KILPATRICK TOWNSEND

5 KEY TAKEAWAYS

Franchising in the United States and Germany

Kilpatrick Townsend Partner Marc Lieberstein recently joined Dr. Mansur Pour Rafsendjani (Noerr Law Firm, Munich) in comparing the impact of recent legal developments in franchising between the U.S. and Germany. The presentation was sponsored by the Franchise and Distribution Law Section of the State Bar of Georgia, chaired under Kilpatrick Townsend Michael W. Tyler.

The following are takeaways from the session:

1

Unlike the United States federal franchise regulations (Federal Trade Commission (Amended) Rule, 16 CFR 436) plus individual state franchise and business opportunity laws and rules, including 14 states which mandate registration with the state before a franchisor can offer to sell franchises in that state, the European Union (EU) does not (yet) have any specific franchise laws or regulations. However, some EU member countries, e.g., France and Sweden, do have national franchise laws concerning disclosure requirements. In other EU member states like Germany franchising is governed by general principles of commercial and civil law. Accordingly, franchisors looking to franchise in the EU should not only consult with EU counsel, but also local EU member country counsel as well.

2

The EU General Data Protection Regulation No 2016/679 (GDPR) took effect on May 25, 2018. EU member countries also have national data protection laws that are still applicable as well, e.g., Germany's Federal Data Protection Act. U.S. franchisors should be aware that the GDPR applies to extraterritorial activity, i.e., to data controllers outside the EU if (i) EU resident's personal data is processed in connection with goods/services offered to him/her (e.g. offering cloud computing services from the U.S., or (ii) the behavior of individuals within the EU is monitored. Any customer or other personal information data transferred between franchisors and franchisees requires justification, and will be permitted if (a) the customer expressly consents or (b) the transfer of such data is otherwise justified by law, e.g. if data transfer is necessary to perform or comply with the contract, e.g., delivery of products to a customer.

3

Brexit may impact U.S. franchise agreements in the EU, and in particular which law will govern those franchise agreements after Brexit is initiated (expected on March 30, 2019). Supply chain costs and insolvency risks are also expected to increase. U.S. franchisors should consider specific "Brexit clauses" to take effect once Brexit in initiated that permit for appropriate adaptation of governing law, pricing matters, sharing of risks, and possibly for termination. With regard to intellectual property, the current withdrawal agreement negotiated between the EU and United Kingdom (UK) provides that registered rights (EUTMs and EU designs) automatically and at no cost give rise to equivalent UK registered rights as of 1 January 2021, and pending applications will have a period of 9 months from that date for the applicants to file for equivalent rights in

3

that registered rights (EUTMs and EU designs) automatically and at no cost give rise to equivalent UK registered rights as of 1 January 2021, and pending applications will have a period of 9 months from that date for the applicants to file for equivalent rights in the UK (subject to potentially new examination, publication etc.). While not necessarily related to the EU or Germany, U.S. franchisors should give similar consideration to U.S. franchise agreements in light of the current situation with the NAFTA and the proposed TPP trade agreement, as well as U.S. immigration laws, all of which could impact supply chain costs, labor and wages, expansion costs, and potentially decrease foreign investment in the U.S.

4

Anti-trust laws in the U.S. and EU serve to prevent unfair restraints of trade. The EU law applies to all cross border agreements and trade, but there are also national laws which may come into play, e.g., Germany's Act against Restriction of Competition. EU anti-trust law, conceptually similar to U.S. law, provides for "per se" violations, e.g., price fixing, but also applies a kind of "rule of reason" to permit some restraints if market share is less than 30%, or if the restrictions are essential to protect know how, e.g., clauses prohibiting a franchisee to run a competing business) or to protect the identity and reputation of the franchise system (compliance with an operations manual, use of specific trademark). Recently, the European Court of Justice ruled that under certain conditions a brand owner/franchisor could restrict its distributors/franchisees to sell products on the Amazon platform (prohibition of platform sales), if the brand owner wants to safeguard the luxury aura of its products. However a brand owner/franchisor may not entirely prohibit internet sales. The U.S. generally does not preclude franchisors from placing territorial or distribution channel restrictions on its franchisees, and there are ways for franchisors to maintain brand value by using Minimum Advertised Pricing policies, using the "Suggested Retail Price" concept, setting higher royalty rates, and exercising audit rights.

5

Franchise termination rights in Germany (and other EU member countries) are very different from those in the U.S. If the franchisor in Germany terminates for something other than good cause, or if the franchise agreement even expires on its terms, and the franchisee is operating under a standard franchise agreement where the franchisor has trained the franchisee to operate the business, and there is an express/implied obligation for the franchisee to transfer customer data to the franchisor upon termination/ expiration, then the franchisor must compensate the franchisee and pay the average one year margin on sales for the last 5 years. No such compensation right exists in the U.S., unless the franchisor acts in a manner that frustrates the purpose of the franchise agreement or otherwise wrongfully terminates the agreement. Indeed, many states in the U.S. have statutes and/or common law rulings that protect franchisees and mandate (a) "good cause" or a breach of the "essence" of a contract for termination (e.g., misuse of the trademark, failure to comply with agreement obligations for payment or quality standards), and (b) a cure period before termination (in California the cure period is sixty (60) days, except in certain situation where the termination is based on egregious conduct, bankruptcy, etc.). Many states in the U.S. also have statutes or common law rulings that mandate "good faith" in connection with any franchise agreement termination which turns on the franchisor's conduct toward the franchisee, and whether franchisor has complied with its obligations to the franchisee. One recent ruling in New Jersey, however, held that a franchisor's ulterior motive for termination does not undermine a termination for material breach of the franchise agreement.

For more information, please contact Marc Lieberstein at mlieberstein@kilpatricktownsend.com