



**COUNTRY
COMPARATIVE
GUIDES 2023**

The Legal 500 Country Comparative Guides

Israel

FRANCHISE & LICENSING

Contributor

Reinhold Cohn Group



Adv. Orit Gonen

Partner | orgonen@gilatadv.co.il

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

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

ISRAEL

FRANCHISE & LICENSING



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

There is no specific legislation regulating franchises in Israel. The only definition of 'franchise agreement' in Israeli legislation can be found in regulations enacted under the Economic Competition Law 1988, which provide a block exemption to franchise agreements under certain circumstances. The definition in the regulations is as follows:

"Franchise Agreement" a contract under which a franchisor grants the franchisee the right to use the franchise for the purposes of marketing certain goods or types of goods, including each of the following:

(1) use of a uniform trade name or trademark or service mark, and uniform characteristics of the goods being sold or of the sale and execution, which are material to the marketing and sale of the goods;

(2) transfer of knowledge from the franchisor to the franchisee which is material to the marketing and sale of the goods;

(3) commercial or technical assistance from the franchisor to the franchisee, during the term of the agreement."

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.

There are no regulatory pre-offer requirements to the offer of sale of a franchise.

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.

The franchise per-se is under no obligation to be registered. Worth noting that in case the franchisee is provided with a license to use the trademarks of the franchisor- such license should be recorded in order to ensure that the use of the trademarks by the franchisee will inure to the benefit of the franchisor otherwise. Non use by the trademark owner might cause the trademarks to become vulnerable to cancellation on non-use ground.

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 specific requirements in respect of pre-contractual disclosure in franchise transaction except under the general contract law, which requires that the parties negotiate in good faith. There is no specific requirement for updating the disclosure, except if the requirement derives from the duty of the parties to act in good faith for the duration of the agreement.

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 general, the duty of disclosure lies towards the party to the franchise agreement. Where multiple parties are involved, it is mandatory to act in good faith towards all parties. Given that there is no specific disclosure requirement, the representations of the franchisor may apply to SPVs which are under the same control as the parent company as long as the duty to act in good faith is fulfilled.

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?

Under the general contract law, the parties to an agreement are under the duty to negotiate in good faith. This duty was interpreted by the courts as requiring each of the parties to refrain from any misrepresentation which might mislead the other. A mis-selling due to misrepresentations may allow the franchisee to seek for the cancellation of the agreement and/or sue for damages caused on the ground of breach of the good faith duties during negotiations and on the ground of negligent misrepresentation.

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

Such an offer will be evaluated under the requirement for good faith and common practice. Additionally, such offer might result in the conclusion that the agreement in question is a "standard agreement" as such term is defined in the Standard Contract Law, 1982 (see section 35 below).

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

Intellectual property rights are respected and protected in Israel. In order to protect trademarks, it is advisable to register same (after consulting with a local agent and defining the scope of the portfolio for best possible protection) although well-known trademarks may be defended as well as long as their owners may prove their notoriety as required under the Israeli Trademarks Ordinance and case law. Know how is protected as far as

it meets the requirements defined under the law for trade secrets. It is highly recommended to protect patentable know how under patent protection. Copyrighted works are protected under the Copyright Act, no registration is required.

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 laws.

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.

The Economic Competition Law 1988 (known as the Antitrust Law) forbids parties from entering into restrictive arrangements which are defined as arrangements made between persons conducting business, under which at least one of the parties restricts itself in a manner which may prevent or reduce business competition between it and the other parties to the arrangement, or some of them, or between it and a person who is not a party to the arrangement. More specifically the law deems an arrangement to be restrictive in case it includes, inter alia, the following: restrictions in respect of the price demanded, offered, or paid and/or the profit which will be derived; division of the market, in whole or in part, by business location or by the persons or types of persons with which business is to be done; the number of assets or services in the business, their quality, or type.

Despite the above broad definition, the Israeli legislator granted an exemption to franchise agreements (under the Economic Competition Rules (block exemption for franchise agreements) (Temporary Order), 2001, in force until September 15, 2026) ("Franchise Exemption") from being defined as forbidden restrictive arrangements as long as the objective of the arrangement is not to reduce or eliminate competition, and the arrangement does not include any restraints which are not necessary to fulfil its objective.

The Franchise Exemption allows the parties to a franchise agreement to address the following aspects: (i)

the franchise territory; (ii) the type and quality of product sold by the franchisee; (iii) the type of customers to whom the franchisee is allowed to sell the goods or services and the manner in which the sale should be performed including restrictions in respect of advertisement; (iv) the restricted use of the franchisor's know-how by the franchisee (v) the quantity of products the franchisee is entitled to sell; (vi) the product price; and (vii) knowledge pertaining to the franchise.

The Franchise Exemption will not apply where: (i) the parties to the agreement are actual competitors; or (ii) a party has monopoly power in the relevant product market or in an adjacent market; or (iii) the agreement's duration is 10 years or longer, or (iv) when the agreement includes restrictive stipulations, such as: (a) restriction of the franchisor from using licensed know-how after the term of the agreement, even when the know-how is in the public domain; or (b) prevention of the franchisee from initiating judicial review of the validity of the rights in know-how transferred from the franchisor to the franchisee or other intellectual property rights; or (c) prevention of the franchisee from selling or supplying goods to consumers outside the territory defined in the agreement; and/or (v) other restrictions that are only meant to reduce competition or are not necessary to fulfil its principal.

The Economic Competition Law deems arrangements whose restrictions involve the right to use a patent, trademark, copyright or proprietary right as not restrictive, provided that the arrangement is made between the owner of the right and the party who receives authorisation to use the right and where the right is subject to registration by law and is registered accordingly.

It has lately been published by the Economic Competition Authority that it intends to amend the Economic Competition Law by way of providing protection to parallel importation (which is allowed under the Israeli legal regime). This proposed amendment forbids official distributors or franchisees from taking measures, against parallel importers, when such measures might reduce or eliminate the competition, and which are not necessary for the sake of fulfilling their duties.

The Israel Competition Authority oversees enforcement of the law when it is violated. The enforcement proceedings begin with an investigation, which may lead to financial sanctions or criminal charges.

The franchise agreement should be carefully drafted to comply with the Franchise Exemption.

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

As detailed in Section 10 above, non-compete and non-solicitation clauses in a franchise agreement will be enforceable as long as their objective is not to reduce or eliminate competition, and they are necessary to fulfil the objective of the entire agreement.

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

The Consumer Protection Act applies to consumption of goods for private purposes thus it is not likely that a franchisee will be considered as consumer under this act.

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

Yes. All contract parties, including the parties to franchise agreements, are subject to the duty of good faith during negotiations, the culpa in contrahendo principle, applied under the Contract (General Part) Law 1973. The Law does not prescribe the extent of disclosure and requires each negotiating party to act in a 'customary manner' and in good faith, thus leaving it to the courts to decide. The duty of good faith applies to the entire relationship between the parties and extends beyond the stage of negotiations.

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?

Generally, the employees of the franchisee should not be considered as employed by the franchisor. As long as a clear separation between the franchisee and the franchisor is kept under the franchise agreement and de facto, the risk that the franchisee's employees will be considered as the franchisor's employees is rather low. A franchise agreement should include a specific indemnification clause to reduce the franchisor's risk of being liable for any payments to the franchisee's

employees.

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?

Commercial agent is defined under the Agency Contract Law (Commercial Agent and Principal), 2012 as: Someone engaged in finding clients, or in activities (of which the purpose is to) for the purpose of entering into a contract between a client and a principal in connection with the purchase of goods that are marketed by the principal. Thus, as long as the franchisee is purchasing the goods from the franchisor (or from anyone connected to it) there is no risk of the franchisee meeting the requirements set by the law in order to be considered as commercial agent.

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 is no specific law affecting the nature and payment of royalties to foreign franchisor except banking regulations relating to anti-laundry activities. As to the interest – the laws regulating interest rates are applicable to loans (granted by banks or non-banks entities) rather than commercial credit line, however under the general contract laws the court might interfere in such matter should it consider the rate to be extremely unreasonable amounting to bad faith.

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?

It is possible to impose contractual penalties for breach of agreements as far as such penalties are reasonable and the enforcement thereof is not unjust. In case of monetary penalties these are subject to the power of the courts to reduce them if it finds that the compensation was determined without any reasonable relation to the damage that could have been foreseen at the time of the conclusion of the contract as a probable result of the breach.

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

Incorporated businesses are subject to regular income tax (corporate tax) imposed on taxable transactions. Certain transactions trigger payment of VAT.

As of 2018, Israel is party to over 50 double tax treaties, essentially following the OECD model. A foreign resident entity may be exempt from corporate tax to the extent that its activities do not constitute a permanent establishment under an applicable tax treaty. There is no detailed legislation or Israeli court decision that provides a clear test under which it is possible to determine whether a non-resident has a taxable presence under Israeli tax law; thus, where there is no tax treaty protection, a non-resident is subject to tax on income accrued or derived in Israel.

Tax is calculated based on the actual income of the business entity or person from its activity in Israel. Income tax is paid on an annual basis and may be subject to payments on account. VAT, when applicable, is paid on a monthly or bimonthly basis, depending on the scope of the transactions.

The Supreme Court held that payment of royalties or management fees by the franchisee to the franchisor will be considered as part of the purchase price of the goods and taken into account in calculating the custom fees due by the franchisee when those payments are a precondition to the purchase of the goods by the franchisee from the franchisor. This decision may affect the financial negotiations between franchisors and franchisees.

As long as the royalties are not tax free the payment thereof is subject to withholding tax.

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?

There is no specific legislation regulating e-commerce in Israel except consumer protection law and regulation which allow the cancellation of remote sale transactions with no need to provide any ground, obligating the seller to full refund (subject to up to 5% withholding sum under certain circumstances).

The restriction of the franchisee from using e-commerce is possible as long as it serves the purpose of the relationship between the parties.

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 Privacy Protection Law and the regulations thereunder are applicable to franchises. No specific legislation exists therefor. Following are some of the Israeli privacy laws provisions applying on database owners (not exhaustive): (i) database owner is required to register its database if such database is, inter alia, used for direct marketing purposes; (ii) direct marketing emails sent to Israeli subjects must include the following details: (1) the registration number of the database and the fact that the email is sent as direct marketing; (2) a notice informing the subject that he has the right to be erased from the database along with an address at which he can make this request; (3) the identity and the address of the database owner and the sources from which he received the data; (iii) database owner is required to apply the provisions of the Privacy Protection Regulations (Data Security) 5777-2017, which provide detailed duties such as maintaining an appropriate level of security on the database, and preparing and maintaining records, processes, and documentation regarding the database. (iv) database owner is required to enable data subjects to review their personal data and allow the amendment thereof if it is incorrect.

It is to be noted that the Israeli Protection of Privacy Law applies to entities owning a database in Israel, and there is no explicit exclusion of companies established outside Israel.

It is highly recommended to assess the degree of care required for any specific database (such as clients database) in order to arrange for the adequate protection in advance.

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.

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?

No such right under applicable laws.

N/A

No, unless it was terminated in circumstances which entitle the franchisee to receive compensation. In circumstances where the agreement is entered into for an indefinite period of time it is assumed under Israeli case law that such an agreement is not perpetual thus each of the parties may terminate it subject to the provision of a prior termination notice. The notice period may be agreed upon in the agreement. In the lack of agreement as to the length of the notice period such period should be "reasonable" and allow the other party to take measures and arrangements for a new business relationship. Under current case law the reasonableness of the period will be determined based on several criteria such as: (i) the term of the relationship between the parties; (ii) the investments made by the franchisee in order to introduce the franchisor's product into the local market; (iii) the time required in order to recoup investments made by the other party in order to enter into and operate the franchise (iv) the nature of the franchisee's business namely does its business rely only on the franchise or not.

In case no proper notice of termination is submitted the other party is entitled to be compensated by the terminating party. The compensation is usually calculated based on the profits deprived from the other party during the period considered as "reasonable" under the specific circumstances.

See above.

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?

No.

The notice period is not regulated under specific legislation.

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.

The ownership of intangible assets created during the franchise relationship should be addressed in the agreement between the parties. As to the goodwill in the local market, it is highly important to agree that any goodwill accrued to the franchisor's product shall inure to the benefit of the franchisor. In that context it is important to note that in case the franchisee is granted with a license to use the franchisor's registered trademarks it is important to record such license with the Trademark Office as explained in Section 3 above.

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

As in any other transaction, customary due diligence should be undertaken.

Before starting to use a new brand in the Israeli market, parties should clear their right to do so, given that under Israeli law, a person may accrue rights in a trademark through use and be entitled to protection, even if the trademark is not registered. Thorough research of the market should be performed before establishing franchises in the market; a search in the database of the Trademark Register alone is not sufficient.

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?

Franchising is rather common in the Israeli market, especially in the food and beverage industry, and in merchandising, especially in the apparel and fashion industry. The Israeli market welcomes franchising, and there are no regulatory issues that have a negative effect on franchising relationships.

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?

No.

No.

N/A

N/A

The Israel Franchise Promotion Centre, established in 2001, is a voluntary centre that promotes franchising in Israel. All members of the organisation are subject to an ethics code that aims to ensure the ethical management of franchise businesses. There is no membership requirement.

A few more institutes also promote franchising and provide services in respect of franchising such as the Israel Franchise Institute.

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)?

No.

No.

No.

29. Are there any requirements for payments in connection with the franchise agreement to be made in the local currency?

No.

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

No. the courts in Israel respect foreign governing law clauses in agreements to which at least one of the parties is foreign, however the foreign law should be

then proved, usually through an opinion prepared by an expert to the foreign law, as any other factual argument.

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?

Any form of dispute resolution is available such as court claims, arbitration, mediation.

Not necessarily.

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

The legal ground for class actions in Israel are limited to a list of laws the breach of which may give rise to a class action. It is unlikely that one of these grounds will be used by franchisees in order to file a class action. There is no such case law yet.

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

Not necessarily however if the agreement is in a foreign language, it must be clear that the local party is well acquainted with such language.

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

Yes.

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

Yes.

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.

As mentioned in Section 10 above the Economic Competition Authority is promoting a change in the applicable law aiming at increasing the competition by restricting the official importers of good from blocking or harming parallel importation.

The Standard Contract Law 1982 applies when franchisors act under standard agreements. Pursuant to this law, the court may find certain terms to be unreasonable practice, unfair or oppressive. The Law further allows franchisors to seek advance approval of its standard agreement. The approval serves as a declaration that the standard terms are not oppressive.

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

Although the Israeli economy was affected by the COVID 19 pandemic, during 2021 there was a growth in the market thus it is reasonable to say that the pandemic had a limited affect especially in the consumption markets. The agility of certain business which were able to shift their activity to e-commerce was noted as a great advantage. Thus, an important lesson is to allow e-commerce by the franchisor. Having said that it is important to regulate and monitor such activity. It is important to make sure that upon termination of the relationship between the parties all domain names will be transferred to the franchisor or to its order and that the franchisee ceases all activity which was allowed only under the franchise activity (such as use of trademarks, tradenames, copyrighted work etc.). It is further important to draft the agreement in a manner which will ensure that all goodwill accrued to the goods will inure to the benefit of the franchisor and that the franchisee will have no ground to claim any rights thereto.

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

N/A

Contributors

Adv. Orit Gonen
Partner

orgonen@gilatadv.co.il

