) law (sections 134 and 138 BGB). In addition, there is slowly but steadily increasing upper court jurisdiction

specific to franchise systems.

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.

Yes, several legal acts apply with regard to competition law:

- The German Act Against Unfair Competition ("UWG") as regards advertising: The UWG prohibits unfair commercial practices like – for example – misleading advertising. In the event of non-compliance with competition law, competitors may file claims for cease-and-desist and, if the conditions are met, profit may be confiscated, too.

Art. 101 of the Treaty on the Functioning of the European Union ("TFEU") and section 1 of the German Competition Act ("GWB") as regards restrictions on competition: Art. 101 TFEU and the GWB concern the antitrust side of competition law. Generally speaking, active sales may be restricted, passive ones cannot. Especially restrictions to internet sales are in constant change. In general, the franchisor must not completely prohibit internet sales by the franchises. However, the prohibition of individual internet platforms is permissible under certain circumstances. If such a prohibition is intended, the individual legal situation should be examined before concluding or amending the franchise agreement accordingly.

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

Basically, yes. Non-compete and non-solicitation clauses are common in franchise agreements. Provided these clauses remain within the permissible limits (i.e. are necessary for the franchise system to function or remain within the limits of the Vertical Block Exemptions Regulation), they are enforceable, possibly also following an interim relief of a German civil court.

12. Are there any consumer protection laws that are relevant to franchising? Are there any circumstances in which franchisees would be treated as consumers?

Consumer protection laws may apply in two different relationships:

Between franchisor and franchisee, a franchisee cannot be considered a consumer under German law and, therefore, cannot claim consumer rights (German Federal Court, 24 February 2005, case no. III ZB 36/04). However, if franchisee is a business founder according to section 513 BGB, such franchisee may withdraw from the franchise agreement within 14 days if the franchise agreement is is a franchise agreement for goods and provides for a purchase commitment in the form of purchase and delivery by instalments (section 512 BGB).

Towards the customers of the franchisee, however, the full range of German and European consumer protection law will regularly apply (unless the franchise business is addressed only to business customers). In this respect, franchisor and franchisee also have to comply with product safety and product liability. Depending on the type of products or services offered, the requirements of food or cosmetics law, for example, must be met. In this area, a clear contractual delimitation of regulatory responsibilities should be defined in the franchise agreement.

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

Yes, to deal in good faith is one of the several principles underlying German civil and commercial law and also franchise relationships are subject to it. The courts have accordingly developed several individual obligations from the principle of good faith in the context of the franchise relationships, including the pre-contractual disclosure obligation or the obligation of the franchisee to promote sales. Additionally, any declaration of the parties of a franchise agreement and the franchise agreement itself must be interpreted in good faith (sections 133 and 157 BGB), and services have to be performed in good faith (Sec. 242 BGB).

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?

In order to prevent that the franchisee is considered an

employee of the franchisor, the entrepreneurial freedom of the franchisee should not be excessively limited, both in the franchise agreement and in the franchise manual. Besides the careful drafting of these documents, the franchise relationship must be performed in a way that the franchisee cannot be qualified as an employee – because courts will assess both the contractual and the practical side of the franchsie relationship. In case contract and practice diverge from another, the practical situation is decisive (cf. German Federal Court, 11 October 2018, case no. VII ZR 298/17; Rohrßen, ZVertriebsR 2019, 323).

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 qualification of a franchisee as commercial agent can be hindered by appropriate clarification in the franchise agreement. However, in Germany this specification hardly helps to avoid the applicability (in case of doubt, by analogy) of the commercial agency law of section 84 et seq. German Commercial Code ("HGB") if the relevant criteria are met. For example, the claim of a commercial agent for goodwill indemnity at termination in accordance with section 89b HGB may also apply (by analogy) to the franchisee if the franchisor can continue to use the franchisee's customer base even after termination of the contract.

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?

The nature and payment of royalties are subject to the agreements between franchisor and fanchisee. However, the amount of royalties to be agreed upon is subject to the absolute limit of usury 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. Usually the parties of a franchise agreement stipulate contractual penalties to deter and simplify the calculation of damages in case of breach of restrictive covenants, such as confidentiality covenants. To b enforceable, such penalties must – if stipulated in a standard form contract / general terms and conditions (s. Question 7) – not exceed the damages typcially to be expected within the normal course of things (cf. Section 310, 307, 309 No. 5 and 6 BGB).

18. What tax considerations are relevant to franchisors and franchisees? Are franchise royalties subject to withholding tax?

Franchisors and franchisees in Germany are especially subject to income tax. The rate to be paid on the annual profits depends on the form of organisation: Stock corporations ("Aktiengesellschaften", in short: "AG") or limited liability companies ("GmbH") are subject to a corporate income tax of 15%, while individuals and partnerships are subject to a staggered income tax of up to 45%.

Moreover, companies generally need to pay a trade tax, whose rate is determined by the local municipality. Its amount regularly varies between 7 and 18%. Wages paid to employees are subjecdt to a wage tax, to be paid by the employee.

Sales of goods or services within the framework of the franchise are subject to VAT – generally 19%, unless for goods or services required for the basic needs, for which the reduced rate of 7% falls due (e.g. for food, hotels or public transport).

19. 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?

A franchisee does in principle not have a right to renewal. Rather, the franchisor is free to decide whether to renew the franchise agreement or to refuse to do so. The franchisor is not obliged to state the reasons for its refusal. Exceptions may exist where the franchisor has a dominant position on the market or where the franchisor has invoked trust in the franchisee to contiue the franchise relationship.

However, the franchisee may a claim for a reasonable return and, at least, to recoup the resources invested. Therefore, if a franchisor declares to be willing to renew

a franchise agreement, the franchisee makes expenses due to this statement and the franchisor then refuses to renew the franchise agreement, the franchisee may be entitled to compensation. The claim may include compensation for damages or frustrated investments.

20. 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?

The right to “extraordinary” termination for good cause is difficult to exclude, at least completely. Furthermore, with regard to the termination rights provided by law, a distinction must be made according to whether the term of the franchise agreement lasts for a limited or unlimited period.

A franchise agreement with an unlimited period can be terminated with cause or without cause, according to the terms stipulated in the agreement. If a termination regime is not stipulated in the agreement, the statutory provisions regarding commercial agents may apply by analogy (cf. German Federal Court, 23 July 1997, case no. VIII ZR 130/96). The notice periods in such case are regulated as follows: one month’s notice in the first year of contractual relationship, two months in the second year, three months in the third to fifth year and six months as of the sixth year.

A franchise agreement with a limited period, instead, can only be terminated for cause with immediate effect, i.e. “extraordinarily”, unless the parties specifically agreed on terms for ordinary termination. If an extraordinary termination is planned, the termination has to be served within a reasonable time after the cause for the termination occurred, if applicable only after a prior last warning.

21. 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 extent to which the franchisor can continue to use the franchisee’s customer base after termination, the franchisor is obliged to pay compensation in accordance with section 89b HGB, applied by analogy. Furthermore, as described under question 15, further claims for compensation may arise, as well as claims from intellectual property.

22. 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 an umbrella organization for the German franchise economy, with about 300 member companies at the moment. A membership is not necessary to run or establish a franchise system in Germany. However, a membership may be advisable, as the association represents the interests of its members on economic, political and social levels.

The association has no legal obligations. Of interest for franchisors and for franchisees, however, is the knowledge database made available free of charge by the association. It provides, inter alia, for information about the code of ethics established by the association, on franchise compliance and about the (possible) contents of franchise contracts. The code of ethics established by the association is binding for its members.

23. Are foreign franchisors treated differently to domestic franchisors?

Only with respect to the possible establishment of franchisor’s companies within Germany, it is necessary to make legal distinctions between EU and non-EU franchisors. EU companies are granted the right to retain their company form within the framework of the freedom of establishment; so, for example, an Italian company can establish itself in Germany. This freedom does not exist for non-EU companies that wish to establish their franchise system within the EU.

Besides that, foreign franchisors are to be legally treated the same as national franchisors. However, from a practical approach, franchisees may prefer binding themselves to and cooperating with domestic franchisors – as they are used to national (German) law and the respective company forms. For the franchisor, in return, opting for a company form according to German law will establish closer contact to the national market. Besides that, choosing a national company can help to minimise the liability risk for the franchisor’s principal company (and thus serves as protection of the shareholders of the franchisor’s principal company).

24. Are there any requirements for

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

No, there are no such provisions obligating the parties of a franchise agreement to take out payments in local or any other specific currency. However, banks and credit institutions are subject to certain reporting requirements for credit transfers. Thus, any payment over EUR 12,500 – or the corresponding amount in a foreign currency – crossing the border has to be reported to the German Central Bank [section 11 of the German Foreign Trade and Payments Act ("AWG") in connection with section 67 and following of the German Foreign Trade and Payments Ordinance ("AWV")].

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

No, it is not mandatory. In a domestic franchise agreement between two German parties, franchisor and franchisee usually, however, agree on the applicability of German law. Even if foreign law may generally be chosen (article 3 Rome-I-Regulation), the national law is the usual choice since a large amount of national mandatory provisions (including the quite strict rules on standard form contracts) would otherwise override conflicting provisions between the parties. For more details, see Rothermel, Internationales Kauf-, Liefer- und Vertriebsrecht (2016), Chapter H, who gives an overview on the various levels of protection of franchisees in various countries worldwide.

26. 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?

On the one hand, the way to the ordinary courts is open to franchisors and franchisees. Mediation proceedings are also possible before the ordinary courts, in addition to"normal" litigation. In time-sensitive matters, litigation allows starting with interim injunctions to reach temporary results. Furthermore, it is possible to opt for a special type of procedure – in the context of litigation – in which only documents (e.g. a franchise agreement) are admissible as evidence. This also allows results (i.e. a judgement) to be produced more quickly. Finally, an expedited payment procedure is available for cases where the claiming party does not expect the debtor to reject a payment claim. Even though this possibility is still being developed, proceedings can already be brought before English-speaking chambers in Frankfurt am Main and Hamburg.

On the other hand, franchisor and franchisee may agree to seek arbitration, in case of dispute. The parties are free to determine the essential framework of such a procedure themselves. They can determine the rules of procedure [e.g. the rules of the German Arbitration Institute (DIS) or the rules of the International Chamber of Commerce], the language of the proceedings or the number of arbitrators. Further advantages of arbitration are that these proceedings can be held confidential (this can be decisive as German court hearings are usually open to the public) and arbitration awards are easily enforceable, especially compared to decisions of foreign courts outside the European Economic Area and Switzerland. However, there are also some disadvantages of arbitrational proceedings. Compared to the ordinary courts, interim relief is typically slower to achieve. In particularly sensitive areas (e.g. where intellectual property rights are infringed), franchise agreements should also keep the path to ordinary jurisdiction open for the respective plaintiff. Costs are, as a rule of thumb until an amount in dispute of EUR 5 million, higher than for German courts. However, the costs of arbitration can be reduced by chosing an effective arbitration institution and by reducing the number of arbitrators from three to one.

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

Not in the end. The German model declaratory action ("Musterfeststellungsklage") – introduced in the aftermath of the high number of cases brought before the German courts in relation asking for damages concerning diesel cars – has gained some notoriety as a "class action light". However, the prerequisite for being able to participate as a claimant in this type of action is that the aggrieved parties are consumers according to German law. This will never be the case with franchisees, as they will be considered entrepreneurs according to German law.

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

First of all, as German law does not have a discovery procedure like e.g. in the USA, legally defined disclosure documents do not exist (see Question 3).

Furthermore, there is no provision which would oblige

the contracting parties to use the German language in their contracts. However, all documents should be in a language the parties understand, both for practical and legal reasons. On the one hand, and in the spirit of a trusting cooperation, the parties can avoid misunderstandings and disputes based on pure language issues. Using a language both parties understand is, on the other hand, also required by the European Code of Ethics for Franchising. Besides, the language of the documents should ideally correspond with the official language of the proceedings foreseen as dispute resolution under the franchise agreement. If German courts shall decide on disputes arising from and based on the franchise agreement, it must be kept in mind that the language of the court is German. However, the parties can agree on an English chamber in Frankfurt am Main or Hamburg (see above question 26). If the agreement is drafted in multiple languages, the franchise agreement should determine which language shall prevail in case of any discrepancy or dispute.

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

Yes, it is possible. According to German law, there are no formal requirements for most of the franchise contracts, i.e. theoretically a written contract is not necessary, even a verbal agreement could be sufficient. The parties are nevertheless well advised to record their agreements in a written contract, for the sake of proof. Generally, most of the electronic signature service providers known on the market can be used. If, however, the franchisee is a founder of a new business according to German law, a written form requirement might apply to this (potential) franchisee – depending on the content of the franchise agreement. In these cases the written form requirement can be met by using an electronic signature, however, only a so-called ”qualified” electronic signature according to section 126a BGB, which requires a specific procedure, including an identification process.

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

In principle, contractual relationships remain in force even after the relevant contractual document has been destroyed. However, for the sake of evidence before German courts, digitizations or copies will usually not replace the original contract document. A solution hereto might be to agree on a new contract signed electronically (see above question 29).

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

There are currently no legislative proposals that explicitly aimed at regulating franchising. It is therefore all the more important to keep an eye on various areas of law with an indirect impact on franchising law and to keep track of the advancing case law on franchise law. This includes, on the European level, keeping track of the Vertical Block Exemptions Regulation, i.e. the EU’s antitrust law. The Regulation will expire on 31 May 2022 – and will most likely be renewed with a few amendments. Such amendments will very likely include specific regulations as regards restrictions to internet sales / online market places and restrictions to online advertising.

Of interest is, for example, a judgement by the Munich Higher Regional Court (“OLG München”) from autumn 2019 (case no. 29 U 4165/18 Kart): the court decided that advertising cost contributions stipulated in a franchise contract are not subject to any fiduciary duties of the franchisor. The court came to this conclusion based on a specific wording in the franchise agreement regarding the advertising cost contributions. Furthermore, the court ruled that price recommendations do not violate the prohibition of fixed prices under (European) competition law. With this judgement, the court deviates from other (higher) court decisions. The reception of the judgement in Germany (and even Europe) by other courts may be eagerly awaited.

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

One of the key lessons is a non-legal one: partners of a franchise contract should communicate with each other and solve problems in a joint discussion and partnership. A judgement against an insolvent party of a franchise contract is of little use. For example, McDonald’s announced in May 2020, that it would support its franchisees to protect the franchise network, especially by suspending or waiving royalties for a limited period of time.

Besides that, basic provisions of German civil law were and are currently particularly relevant: German law bases on the principle that agreements must be kept (“pacta sunt servanda”). This principle has not been changed by the specific COVID-19 law enacted to mitigate some of the consequences of COVID-19. For

example, tenants were neither allowed to terminate their lease contracts due to the crisis nor to suspend the lease payments. Instead, the tenants were allowed to withhold the rents for April, May and June 2020 until 30 June 2022, without risking that the landlord terminates the lease for non-payment, but subject to the burden of proof, in the case of a dispute, that the non-payment was due to the pandemic.

In addition, if no amicable solution is reached with regard to payment difficulties, the existence of a right of the franchisee to adjust the contract is currently being discussed. However, the extent to which this right actually exists and – if so – to what extent it may be exercised by a franchisee, has yet to be clarified in court.

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